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

In the Matter of Determination of Rates and Terms for Business Establishment Services	Docket No. 2007-1 CRB DTRA-BE (2009-2013)
In the Matter of Determination of Rates and Terms for Business Establishment Services	Docket No. 2012-1 CRB Business Establishments II (2014-2018)

MUSIC CHOICE'S OPENING BRIEF RE: BES GROSS PROCEEDS REFERRAL

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INTRODUCTION

At all relevant times, the regulations applicable to the Business Establishment Service ("BES") license overseen by the Judges has provided that a BES must calculate its royalties due to SoundExchange, Inc. ("SoundExchange") based upon a percentage of "Gross Proceeds." *See, e.g.*, 37 C.F.R. § 384.3(a)(1) (2019). Gross Proceeds, in turn, are defined as "fees and payments . . . that are derived from the use of sound recordings [pursuant to the BES license] for the sole purpose of facilitating a transmission to the public of a performance of a sound recording [under the BES sound recording performance right exemption]." *Id.* at § 384.3(a)(2). In this proceeding, the Judges have been asked to interpret the meaning of the BES Gross Proceeds definition.

SoundExchange, in private civil litigation pending in a federal District Court, has taken the position that this definition requires Music Choice to include all revenue from its BES within Gross Proceeds, irrespective of whether any ephemeral copies—as that term is used in section 112—are made solely to facilitate a given BES transmission. For the purposes of its BES royalty payments, Music Choice has only included within Gross Proceeds its BES revenues attributable to transmissions to subscribers where ephemeral copies were in fact made solely to facilitate those transmissions. Thus, for example, if 50 channels were transmitted to a particular business subscriber and only five of those channels required the creation of unique ephemeral copies to facilitate that transmission, Music Choice would include 10% of the revenue from that subscriber's payments within Gross Proceeds. Where a transmission to another subscriber—due to differences in Music Choice's distribution network—required the creation of unique ephemeral copies for all 50 channels, Music Choice would include 100% of the revenue from that subscriber. SoundExchange argues that any exclusion of any BES revenue from Gross Proceeds was prohibited by the Gross Proceeds definition. SoundExchange is clearly wrong.

The text of the Gross Proceeds definition expressly states that those Proceeds are limited to revenues that are "derived from" the licensed ephemeral copies used "for the sole purpose of facilitating a transmission" to a BES subscriber. 37 C.F.R. § 384.3(a)(2) (2019). SoundExchange's position asks the Judges to completely ignore the clear limiting language in the regulation—limiting language that has always been included in the BES Gross Proceeds definition. But it is well-established that where the text of a regulation is clear, interpretation of that regulation must begin and end with the plain meaning of that text. And particularly where there is limiting language in a regulation, any interpretation that would render the limiting language meaningless must be rejected. For these reasons alone, the Gross Proceeds definition must be interpreted to mean what it says: that a BES may exclude from Gross Proceeds any revenue that is not derived from ephemeral copies made solely for the purpose of facilitating a BES transmission.

Even if the Judges were to look beyond the plain meaning of the regulatory text, the unique nature and legislative history of the BES performance right exemption, the section 112(e) ephemeral recording license, and the section 112 ephemeral recording exemption more broadly, all support the need to give real meaning to the limiting language in the Gross Proceeds definition. When the sound recording digital performance right was first created in 1995, the BES were fully exempted from that right. For similar reasons it applied to terrestrial broadcasters given the same exemption status, Congress did not intend for the BES to pay copyright owners for public performances of sound recordings at all. When the section 112(e) license was later created, BES were included, but Congress provided no explanation for that inclusion. For every type of section 112(e) licensee other than BES, the section 112(e) license is an "add-on" to a section 114 performance license. But as the Register of Copyrights has opined, even with respect

to those licensees, the section 112(e) license is an anomaly, was the product of a back-room deal as part of various tradeoffs to secure passage of the overall DMCA, has no independent value apart from the value of the public performance right, and makes no sense from an economic or copyright policy perspective. The Judges have similarly found that SoundExchange has not established any independent value for the ephemeral license. And SoundExchange itself has repeatedly—and successfully—argued that marketplace evidence demonstrates that the section 112(e) license should *not* be assigned any independent royalty rate, but rather should be subsumed within the royalty paid for the performance license and only attributed a very small percentage of that royalty for accounting and royalty distribution purposes.

All of these factors further demonstrate why the limiting language in the Gross Proceeds definition should be given full effect. SoundExchange's suggested interpretation would read that limitation out of the definition entirely. And by seeking payment for all BES revenues, even where no incremental ephemeral copies are made for the BES transmission generating that revenue, SoundExchange's proposed interpretation would effectively give its record company members a royalty based upon the value of the public performances rendered. Such a result would be contrary to Congress's intent in excluding the BES from any performance royalty obligation and the acknowledged lack of independent value for ephemeral copies.

BACKGROUND

As demonstrated below, the plain language of the Gross Proceeds definition in the BES license regulations clearly provides that a BES such as Music Choice is only required to pay ephemeral copy license royalties based upon a percentage of revenue derived from the use of ephemeral copies made solely for the purpose of facilitating BES transmissions. Nonetheless, an understanding of the nature of the dispute leading to the instant legal referral and the unique history and nature of the section 112(e) and BES licenses provide helpful context that further

supports strict construction of that plain language and demonstrates why SoundExchange's attempt to read key terms out of the regulation must be rejected.

I. The Audit Dispute and District Court Referral

Music Choice briefly sets forth the basic background of the dispute between it and SoundExchange that led to the District Court's referral to the Copyright Royalty Board for the Judges' interpretation of the applicable Gross Proceeds definition in the BES regulations. Music Choice does so merely to provide the Judges with the context related to that referral, and not for the purpose of asking the Judges to consider, find, or resolve any facts related to the parties' private dispute, which the Judges have previously ruled is beyond their jurisdiction and the scope of this proceeding. Order Reopening Two Proceedings and Scheduling Briefing, Doc. No. 26360, p. 2. *See also* Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 82 Fed. Reg. 56,725, 56,727 (Nov. 30, 2017) (rejecting the argument that the Judges' "continuing jurisdiction to interpret, or their ability to provide 'interpretive guidance,' somehow endows them with jurisdiction to resolve factual disputes relating to application of those regulations."); *id.*, at 56,726 ("the District Court could not have referred to the Judges resolution of the ultimate issues of fact presented by the SoundExchange litigation. The District Court is the forum in which resolution of the factual dispute lies. . . . Notwithstanding language or rhetoric regarding the application of the CRB regulations to the facts of the District Court matter, the narrow question referable to the Judges was one of interpretation."); Determination of Royalty Rates and Terms for Ephemeral Recording and Webcasting Digital Performance of Sound Recordings (Web IV), 81 Fed. Reg. 26,316, 26,401 n.228 (May 2, 2016) (Where a payment dispute arises from an audit of payments made under the statutory license "any attempt to seek a remedy based upon an auditor's findings, and any attempt to challenge those findings, must be made in a court of competent jurisdiction,

or through any private alternative dispute resolution procedure to which the affected parties may have agreed.").

A. SoundExchange's audit of Music Choice's BES payments

The underlying dispute between SoundExchange and Music Choice arises out of SoundExchange's purported audit of Music Choice's BES royalty payments, which SoundExchange began in 2017. Answer at ¶¶ 7, 24, *SoundExchange, Inc. v. Music Choice*, No. CV 19-999 (RBW) (D.D.C. Jun. 24, 2019), ECF No. 8. Because SoundExchange did not actually seek to commence the requested audit until 2017 (and there had been no audits of prior periods), pursuant to the applicable audit regulations, Music Choice fully cooperated and provided all required financial information to the accounting firm SoundExchange had designated to conduct the audit for the prior three years: 2014, 2015, and 2016. *Id.* As Music Choice subsequently learned and demonstrated in its various submissions in the pending *SDARS III* remand, SoundExchange's accountant, Lewis Stark, and his firm at the time, Prager Metis, were not in fact independent auditors and did not conduct an independent audit under the applicable accounting standards. *See* Music Choice's Opening Remand Brief, 16-CRB-0001-SR/PSSR (2018-2022) (Remand), Doc. No. 25392, pp. 31–33; Music Choice's Responsive Brief on Remand, 16-CRB-0001-SR/PSSR (2018-2022) (Remand), Doc. No. 25713, pp. 27–28, 30, 32–33.

In that purported audit, which proceeded through most of 2018, Music Choice explained that it calculated and paid its BES royalties—consistent with the definition of Gross Proceeds in the applicable BES regulations—based upon the revenue attributable to transmissions to BES subscribers where ephemeral copies were made solely for the purpose of those transmissions. SoundExchange, and its partisan forensic accountant Mr. Stark (at SoundExchange's direction) took the position that Music Choice must pay BES royalties based upon all revenue from its

BES, irrespective of the extent to which any ephemeral copies were made solely in connection with that revenue. Based upon SoundExchange's flawed interpretation of the Gross Revenue definition, Mr. Stark took the position that Music Choice had underpaid its BES royalties. Other than this one interpretive dispute, Mr. Stark only purported to identify two very small alleged underpayments, totaling an inconsequential amount. Music Choice's Responsive Brief on Remand, p. 34.

B. SoundExchange's civil action

On April 10, 2019, SoundExchange filed a Complaint in the United States District Court for the District of Columbia, purporting to state causes of action under the Copyright Act for the underpayment of royalties due pursuant to the Section 112(e) statutory license for BES based upon its position that Music Choice's Gross Proceeds must include all revenue from its BES, irrespective of whether that revenue is derived from ephemeral copies made solely for its BES transmissions. Complaint, *SoundExchange, Inc. v. Music Choice*, No. CV 19-999 (RBW) (D.D.C. Apr. 10, 2019), ECF No. 1. Music Choice filed its Answer on June 24, 2019. Answer, *SoundExchange, Inc. v. Music Choice*, No. CV 19-999 (RBW) (D.D.C. Jun. 24, 2019), ECF No. 8.

C. The District Court's referral

On April 8, 2020, in a report regarding the case schedule submitted in advance of the initial scheduling conference, SoundExchange for the first time raised the possibility that the regulatory interpretation of the Gross Proceeds definition might be appropriately referred to the Copyright Royalty Board under the doctrine of primary jurisdiction. Meet and Confer Statement at 14–15, *SoundExchange, Inc. v. Music Choice*, No. CV 19-999 (RBW) (D.D.C. Apr. 8, 2020), ECF No. 20.

At the District Court's request, on July 7, 2020, the parties submitted briefing on the issue of whether such a referral was appropriate. Those briefs remained pending for nearly eighteen months. On December 20, 2021, the District Court issued a Memorandum Opinion, staying that case pending an advisory opinion from the Board on the narrow question of its legal interpretation of the Gross Proceeds definition in the BES regulations. Memorandum Opinion at 14–15, *SoundExchange, Inc. v. Music Choice*, No. CV 19-999 (RBW) (D.D.C. Dec. 20, 2021), ECF No. 29.

II. The Business Establishment Services License is Fundamentally Different From Any Other Statutory Sound Recording License

The definition of Gross Proceeds in the BES regulations is clear on its face and has remained substantively unchanged for the entire existence of those regulations. Nonetheless, when interpreting that definition, it is important to consider the unique history, purpose, and scope of the BES license. That license is quite unlike any other statutory license the Judges have dealt with to this date, and the Judges have never previously had occasion to grapple with the BES license because the rates and terms have been settled for every rate period since the Copyright Royalty Board was established.

As the Register of Copyrights has opined, the section 112(e) ephemeral copy license is an anomaly, was the product of a back-room industry deal (to which Music Choice was not a party) in connection with various trade-offs to secure passage of the DMCA, and makes no sense from either an economic or copyright policy perspective. The license is particularly problematic with respect to BES. Unlike all other sound recording statutory licensees, BES are completely exempt from the sound recording performance right. The only right covered by the BES license is the right to make ephemeral copies, and as the Register herself noted, that right has no value independent from the performance right. The Judges have similarly noted the lack of any

marketplace evidence establishing any independent value of the right, and even SoundExchange has repeatedly argued that the ephemeral license should not be assigned any independent value, but instead a small portion—five percent—of the performance license fee should simply be allocated to the ephemeral license for accounting purposes.

Given the total lack of independent value for the licensed right, and the fact that Congress intended for a BES to avoid any royalty obligation for the sound recording performances rendered, SoundExchange's broad reading of the Gross Proceeds definition to include all revenue received by a BES, irrespective of its actual creation of incremental copies, must be rejected. Through this position, SoundExchange improperly seeks to obtain for its record company members[1] payment for the value of the very performances that drive the BES revenue, contrary to Congress's intent.

A. When granting the sound recording digital performance right, Congress treated BES the same as terrestrial radio and, for the same reasons, exempted BES entirely from that right

Unlike every other category of statutory sound recording licensee subject to proceedings before the Copyright Royalty Board, BES are completely exempt from the sound recording performance right. 17 U.S.C. §114(d)(1)(C)(iv). Consequently, like terrestrial radio, a BES need not obtain any performance license or pay any royalty for its transmission of sound recordings to a commercial business subscriber for the purpose of performing the BES's music programming to the public as background music.

When the digital performance right was first created in the Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat. 336 (1995) (the "DPRSRA"), Congress was faced with balancing the rights and interests of many different types of

[1] Unlike with the section 114 performance licenses, section 112 ephemeral license royalties are not required to be shared with the recording artists. 17 U.S.C. § 112; 37 C.F.R. § 384.4(g)(1) (2014).

stakeholders that could be affected by the creation of this new right. Congress's overarching intent was to support the continued development and creation of new digital music transmission technologies and services, while protecting sound recording owners from those types of technologies and services deemed most likely to negatively impact record sales and protecting established sound recording users from undue disruption. S. Rep. No. 104-128, at 13 (1995) ["DPRSRA Senate Report"] ("[T]he Committee has sought to address the concerns of record producers and performers regarding the effects that new digital technology and distribution systems might have on their core business without upsetting the longstanding business and contractual relationships among record producers and performers, music composers and publishers and broadcasters that have served all of these industries for decades. Accordingly, the Committee has chosen to create a carefully crafted and narrow performance rights, applicable only to certain digital transmissions of sound recordings."); H.R. Rep. No. 104-274, at 13 (1995) ["DPRSRA House Report"] ("This legislation is a narrowly crafted response to one of the concerns expressed by representatives of the recording community, namely that certain types of subscription and interaction audio services might adversely affect sales of sound recordings and erode copyright owners' ability to control and be paid for use of their work.").

As part of that balance, certain types of digital transmissions and services deemed unlikely to supplant record sales at all were exempted entirely from the new performance right, while other types of non-interactive services deemed less likely to significantly impact record sales were subjected to the new performance right but granted a statutory license to facilitate their use of sound recordings on reasonable terms. Fully interactive services—deemed most likely to adversely impact record sales—were made fully subject to the exclusive performance right such that record companies could choose whether or not to grant licenses at all and on what

terms. 17 U.S.C. § 114; DPRSRA House Report, at 14 ("In deciding to grant a new exclusive right to perform copyrighted sound recordings publicly by means of digital audio transmission, it is important to strike a balance among all of the interests affected thereby. That balance is reflected in various limitations on the new performance rights that are set forth in the bill's amendments to section 114 of title 17 . . ."); DPRSRA Senate Report, at 16 (noting that the exemptions incorporated in section 114(d)(1) were important elements of this balance and were designed to avoid disruption of existing types of services that were unlikely to harm record sales while interactive services were most likely to harm record sales).

Although the initial version of the bill did not include BES transmissions within the exclusions of section 114(d)(1), after testimony from both BES providers and ASCAP—representing the interests of songwriters and music publishers—urging Congress to provide the full exemption to BES because they were similar to terrestrial radio in that they did not reduce record sales and were provided free to the consumers visiting the various business establishments served, the BES exemption was added to the bill before it was eventually passed and enacted into law. *See The Performance Rights in Sound Recordings Act of 1995, Hearing Before the S. Comm. on the Judiciary*, 104th Cong. 104–709, at 60–62 (1995) (testimony of Steven Randall for Muzak), 70 (testimony of Hal David for ASCAP, arguing that BES should be exempted for the same reasons as broadcasters). Thus, similar to terrestrial radio broadcasters, Congress did not intend for sound recording copyright owners to be paid for performances of sound recordings rendered or facilitated by BES.

B. The section 112(e) ephemeral copy license, especially as applied to BES, is anomalous and has no marketplace value independent of the performance right

The so-called ephemeral recording license in section 112(e) is a strange feature of the Copyright Act. As originally passed, section 112 provided a full exemption for making certain

copies of all types of copyrighted works (other than audiovisual works), incidental to an otherwise lawful performance of those works. When sound recordings were first given a limited digital performance right in 1995, incidental copies made to render digital performances were also subject to the full exemption in section 112. It was only when the DMCA was passed in 1998 that an additional statutory license was added to section 112, at a time when music streaming was in its pre-infancy, both from a technological and a business standpoint. Since that time, the section 112 license has been treated primarily as an afterthought to be dealt with as part of proceedings to set rates and terms for licensees that use both the section 114 performance and section 112 ephemeral licenses for the same service.

Even for licensees required to pay for digital performances, the section 112 license has never made any sense. As the Register of Copyrights has noted, from a technological perspective, it was not drafted to adequately cover the uses that Congress intended to cover, and from an economic and copyright policy perspective, the entire value of a digital music services' use of sound recordings comes from the performance of those recordings. As the Register has also noted, such incidental copies are likely non-infringing even in the absence of an exemption or license. The Judges have similarly grappled with the fact that SoundExchange in all these years has never been able to establish any independent value for the ephemeral right. And SoundExchange itself has acknowledged that there is no marketplace basis for setting an independent rate for these copies and instead has repeatedly—and successfully—argued that the royalty for the section 112 license should merely be included within the performance royalty and deemed to be a very small—five percent—portion of that royalty, rendering the "royalty" nothing more than an accounting exercise.

With respect to BES, which Congress expressly excluded from any performance royalty obligation, the section 112 license makes even less sense. For BES, the ephemeral license royalty is not merely an accounting exercise. As the Register has noted and advised, sound economic and copyright policy would exempt BES from any payment at all for these incidental rights. In any event, an expansive interpretation of the BES regulations that would sweep in revenue that was not generated from the creation of new ephemeral copies would add insult to injury in this regard, would effectively allow SoundExchange to collect royalties based on the value of the very performances that Congress expressly exempted, and should be rejected.

1. The creation of the section 112 ephemeral copy exemption

The statutory treatment of "ephemeral copies" in the Copyright Act first occurred with the passage of the 1976 Copyright Act. During the copyright law revision process leading to the passage of the Act—which included decades of hearings, roundtables, and negotiations between the various stakeholders—the issue was first addressed in 1965 by the Register of Copyrights. At that time, the Register noted that various broadcasters had strongly urged that the new copyright statute provide clarity regarding longstanding industry custom and practice. Reg. of Copyrights, 89th Cong., *Supp. Rep. of the Register of Copyrights on the General Revision of the U.S. Copyright Law: 1965 Revision Bill*, at 44–45 (H. Comm. Print 1965) ["Register's 1965 Revision Bill Rpt."]. For many years, broadcasters made what they called "ephemeral recordings" of their broadcasts, which included musical and other copyrighted works. In the context of music, this included copying the various recordings (and embodied musical works) comprising a particular broadcast transmission onto tape before the broadcast so that the program could be broadcast more easily from that tape, rather than from individual vinyl records played on a turntable. *See Copyright Law Revision: Hearings on H.R. 4347 et al. Before Subcomm. No. 3 of the H. Judiciary Comm.*, 89th Cong., 1721–22 (1965). The Register noted that such incidental copies,

made solely for the purpose of lawful performances, were essential to broadcasters and had been utilized for many years without objection from copyright owners. Register's 1965 Revision Bill Rpt., at 45–46. Consequently, the Register recommended creating an express exemption into the new Copyright Act, recognizing this practice and freeing broadcasters and others from uncertainty in the future.

The provision recommended by the Register was ultimately implemented in section 112 of the 1976 Copyright Act. As originally enacted, section 112 provided a full exemption for any entity permitted to publicly perform or display a copyrighted work to make one copy or phonorecord of each transmission program embodying such performance or display, solely for the purpose of rendering its transmission of that program. 17 U.S.C. § 112(a) (1978). In passing the 1976 Act, Congress noted that this exemption was meant to accommodate the necessary and previously undisputed practices of broadcasters identified by the Register, and was consistent with various exemptions and privileges recognized in other countries around the world:

> This is the problem of what are commonly called "ephemeral recordings": copies or phonorecords of a work made for purposes of later transmission by a broadcasting organization legally entitled to transmit the work. In other words, where a broadcaster has the privilege of performing or displaying a work either because he is licensed or because the performance or display is exempted under the statute, the question is whether he should be given the additional privilege of recording the performance or display to facilitate its transmission. The need for a limited exemption in these cases because of the practical exigencies of broadcasting has been generally recognized, but the scope of the exemption has been a controversial issue.

H.R. Rep. No. 94-1476, at 101 (1975). Thus, the privilege was not meant to provide a new right to broadcasters and other transmitting entities; it was merely meant to codify and clarify longstanding industry practices.

As intended by Congress, "[t]he ephemeral recording privilege would extend to copies or phonorecords made in advance for later broadcasts, as well as recordings of a program that are made while it is being transmitted and intended for deferred transmission or preservation." *Id.* at 103. Moreover, the privilege allowed one copy to be made for each program transmitted by the transmitting entity. Thus, the privilege "would not be limited as to the number of times the work itself could be duplicated as part of other 'transmission programs.'" *Id.* at 102.

The exemption was not limited to broadcasters, and included other types of transmitting entities such as commercial background music services:

> it makes no difference what type of public transmission the organization is making: commercial radio and television broadcasts, public television broadcasts not exempted by section 110(2), pay-TV, closed circuit, *background music*, and so forth.

Id. (emphasis added). As noted above, ephemeral copies were fully exempted under the original version of section 112: there was no need to license or pay royalties for such copies.

2. The creation of the section 112 ephemeral copy license to supplement the exemption

As discussed above, sound recordings were not given any public performance right at the time the 1976 Act was enacted. When the sound recording performance right was first created in 1995 by the DPRSRA—and the BES were fully exempted from that right—there was no ephemeral license in section 112. Yet no sound recording copyright owner had taken the position that a BES needed to obtain a license for ephemeral copies, as defined in section 112, made by a BES during that period between the passage of the DPRSRA and the enactment of the section 112(e) ephemeral license. Nonetheless, as part of a complicated and undocumented set of deals and trade-offs among various stakeholders in connection with the passage of the DMCA, that legislation amended section 112 in 1998 to create the section 112(e) ephemeral recording license. *See* U.S. Copyright Off., DMCA Section 104 Report: A Report of the Register of Copyrights

Pursuant to §104 of the Digital Millennium Copyright Act, at 144 n.434 (2001) ["Register's DMCA Section 104 Rpt."] (noting that the section 112(e) license provision was part of a larger stakeholder compromise).

The section 112(e) license is available to various types of digital music services that make digital transmissions of sound recordings. As described by the Register of Copyrights, "recognizing that such digital services must make server reproductions—sometimes called "ephemeral" copies—to facilitate their digital transmissions, Congress established a . . . statutory license under section 112 to authorize the creation of these copies." U.S. Copyright Off., Copyright and the Music Marketplace: A Report of the Register of Copyrights, at 46 (2015) ["Copyright and the Music Marketplace"]. That license, unlike the exemption in section 112(a), only applies to the sound recording right. 17 U.S.C. § 112; H.R. Rep. No. 105-796, at 90 (1998) ["DMCA Conf. Rept."]. Notably, notwithstanding this limitation, Music Choice is not aware of any musical work copyright owner taking the position that BES or any other non-interactive digital music services must obtain licenses for the musical works embodied in these ephemeral copies.

Not surprisingly, given the Register's explanation of the genesis of the 112(e) license provision as part of a broader set of back-room industry deals to facilitate passage of the overall bill, there is no explanation anywhere to be found in the legislative history of the DMCA as to why Congress felt it necessary to include the BES in this license, or why the issue was not dealt with as a full exemption. With respect to webcasters and other section 114(f) licensees, Congress merely noted that such a licensee might choose to use the statutory license to make multiple server copies "to use on different servers or to make transmissions at different transmission rates or using different transmission software." DMCA Conf. Rept., at 89–90. If this were the intent of

the license, the actual statutory terms do a poor job of addressing that purpose. For example, the restrictions on the section 112(e) license exclude from the license any ephemeral copies that are retained longer than six months, unless retained solely for archival purposes. 17 U.S.C. § 112(e)(1)(C). And the license is limited to only one additional copy beyond that exempted by section 112(a), unless the implementing regulations for a given licensee type provide otherwise. *Id.* § 112(e)(1). As the Register has pointed out, many licensees have noted that these restrictions are inconsistent with industry practices, are impractical, and provide no benefit to copyright owners. Copyright and the Music Marketplace, at 117. Faced with these complaints, the Register, after acknowledging them, noted that copyright owners had not sought to enforce any of these restrictions, so she did not view the need to address the statutory language as "an especially pressing issue." Nevertheless, she recommended that Congress "refine the statutory language with respect to the number and retention of server copies so as to eliminate any doubt as to the operation of the section 112 license." *Id.* at 179.

3. The section 112(e) license is an anomaly and has no independent marketplace value

It is patently evident from the history set forth above, as well as from both a conceptual and practical marketplace perspective, that the section 112(e) license—especially as applied to the BES—is an anomaly and has no independent value. This has been recognized explicitly by the Register of Copyrights, and at least implicitly by the Judges and even SoundExchange itself.

(a) The Register of Copyrights has recognized that the section 112(e) license is an anomaly, has no independent value, and is at odds with sound economic and copyright policy

Pursuant to section 104 of the DMCA, the Register of Copyrights was required to present a report to Congress on her evaluation of the effects of the implementation of the DMCA. Digital Millennium Copyright Act of 1998, §104(b), Pub. L. No. 105-304, 112 Stat. 2869, 2876 (1998).

In that Report, the Register discussed the newly created section 112(e) ephemeral recording license, as well as the more general issue of other incidental copies, including buffer copies, that may be made for the purpose of transmitting licensed or otherwise lawful digital performances. Register's DMCA Section 104 Rpt., at 142–46. In that section of her Report, the Register specifically criticized the section 112(e) license:

> The webcasting amendments in section 405 of the DMCA created a new compulsory license to make ephemeral recordings of sound recordings under specified circumstances. 17 U.S.C. § 112(e). In light of the original purpose of section 112, and a subsequent legislative proposal to exempt certain ephemeral recordings used to facilitate the transmission of digital distance education materials . . . section 112(e) can best be viewed as an aberration. As we indicated in 1998 to the affected parties who championed this provision as part of an overall compromise, we saw no justification for the disparate treatment of broadcasters and webcasters regarding the making of ephemeral recordings. Nor did we see any justification for the imposition of a royalty obligation under a statutory license to make copies that have no independent economic value and are made solely to enable another use that is permitted under a separate compulsory license. Our views have not changed in the interim, and we would favor repeal of section 112(e) and the adopting of an appropriately-crafted ephemeral recording exemption.

Id. at 144 n.434 (citation omitted).

The Register has taken the position that, as applied to digital music services' use of sound recordings, "ephemeral recordings" as that term is used in section 112(e) refers to server copies made for the purpose of a transmission. *See* Copyright and the Music Marketplace, at 46; Register's DMCA Section 104 Rpt., at 142–46 (differentiating between buffer and similar incidental copies made in the course of a transmission and "ephemeral recordings" subject to section 112). But the Register noted that such buffer and other copies made in the course of a particular transmission are similarly devoid of any independent value. *Id.* As the Register explained, focusing on the context of musical works reproduction rights for licensed webcasters:

> The economic value of licensed streaming is in the public performance of the musical work and sound recording, both of which are paid for. The buffer copies have no independent significance. They are made solely to enable the performance. The same copyright owners appear to be seeking a second compensation for the same activity merely because of the happenstance that the transmission technology implicates the reproduction right . . . .

Id. at 143. The Register then analogized the problem to that of the section 112 ephemeral recording exemption, repeating that ephemeral copies—server copies made solely to facilitate a transmission of a lawful performance—"have no economic value independent of the public performance they enable." *Id.* at 144.

Indeed, the Register went so far as to agree that such copies are likely to be non-infringing fair use, but that transmitting entities should not have to endure the uncertainty and disruption involved in litigating that issue. *Id.* at 145. As the law has developed in this area over time, several courts have in fact held that various types of incidental copies made for the purpose of internet transmissions are non-infringing. *See, e.g.*, *IMAPizza, LLC v. At Pizza Ltd.*, 965 F.3d 871, 877 (D.C. Cir. 2020) ("The Copyright Act defines 'copies' as 'material objects . . . in which a work is fixed' and considers a work 'fixed' in a tangible medium of expression when its embodiment in a copy . . . is sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration. 17 U.S.C. § 101. . . [T]his definition of copy does not include 'ephemeral transmission of a picture across the internet.' Instead, the copy becomes 'fixed' when the picture is reproduced for a viewer."). In light of these serious economic and copyright policy problems raised by the section 112 license (and incidental copies more broadly), the Register recommended that Congress pass an explicit exemption for such copies and eliminate the section 112(e) license entirely. Register's DMCA Section 104 Rpt., at 142.

(b) The Copyright Royalty Judges have recognized that the section 112(e) license has no independent value

Given the problems with the section 112(e) license described above, it is not surprising that the Judges have had some unease in setting rates for that license. In the *SDARS I* proceeding, faced with the fact that SoundExchange had failed to introduce any marketplace evidence establishing a discernible value for that license, the Judges declined to set any rate or minimum payment for the ephemeral recording license. Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, Docket No. 2006-1 CRB DSTRA, 73 Fed. Reg. 4080, 4098 (Jan. 24, 2008) ["*SDARS I*"] (characterizing the evidence as "virtually nonexistent" and stating that "[n]o party presented any evidence as to the independent value arising from the Section 112 license."). As the Judges correctly characterized the matter:

> We are left with a record that demonstrates that the license is merely an add-on to the securing of the performance rights granted by the Section 114 license. SoundExchange's proposal to include the Section 112 license within the rates set for the Section 114 license reflects this reality and we accept it as we did in Webcaster II. However, just as we did in Webcaster II, we decline, for the reasons stated above, to ascribe any particular percentage of the Section 114 royalty as representative of the value of the Section 112 license.

Id.

Although the Register subsequently ruled that the Judges' failure to set any rate or minimum fee constituted legal error, the Register did not take issue with the finding that SoundExchange had failed to establish any independent value for the right. *See* Review of Copyright Royalty Judges Determination, Docket No. 2008-2, 73 Fed. Reg. 9,143, 9,145 (Feb. 19, 2008). Rather, the Register merely noted that the statute requires a rate to be set, irrespective of whether the participants offer any evidence to value the rate, but also noted—without taking a position for lack of ripeness—that the Judges may be free to set the rate at zero. *Id.* at 9,145–46 & n.3.

On remand after an appeal of *SDARS I*, the participants settled the issue by agreeing that the section 112(e) royalty would be "included within, and constitute 5% of" the SDARS section 114 royalty payments. Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, Docket No. 2006-1 CRB DSTRA, 75 Fed. Reg. 5513, 5,513–14 (Feb. 3, 2010). Since that time, the section 112(e) license set for any type of licensee subject to the section 114 license has not been ascribed any independent value, but rather has been included within the performance right fee and merely deemed to be 5% of that fee. Because the section 112 "rate" does not actually change the amount of money a licensee must pay, but merely impacts how that money gets distributed—the more allocated to section 112, the less recording artists get—licensees never have any material incentive to fight for a lower rate. As the Register has characterized this state of affairs, "[s]ection 112 rates have been a relatively insignificant part of the CRB's ratesetting proceedings, and have been established as a modest percentage of the 114 rate." Copyright and the Music Marketplace, at 51 n.245.

(c) SoundExchange itself has repeatedly argued that the section 112(e) license has no separate value

As explained above, because the ephemeral copies at issue have no independent value, SoundExchange has been unable to provide any marketplace evidence of any independent value. In several consecutive proceedings for various section 114 / 112 license types, SoundExchange proposes the same structure, wherein the section 112 license has no separate fee but is merely allocated 5% of the section 114 payment. In support, SoundExchange introduces the same testimony based on a handful of license agreements, and argues that voluntary performance licenses typically also include the right to make any copies necessary to transmit the performances. *See, e.g.*, Determination of Rates and Terms for Digital Performance of Sound Recordings and Making of Ephemeral Copies to Facilitate Those Performances (Web V), Docket

No. 19-CRB-0005-WR (2021-2025), Doc. No. 9547, Proposed Rates and Terms at 3 (Sept. 26, 2019) [*"Web V"*]; Doc. No. 9549, SoundExchange WDT Vol. 1, WDT of Jonathan Bender at 25; Designated Testimony of George S. Ford at 11–13. Notably, SoundExchange expert Dr. Ford specifically argued that the marketplace evidence he relied on supported using the proposed structure, where the section 112 ephemeral copying right is not separately priced but rather is included as part of the performance license and merely allocated a percentage of the fee for that license. Designated Written Testimony of George S. Ford, at 11 & n.19. At trial, Dr. Ford acknowledged that several of the voluntary agreements for comparable services he relied upon that included ephemeral copying rights along with performance rights did not provide any allocation or other nominal rate for the ephemeral right—the right was simply included as an add-on without any specific payment attributable to it. *Web V*, Doc. No. 9549, Designated Trial Testimony of George S. Ford, Tr. 412:4–19. He also admitted that he had not seen a single marketplace agreement for a comparable service that had a true separate fee for those copies. *Id.* at 412:20–413:1. He testified that he had seen only one agreement that expressly allocated a percentage of the performance fee to the ephemeral copying right. *Id.* at 413:2–414:4. He further testified that his opinion—based in part on these agreements—was that it would be inappropriate to set a separate rate for the ephemeral right, and that the better approach is to assign a small portion of the performance fee to serve as the "royalty" for the ephemeral right. *Id.* at 415:14–20.

Dr. Ford also testified that he had seen one agreement with a commercial background music service, which he did not proffer as a benchmark, in which what he characterized as the ephemeral right was "sold separately" because performance rights were not included in that license. *Id.* at 415:5–13. He did not discuss any other details of that agreement, but it should be noted that many commercial background music services—especially at the time of Dr. Ford's

testimony—provided a particular type of service called an "on-premise" service. In that type of offering, the background music service provider creates and distributes physical copies of its sound recording programming for the business establishment to play at each of their locations. *See* Report of the Copyright Arbitration Royalty Panel, *Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Interim Public Version, Docket No. 2000-9 CARP DTRA 1 & 2, at 112 (Feb. 20, 2002) ["*Web I* CARP Rept."] (explaining that such "on-premise" services distributed physical copies of their sound recording programming to each business location, sometimes on tapes and CDs, and later on physical hard drives, from which the services' programming would later be performed at those locations). These types of services—which Music Choice does not offer—obviously need a very different bundle of rights than either webcasters or statutory BES. In particular, they need the right to distribute copies of sound recordings. These significant rights are not available in any statutory license, which is likely why the service entered into the direct license agreement mentioned by Dr. Ford. But those duplication and distribution rights are very different from the limited rights provided by the section 112(e) license. And even if the duplication rights granted to on-premise services were comparable to the more limited ephemeral rights—they are not—they are bundled with the more significant distribution rights, and not priced independently.[2]

[2] The first BES rates and terms for the BES license were set in a combined CARP proceeding with the webcasting license. That proceeding primarily focused on the first rates and terms for webcasters. Indeed, in a Report spanning over 135 pages, the CARP devoted 78 pages to its analysis of the webcasting rate and a scant 18 pages to the BES rate. In that proceeding, the only marketplace agreements before the Panel were some voluntary webcasting agreements and a handful of these types of "on-premise" background music service licenses, which covered distribution and other rights well beyond those included in the section 112(e) ephemeral license, and even rights beyond the use of sound recordings. *Web I* CARP Rept., at 122 (noting that the proposed benchmark agreements included both reproduction and distribution rights, and not ephemeral rights), 124 ("It is true . . . that these agreements convey to the licensees some benefits beyond the use of sound recordings."). At a time when the technologies, legal landscape, and licenses themselves were very new, the CARP unfortunately used only the "on-premise" licenses as benchmarks to set the rate and terms for the BES license. It did so without even adjusting for the different rights involved (including the acknowledged rights other than sound recording rights), and assumed that even the most insignificant and transitory incidental buffer copies would require a license. *Id.* at 121–26. Twenty years later, much has changed on all fronts. As the Judges have repeatedly held, where the rights licensed

C. Relevant legislative history and other context supports the plain meaning of the BES Gross Proceeds definition

The Register and the Judges have repeatedly recognized that the ephemeral copying right to make incidental copies for the purpose of facilitating transmissions of authorized performances has no independent economic value. Even SoundExchange has repeatedly argued to the Judges that both economic theory and marketplace evidence indicate that the ephemeral copying right should not be priced separately but rather should merely be allocated a small portion of the performance royalty. But even though Congress decided long ago to treat BES like terrestrial radio and exempt them entirely from paying any royalties to perform sound recordings, they still must pay some rate and minimum fee if they choose to avail themselves of the section 112(e) license. Although the ultimate question of the appropriate rate for the BES license is not at issue in this limited referral, the unusual nature of the license set forth above provides helpful context. It further supports the importance of interpreting the Gross Proceeds definition in the limited fashion that the plain language of the regulation already dictates. If a BES must pay royalties for an anomalous license without any value independent of the performance—valued by Congress as free—then at the very least, that BES should only have to pay the royalty to the extent it actually makes ephemeral copies "solely for the purpose of" its BES transmissions.

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are fundamentally different, voluntary license agreements make unreliable benchmarks. *See* Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, Docket No. 2011-1 CRB PSS/Satellite II, 78 Fed. Reg. 23,054, 23,058 (Apr. 17, 2013) (rejecting musical works performance license benchmarks, even where such benchmarks were previously used by the CARP, because licenses covered different rights and rejecting interactive webcasting, ringtone, and digital download benchmarks because they included different products and rights than the target statutory license). And even when there are material but less significant differences, adjustments must be made. *See* Determination of Rates and Terms for Digital Performance of Sound Recordings and Making of Ephemeral Copies To Facilitate Those Performances (Web V), Docket No. 19–CRB–0005–WR (2021–2025), 86 Fed. Reg. 59,452, 59,475, 59,505 (Oct. 27, 2021) (making various adjustments to benchmark rates to account for differences between benchmark and target services). Music Choice respectfully suggests that as the law and understanding of the markets and technologies have now developed, the Judges would not consider these "on-premise" license agreements to be usable benchmarks, at least not without significant and principled adjustments.

ARGUMENT

I. The Plain Meaning of the "Gross Proceeds" Definition Only Requires Royalty Payments from Revenue Attributable to Copies Made Solely to Facilitate a BES Transmission

As the Judges have previously explained, "where regulatory language is clear, 'construction of a regulation must begin with the words of the regulation and their plain meaning.'" Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 82 Fed. Reg. 56,725, 56,733 (Nov. 30, 2017) (quoting *Pfizer v. Heckler*, 735 F.2d 1502, 1507 (D.C. Cir. 1984)). This basic principle governing the interpretation of regulatory terms is no different than with statutory interpretation—regulatory terms are to be interpreted using settled principles of statutory and rule construction. *See, e.g.*, *Pfizer*, 735 F.2d. at 1509 (applying "settled principles of statutory and rule construction" when interpreting an agency regulation). Thus, just like when a statute is unambiguous, when a regulation is unambiguous, courts should not look beyond the text of the regulation itself unless the plain meaning of the regulation would lead to an absurd result. *See, e.g., U.S. ex rel. Totten v. Bombardier Corp.*, 380 F.3d 488, 494–95 (D.C. Cir. 2004); *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004) (statute must be implemented according to its plain terms unless "the text is … absurd") (internal quotation marks omitted).

Here, the regulatory language at issue is perfectly clear—it explicitly calls for the inclusion of only those revenues that are derived from copies of sound recordings that are made "for the sole purpose of facilitating a transmission to the public of a performance of a sound recording." 37 C.F.R. § 384.3(a)(2) (2019). The "sole purpose" language in the definition must place some limitation on the revenues that are to be included in "Gross Proceeds"—not all BES revenues are included. Were that not the case, the "sole purpose" language would be superfluous—a result that is at odds with long-settled cannons of regulatory and statutory

interpretation. *See, e.g.*, *U.S. v. Butler*, 297 U.S. 1, 65 (1936). And, while the definition of "Gross Proceeds" does not specify precisely how a BES provider should go about allocating revenues between those that should be included within "Gross Proceeds" and those that should not, it does clearly state the overarching principle that must be used to apportion revenues—only those revenues attributable to BES transmissions where copies are made *solely* for the purpose of facilitating those transmissions by the BES provider are to be included. Given this clear limiting language in the regulatory text, there is no other reading of the "Gross Proceeds" definition that makes any sense.[3]

The reading that SoundExchange insists upon—one in which "Gross Proceeds" includes *all* BES revenues, regardless of whether they are derived from ephemeral copies of sound recordings made for the sole purpose of facilitating a BES transmission—is a reading that is entirely at odds with the plain meaning of the "Gross Proceeds" definition. Were SoundExchange correct, the language "for the sole purpose of facilitating a transmission" would be superfluous. In other words, SoundExchange's preferred interpretation of "Gross Proceeds" reads out of the definition key limiting language. Such an approach cannot be squared with established precedent.

It has been well-settled for many decades that limiting language in a statute or regulation cannot simply be ignored—limiting "words cannot be meaningless, else they would not have

[3] In its decision referring the question of regulatory interpretation to the Judges, the District Court concluded, without any supporting explanation or rationale, that "the Board's definition of 'Gross Proceeds' in 37 C.F.R. § 384.3(a)(2) is 'ambiguous and do[es] not, on [its] face, make clear whether [Music Choice's] approaches were permissible under the regulations.'" Meet and Confer Statement at 9 n.2, *SoundExchange, Inc. v. Music Choice*, No. CV 19-999 (RBW) (D.D.C. Apr. 8, 2020), ECF No. 20. While never explained, that statement appears to be speaking to the issue of whether the specific approach Music Choice took to determine which revenues should be included in "Gross Proceeds" was consistent with the governing regulations. It does not appear to address the larger issue of whether there is any ambiguity regarding whether there is a limitation on the revenues that are to be included in Gross Proceeds or what that limitation is. In any event, now that the District Court has referred the interpretive question to the Judges, the sole concern is whether the Judges find the Gross Proceeds definition ambiguous. Music Choice respectfully suggests that there are no grounds for the Judges to find any such ambiguity.

been used." *Butler*, 297 U.S. at 65. *See also Gustafson v. Alloyd Co.*, 513 U.S. 561, 577 (1995) ("the presence of limiting language in [the statute] requires a narrow construction."); *Lowe v. SEC*, 472 U.S. 181, 207 n.53 (1985) ("[W]e must give effect to every word that Congress used in the statute."); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979) ("In construing a statute we are obligated to give effect, if possible, to every word Congress used."); *See also*; *Burdon Cent. Sugar Ref. Co. v. Payne*, 167 U.S. 127, 142 (1897) (in analogous contract interpretation context, "the contract must be so construed as to give meaning to all its provisions, and … that interpretation would be incorrect which would obliterate one portion of the contract in order to enforce another part."). But that is precisely how SoundExchange is asking the Judges to interpret the "Gross Proceeds" definition—to ignore limiting words that plainly have meaning. This approach clearly violates the well-established rule that "courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Carcieri v. Salazar*, 555 U.S. 379, 392–93 (2009) (citing *Conn. Nat. Bank* v. *Germain*, 503 U.S. 249, 253–54 (1992)).

Moreover, if the intent of the regulation were to require services like Music Choice to include all BES revenues in "Gross Proceeds," irrespective of whether any incremental ephemeral copies were made solely to facilitate BES transmissions, the regulation could easily have been written to call for exactly that. Doing so would have been far simpler and less cumbersome than the language that is, and has always been, included in the definition of "Gross Proceeds." The definition could have left out the "sole purpose" limiting language or, as the Board has done in other proceedings, simply stated that the applicable revenue base should include all of a service's revenue (in some cases subject to enumerated deductions). *See, e.g.*, Determination of Royalty Rates and Terms for Making and Distributing Phonorecords ["*Phono*

III"], Final Rule, 84 Fed. Reg. 1,918, 1,966 (Feb. 5, 2019) (defining "Service Revenue" to include, among other things, "All revenue from End Users recognized by a Service for the provision of any Offering"). But, of course, that is not what was done in the original BES regulations, nor is it what the regulations in any of the subsequent BES settlements called for, all of which maintained the same definition of Gross Proceeds by agreement of the relevant parties, including the limiting language that SoundExchange asks the Judges to ignore.

In short, the definition of Gross Proceeds has consistently contained the limiting language that unambiguously calls for including only certain revenues in the Gross Proceeds pool—only those revenues attributable to copies made for the sole purpose of transmitting a sound recording on a BES service. Under well-established principles of regulatory interpretation, that should settle the matter currently before the Judges. But, as we next address, even if one were to conclude that there was some ambiguity in the definition of Gross Proceeds, or that it was, for some other reason, appropriate to look to other evidence (for example, to determine if the plain meaning leads to an absurd result), that evidence only serves to further confirm that the limitation imposed by the "for the sole purpose" language serves valid economic and copyright policy purposes, and therefore that limitation must be given its full effect.

II. The Plain Meaning of the Definition of Gross Proceeds is Confirmed by the Unique Nature of the BES License and the Judges' Prior Rulings

As discussed in greater detail *supra*, pp. 7-18, the unique nature of the BES license and the historical context in which it was created further supports why the plain meaning of the Gross Proceeds definition—with its language expressly limiting those revenues that are to be included within the revenue pool—should be strictly construed as written. First, unlike all other sound recording statutory licensees, BES providers are completely exempt from the sound recording performance right. The only right covered by the BES license is the right to make ephemeral

copies, and as the Register herself noted, that right has no independent value separate and apart from the performance right. The Judges have similarly noted the lack of any marketplace evidence establishing an independent value for this right, and even SoundExchange has repeatedly argued that the ephemeral license should not be assigned any independent value. Instead, according to SoundExchange, only a small portion—five percent—of the performance license fee should be allocated to the ephemeral license (and, at that, just for accounting purposes), and that there should be no separate stand-alone royalty for the license. Stated succinctly, even SoundExchange has taken the position that ephemeral rights have no independent value and should not have a separate, incremental royalty from the performance royalty. *See supra* pp. 20-22.

The total lack of independent value for the licensed right, and the fact that Congress intended for BES providers to avoid any royalty obligation for the sound recording performances rendered, strongly suggest that the total BES license payment should be minimal, if not zero. And it certainly should not be anywhere close to the percentage of revenue paid by other services that are required to pay royalties for both sound recording performance rights and ephemeral rights. Accordingly, it only makes sense that the Gross Proceeds revenue pool should be limited—a limitation that is, and has always been, accomplished in the BES regulations through the "for the sole purpose of facilitating a transmission to the public of a performance of a sound recording" language. SoundExchange's efforts to read this language out of the regulation entirely and instead seek royalties based on all BES revenues is not only at odds with the plain meaning of the regulatory term, but also this historical and legislative context. That erroneous reading—if accepted by the Judges—would effectively give sound recording copyright owners the very

performance royalty that Congress purposefully withheld from the record companies when it created the digital performance right.

Second, as the Register has also previously explained, sound economic and copyright policy calls for an exemption for BES providers from *any* payment for the rights covered by the section 112 license at issue. Indeed, the Register went so far as to make the recommendation that Congress clarify that there is no need for a license to create ephemeral copies, that there should not be any royalty obligation for the creation of such copies, and that the section 112(e) license should be eliminated entirely. This recommendation was driven, at least in part, by the Register's conclusion that these sorts of incidental copies are likely to be non-infringing, a conclusion that courts have now agreed with. *See supra* pp. 17-18. These conclusions, and this additional context for the BES license, only lend further support for the plain meaning of the regulation at issue. The language limiting the revenues that should be captured by the Gross Proceeds definition has real meaning, serves a rational purpose consistent with Congress's intent in creating the BES exemption from performance royalty obligations and the section 112 ephemeral recording provisions more generally, and appropriately should be used to limit BES royalty obligations where applicable.

In addition to this historic and legislative context, the Judges' prior rulings further confirm the propriety of limiting those revenues that are to be incorporated into the "Gross Proceeds" revenue pool to only those revenues that are attributable to the specific rights granted by the BES license—the right to make ephemeral copies to facilitate the transmission of sound recordings by BES providers. As the Judges have previously made clear, "it is almost axiomatic" that revenues unrelated to the particular statutory license at issue "should not be included in the revenue base" used to calculate royalties for a license where the royalty is calculated as a

percentage of revenue. *Phono III*, 84 Fed. Reg. at 1,961. And the Judges have routinely rejected proposed definitions of the revenue pool against which a percentage-of-revenue royalty rate is to be applied when those proposals called for including revenues that are unrelated to the statutory license at issue. For example, in *SDARS II*, the Judges rejected SoundExchange's proposed expansive definition of "Gross Revenues" because it was the Judges' intention "to unambiguously relate the fee charged for a service that an SDARS provided to the value of the sound recording performance rights covered by the statutory licenses." Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, Docket No. 2011-1 CRB PSS/Satellite II, 78 Fed. Reg. 23,054, 23,072 (Apr. 17, 2013) ["*SDARS II"*]. In that same proceeding, the Judges similarly rejected the argument that a more expansive revenue definition was appropriate since it might be easier to administer and might be less prone to manipulation because that proposal would run contrary to the Judges' prior determination to "include only those revenues related to the value of the [statutory] rights at issue in th[e] proceeding." *Id.*

To implement this "axiomatic" principle, the Judges have routinely excluded revenues from the pool against which the percentage-of-revenue royalty rate is applied or otherwise have made adjustments to reduce the overall royalty obligation. For example, in *SDARS II*, the Judges concluded that revenues that were not attributable to the statutory license, including those related to hardware sales, should be excluded from the revenue base against which the royalty rate was applied. *SDARS II*, at 23,096 (excluding "monies received by Licensee's carriers from others and not accounted for by Licensee's carriers to Licensee, for the provision of hardware by anyone and used in connection with the programming service" from the definition of "Gross Revenues."). In the same proceeding, the Judges similarly concluded that a downward

adjustment to the royalties owed was appropriate to account for the performance of any directly licensed sound recordings as well as for the performance of any pre-1972 sound recordings which, at the time, were "not licensed under the statutory royalty regime." *Id.* at 23,072. Similarly, in *Phonorecords III*, the Judges concluded that "Service Revenue" needed to be reduced to "exclude revenue derived by the Service solely in connection with activities other than" those covered by the statutory license there at issue. *Phono III*, at 2,032.

The plain meaning of the "Gross Proceeds" definition is entirely in line with these prior findings by the Judges. "Gross Proceeds," by its plain terms, only captures revenues associated with ephemeral copies made solely for the transmission of a sound recording by a BES provider. To the extent no ephemeral copy needs to be created to transmit a sound recording or to the extent an ephemeral copy has already been created pursuant to another license (and thus no additional copy needs to be created to facilitate a BES transmission), the revenues associated with those transmissions need not, and should not, be included.

The approach that SoundExchange is advocating for, on the other hand—one that cannot be squared with the plain reading of the regulation—is at odds with the unique nature of the BES license as well as the Judges' prior rulings. By insisting that all BES royalties be included in the definition of "Gross Proceeds," regardless of whether there is an ephemeral copy of a sound recording being made for the sole purpose of facilitating the transmission of that recording by the BES provider, SoundExchange is attempting to capture, for itself and its affiliated record labels, payment for activities that are not covered by the license at issue. In effect, SoundExchange is pretending as if the issue is not whether an ephemeral copy is being made, but instead whether any performances of sound recordings are being made. In other words, SoundExchange is attempting to be paid for the very performances of sound recordings by BES providers that

Congress explicitly exempted from any licensing or payment requirement. In this respect, SoundExchange is ignoring the unique nature of the BES license, and is attempting to treat it as if it were a license covering both the creation of any ephemeral copies and the performance of any sound recordings. But, as noted above, BES providers, like terrestrial radio stations, are totally exempt from securing a license and paying royalties for any sound recording performance rights. *See supra* pp. 8-10. SoundExchange's efforts to be paid for such performances based on all BES revenues must be rejected.

SoundExchange similarly ignores that the ephemeral copies covered by the BES license have no independent value. These copies serve only to facilitate a performance of a sound recording for which BES providers are not required to pay royalties. As discussed above, the Register has repeatedly concluded that the section 112(e) license implementation was misguided, makes no sense, and constitutes unsound copyright and economic policy. *See supra* pp. 16-18. Accordingly, section 112(e) should, at the very least, be treated as an anomaly. Indeed, SoundExchange itself has tacitly acknowledged as much. For years and across many different proceedings setting rates and terms for sound recording licenses, SoundExchange has repeatedly taken the position that royalties for ephemeral copies have no independent value, that they should be subsumed within the sound recording performance royalty, and that they should be treated as accounting for only five percent of the total sound recording performance royalty. *See supra* pp. 20-22.

Were SoundExchange's own logic applied here, the total royalty for the BES license would be zero, since the sound recording performance royalty for a BES provider, as determined by Congress, is also zero (and five percent of zero is zero). But even if it were assumed, counterfactually, that Congress had decided to impose a performance royalty obligation on BES,

the resulting allocation to the ephemeral license would be a small fraction of the existing BES rate. Existing section 114 performance license rates for services—such as BES—that were established prior to creation of the section 112(e) license start as low as 7.5% of revenue and top out at 15.5% of revenue. 37 C.F.R. § 382.10(a), 382.21(a) (2018). And even the unregulated market for on-demand streaming services that have now largely replaced record sales, where the major record companies abuse the market power generated by the inherent complementary oligopoly structure of the seller side of that market, the effective sound recording performance royalty rate is approximately 52% of revenue. *See* Tim Ingham, *Apple Music Just Made a Lot of Claims About What it Pays Artists. Let's Take a Closer Look.*, MUSIC BUSINESS WORLDWIDE (Apr. 19, 2021) https://www.musicbusinessworldwide.com/apple-music-just-made-a-lot-of-claims-about-how-it-pays-artists-lets-take-a-closer-look-at-them/ .

Clearly, if Congress had decided to impose a sound recording performance obligation on BES, it would have been—similar to the PSS and SDARS—at the lowest end of the range of rates, and certainly would have been substantially lower than the 52% Cournot complement rate extracted from interactive services. Indeed, if that rate were even usable as a benchmark for a service as dissimilar as a BES, it would have to be adjusted downward significantly to account at least for the interactivity functionality and the lack of competition and resulting market power driving that high rate. But even conservatively assuming an absurdly high hypothetical performance rate of 20%, the portion that would be allocated to the section 112 ephemeral copying license would be a mere one percent of revenue—a rate that is well below the prevailing BES rate for 2022 of 13.25%. This extreme disparity between the current BES rate and any rational value of the license makes it even more important that the limiting language in the Gross

Proceeds definition be given full effect by including only those revenues that are attributable to copies made solely for the purpose of transmitting sound recordings by a BES provider.

Despite the fact that this analysis resulting in a BES royalty of zero—or at the very most one percent of revenue—is entirely based on SoundExchange's own logic and repeated successful arguments before the Judges, it nevertheless seeks to have BES providers include all of their revenues in the Gross Proceeds revenue pool, and not allow for any adjustment so that the Gross Proceeds pool only captures those revenues that are attributable to those copies made for the sole purpose of facilitating a BES transmission. By interpreting the governing regulations in this improper manner, SoundExchange is attempting to secure for itself and its associated record companies an improper windfall. In providing guidance on the intent of the Gross Proceeds definition to the District Court, the Judges should clearly reject this attempt to subvert the purposes of the BES performance right exemption.

III. In the Absence of a Specific Methodology in the Regulations for Apportioning Revenues Derived from Copies Made for the Sole Purpose of Facilitating a BES Transmission, a BES Provider is Entitled to Use a Reasonable Methodology

As the Judges previously concluded, their role here is narrow and limited only to "addressing the meaning of 'Gross Proceeds' as defined in 37 C.F.R. 384.3(a)." Order Reopening Two Proceedings and Scheduling Briefing, eCRB Doc. No. 26360 (March 22, 2022), at 2. As a result, and as explained above, the Judges need not do more than provide guidance regarding the meaning of the "Gross Proceeds" definition at issue. That said, to the extent the Judges find it appropriate to provide additional general guidance for the District Court's consideration, there is more they can offer. Specifically, the Judges may also provide guidance regarding the standard that should be used to evaluate the approach that a BES provider has taken to apportion its revenues such that only those revenues that are associated with copies that are made for the sole purpose of facilitating a BES transmission of a sound recording are

included in the Gross Proceeds revenue pool. *See, e.g.*, Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, Ruling on Regulatory Interpretation, 82 Fed. Reg. 56,725, 56,735 (Nov. 30, 2017) (providing guidance to the district court regarding the meaning of certain regulations along with certain guiding principles, but declining to go further given the limitations on their jurisdiction). To be clear, Music Choice respectfully notes that it would be inappropriate to provide such guidance if doing so required any fact-finding. *See id.*; *see also* Order Reopening Two Proceedings and Scheduling Briefing, at 2 (agreeing with Music Choice that discovery is inappropriate for purposes of addressing the referred question, as any "fact-finding by the Judges would usurp the role of the District Court."). But, to the extent the Judges can provide any further guidance within the confines of their limited role here, such guidance may assist the District Court and ultimately help to make any further proceedings before that court more efficient.

Where, as here, the regulatory royalty formula at issue does not provide a specific approach for allocating revenues between those included in Gross Proceeds and those excluded, a "reasonableness" standard should be applied. Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, Ruling on Regulatory Interpretation, 82 Fed. Reg. 56,725, 56,726 (Nov. 30, 2017) (absent specific guidance in the regulation, the Judges concluded "that a standard of reasonableness should prevail."); *id.* at 56,727 (after concluding that GAAP broadly applied to the Gross Revenue definition there at issue, and that GAAP did not provide specific guidance for allocating revenues, the Judges applied a "reasonableness standard" to both inclusions and exclusions from Gross Revenue).

Applying the same "reasonableness" standard here as was used in the *SDARS* matter makes immanent sense. As an initial matter, the "Gross Proceeds" provision does not itself

specify precisely how revenues should be allocated, even though it does clearly contemplate that some allocation will be necessary to separate out just those revenues that are attributable to any copies being made solely for the purpose of transmitting a sound recording by a BES provider. It is therefore appropriate for the Judges to provide the District Court with higher-level guidance regarding the standard to use to evaluate whether the particular approach taken by Music Choice complied with the regulatory terms.

Using a flexible "reasonableness" standard makes all the more sense in this context, as there are a variety of different BES providers in the market and each may use different technologies or may use different means to transmit sound recordings to their customers. In fact, even an individual BES provider may offer a variety of different technologies that its customers can choose between, which may entail different methods of delivering sound recordings to different customers. Under such circumstances, there may be differing needs for creating (or not) additional ephemeral copies for the sole purpose of facilitating a transmission of a sound recording. For example, one BES may offer 50 different channels to its subscribers and, because of the nature of its offering and the technology it uses to transmit its programming, may have to create copies solely for the purpose of transmitting some, but not all, of those channels to its subscribers. Under these circumstances, it would be reasonable and appropriate for that BES provider to calculate the portion of revenues from that subscriber that should be included within Gross Proceeds based on the percentage of channels that require new copies to be made solely to transmit the sound recordings included on those channels.[4] In other instances, that same service

[4] For example, if a BES provider offered 50 channels to a subscriber, but because of the technology used, only had to create new copies to transmit the sound recordings contained in five of those channels (and for the remaining 45 channels, no new copies were needed because they had already been made for the purpose of a non-BES-licensed transmission), then it would be reasonable to only include 10% of that subscriber's revenue in Gross Proceeds for purposes of calculating the BES royalty (five channels/50 channels).

might transmit its BES package to certain subscribers—but not others—in a way that requires making additional ephemeral copies for all of the channels, in which case all of the revenue from those subscribers would be included in the Gross Proceeds revenue base. For another service, it may be more appropriate to look to some other relevant technical feature of its distribution platforms to best determine what portion of the revenue should be included in Gross Proceeds. As a result, a "one-size-fits-all" approach to apportioning revenue makes little sense and may unnecessarily hamper the ability of certain BES providers to take advantage of the statutory license. A more flexible "reasonableness" standard that allows different BES providers to apportion revenues in a way that makes sense for their particular circumstances is far more appropriate.

In short, should the Judges determine that such additional guidance might aid the District Court, it is well within their purview to provide this guidance, so long as that guidance does not cross over into fact-finding. Music Choice respectfully suggests that, consistent with their prior ruling on a similar question, the Judges should instruct the District Court that a BES has the flexibility to use any reasonable method to apportion revenue such that only revenue reasonably attributable to ephemeral copies made solely to facilitate BES transmissions are included in the Gross Proceeds calculation.

CONCLUSION

For the reasons set forth above, Music Choice respectfully requests that the Judges instruct the District Court that the definition of Gross Proceeds applicable to BES only requires a BES to include revenues from its BES within Gross Proceeds to the extent that revenue is derived from ephemeral copies of sound recordings that are made solely for the purpose of facilitating the transmission of a public performance of that sound recording to a subscriber, and therefore may exclude from Gross Proceeds any revenue that is not derived from such ephemeral

copies; and further that a BES may use any reasonable method to exclude revenue from Gross Proceeds that are not derived from ephemeral copies made solely for the purpose of facilitating such transmissions, including based upon the percentage of channels within the service transmitted to a particular subscriber, if any, that do not require unique ephemeral copies to be made solely for that BES transmission.

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Respectfully submitted,

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Proof of Delivery

I hereby certify that on Friday, May 06, 2022, I provided a true and correct copy of the Music Choice's Opening Brief re: BES Gross Proceeds Referral to the following:

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Music Reports, Inc., represented by William Colitre, served via Overnight Service

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Signed: /s/ Paul Fakler