PUBLIC

UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress

In re	
DETERMINATION OF ROYALTY RATES AND TERMS FOR MAKING AND DISTRIBUTING PHONORECORDS (Phonorecords III)	**Docket No. 16-CRB-0003-PR (2018–2022) (Remand)**

ORDER GRANTING IN PART AND DENYING IN PART COPYRIGHT OWNERS' MOTION FOR RECONSIDERATION OR, IN THE ALTERNATIVE, CLARIFICATION

On December 17, 2021, Copyright Owners[1] filed a Motion for Reconsideration or, in the Alternative, for Clarification of the December 9, 2021 Notice and *Sua Sponte* Order Directing the Parties to Provide Additional Materials (*Motion*). On December 28, 2021, the Services[2] filed their Joint Partial Opposition to Copyright Owners' Motion (*Opposition*).[3]

For the reasons set forth below, the Copyright Royalty Judges (Judges) **GRANT IN PART AND DENY IN PART** Copyright Owners' Motion.

I. Background

On February 5, 2019, the Judges issued a Final Determination in the captioned proceeding. *Determination of Royal Rates and Terms for Making and Distributing Phonorecords*, 84 Fed. Reg. 1918 (Feb. 5, 2019) (*Phonorecords III Determination*).[4] The Services and Copyright Owners filed separate appeals. The D.C. Circuit affirmed in part, and vacated and remanded in part, returning the proceeding to the Judges for further action consistent with the D.C. Circuit's opinion. *Johnson v. Copyright Royalty Board,* 969 F.3d 363, 397 (D.C. Cir. 2020).

[1] Copyright Owners are comprised of the National Music Publishers' Association, Inc., and the Nashville Songwriters Association International.

[2] The Services are comprised of Amazon.com Services LLC, Google LLC, Pandora Media, LLC, and Spotify USA Inc.

3 The Motion and Opposition were filed pursuant to the Judges' December 13, 2021 Order Following Status Conference and Modifying Scheduling Orders (December 13 Order), which authorized only those two submissions, in response to Copyright Owners' request in the status conference to brief the issues considered herein. In the evening of January 5, 2021, Copyright Owners uploaded to the eCRB filing system a Reply submission. The Judges' December 13 Order does not allow for this submission. Further, Copyright Owners did not seek leave from the Judges' to make this filing. Accordingly, the Reply is improper and will be disregarded.

[4] The *Determination* was supported by two of the three Judges. The third Judge wrote a dissent. *Phonorecords III Determination*, 84 Fed. Reg. at 1963 *et seq.* (dissenting opinion).

On December 23, 2020, the Judges entered an *Order Adopting Schedule for Proceedings on Remand* (*Remand Scheduling Order)*. After setting forth the schedule for remand proceedings, the *Remand Scheduling Order* further provided:

> In accordance with the *Order Regarding Proceedings on Remand*, after the filing of reply briefs and rebuttal submissions the Judges will determine, in their discretion, whether to request additional briefing, oral argument, and/or live testimony.

Remand Scheduling Order at 3.[5]

After the parties completed the itemized tasks in the *Remand Scheduling Order*, the Judges indeed determined that they required additional input from the parties. More particularly, the Judges informed the parties of the following.

> Having reviewed the parties' submissions after remand in this proceeding, the Judges hereby give notice to the parties that they are seeking further input with respect to two issues. First, the Judges are considering the possibility of setting rates and a rate structure for the *Phonorecords III* period that no participant has specifically proposed, but that would incorporate only record evidence. Secondly, the Judges seek further input with regard to the remand of the Judges' change in the Final Determination in this proceeding to the definition of "Service Revenue" as it relates to bundled offerings.

Notice and Sua Sponte Order Directing the Parties to Provide Additional Materials (December 9, 2021) (*Additional Materials Order*).[6]

In the *Additional Materials Order*, the Judges gave notice that they were *contemplating* a form of rate structure different from any proposed by either side (the Judges' "Working Proposal"). More particularly, the Judges were seeking input from the parties to make certain that their Working Proposal was procedurally consistent with the directives of the D.C. Circuit in *Johnson*. Specifically, in their *Additional Materials Order*, the Judges quoted the following language from *Johnson.*

> Agencies have the authority to modify proposals set forth by the parties, or to suggest models of their own. *See SoundExchange, Inc. v. Copyright Royalty Bd.*, 904 F.3d 41, 50–51, 57 (D.C. Cir. 2018) (upholding Copyright Royalty Board's decision to modify a party's proposed rates in light of its interpretation of Section 114 of the Copyright Act); *Association of American Publishers, Inc. v. Governors of USPS*, 485 F.2d 768, 773 (D.C. Cir. 1973). Some degree of deviation and

5 The Judges have the authority to enter these post-remand scheduling orders pursuant to 17 U.S.C. § 801(c), which enables them to "make any necessary procedural or evidentiary rulings in any proceeding under this chapter."

6 The Judges clearly have the authority to modify procedural scheduling orders under 17 U.S.C. § 801(c). Further, as a general rule, a scheduling order is interlocutory in nature, and is thus subject to modification. Cf. Capitol Sprinkler Inspection, Inc. v. Guest Services, Inc., 630 F.3d 217, 223 (D.C. Cir. 2011). In any event, the Remand Scheduling Order (quoted above) expressly contemplated the potential need for additional submissions.

> combination is permissible. … But the ultimate proposal adopted by the Board has to be within a reasonable range of contemplated outcomes.

Additional Materials Order at 1 (quoting *Johnson*, 969 F.3d at 382).

The Judges further noted that they were not concluding that either statutory or decisional law required this added procedure; rather, the Judges were 1) affording the parties advance notice that they might choose an alternate rate structure and 2) hoping to benefit from the parties' supplemental submissions. *See id.* at 2.

In the *Additional Materials Order*, the Judges ordered the parties to make their supplemental submissions by December 29, 2021. *Id.* at 5. That date was extended to January 24, 2022, after Copyright Owners advised in a status conference that they would be filing the instant Motion.

II. Participants' Briefing and Judges' Analysis

A. Copyright Owners' and Services' Arguments

In the Motion, Copyright Owners make several arguments, which the Judges consider seriatim along with the Services arguments.

1. The Working Proposal Should be "Abrogated" because it Conflicts with the Scope of the Remand as set forth in the Judges' Remand Order

Copyright Owners claim that the Working Proposal should be "abrogated." They assert that the Working Proposal conflicts with the "consensus" among the parties and the Judges regarding rate-related issues, which they argue was – according to the Judge's *Remand Order* – limited to "the adoption of a rate structure that includes an uncapped TCC prong." *Motion* at 4. Accordingly, Copyright Owners claim that the Judges are precluded from seeking additional materials (evidence, testimony, and briefing) that address the Working Proposal. More particularly, Copyright Owners note that the Working Proposal includes both a potential change in the "percent-of-revenue prong" and the potential "elimination of the separate 'greater of' TCC rate prong included in the [vacated] Final Determination," thus "using only the percent-of-revenue basis for establishing mechanical royalty rates …" *Id.* at 6.

The Judges find this argument meritless. As stated *supra*, the Judges have clear statutory authority to modify their interlocutory procedural orders. Further, the "consensus" on which Copyright Owners rely was reached *before the parties made their substantive post-remand submissions*. The Judges have considered those submissions and, as discussed in more detail *infra*, at present have found them wanting. Copyright Owners would have the Judges straight-jacket themselves into a narrow position of adopting either their rate and rate structure proposal (the vacated rate and rate structure finding in the *Phonorecords III Determination*) or the Services' benchmark that essentially adopts the *Phonorecords II* rate and rate structure approach. However, as the D.C. Circuit makes explicit: "[a]gencies have the authority not only to adopt one

of the parties' proposals, but also to modify the parties' proposals or to suggest models of their own." *Johnson*, 969 F.3d at 382.[7]

To be clear, the Judges are neither finding nor stating here that any or all of Copyright Owners' substantive critiques of the Working Proposal have dispositive merit, some merit, or are wholly meritless. But the procedure for the parties to critique the *substance* of the Working Proposal is set forth in the *Additional Materials Order*, with submissions now due by January 24. In the substantive submission, Copyright Owners may address the interplay of the Working Proposal with, *inter alia*, the asserted benefits of an uncapped TCC, the parties' prior positions on uncapped TCCs, the potential use of only a percent-of-revenue rate structure, and the level of those rates. In fact, the Judges took pains to give the parties wide latitude in how they might choose to address the substance of the Working Proposal. *See Additional Materials Order* at 4 ("The Judges emphasize that nothing in this [*Additional Materials Order*] is intended to preclude any party herein from challenging any element of the possible rates and rate structure described in this Notice and Order. More particularly, but without limitation, the parties may challenge any assumptions (express or implied), data, testimony, other evidence or legal bases they believe to be relevant to the rate and rate structure approach the Judges have described herein.").

2. The *Additional Materials Order* Fails to Identify a "Compelling Need" for Further Submissions to Assist the Judges

Copyright Owners assert that the Judges have failed to identify a "compelling need" for, or "cogently explain," their exercise of their discretion in the manner set forth in the *Additional Materials Order*. Absent a "reasoned explanation" for this purported "change of course," Copyright Owners aver, the Judges' action is a "*volte-face*" that constitutes "arbitrary and capricious" conduct. Motion at 7-8 (citing cases).

The Judges reject Copyright Owners' argument. The *Additional Materials Order* clearly demonstrates that the Judges are not convinced at this time that the rate and rate structure proposals of Copyright Owners or the Services are sufficiently consistent with either the letter or spirit of *Johnson*, or with the guiding statutory provisions set forth in 17 U.S.C. § 801(b)(1). To repeat, at the very outset of the *Additional Materials Order*, the Judges noted that "[a]gencies have the authority to modify proposals set forth by the parties, or to suggest models of their own." *Additional Materials Order* at 1 (quoting *Johnson*, 969 F.3d at 382). The Judges then stated expressly that they are considering their Working Proposal "as a possible alternative to the proposals of the parties." *Additional Materials Order* at 2.

Thus, the Judges have identified a "compelling need"[8] to issue the *Additional Materials Order* containing the Working Proposal that differed from the (so far) unconvincing proposals of

[7] The Services assert that Copyright Owners seem to believe that there is no alternative rate and rate structure finding possible except for the re-adoption of the vacated rate and rate structure approach in the *Phonorecords III Determination*. *Opposition* at 2-3. That of course would not only be inconsistent with *Johnson*, but would render the D.C. Circuit's vacating and remanding of the proceeding without force or effect.

[8] Copyright Owners' use the phrase "compelling need" in the nature of a standard the Judges must satisfy, but nowhere in their Motion do they identify either the source or content of such a standard. But the Judges do find a compelling need for the additional materials they seek.

the parties. Moreover, the Judges' have not only a *need*, but also a *duty*, to establish rates and a rate structure that they find to be most consonant with their statutory obligations.

Additionally, if the Judges decide to craft rates and a rate structure from the record evidence and testimony that depart from the parties' proposals, they must take note of two procedural points. First, they must determine if their deviation is "within a range of contemplated outcomes," such that no party is "blindsided." Second, if their approach does "deviate substantially and unforeseeably from the parties' … proposals … arguments … and the preexisting rate structures," the Judges are "duty bound to give a heads up to the parties with regard to such an extreme change …." *Johnson*, 969 F.3d at 381-82. To ensure that the parties are not "blindsided," the Judges are providing the parties with a "heads up" in the form of their Working Proposal, so that the parties can prepare arguments and any appropriate evidence or testimony that would serve to support, reject, or modify the Working Proposal.

3. The Working Proposal Improperly Considers Eliminating the TCC Rate Prong Because the Majority's Implementation of a TCC Rate Prong was *not* the Subject of the Appeal

Copyright Owners object to the Judges' consideration of the elimination of the TCC rate prong in the Working Proposal. This objection can be made in their submission due January 24, given the wide latitude the Judges are affording the parties with regard to their responses to the Working Proposal. *See id.* at 4. Thus, it would be premature for the Judges to rule now on Copyright Owners' assertions with regard to this issue. (Copyright Owners may address these objections in their January 24 submission, and the Services may address them in their submission as well.)

In the interest of thoroughness, and to assist the parties in making their forthcoming submissions more informative, the Judges note the following points raised by Copyright Owners.

1) No party sought the elimination of an uncapped TCC rate prong across *all* Service offerings ("universal" in Copyright Owners' parlance).

2) The use of several uncapped TCC rate prongs in the Services' *Phonorecords II*-based benchmark was not a subject of the appeal.[9]

3) The *Phonorecords II* rate structure, and the Services' benchmark based on that structure, also include capped TCC rates in the "lesser-of" rate prong that is nested within one of the "greater-of" rate prongs, which also were not a subject of the appeal.

The Judges will be mindful of these points as they consider the parties' January 24 submissions, and the impact of these points, if any, on the Working Proposal.

[9] In their submissions, the parties do not clearly set forth itemizations of their respective understandings of the offerings in the Phonorecords II rate structure that contained uncapped TCC prongs and mechanical floors, and it is not clear that they agree on this matter. By way of this Order, the Judges require the parties to submit such itemizations in their respective January 24 submissions.

4. The Judges' Further Analysis of the Revenue Rate Percentages is Foreclosed as "Outside the Scope of the Circuit's Mandate"

The Judges are puzzled by this objection to their attempt to craft rates and a rate structure based on the record. As noted *supra*, the Working Proposal adopts the Shapley Value synthesis of expert testimony undertaken in *the Phonorecords III Determination*. Importantly, the Majority in that *Determination* derived the percent-of-revenue rates (*i.e.*, *the non-TCC rates*) from the Shapley Value analysis they utilized to set the percentages on their TCC prong. *See Phonorecords III Determination*, 84 Fed. Reg at 74 (describing the Majority's "exercise" as "produc[ing] a broad range of potential … TCC rates ranging … *which correspond[s] to implied percent of revenue rates* ….") (emphasis added).

What the Working Proposal does – as explicitly stated in the *Additional Materials Order* – is express a concern, not that the foregoing calculations should be overridden, but rather that this analysis (this "exercise," per the *Phonorecords III Determination*) is "incomplete," because it fails to acknowledge that the Major record companies, as complementary oligopolists, "do not retain so much of the Services' revenue that they deprive the interactive service sector of revenues sufficient to allow them to survive as a consumer service." *Additional Materials Order* at 2; *see also Phonorecords III Determination,* 84 Fed. Reg. at 74 (noting the "powerful economic motivation for record companies to pursue deals with the Services that ensure the continued survival *and growth* of the music streaming industry." (emphasis added.)

Thus, in the Working Proposal, the Judges indicated their interest in potentially identifying *from the existing record* an appropriate percentage of revenue that these complementary oligopolists allow the Services to retain, and then applying *the same percentages* that the Majority utilized in the *Phonorecords III Determination*. Simply put, the Judges have not indicated a willingness to revisit the Shapley Value proportions, but rather to apply them in a formula that is based on the record and that reflects the *actual* workings of the market. In no way is this contemplated approach outside the scope of the D.C. Circuit's mandate, as Copyright Owners assert.

5. The Record Should Not Be Supplemented with Evidence on the Service Revenue Definition through New Agency Action

Neither Copyright Owners nor the Services dispute that additional *briefing* on the issue of "new agency action" in relation to the definition of "Service Revenue" is appropriate. However, they both maintain that there is no need for additional *evidence* regarding the definition of "Service Revenue." *Motion* at 15; *Opposition* at 22. As both Copyright Owners and the Services have expressed their view that new evidence is not necessary and is inappropriate, the Judges will not compel new evidence on this issue. Therefore, the Judges will only allow briefing and legal argument, rather than new evidence regarding the Service Revenue definition/New Agency Action issue.[10]

[10] Copyright Owners have taken the clear position in their various submissions that this Remand proceeding is "new agency action" which allows adoption of a Service Revenue definition without limitation to the definition expressed in the Initial Determination. *Motion* at 16. Thus far, the Services have been less clear in expressing their position on whether and how this Remand qualifies as new agency action. The Services concede that this Remand *allows* the

6. The Procedures in the *Additional Materials Order* Do Not Satisfy Due Process or Meet the Requirements of the D.C. Circuit's Mandate in *Johnson*

Copyright Owners assert first that the procedures in the *Additional Materials Order* do not satisfy "due process." This assertion can be easily dismissed. Copyright Owners do not cite any authority to support a due process claim. Nor do the Judges identify any such due process concerns. Accordingly, the Judges **DENY** the Motion to the extent it seeks any relief based on due process grounds.[11]

The second procedural objection raised by Copyright Owners in their Motion is that the procedural framework in the *Additional Materials Order* is inconsistent with the requirements set forth in *Johnson*. The Judges identify two procedural points raised by Copyright Owners – the absence of additional discovery and of rebuttal submissions. *See Motion* at 17 (noting the absence of a right to further "rebuttal") and 19 (noting the absence of a right to further "discovery").

In response, the Services have noted that the Judges are under no duty to provide exactly the same procedures and time frames as they did for the initial and reply remand submissions. *Opposition* at 1, 17. The Judges agree. The *Additional Materials Order* narrows the issues to a particular sub-set, as set forth in the enumerated points that comprise the Working Proposal (set forth in the aforementioned Order). This sub-set of issues does not require the same pre-hearing procedures as were adopted for the larger initial remand submissions.

The Services do not adequately address the issue, posed by Copyright Owners, of whether further discovery and/or rebuttal should be permitted. The Services state only that the Judges must provide an opportunity for rebuttal "as may be required," and argue that the hearing will provide the opportunity for rebuttal. *Opposition* at 17. The Judges find this point essentially tautological: Their task is to determine whether to require rebuttal submissions in order to develop a sufficient written record before the hearing. With regard to "discovery," the Services argue that Copyright Owners "do not identify any … discovery that they believe is necessary." *Opposition* at 1. But this puts the cart before the horse: Until Copyright Owners read the

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Judges to engage in new agency action. *Opposition* at 22. In their Written Direct Remand Submission and Reply Brief, the Services focus on the statutory paths for modifying a Determination, with relatively little attention to the Final Determination having been vacated and remanded or whether and how this remand may qualify as "new agency action." In the same briefing materials, the Services assert that "on the existing record" the Judges cannot modify the Service Revenue definition. Written Direct Remand Submission at 68. They also maintain that adoption of any alternative to the Service Revenue definition in the Initial Determination must be based on "on the written record." *Id*. In light of the disagreement on whether and how this remand proceeding may constitute "new agency action" the Judges opened the door to additional evidence as well as briefing on the Service Revenue definition. To the extent that providing meaningful opportunity to submit new evidence is an element of "new agency action," the Judges determine that the *Additional Materials Order* provided such a meaningful opportunity, and that portion of the *Additional Materials Order* is hereby rescinded based on the positions taken by both Copyright Owners and the Services.

[11] The Judges agree with the Services that their post-remand procedures are consistent with the Administrative Procedure Act (APA). *See Opposition* at 16-18. The Judges further note that Copyright Owners did not assert that the Judges' post-remand procedures, including those set forth in the *Additional Materials Order*, are inconsistent with any APA provisions.

Services' January 24 submission, they cannot describe the discovery they would require. (And of course, this point equally applies to discovery the Services would seek of Copyright Owners.)

In sum, the Judges do not believe that further discovery and/or further rebuttal are *legally required* at this stage of the proceeding. However, the Judges believe that some additional discovery and rebuttal testimony would be *helpful*, allowing the Judges to issue a remand determination that is further informed by the parties' litigation practice.

Accordingly, in the exercise of their statutory discretion under 17 U.S.C. § 801(c), the Judges establish the following schedule and related directives:

> The page limits on the January 24 submissions, as set forth in the *Additional Materials Order*, are expanded from twenty (20) pages to fifty (50) pages per side;
>
> The parties have until February 14 to take the depositions of any witness who provides testimony as part of the submissions due by January 24;
>
> The parties have until February 24, *i.e.*, ten (10) days, from the February 14 deposition deadline, to file any rebuttal submissions, limited to rebutting the January 24 submissions made by their adverse party.
>
> Rebuttal submissions may be in the form of briefs and/or expert witness statements, and shall be limited to a cumulative fifty (50) pages per side, allocated at the parties' discretion between briefs and/or expert witness statements.
>
> The hearing will begin no sooner than February 28, 2022.[12]

7. The Judges Should Provide the Parties with Additional Detail Regarding the Working Proposal

Copyright Owners have alternatively asked for clarification, in the form of additional information regarding the Working Proposal. *Motion* at 21-28. In like fashion, the Services have requested, more generally, any further information that the Judges can provide to assist the parties in preparing their January 24 submissions. *Opposition* at 18, 22, 24. As an initial matter, and to state the obvious, the Judges are not in an adversarial posture vis-à-vis the parties. Accordingly, they will not get into a protracted discovery-like back-and-forth process with the parties. Moreover, the Judges assume the parties to be well-aware of the hearing record they have created.

Nonetheless, in order to potentially sharpen the parties' January 24 submissions, the Judges, in the further exercise of their statutory discretion under 17 U.S.C. § 801(c), provide the parties with the following clarifying guidance regarding record evidence that to date has informed their development of the Working Proposal.

[12] The Judges will issue a revised Scheduling Order presently.

The Judges utilize an example to elucidate their Working Proposal. Therein, as noted *supra*, they apply *without alteration* the Majority's 26.2% TCC that generated the percent-of-revenue rate of 15.1% (*see Phonorecords III Determination,* 84 Fed. Reg. at 75).[13] As noted *supra*, the Working Proposal uses a hypothetical percent-of-revenue rate of 32% as the revenue percentage that the complementary oligopolistic Major record companies allowed the Services to retain. Arithmetically, this 32% example means that the licensors of the sound recordings and the musical works would have been paid 68% of the revenues generated by interactive services.

Copyright Owners seek information regarding the evidentiary source of any such *actual* percentage divisions of revenue between interactive services, on the one hand, and both classes of copyright holders, on the other. In response, the Judges first note that one of Copyright Owners' expert economic witnesses, Dr. Jeffrey Eisenach, testified that "[t]he industry standard [is] that approximately 70% of service revenue is allocated to rightsholders …." Trial Ex. 3027 ¶ 171 (Eisenach WDT). Again, arithmetically, that would mean the "industry standard" per Dr. Eisenach is that 30% of the revenue generated by interactive streaming would be retained by the interactive services (rather than the 32% hypothetical figure in the Working Proposal). *See also* Trial Ex. 3033 ¶ 79 (Eisenach WRT) ("interactive streaming services, such as Spotify, enjoy a standard split of revenues — roughly 70/30 in favor of copyright owners").

In addition to this standard, Dr. Eisenach testified that, with regard to the effective sound recording percent-of-revenue rate, "a review of license agreements for sound recordings between labels and interactive services demonstrate that, while there is variability in the payment terms across services and labels, it is standard for label licenses to include a royalty prong of approximately [redacted] percent of service revenue for the sound recording license. This standard term is borne out by actual payments." Eisenach WDT ¶ 169. Applying the 26.2% TCC calculated by the Majority in the *Phonorecords III Determination* and left undisturbed by the D.C. Circuit in *Johnson* (rejecting the Services' challenge), the "All In" royalty rate for musical works would be [redacted]% (rounded).

Another economic expert witness for Copyright Owners, Professor Richard Watt, found the range for total royalties to be 64% to 70% of interactive services revenue, indicating a revenue retention by the Services of 30% to 36%. Professor Watt opined that the mid-point of this range – 67% – was a "conservative" figure, one that he chose to apply in his Shapley analysis. Trial Ex. 3034 ¶¶ 6 & 34-35 (Watt WRT). The rightsholders would thus receive 67% of the interactive services revenue allocated to them. And, arithmetically, the Services would

[13] The Judges do not alter this 26.2% TCC figure because, as Copyright Owners correctly note, the D.C. Circuit found the Majority's derivation of the TCC percentage to not be the "type of line-drawing and reasoned weighing of the evidence [that] falls squarely within the Board's wheelhouse as an expert administrative agency." *Johnson*, 969 F.3d at 384, 386. The Judges thus disagree with the Services' to the extent that they assert that *Johnson* permits them to change the Majority's methodology and calculations that generated the 26.2% TCC computation. *See Opposition* at 8-9. But, to repeat for emphasis, the Judges do not understand *Johnson* to prevent them from incorporating this 26.2% figure into rates and a rate structure that differ from those in the Majority's *Phonorecords III Determination* (such as in the Working Proposal), or prevent them from disregarding the 26.2% TCC entirely, in favor of a proposal (*e.g.*, the *Phonorecords II*-based benchmark favored by the dissent in the *Phonorecords III Determination*) in which that TCC calculation is not relevant.

retain 33% of that revenue. Applying the Working Proposal, the "All In" musical works rate would be calculated as follows:

$1.262x = .67$

$x = .53091$ (53.1% rounded) (sound recording rate)

.262(.531) = .1391 (13.9% rounded) ("All In" musical works rate).

Professor Watt also cites Spotify financial data that he understood to indicate that music services' non-content costs would fall to [redacted] of "Service Revenue" during the Phonorecords III rate period. Watt WRT ¶ 33 n. 21.[14] If that percentage were to be applied, then the services would retain that percentage. And, arithmetically, the rightsholders would divide the remaining [redacted] with 26.2% of that [redacted]% ([redacted]% of revenue) paid as "All In" musical works royalties and 73.8% (*i.e.*, 1 - .262) of that [redacted]% ([redacted]% of revenue) paid as sound recording royalties.

On the Services' side, Barry McCarthy, Spotify's Chief Financial Officer, testified:

[redacted]

Trial Ex. 1060 ¶ 28 (McCarthy WDT). Mr. McCarthy thus concluded that [redacted]. *Id.* ¶ 29.[15] The Judges note that [redacted] Professor Watt's 64% to 70% range discussed *supra*.[16]

[14] Non-content costs are essentially the same as the revenues a service needs to remain viable. See, e.g., Id.; but see note 14, infra.

[15] Mr. McCarthy testified that [redacted]

[16] Copyright Owners also assert that Point 7 in the rate formula in the Judges' *Additional Materials Order* is incorrect. Motion at 15 n. 10. This is precisely the type of argument that the Judges expect to be a part of the January 24 submissions, and it is thus premature. However, in the interest of obtaining more useful submissions on January 24, the Judges refer the parties to Copyright Owners' Reply Brief on Remand at 54 n. 41 and at 63 for their own previous explanation of the Majority's use of a 3.82:1 ratio, the reciprocal of which is the 26.2% TCC set by the Majority. *See also Phonorecords III Determination* at 71 & 73 ("The Judges find that the problem of, in essence, importing complementary oligopoly profits into the musical works rate through a TCC percentage can be avoided by reducing the TCC percentage."); *Johnson*, 969 F.3d at 386 (stating that the Judges' reconciliation and synthesis of different Shapley Value models was the "type of line-drawing and reasoned weighing of the evidence [that] falls squarely within the Board's wheelhouse as an expert administrative agency.").

And, to answer a question posed by Copyright Owners, see Motion at 28, the expert who testified regarding the division of the Shapley surplus between the Major sound recording companies and Copyright Owners was Professor Watt, whose testimony in this regard was quoted by the Majority. *See Phonorecords III Determination* at 72

Applying the Working Proposal to Mr. McCarthy's [redacted] total royalty figure, the "All In" musical works rate would be computed as follows:

$x + .262\,x =$ [redacted]

$1.262\,x =$ [redacted]

$x =$ [redacted] (sound recording rate)

.262 multiplied by [redacted] = [redacted]% ("All In" musical works rate)

Applying Mr. McCarthy's [redacted]% figure, using the above formula from the Working Proposal, would result in a sound recording rate of [redacted]% and an "All In" musical works rate of [redacted]%.

Copyright Owners also ask for clarification regarding the rate structure proposal to which additional submissions are to respond. *Motion* at 21. This request for clarification misses the point of the *Additional Materials Order* and the Working Proposal. The gravamen of the Working Proposal is that the Judges are contemplating the incorporation into their remand Determination, *from evidence and testimony already in the record*,[17] of a market-based percent-of-revenue that the Major record labels allow the interactive services to retain in order to provide for the latter's viability. Only thereafter in the analysis, would the 26.2% TCC computation be applied to a rate structure to be determined based on the evidence.

However, the Judges did indicate in their Working Proposal that they were considering "the elimination of the separate 'greater of' TCC rate prong included in the Final Determination." *Additional Materials Order* at 4. To be clear, in this regard the Judges remain concerned, as was the D.C. Circuit, that a wholly uncapped "greater-of" TCC prong "yokes the mechanical license royalties to the sound recording rightsholders' unchecked market power." *Johnson*, 369 F.3d at 382.

Beyond that concern, the Judges have not identified a rate structure within which a rate potentially calculated as set forth above would be adopted, if at all. That is a principal reason why the Judges have sought the parties' arguments – in their submissions due by January 24.

(quoting Watt WRT ¶ 36). See also Opposition at 21-22. Further, the fact that any mechanical rate "might" provide a share of the surplus to Copyright Owners (either greater than, equal to, or less than the share derived from a Shapley Value model) is obvious. The Judges were simply making this statement in as precise a manner as possible, and it is a point implicit in Professor Watt's testimony cited by the Majority.

[17] Thus, the Judges here confirm Copyright Owners' tentative understanding that the *Additional Materials Order* "only references percentages in the record" and not "new fact evidence" concerning "revenue rate derivation." The parties provided evidence of royalty percentages in support of and in opposition to the pre-remand proposals in the pre-remand proceeding, and the Judges do not require additional evidence in this regard. (The Judges are not seeking to re-do the entire *Phonorecords III* proceeding.) And, to confirm Copyright Owners' further tentative understanding, the Judges are seeking "additional explanation concerning any such percentages, either in briefing or in new expert testimony," *i.e.*, "additional opinion that relies only on fact evidence already in the extant record." *See Motion* at 27.

The Judges acknowledge that the rate-setting process in this remand is an awkward but necessary collaborative endeavor. The parties advocate for their rates and structure, but the Judges may reject what the parties propose, and substitute their own rate structure. *See Johnson*, 969 F.3d at 381-82 (although the Judges "have the authority … *to suggest models of their own* [in which] [s]ome degree of deviation and combination is permissible … [i]f [they] want[] to implement such an extreme change in the rate structure, [they are] duty bound to give a heads up to the parties.") (emphasis added). To reiterate what the Judges have explained *supra*, even though they do not conclude that they are proposing changes that *require* such a "heads up" to avoid "procedurally blindsid[ing]" the parties, *id.* at 381, the Judges believe they are likely to benefit from the parties' input on the points set forth in their Working Proposal.

8. Copyright Owners' Additional Questions

The additional questions Copyright Owners have posed to the Judges are best addressed by Copyright Owners and the Services in their submissions due by January 24. That is, the parties shall address (without limitation) in those submissions the following:

1) Whether the Working Proposal can be applicable to, and compatible with:

    a. The Majority's approach in the *Phonorecords III Determination*.

    b. The Phonorecords II-based benchmark proposed by the Services and preferred by the Dissent in *Phonorecords III* (*i.e.*, including the Mechanical Floors).

    c. The potential elimination of a TCC prong and reliance on a single percent-of-revenue prong (a potential rate structure proposed in the Working Proposal).

    d. A rate structure that contains or omits Mechanical Floors for all offerings.

2) Whether the elimination of a TCC rate prong is feasible and appropriate, in light of the existence of TCC rates (capped and uncapped) in the Phonorecords II-based benchmarks.

3) Whether it would be appropriate and sufficient to apply the Phonorecords II-based benchmark (with Mechanical Floors as set forth in the Dissent), but substitute out the 10.5% rate in that benchmark and insert instead the rate produced by the Working Proposal, while leaving the rates in the "lesser of" rate prong and in the Mechanical Floors unchanged.[18]

[18] For example, consider the following hypothetical application of Dr. Eisenach's "70/30" industry standard to the Working Proposal:

> Assume the record evidence supports an initial decision by the Major record companies, as complementary oligopolists, to allow the interactive services to retain 30% of interactive service revenue to maintain their viability.
>
> Then, $1.262x = .70$ (footnote continues on following page)

Regarding this point, the parties should address the following:

a. Whether the problem of potential revenue displacement or deferral would be ameliorated by the alternative rate prongs and Mechanical Floors, as had been the case under the Phonorecords II rate.

b. Whether it would be appropriate instead to reject the Phonorecords II-based benchmark favored by the Dissent, and retain the TCC prong from the Majority opinion in the *Phonorecords III Determination* because that prong incorporates what Copyright Owners aver are the record companies' superior protections against revenue displacement and deferral.

c. Would an explicit TCC prong, be appropriate, even though it generates increases or decreases in the "All In" rate solely based on changes in the sound recording rates, when future changes in non-content costs, surplus, and other variable factors are unknown?

d. Whether the dollar value of the TCC-based royalties derived from the application of the Working Proposal (14.5% in the example in note 17, *supra*), should be calculated as a percentage of the dollar royalty revenue paid to the record companies?

In responding to point (d), the parties should be mindful of the following:

i. What is the impact, if any, of the Major record companies' complementary oligopoly power on the appropriateness of relying on their rates and "greater-of" rate structures to determine the revenue base for the calculation of royalties to be paid and received under statutory mechanical rate?

ii. Why are the protections against revenue displacement or deferral in the record companies' contracts with interactive services more appropriate, or less appropriate, for structuring the mechanical royalty rate, compared with the

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(footnote continued from previous page)

x = 55.5% (rounded)
1.262 multiplied by .555 = .145.

Thus, a 14.5% rate would be substituted for the 10.5% rate in the *Phonorecords II*-based benchmark.

protections contained in the Phonorecords II-based benchmark (with Mechanical Floors), as set forth in the Dissent in the *Phonorecords III Determination*?

4) How would incorporation of the Working Proposal meet, or fail to meet, the four objectives set forth in 17 U.S.C. § 801(b)(1)?

III. CONCLUSIONS AND ORDER[19]

For the reasons set forth herein, the Judges hereby order as follows.

1. Copyright Owners' Motion is **GRANTED IN PART AND DENIED IN PART.**

2. The Judges **DENY** Copyright Owners' Motion to the extent it seeks Reconsideration of the Judges' December 9, 2021 Notice and *Sua Sponte* Order.

3. The Judges **GRANT IN PART AND DENY IN PART** Copyright Owners' Motion to the extent it seeks clarification of the Judges' December 9, 2021 Notice and *Sua Sponte* Order, as set forth in paragraphs 5 and 6 below.

4. The Judges **GRANT** Copyright Owners' Motion to the extent that submission of additional materials shall be limited to briefing in response to the questions posed relating to the definition of "Service Revenue" for bundled offerings, including the question of what constitutes "new agency action."

5. Copyright Owners' Motion seeking "Clarification" is **GRANTED IN PART** to the extent the Judges have provided additional guidance in this Order.

6. In all other respects, Copyright Owners' Motion seeking clarification is **DENIED**.

7. The Judges further **ORDER** the parties to submit as part of their January 24 submissions an itemization of their respective understandings of the offerings in the Phonorecords II rate structure that contained uncapped TCC prongs and/or mechanical floors.

8. The Judges hereby adjust the submission page limits and schedule in this proceeding as follows:

    a. The page limits on the January 24 submissions, as set forth in the *Additional Materials Order*, are expanded from twenty (20) pages to fifty (50) pages per side.

[19] The parties shall jointly submit a proposed redacted public version of this order no later than January 11, 2022.

b. The parties have until February 14 to take the depositions of any witness who provides testimony as part of the submissions due by January 24.

c. The parties have until February 24, *i.e.*, ten (10) days from the February 14 deposition deadline, to file any rebuttal submissions, limited to rebutting the January 24 submissions made by their adverse party. Rebuttal submissions may be in the form of briefs and/or expert witness statements, and shall be limited to a cumulative fifty (50) pages per side, allocated at the parties' discretion between briefs and/or expert witness statements.

d. The hearing will begin no sooner than February 28, 2022.

/s/
David R. Strickler
Copyright Royalty Judge

DATED: January 6, 2022