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)

SOUNDEXCHANGE'S OPENING LEGAL BRIEF CONCERNING THE MEANING OF 37 C.F.R. § 384.3(a)

Pursuant to the Judges' order of March 22, 2022, SoundExchange Inc. ("SoundExchange") submits this opening legal brief concerning the meaning of 37 C.F.R. § 384.3(a). That regulation specifies how the provider of a Business Establishment Service ("BES") like Music Choice must compute the royalties it owes for its use of sound recordings pursuant to the statutory license in 17 U.S.C. § 112(e). For many years, Music Choice has withheld statutory royalties based on a flawed interpretation of 37 C.F.R. § 384.3(a). In both this proceeding and before the District Court, Music Choice has advanced the view that 37 C.F.R. § 384.3(a) does not require it to pay statutory royalties for BES proceeds that it deems allocable to multi-use copies of sound recordings—copies used to provide a BES and also used for any other purpose (in this case, to provide a preexisting subscription service ("PSS")).

The Judges should reject Music Choice's interpretation, as it flouts long-standing canons of interpretation. Specifically, it creates an irremediable inconsistency between the two parts of 37 C.F.R. § 384.3(a)—paragraphs (a)(1) and (a)(2)—one of which uses the term "Gross Proceeds"

and the other of which defines it. In addition, Music Choice's reading creates absurd results, as it would exempt Music Choice from paying either PSS *or* BES royalties for its dual use of copies from 2013 to 2017. Finally, Music Choice's position is at odds with the history of the regulations, which were expressly intended to require a BES provider to pay as a statutory royalty a percentage of *all* of its BES revenue derived from the use of copyrighted recordings.

SUMMARY OF ARGUMENT

The operation of the Section 112(e) license for BES is straightforward. If the provider of a qualifying BES wishes to rely on Section 112(e) for reproductions, it obtains blanket license coverage for "any number of Ephemeral Recordings in the operation of a Business Establishment Service." 37 C.F.R. § 384.3(a)(1). However, the price of that coverage is that the BES provider must pay statutory royalties that are a set percentage of the "'Gross Proceeds' derived from the use in such service of musical programs that are attributable to recordings subject to [copyright] protection." 37 C.F.R. § 384.3(a)(1).

Music Choice has exploited an ambiguity in the regulatory language to advance the counterintuitive proposition that the vast majority of its BES revenue can be excluded from the calculation of its BES royalties. Specifically, Music Choice asserts that, because it allegedly uses some of the same ephemeral copies to provide its BES as it uses to provide its consumer-oriented PSS, it should be able to use an opaque methodology to exclude revenue that it believes is somehow allocable to channels or copies common to both services.

Creative though this might be, Music Choice's interpretation of 37 C.F.R. § 384.3(a)(2) runs headlong into 37 C.F.R. § 384.3(a)(1). All of Music Choice's BES revenue is "derived from the use in such service of musical programs that are attributable to recordings subject to [copyright] protection," and therefore all such revenue is royalty-generating. 37 C.F.R. § 384.3(a)(1). Music

Choice's interpretation of 37 C.F.R. § 384.3(a) conflicts with the long-standing interpretative canon that all parts of a legal text should be interpreted to have meaning.

Music Choice's interpretation also is directly contrary to the express holding of the Copyright Arbitration Royalty Panel ("CARP") that originally adopted the first BES rate regulation. *See* Report of the Copyright Arbitration Royalty Panel in Docket No. 2000-9 at B-7 (Feb. 20, 2002) [hereinafter "*Web I* CARP Report"]. The CARP made clear that all BES providers should pay royalties on the same basis for a blanket license covering "all ephemeral copies which may be utilized." *Id.* at 118-19. The CARP specifically made no distinction for the "different kinds of ephemeral copies" made or utilized by BES providers "at numerous different stages of the process" of providing their services. *Id.* And notably, the direct licenses relied upon by the CARP as benchmarks confirm this same understanding: a BES provider licensee pays a royalty that is a set percentage of the revenue derived from its BES.

Finally, Music Choice's interpretation leads to absurd results. If Music Choice were correct, then it would owe royalties if it used copies of recordings in only its BES or its PSS, but *no* royalties if it used copies in *both*. It is no wonder that this interpretation cannot be squared with the text of the regulation or the *Web I* decision in which that language has its roots.

BACKGROUND

I. BES History and Background

BES have existed for a long time. The familiar Muzak business service debuted in 1934.[1] By 1971, Muzak faced competition in the BES space from AEI Music Network. *Web I* CARP Report at 111.

BES serve a different purpose than consumer services. Muzak was originally "based on the idea that a catchy soundtrack can put consumers in a shopping state of mind."[2] Over the decades, research confirmed that the music played in stores can affect consumer attitudes, behavior, and sales volumes. *See, e.g.*, Robert E. Milliman, *Using Background Music to Affect the Behavior of Supermarket Shoppers*, 46 J. Marketing 86 (1982).[3] Indeed, Music Choice markets its BES on the basis that "[i]t has been proven that music affects how people feel, react, and shop."[4] The unique history and purpose of BES meant that when consumer-oriented music services were just emerging, BES had "large numbers of paying customers and substantial revenues." *Web I* CARP Report at 112.

Broadly speaking, there are two different ways of delivering music to play in stores. Muzak originally transmitted its programming over telephone lines.[5] While technologies have changed

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[1] David Lazarus, *Whatever happened to Muzak? It's now Mood, and it's not elevator music*, L.A. Times (July 7, 2017), https://www.latimes.com/business/lazarus/la-fi-lazarus-store-music-20170707-story.html.

[2] *Id.*

[3] Available at https://www.jstor.org/stable/1251706.

[4] Music Choice Home Page, https://ww1.musicchoice.com/ (last visited May 3, 2022) (Ex. D to Decl. of Mary Marshall).

[5] David Kushner, *Modern Muzak: It's Not Your Parents' Elevator Music*, N.Y. Times (Aug. 27, 1998), https://www.nytimes.com/1998/08/27/technology/modern-muzak-it-s-not-your-parents-elevator-music.html.

(and now include, for example, transmission by satellite and internet), real-time transmission of performances remains an important method for getting music to business establishments.[6] BES delivered by means of transmission of performances are sometimes described as employing a "broadcast" model. *Web I* CARP Report at 113. For decades, broadcast model BES did not obtain licenses for the sound recordings used in their services, because there was no sound recording performance right until 1995.

As an alternative, some BES distribute copies of music to businesses that are then played in-store. These services are sometimes referred to as "on-premises." For many years, it was common for on-premises services to deliver music in the form of tapes or CDs that could be played on specialized equipment in stores. *Id*. at 112. Later, such services relied on downloads to hard drives. *See id*. There is a long history of direct licensing of the sound recordings used in on-premises services. *Id*.

Some BES providers offer businesses choices among various delivery options. For example, as of 2001, AEI offered a choice among BES service delivered by means of direct satellite broadcast, cable television networks, specially formatted CDs physically mailed to businesses each month, or hard drives preloaded with music and thereafter updated with daily downloads. Trial Testimony of Douglas G. Talley in Docket No. 2000-9 CARP DTRA 1 & 2, 8631:3-15, 8640:6-19, 8654:7-14 (Sept. 6, 2001) (Ex. A to Decl. of Mary Marshall) [hereinafter "Talley *Web I* Testimony"]. Currently, Mood Media advertises BES delivered by internet

[6] *See* Elliot Grossman, *Satellite Woes Silence Muzak*, Morning Call (May 29, 1998), https://www.mcall.com/news/mc-xpm-1998-05-29-3197358-story.html.

streaming, download, satellite, or DVD.[7] Regardless of the delivery method, the experience of the business-owner customer is similar: "They select a channel and the music streams out." *Id*. at 8640:20-8641:1; *see also id.* at 8641:11-13.

II. The BES Statutory License

BES occupy a unique position in the sound recording statutory licensing system.

When Congress created a digital performance right in sound recordings in 1995, its focus was on consumer-oriented subscription and interactive audio entertainment services. *See* S. Rep. No. 104-128 at 15 (1995). Because BES were mature businesses that had been operating without sound recording performance licenses for decades, Congress chose to exempt from the new performance right "certain noninteractive transmissions and retransmissions made to business establishments for use in the ordinary course of their business, such as for background music played in offices, retail stores or restaurants. *Id*. at 23; *see also* 17 U.S.C. § 114(d)(1)(C)(iv).

However, not long after enactment of the digital performance right in sound recordings, it became apparent that the providers of broadcast model BES, as well as other types of digital music services, needed to make millions of copies of copyrighted recordings to make their transmissions. Indeed, delivery of a broadcast BES requires making copies at every stage of operations, including quality control of incoming recordings, editing, compression, encryption, storage in a repertoire repository, backup, queueing of channel programming, transcoding, multiplexing and caching and buffering in the transmission process. *Web I* CARP Report at 117-18; Talley *Web I* Testimony at 8632:17-8633:14, 8634:17-8636:1, 8639:1-21, 8647:14-20, 8648:1-8649:14, 8656:15-8661:21, 8666:2-8667:1. As the CARP recognized, these copies are essential to the provision of a BES:

[7] *See* Mood Media, Mood Music Delivery, https://us.moodmedia.com/sound/music-delivery/ (last visited April 21, 2022); Mood Media, Mood Harmony, https://us.moodmedia.com/sound/harmony-music-for-business/ (last visited April 21, 2022).

"Without such ephemerals, no broadcast service could be operated, and no revenue could be generated." *Web I* CARP Report at 118.

Congress soon addressed the need for an efficient mechanism to license the copying needed to provide a broadcast model BES. It did so by enacting the Section 112(e) statutory license as part of the Digital Millennium Copyright Act ("DMCA"). *See* H.R. Conf. Rep. No. 105-796 at 89 (Oct. 8, 1998) (stating that the Section 112(e) license was "intended primarily for the benefit of entities that transmit performances of sound recordings to business establishments pursuant to . . . section 114(d)(1)(C)(iv)"). The Section 112(e) statutory license allows BES transmitting exempt performances to make copies of sound recordings to facilitate such performances if the requirements of the statutory license are met. While the statute provides a default of one copy per sound recording, 17 U.S.C. § 112(e), implementing regulations have always allowed for more. 37 C.F.R. § 384.3(a) (specifying royalty rate "[f]or the making of any number of Ephemeral Recordings in the operation of a Business Establishment Service").

III. The Statutory Royalty Rate for BES

One of the requirements of the Section 112(e) statutory license is that service providers must pay statutory royalties. 17 U.S.C. § 112(e)(6).

A. The *Web I* CARP

The statutory royalty rate for BES has been litigated only once, in the first CARP proceeding after enactment of the DMCA (sometimes referred to as *Web I*). AEI participated fully in the proceeding, along with DMX Music, which at the time provided both a PSS and a BES. *Web I* CARP Report at 111; *Designation as a Preexisting Subscription Service*, 71 Fed. Reg. 64,639, 64,640-41 (Nov. 3, 2006). AEI and DMX merged during the course of the proceeding. *Web I* CARP Report at 112. Music Choice was then a relatively new entrant into the BES business.

It filed to participate in the proceeding, but subsequently withdrew. *Id*. at 111-12. SoundExchange was then a division of the Recording Industry Association of America ("RIAA"), which represented artists and copyright owners in the proceeding. *Id*. at 4.

The participants in the litigation agreed that on-premises services are not eligible for the Section 112(e) license (because they do not transmit performances). *Id*. at 112-13. However, AEI/DMX had recently launched a broadcast model BES to complement its longstanding on-premises BES. *Id*. at 113. AEI/DMX asserted that the direct licenses it had for its on-premises BES covered the copies of recordings in its repertoire repository, and allowed use of those copies in its broadcast BES. *Id*. at 114. Accordingly, it asked the CARP to set a rate that would only cover the *other* copies made and used in the broadcast BES—cache and buffer copies. *Id*. It argued that a zero rate for those copies would be justified, though it offered to pay a "*de minimis*" flat fee for the right to make those copies. *Id*. at 119; *see also id*. at 114-15.

The CARP decisively rejected AEI/DMX's approach to the scope of the rates to be set. The CARP recognized that different BES providers may have different technological architectures and different needs for reproduction rights licensing. *Id*. at 117. However, it concluded that the Section 112(e) license was intended as a "blanket license which would afford each licensee all the rights necessary to operate" a BES, including "the right to make any and all ephemeral copies utilized in a" BES. *Id*. at 118. The CARP expressly rebuffed AEI/DMX's request to "subdivide this package of rights into multiple mini-licenses for the making of different kinds of ephemeral copies." *Id*. Accordingly, it determined to set a rate that would cover "all ephemeral copies which may be utilized in the operation of a broadcast service," regardless of "whether a particular licensee's model" uses some copies that may be otherwise licensed. *Id*. at 119.

Turning to the rates to be set, the CARP adopted as benchmarks existing direct license agreements for BES. *Id.* at 121-23. Those included a variety of agreements for on-premises BES, though some agreements also included rights for broadcast BES delivered by satellite. *Id*. at 124-25. Those agreements generally called for a royalty payment that was a stated percentage "of gross proceeds derived by the background music company from the licensed service." *Id.* at 124. The CARP found that the percentage rates in those agreements could be applied directly to the market for broadcast BES covered by the statutory license. The CARP reasoned that record companies operating in a free market would not choose to license to broadcast BES at rates lower than those offered to on-premises BES, *id*. at 120-21, and observed that some agreements in fact "set a uniform percentage rate" for both types of service. *Id*. at 124. Because RIAA's proposed percentage rate of 10% of gross proceeds was at the low end of the range of rates reflected in the direct license agreements, the CARP adopted RIAA's proposal. *Id*. at 126.

That left the question how to define "gross proceeds" for the purpose of statutory license rate regulations. *Id*. Returning to the benchmark agreements, the CARP found that a plurality used "substantially uniform language," which the CARP adapted "to fit the Section 112(e) license." *Id*. at 126-27. Thus, in words very much like current 37 C.F.R. § 384.3(a)(1), the CARP determined that the royalty should simply be 10% "of the Licensee's annual gross proceeds derived from the use in such broadcast service of the musical programs which are attributable to copyrighted recordings." *Id*. at B-7. While acknowledging that this regulatory language was "not detailed," the CARP determined that it was sufficient, because "the parties have developed workable understandings for applying it in actual practice." *Id*. at 127. The CARP also adopted a formula for allocating gross proceeds between copyrighted recordings and any public domain recordings. *Id*. at 127 n.79.

B. The Librarian's Review of the *Web I* CARP Decision

The Librarian of Congress reviewed the CARP's decision.[8] *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, 67 Fed. Reg. 45,240 (July 8, 2002). In doing so, the Librarian rejected the argument advanced by AEI/DMX that it was arbitrary for the CARP to set a rate for a blanket license covering all ephemeral copies used to provide a BES, when AEI/DMX had requested a rate only for its buffer and cache copies. *Id*. at 45,263. The Librarian found it "consistent with the purpose of the section 112 license" for CARP to have set a Section 112(e) rate for a blanket license of "all the rights necessary" for a BES. *Id*. The Librarian also affirmed the CARP's reliance on existing BES direct license agreements as benchmarks, finding the CARP's adoption of a 10% rate based on those agreements to be "well-founded and supported by the record." *Id.* at 45,243; *see also id*. at 45,265.

The Librarian disagreed with the CARP's conclusions about BES rates in only one respect relevant to this proceeding—the specificity of the regulations as to whether gross proceeds include in-kind payments.

The CARP had relied on benchmark agreements in stating the royalty simply as 10% "of the Licensee's annual gross proceeds derived from the use in such broadcast service of the musical programs which are attributable to copyrighted recordings." *Web I* CARP Report at B-7; *see* 67 Fed. Reg. at 45,268. RIAA objected to this regulatory language, instead proposing a much more elaborate definition based on a different benchmark. *Id*. The Librarian was mostly unmoved by RIAA's arguments. Instead, the Librarian was sympathetic to the CARP's view that a simple

[8] As a practical matter, the Register of Copyrights reviewed the CARP's decision. She made a recommendation to the Librarian, which the Librarian fully endorsed and adopted. 67 Fed. Reg. at 45,272. Accordingly, this brief treats the Register's recommendation as the Librarian's decision.

definition was sufficient. Crediting testimony of an AEI/DMX witness explaining that gross proceeds "is merely the amount the Business Establishment Services receive from their customers for use of the music," the Librarian found that "the definition may be as simple as the CARP's characterization of the term." *Id*.

However, RIAA persuaded the Librarian that the CARP's regulatory language "does not necessarily appear to capture in-kind payments of goods, free advertising or other similar payments for use of the license." *Id*. As a result, the Librarian decided "to *expand on* the CARP's approach and adopt a definition of 'gross proceeds' which clarifies that 'gross proceeds' shall include all fees and payments from any source, including those made in kind, derived from the use of copyrighted sound recordings to facilitate the transmission of the sound recording pursuant to the section 112 license." *Id*. (emphasis added). To achieve that purpose, the Librarian adopted a definition of gross proceeds with language very similar to the first sentence of current 37 C.F.R. § 384.3(a)(2):

> "Gross proceeds" shall mean all fees and payments, including those made in kind, received from any source before, during or after the License term which are derived from the use of copyrighted sound recordings pursuant to 17 U.S.C. 112(e) for the sole purpose of facilitating a transmission to the public a performance of a sound recording under the limitation on the exclusive rights specified in section 114(d)(1)(c)(iv).

Id. The Librarian included this new definition in a definitions section separate from the main BES rate regulation, while leaving the CARP's language intact, with only minor editorial changes:

> For the making of any number of ephemeral recordings in the operation of a service pursuant to the Business Establishment exemption contained in 17 U.S.C. 114(d)(1)(C)(iv), a Business Establishment Service shall pay a section 112(e) ephemeral recording royalty equal to ten percent (10%) of the Licensee's annual gross proceeds derived from the use in such service of the musical programs which are attributable to copyrighted recordings.

> The attribution of gross proceeds to copyrighted recordings may be made on the basis of:
>
> (1) For classical programs, the proportion that the playing time of copyrighted classical recordings bears to the total playing time of all classical recordings in the program,
>
> (2) For all other programs, the proportion that the number of copyrighted recordings bears to the total number of all recordings in the program.

67 Fed. Reg. at 45,273-74.

C. Subsequent Changes to the Regulatory Language

Statutory royalty rates and terms for BES were subsequently settled in 2003, 2007, 2012, and 2018. 69 Fed. Reg. 5693 (Feb. 6, 2004); 73 Fed. Reg. 16,199 (Mar. 27, 2008); 78 Fed. Reg. 66,276 (Nov. 5, 2013); 83 Fed. Reg. 60,362 (Nov. 26, 2018). As a result of these settlements, the percentage rate has slowly increased to the current rate of 13.25%.

Over time, the wording of the BES royalty regulations has remained essentially the same, save for a few editorial changes. *See* Ex. B to Decl. of Mary Marshall (redline tracking editorial changes over time). The 2003 settlement inserted the Librarian's definition of gross proceeds into the middle of the *Web I* CARP's royalty provision and made minor changes in wording. 69 Fed. Reg. at 5698. Implementation of the 2007 settlement of the *BES I* proceeding moved the regulations to their current location (37 C.F.R. § 384.3(a)) and made additional editorial changes:

> For the making of any number of Ephemeral Recordings in the operation of a service pursuant to the limitation on exclusive rights specified by 17 U.S.C. 114(d)(1)(C)(iv), a Licensee shall pay 10% of such Licensee's "Gross Proceeds" derived from the use in such service of musical programs that are attributable to copyrighted recordings. "Gross Proceeds" as used in this section means all fees and payments, including those made in kind, received from any source before, during or after the License Period that are derived from the use of copyrighted sound recordings during the License Period pursuant to 17 U.S.C. 112(e) for the sole purpose of facilitating a transmission to the public of a performance of a sound

> recording under the limitation on exclusive rights specified in 17 U.S.C. 114(d)(1)(C)(iv). The attribution of Gross Proceeds to copyrighted recordings may be made on the basis of:
>
> (1) For classical programs, the proportion that the playing time of copyrighted classical recordings bears to the total playing time of all classical recordings in the program, and
>
> (2) For all other programs, the proportion that the number of copyrighted recordings bears to the total number of all recordings in the program.

73 Fed. Reg. at 16,200. *See* Ex. B to Decl. of Mary Marshall.

Only one editorial change was made (along with a change in rate) in connection with the settlement of the *BES II* proceeding in 2012:

> For the making of any number of Ephemeral Recordings in the operation of a ~~service pursuant to the limitation on exclusive rights specified by 17 U.S.C. 114(d)(1)(C)(iv)~~ Business Establishment Service, a Licensee shall pay ~~10%~~ 12.5% of such Licensee's "Gross Proceeds" derived from the use in such service of musical programs that are attributable to copyrighted recordings. "Gross Proceeds" as used in this section means all fees and payments, including those made in kind, received from any source before, during or after the License Period that are derived from the use of copyrighted sound recordings during the License Period pursuant to 17 U.S.C. 112(e) for the sole purpose of facilitating a transmission to the public of a performance of a sound recording under the limitation on exclusive rights specified in 17 U.S.C. 114(d)(1)(C)(iv). The attribution of Gross Proceeds to copyrighted recordings may be made on the basis of:
>
> (1) For classical programs, the proportion that the playing time of copyrighted classical recordings bears to the total playing time of all classical recordings in the program, and
>
> (2) For all other programs, the proportion that the number of copyrighted recordings bears to the total number of all recordings in the program.

See 78 Fed. Reg. at 66,277 (strikethroughs and underlines added to show changes from the immediate predecessor regulation); *see also* Ex. B to Decl. of Mary Marshall.

The 2018 *BES III* settlement inserted a schedule of increasing rates into the middle of the provision and broke it into two paragraphs. 83 Fed. Reg. at 60,363; *see also* Ex. B to Decl. of Mary Marshall. In 2019, the Judges conformed the language of 37 C.F.R. § 384.3(a) to the Hatch-Goodlatte Music Modernization Act by replacing references to copyrighted recordings with references to recordings protected under title 17, to accommodate pre-1972 recordings protected under 17 U.S.C. § 1401.[9] 84 Fed. Reg. 32,296, 32,313 (July 8, 2019); *see also* Ex. B to Decl. of Mary Marshall.

While the BES rate regulation has changed a little over time, the *Web I* regulatory language has been conserved in all material respects, and SoundExchange views all versions of the regulation as substantively equivalent for purposes relevant to this proceeding.

IV. Music Choice's BES

Although Music Choice is primarily known for its consumer-facing PSS, it has operated a broadcast BES since the 1990s. Music Choice has described its BES as "separate" from its PSS, in comments made to the Copyright Office. *See* Comments of Music Choice in Copyright Office Docket No. 2014-03 at 3 (May 23, 2014) [hereinafter "MC Copyright Comments"].[10] Music Choice's BES is transmitted through cable and satellite operators and also sold through local dealers. *See* Music Choice's Comments in Connection with the Department of Justice's Review

[9] For ease of reference, this brief uses the term copyrighted recordings to refer to both post-1971 recordings subject to traditional copyright protection and pre-1972 recordings protected under 17 U.S.C. § 1401.

[10] Available at https://www.copyright.gov/docs/musiclicensingstudy/comments/Docket2014_3/Music_Choice_MLS_2014.pdf.

of the ASCAP and BMI Consent Decrees at 5 (Aug. 9, 2019)[11]; MC Copyright Comments at 3, 12.

Music Choice has acknowledged that to deliver digital performances, it is necessary to make "server, cache, buffer, and other intermediate copies." MC Copyright Comments at 13. In fact, Music Choice has highlighted that "[i]n many instances, multiple server copies are necessary for the purposes of redundancy and to allow for transmission in varying bitrates, among other reasons." *Id*. It also has noted that "by their very nature, buffer and cache copies often require that more than one copy be made at the same time." *Id*.

V. Music Choice's BES Royalty Payments

Pursuant to 37 C.F.R. § 384.6, SoundExchange engaged Prager Metis CPAs, LLC ("Prager Metis") to verify the royalty statements provided by Music Choice to SoundExchange for its BES for the period January 1, 2013 through December 31, 2016. See 82 Fed. Reg. 7878 (Jan. 23, 2017); 82 Fed. Reg. 34,554 (July 25, 2017). As a result of that verification procedure, Prager Metis discovered that Music Choice had significantly underpaid BES royalties, by excluding from its calculation the vast majority of its Gross Proceeds.[12] In its answer filed in the District Court, Music Choice explained the practice identified by the auditor: "for the purpose of calculating Gross Proceeds as defined in the applicable regulation Music Choice included only revenue attributable to channels solely provided to Business Establishment Service subscribers." Music Choice's Answer to Complaint with Jury Demand, *SoundExchange Inc. v. Music Choice*, 19-cv-0999, ECF No. 8 at ¶ 26 [hereinafter "Answer"]. In other words, Music Choice's position has been that, because only some of its BES channels are delivered exclusively to BES customers, it should be

[11] Available at https://www.justice.gov/atr/page/file/1201956/download.
[12] SoundExchange would be happy to provide the Judges a copy of the Prager Metis report upon entry of a protective order in the above-captioned proceedings.

able to allocate a sliver of its BES proceeds to just those channels, and pay royalties only on that subset of revenue.

SoundExchange has no way to know what calculations Music Choice actually performed, but information received to date indicates that the District Court will need to engage in fact-finding to resolve this dispute, regardless of the Judges' determination in this referral.

For one thing, Music Choice has offered varying descriptions of its BES offering. Over the period from 2009 to 2018, it described its BES as offering approximately 50 channels of programming delivered by satellite and internet[13]—slightly more than the 46 music channels

[13] "Music Choice, the perfect answer to the commercial business owner's needs," Music Choice (Oct. 11, 2008), https://web.archive.org/web/20081011104414/http://www.musicchoice.com/what_we_are/business.html (description of channels at approximately the beginning of *BES I* period) (Ex. E to Decl. of Mary Marshall); "Music Choice Commercial via Satellite," Music Choice (Jan. 17, 2009), https://web.archive.org/web/20090117084104/http://musicchoice.com/affiliate/home/pdf/Commercial_Satellite.pdf (same) (Ex. F to Decl. of Mary Marshall); "Music Choice Commercial via Broadband," Music Choice (Jan. 17, 2009), https://web.archive.org/web/20090117184225/http://www.musicchoice.com/affiliate/home/pdf/BNW_Commercial_Broadband.pdf (same) (Ex. G to Decl. of Mary Marshall); "MC For Business," Music Choice (Oct. 23, 2018), https://web.archive.org/web/20181023211244/http://corporate.musicchoice.com/about-us/mc-business (description of channels at approximately the end of *BES II* period) (Ex. H to Decl. of Mary Marshall).

In a previous proceeding, Music Choice argued that the Judges should not take into account without additional verification material from websites archived by the Internet Archive and made available through its Wayback Machine. Music Choice's Responsive Brief on Remand at 10, Docket No. 16-CRB-0001-SR/PSSR (2018–2022), *available at* https://app.crb.gov/document/download/25715. However, courts routinely rely on webpages archived via the Wayback Machine as they would rely on any other website. *See, e.g., Monster Energy Co. v. City Beverages, LLC*, 940 F.3d 1130, 1140 n.3 (9th Cir. 2019); *Arteaga v. United States*, 711 F.3d 828, 834 (7th Cir. 2013); *Khan v. Bank of New York Mellon*, 525 F. App'x 778, 780 (10th Cir. 2013). Information about the Internet Archive's archiving practices and operation of the Wayback Machine is publicly available. *See* Internet Archive, Wayback Machine General Information, https://help.archive.org/help/wayback-machine-general-information/ (last visited May 5, 2022). And as with other websites, the links provided in the above citations allow the Judges to access the sites and evaluate their validity. This provides "evidence sufficient to support a finding that the" websites are what SoundExchange claims. 37 C.F.R. § 351.10(a).

reportedly offered on its consumer PSS in 2018.[14] However, there are indications that Music Choice has provided many more channels than that. When Music Choice filed its Answer in the District Court in 2019, it admitted that "it has provided, in some instances and at certain times, nearly one hundred channels to certain of its Business Establishment Service subscribers." Answer ¶ 22. Today it advertises "over 100 different commercial free music stations with your customers in mind,"[15] and elsewhere, "almost 200 channels."[16] If Music Choice indeed offers this many channels, then it has grossly underpaid SoundExchange royalties even assuming its allocation methodology has a foundation in the regulations (which it does not). This is an issue that the District Court will necessarily need to consider upon completion of the referral to the Judges, after an appropriate period of fact discovery.

In addition, Music Choice's briefing to the Judges concerning this referral suggests that its allocations may have been different and more complicated than previously explained. Specifically, Music Choice's briefing suggests that it may have made allocations based on the number of *copies* made per subscriber, rather than based on *channels* provided. That potential practice is implied by (1) Music Choice's plainly-incorrect assertion that a BES provider does not need to pay BES royalties at all if it makes only one copy of a sound recording;[17] and (2) its

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[14] "Products," Music Choice (Sep. 22, 2018), https://web.archive.org/web/20180922073453/http://corporate.musicchoice.com/about-us/products /(Ex. I to Decl. of Mary Marshall).

[15] Music Choice Home Page, https://ww1.musicchoice.com/ (last visited May 3, 2022) (Ex. D to Decl. of Mary Marshall).

[16] Commercial Dealer Network, Music Choice, https://ww1.musicchoice.com/commercial-dealer-network (last visited May 3, 2022) (Ex. J to Decl. of Mary Marshall).

[17] For this proposition, Music Choice cites the ephemeral recordings exemption in 17 U.S.C. § 112(a)(1). *See* Music Choice's Response in Opposition to SoundExchange's Motion to Reopen Business Establishment Service Rate Proceedings, at 3, 5 (Feb. 23, 2022). But Section

assertion that it has only had to "make more than one additional ephemeral copy to facilitate [its] transmissions" "for certain subscribers."[18]

For present purposes, SoundExchange observes only that the opaque nature of Music Choice's methodology violates the Judges' standards for allowing Licensees to take revenue deductions when computing royalty obligations. In *SDARS II*, the Judges found that Sirius XM's royalty obligations could be reduced through a deduction for the use of directly licensed and pre-1972 recordings. 78 Fed. Reg. 23,054, 23,073 (April 17, 2013). But the Judges specified that "[r]easonable accuracy and transparency are required for calculation" of such a deduction. *Id*. They reiterated that a deduction "must be precise and the methodology transparent." *Id*. Thus, they specified an exact formula to be used in calculating these deductions and required Sirius XM to report details of the calculation to SoundExchange on a monthly basis (including lists of the recordings involved). *Id*. at 23,073, 23,098-99. A similar issue arose a few years later when the District Court referred to the Judges a dispute between SoundExchange and Sirius XM concerning its treatment of pre-1972 recordings during the *SDARS I* rate period. The Judges interpreted the

112(a) applies only to certain kinds of transmitting organizations (licensees, transferees, services relying on Section 114(a), and broadcasters). BES providers operating under Section 114(d)(1)(C)(iv) are not among them. Hence, they are not eligible for Section 112(a). Moreover, Section 112(a) applies only to copies of transmission programs, which are defined as "a body of material . . . produced for the sole purpose of transmission . . . in sequence and as a unit." An individual recording is not a transmission program.

[18] *Id.* at 6. Claims that Music Choice may make about the small number of copies it makes, of what, and for whom, should be viewed with skepticism. In *Web I*, an AEI/DMX witness testified about the difficulty or impossibility of counting the millions of ephemeral copies necessary for digital transmission of performances. Talley *Web I* Testimony at 8647:13-8649:8 (Ex. A to Decl. of Mary Marshall). Music Choice transmits to multiple subscribers, in multiple bitrates, by at least satellite and internet, and it markets a BES with different features than its consumer-oriented PSS. It simply is not apparent how Music Choice could possibly know and count all the copies it makes, let alone operate in a way that involves little copying (at least in excess of the copying necessary for delivery of its consumer-oriented PSS).

definition of gross revenues in the *SDARS I* regulations to permit a deduction based on Sirius XM's use of pre-1972 recordings. 82 Fed. Reg. 56,725, 56,732 (Nov. 30, 2017). But they again reiterated that the methodology for any such deduction must be "precise," "reasonably accurate" and "methodologically transparent." *Id*.

Music Choice's allocations do not meet this standard. It has hid the details of its allocation methodology from SoundExchange for years. To the extent it has provided any information, its explanations have shifted over time and cannot be reconciled with publicly-available information about its offerings.

VI. Relevant Procedural History

On April 10, 2019, SoundExchange filed suit against Music Choice to recover the millions of dollars in statutory royalty underpayments owed from Music Choice's BES. In December of 2021, the District Court determined that 37 C.F.R. § 384.3(a) is ambiguous and that the Judges are best situated to interpret the regulation by applying their technical and policy expertise. *SoundExchange, Inc. v. Music Choice*, No. 19-999 (RBW), 2021 WL 5998382, *4 n.2, *9 (Dec. 20, 2021) [hereinafter "District Court Opinion"]. It thus referred interpretation of the regulation to the Judges under the doctrine of primary jurisdiction. *Id*. *12. On March 22, 2022 the Judges reopened the above-captioned proceedings and set a briefing schedule for the referral, pursuant to which this is SoundExchange's opening brief.

ARGUMENT

As the District Court determined, 37 C.F.R. § 384.3(a) is ambiguous. The Judges should decline to adopt Music Choice's interpretation as it does not give effect to all parts of the regulation and produces an incoherent textual result. Music Choice's interpretation also fails to align with the clear intent of the regulation's drafters, as it conflicts with the content and reasoning of *Web I*

CARP Decision and the Librarian's review of that decision. Finally, if Music Choice's interpretation of the relevant regulations were correct, then the entire royalty regime for BES and PSS would be nonsensical and contrary to the willing buyer/willing seller agreements that the regulations are designed to imitate. The Judges can and should avoid this absurd result.

I. 37 C.F.R. § 384.3(a) Is Ambiguous

37 C.F.R. § 384.3 is entitled "Royalty fees for ephemeral recordings." The part of that regulation at issue in this proceeding is paragraph (a), captioned "Basic royalty rate." The current version of paragraph (a) contains the following two subparagraphs:

> (1) For the making of any number of Ephemeral Recordings in the operation of a Business Establishment Service, a Licensee shall pay a royalty equal to the following percentages of such Licensee's "Gross Proceeds" derived from the use in such service of musical programs that are attributable to recordings subject to protection under title 17, United States Code: [setting forth years and percentage rates].
>
> (2) "Gross Proceeds" as used in this section means all fees and payments, including those made in kind, received from any source before, during or after the License Period that are derived from the use of sound recordings subject to protection under title 17, United States Code, during the License Period pursuant to 17 U.S.C. 112(e) for the sole purpose of facilitating a transmission to the public of a performance of a sound recording under the limitation on exclusive rights specified in 17 U.S.C. 114(d)(1)(C)(iv). The attribution of Gross Proceeds to recordings subject to protection under title 17, United States Code, may be made on the basis of:
>
> (i) For classical programs, the proportion that the playing time of classical recordings subject to protection under title 17, United States Code, bears to the total playing time of all classical recordings subject to protection under title 17, United States Code in the program; and
>
> (ii) For all other programs, the proportion that the number of recordings subject to protection under title 17, United States Code, bears to the total number of all recordings subject to protection under title 17, United States Code in the program.

37 C.F.R. § 384.3(a) (July 8, 2019).[19]

This provision contains inherent and irreducible ambiguities. Plugging the definition of Gross Proceeds from paragraph (a)(2) into the place in paragraph (a)(1) where that term is used produces a payment provision that is ungrammatical and extremely difficult to parse:

> For the making of any number of Ephemeral Recordings in the operation of a Business Establishment Service, a Licensee shall pay a royalty equal to the following percentages of such Licensee's all fees and payments, including those made in kind, received from any source before, during or after the License Period that are derived from the use of sound recordings subject to protection under title 17, United States Code, during the License Period pursuant to 17 U.S.C. 112(e) for the sole purpose of facilitating a transmission to the public of a performance of a sound recording under the limitation on exclusive rights specified in 17 U.S.C. 114(d)(1)(C)(iv) derived *from* the use in such service of musical programs that are attributable to recordings subject to protection under title 17, United States Code.

In the language above, the red text is the definition of Gross Proceeds from paragraph (a)(2), substituted for the words "Gross Proceeds" in paragraph (a)(1).

In its opinion referring this matter to the Judges, the District Court determined that 37 C.F.R § 384.3(a) is ambiguous, as it does not, on its face, make clear whether Music Choice's method of calculating royalties is permissible. District Court Opinion, *4 n.2. That is plainly correct.

Any effort to interpret the provision as a whole must confront at least two difficult linguistic and interpretive challenges: (1) how to read the word "including," which appears early in the definition, and (2) what to make of the two instances of the phrase "derived from," one of which appears in paragraph (a)(1) and one of which appears in paragraph (a)(2).

[19] Aside from specific rates, this section of the regulations is materially unchanged from earlier rate periods. *See, e.g.*, Ex. B to Decl. of Mary Marshall.

As to the former challenge, the D.C. Circuit has explained that it is "hornbook law that the word 'including' indicates that the specified list . . . that follows is illustrative, not exclusive." *American Hospital Association v. Azar*, 983 F.3d 528, 534 (D.C. Cir. 2020) (quoting *Puerto Rico Maritime Shipping Authority v. Interstate Commerce Commission*, 645 F.2d 1102, 1112 n.26 (D.C. Cir. 1981) (alteration in original)). The question then is whether the lengthy matter that follows the word "including" in paragraph (a)(2) is a list of illustrative examples, just one illustrative example, or one or more illustrative examples plus some words that relate back to the "all fees and payments" at the beginning of the definition. The words of the regulation do not supply an answer. It is not clear from the words of the definition itself which of those was intended.

As to the latter challenge, the two instances of the phrase "derived from" introduce different clauses that, if possible, must both be given effect. *See Duncan v. Walker*, 533 U.S. 167, 174 (2001) (observing that it is a court's "duty to give effect, if possible, to every clause and word of a statute" (citation omitted)).

Given these challenges, 37 C.F.R. § 384.3(a) is capable of numerous interpretations, which are all unsatisfying in various ways and cannot all be right. One such interpretation is that offered by Music Choice, the severe limitations of which are discussed below. But another, mutually exclusive, interpretation is that paragraph (a)(2) means what it says when it uses the phrase "all fees and payments"—and that the word "including" sets up a list of examples. Under this plausible interpretation, paragraph (a)(2) can be parsed as follows:

all fees and payments

including those

made in kind,

received from any source before, during or after the License Period

> that are derived from the use of copyrighted sound recordings during the License Period pursuant to 17 U.S.C. 112(e) for the sole purpose of facilitating a transmission to the public of a performance of a sound recording under the limitation on exclusive rights specified in 17 USC 114(d)(1)(C)(iv).

37 C.F.R. § 384.3(a)(2). Read this way, the clauses following "including those" are plainly not meant to be exhaustive. Certainly, neither the CARP nor the Register intended to include within "all fees and payments" *only* "in kind" revenue. For the same reason and under the same logic, (a)(2) does not limit "all fees and payments" to *only* those derived from the use of ephemeral copies for the "sole purpose" of BES transmissions.

There is yet another, equally plausible textual alternative. Under this reading, the words that follow "including those" in paragraph (a)(2) are meant not as a nonexhaustive list, but rather as a specific example of in-kind payments included in Gross Proceeds. Under this interpretation, the definition of Gross Proceeds in paragraph (a)(2) can be parsed as follows:

> all fees and payments,
>
> > including those made in kind, received from any source before, during or after the License Period that are derived from the use of copyrighted sound recordings during the License Period pursuant to 17 U.S.C. 112(e) for the sole purpose of facilitating a transmission to the public of a performance of a sound recording under the limitation on exclusive rights specified in 17 USC 114(d)(1)(C)(iv).

37 C.F.R. § 384.3(a)(2). Read *this* way, the regulation means what it says with respect to "fees and payments" ("all" are included), and then goes on to specify what kinds of "in kind" consideration count as well—those that come from "any source," before or after the license period, provided that the consideration was offered "for the sole purpose" of facilitating a BES transmission. While this reading would result in all fees and payments (not necessarily just from a BES) counting as "Gross Proceeds" under paragraph (a)(2), that is entirely plausible, since

paragraph (a)(1) limits the royalty-bearing Gross Proceeds to only those "derived from the use in" a BES of musical programs attributable to copyrighted recordings.

SoundExchange does not press the position that either of the foregoing interpretations is the best or most plausible interpretation of (a)(2). The point, instead, is that the regulatory text contains irreducible ambiguity. When a regulation or statute is ambiguous, the Judges may look elsewhere in the regulatory scheme to determine the implication of words or phrases. *King v. Burwell*, 576 U.S. 473, 486 (2015). That is necessary because "oftentimes the 'meaning—or ambiguity—of certain words or phrases may only become evident when placed in context.'" *Id.* (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000)). Moreover, in a dispute over the proper meaning of a regulation, it is the job of the regulatory authority to "decide which among several competing interpretations best serves the regulatory purpose." *See Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994). Here, the Judges can and should resolve ambiguities in the text of 37 C.F.R § 384.3(a) by examining the history of the regulation and the expressed intent of the regulation's drafters.

II. Music Choice's Interpretation of 37 C.F.R. § 384.3(a) Creates Incoherence Between Its Two Subparagraphs

Music Choice urges the Judges to interpret paragraph (a)(2) in a manner that creates incoherence with paragraph (a)(1). In Music Choice's view, Gross Proceeds refers to "all fees and payments" "derived from the use of" ephemeral copies of sound recordings, but *only* if those copies are used "for the *sole* purpose of facilitating a transmission" through a BES. That is, if a BES provider can find some other use for the copies it makes (such as providing a PSS), the copies are free. But this position is totally undermined by the plain language of paragraph (a)(1). By the express terms of that provision, a BES provider must pay a percentage of its Gross Proceeds "derived from the use in [a BES] of musical programs that are attributable to recordings subject to

protection under title 17, United States Code." This provision does not limit Gross Proceeds in the manner Music Choice would like. It is straightforward: If a Licensee uses copyrighted recordings in its BES to generate Gross Proceeds, then the Licensee needs to pay a set percentage of those Gross Proceeds as a royalty. There is no suggestion in paragraph (a)(1) that a Licensee can examine its BES Gross Proceeds and make up some kind of allocation methodology to make some proceeds royalty-bearing and other proceeds not.

Yet that is precisely how Music Choice reads paragraph (a)(2). That prompts some simple questions: Why would the Librarian have affirmed such a broad requirement in paragraph (a)(1) only to effectively unwork it in paragraph (a)(2)—let alone unwork it through the single word "sole"? And why would the Librarian have designed such a scheme without so much as mentioning the word "sole" that allegedly does so much work? Music Choice has no explanation why the Librarian would have inserted such an inconsistency into the regulations.

Music Choice's cramped interpretation of paragraph (a)(2) effectively eliminates from paragraph (a)(1) the words "derived from the use in such service of musical programs that are attributable to recordings subject to protection under title 17, United States Code." Such an interpretation violates the "endlessly reiterated principle of statutory construction . . . that all words in a statute are to be assigned meaning, and that nothing therein is to be construed as surplusage." *Qi-Zhuo v. Meissner*, 70 F.3d 136, 139 (D.C. Cir. 1995); *see also Duncan v. Walker*, 533 U.S. at 174. "It is a cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001). The "surplusage canon" applies with particular force "when the intersection of subsections becomes so great that one subsection renders another meaningless." *S.E.C. v. Familant*, 910 F. Supp. 2d 83, 95 (D.D.C. 2012). Courts

have invalidated interpretations of both statutes and regulations by regulatory agencies on the basis that those agencies' interpretations did not heed the rule against surplusage. *See, e.g.*, *Indep. Ins. Agents of Am., Inc. v. Hawke*, 211 F.3d 638, 644-45 (D.C. Cir. 2000); *Amarin Pharm. Ireland Ltd. v. Food and Drug Administration*, 106 F. Supp. 3d 196, 209 (D.D.C. 2015), *dismissed for lack of jurisdiction*, 15-5214, 2015 WL 9997417 (D.C. Cir. Dec. 9, 2015).

SoundExchange has offered two alternative interpretations of the regulation in the previous section. Either interpretation has the notable benefits of preserving consistency between the two subparagraphs of 37 C.F.R. § 384.3(a) and avoiding any obvious redundancy or surplusage within the regulation. Moreover, as explained below, either interpretation avoids the absurd results of Music Choice's interpretation and better gives effect to the clear intent of the regulation's drafters, as evidenced by the *Web I* record.

III. Music Choice's Interpretation of 37 C.F.R. § 384.3(a) Produces Absurd Results

Music Choice's view that it is not obligated to pay statutory royalties for use of copies in its BES—so long as it finds some other, additional use for those copies, such as in a PSS—produces absurd results when viewing the statutory license system as a whole.

During 2013-2017, both the BES and PSS regulations similarly used the word "solely" with reference to use of ephemeral recordings in those services. Specifically, the version of the PSS rate regulations in effect during the *SDARS II* rate period (2013-2017) stated the PSS ephemeral royalty as follows:

> The royalty payable under 17 U.S.C. 112(e) for the making of phonorecords used by the Licensee *solely* to facilitate transmissions for which it pays royalties as and when provided in this subpart shall be included within, and constitute 5% of, the total royalties payable under 17 U.S.C. 112(e) and 114.

SDARS II, 78 Fed. Reg. 23,054, 23,097 (Apr. 17, 2013) (adopting 37 C.F.R. § 382.3(c)) (emphasis added).

If Music Choice's interpretation of the word "solely" were correct, then the only copies for which it would owe royalties are those used in *either* its BES or its PSS, *but not in both*. That is, if Music Choice could deliver both a BES and a PSS with a high proportion of dual-use copies, its interpretation would mean that most of the copies made by Music Choice would not generate any BES or PSS royalties. Music Choice would pay *less* in statutory royalties when it used and profited off copies *more*. Interpreting either the BES or PSS regulations to allow free copying if multiple uses can be found for the copies makes no sense. The Judges should not interpret these ambiguous regulations in a manner that creates such a strange result, which cannot be what the drafters of the regulations intended.

The BES and PSS licenses are separate and distinct. When a service uses copies in its PSS, it needs to pay royalties under the PSS license. And when it uses copies in its BES, it needs to pay royalties under the BES license. That is not a complicated concept, and even Music Choice has implicitly acknowledged it is correct. As Music Choice's CEO David Del Beccaro testified in *SDARS III*, the BES business "is not covered by the PSS license." Written Direct Testimony of David J. Del Beccaro in Docket No. 16-CRB-0001-SR/PSSR, at 29 n.3 (Oct. 19, 2016). That statement is entirely inconsistent with the interpretation of 37 C.F.R. § 384.3(a) now advocated by Music Choice—that its payments under the PSS license actually cover a vast majority of its BES business.

IV. Music Choice's Interpretation of 37 C.F.R. § 384.3(a) Cannot Be Squared with Past Determinations Concerning That Provision

The Judges are required to act in accordance with prior determinations and interpretations of the "Librarian of Congress, the Register of Copyrights, copyright arbitration royalty panels (to

the extent those determinations are not inconsistent with a decision of the Librarian of Congress or the Register of Copyrights), and the Copyright Royalty Judges." 17 U.S.C. § 803(a)(1). Music Choice's interpretation of 37 C.F.R. § 384.3(a) is inconsistent with the *Web I* CARP Decision, the Librarian's review of that decision, and the Judges' analysis of SDARS royalty allocations. As such, it must be rejected.

A. Music Choice's Interpretation is Inconsistent with the CARP's Decision to Adopt a Blanket License Rate Structure

Music Choice's interpretation of 37 C.F.R. § 384.3(a) is totally out of step with the logic of *Web I*. Because *Web I* was the first time that BES rates were litigated, the CARP had to confront at the outset of its analysis the fundamental question of "what we are setting a royalty for." *Web I* CARP Report at 116. The CARP provided a decisive answer to that question: "blanket licenses which would afford each licensee all the rights necessary to operate" a BES. *Id*. at 118. The CARP expressly rejected AEI/DMX's request to "subdivide this package of rights into multiple mini-licenses for the making of different kinds of ephemeral copies." *Id*. Music Choice's interpretation of 37 C.F.R. § 384.3(a) is an effort to do precisely what AEI/DMX wanted and the CARP rejected.

In *Web I*, the nature and scope of the BES rate was hotly contested by the parties. AEI/DMX argued vigorously that it only should have to pay for the copies it needed based on its unique technological architecture and existing direct license agreements. *Id*. at 114. Specifically, it argued that, because it had already paid through direct licensing for copies used in its on-premises BES, it should not have to pay through statutory licensing to use those copies in its broadcast BES. *Id*. As a result, AEI/DMX asked the CARP to set a rate that would only cover the *other* copies made and used in its broadcast BES (cache and buffer copies). This is essentially the same argument that Music Choice advances here: the PSS statutory royalties it pays cover many of the copies it uses in its BES, so it should only have to pay BES royalties for other copies.

The CARP rejected AEI/DMX's approach. The CARP recognized that different BES providers may have different technological architectures and different needs for reproduction rights licensing. *Id*. at 117. However, it concluded that the Section 112(e) license was intended as a "blanket license which would afford each licensee all the rights necessary to operate" a BES, including "the right to make any and all ephemeral copies utilized in a" BES. *Id*. at 118. The Librarian affirmed this conclusion. 67 Fed. Reg. at 45,263.

A "blanket license" is a well-understood term of art referring to a license that allows licensees to use a broad repertoire "as often as the licensees desire" for fees that "do not directly depend on the amount or type of music used." *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc*., 441 U.S. 1, 4 (1979).[20] The *Web I* CARP was well aware of this concept. *See Web I* CARP Report, at 5 n.6 (describing blanket license offered by musical work performance rights organizations as one "that permit[s] the licensee to perform any musical works within their repertories for a set license fee."). It chose to adopt a blanket license model in lieu of other licensing models that exist.[21] For instance, as the Librarian explained, "it is conceivable" that the

[20] *See also* ASCAP, Common Licensing Terms Defined, https://www.ascap.com/help/ascap-licensing/licensing-terms-defined ("A 'blanket license' is a license which allows the music user to perform the ASCAP repertory . . . as much or as little as they like.) (last visited April 28, 2022); BMI, U.S. Television Royalties, https://www.bmi.com/creators/royalty/us_television_royalties ("A blanket licensee pays a single fee that covers the performance of any BMI-licensed work in the licensee's syndicated and locally-originated programs.") (last visited April 28, 2022).

[21] For example, ASCAP and BMI offer "per program licenses" as an alternative to blanket licenses. A per program license is "similar to the blanket license in that it authorizes a radio or television broadcaster to use all music in the ASCAP repertory. However, the fee varies depending on the specific radio or television programs that contain that music, requiring that the user keep track of all music used." ASCAP, Common Licensing Terms Defined; *see also* BMI, U.S. Television Royalties, https://www.bmi.com/creators/royalty/us_television_royalties ("A per-program licensee pays a fee to BMI only when there is BMI music used in the syndicated or locally originating program broadcast on the station, as well as for certain incidental and ambient uses of music.") (last visited May 3, 2022).

CARP "might have chosen to differentiate among" categories of ephemeral recordings or types of BES by adopting a differentiated rate structure. 67 Fed. Reg. at 45,264. But the CARP chose not to do so.

Instead, the CARP expressly decided *not* to allow BES providers to pick and choose license coverage for different types of ephemeral recordings, or to pay based on usage—ideas the CARP referred to as "subdivid[ing] this package of rights into multiple mini-licenses for the making of different kinds of ephemeral copies." *Id*. at 118. In doing so, the CARP recognized that a BES provider like AEI/DMX might not need the full scope of coverage provided by the blanket license. It also acknowledged that BES providers could make choices about their technological implementations that might lead to more or less copying. But it determined to set a rate that would cover "all ephemeral copies which may be utilized in the operation of a broadcast service," regardless "whether a particular licensee's model" uses some copies that may not be made in another licensee's service or may be otherwise licensed. *Id*. at 119.

Music Choice's actual allocation methodology is unclear and may be based on channels, subscribers or copies, or some combination of them. This is a factual question that will need to be explored in discovery before the District Court. But regardless of the precise methodology, Music Choice's allocation of proceeds based on the extent of its use of the BES license twists the blanket model envisioned by the *Web I* CARP into its exact opposite: one where a BES provider gets to choose which of the copies it makes do or do not count towards its BES royalties. In effect, Music Choice is helping itself to the kind of "mini-license" the CARP rejected. There is simply no way to reconcile Music Choice's argument—that it does not need statutory license coverage for copies used both in its broadcast BES and its PSS—with the CARP's express rejection of AEI/DMX's argument that it does not need statutory license coverage for copies used both in its broadcast BES

and on-premises BES. In short, Music Choice's interpretation is inconsistent with the CARP's decision to adopt a blanket license rate structure.

B. Music Choice's Interpretation is Inconsistent with the CARP's Analysis of Benchmarks under the Willing Buyer/Willing Seller Rate Standard

Music Choice's interpretation of 37 C.F.R. § 384.3(a) is also a far cry from the marketplace agreements the CARP relied on as benchmarks when setting the BES rate. Those agreements required payment of royalties based on a licensee's gross proceeds—*not* based on a portion of gross proceeds reflecting the extent of the licensee's usage. As a result, Music Choice's interpretation is contrary to the governing rate standard.

As the Judges know well, rates under Section 112(e) are to be those "that most clearly represent the fees that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 112(e)(4). As the Judges have frequently done, the CARP relied on marketplace benchmarks to set a rate conforming to that standard. Specifically, and as explained above, the CARP based its BES rate decision on benchmarks that were existing direct license agreements for BES. *Web I* CARP Report at 121-23. Those included agreements between sound recording copyright owners and a number of BES providers, such as Muzak, AEI/DMX and Play Network. *Id*. at 127. The agreements covered the various providers' on-premises BES, with some also "set[ting]" a uniform percentage rate" to also cover rights for broadcast BES delivered by satellite. *Id*. at 124-25. The CARP found that these rates could be applied directly to the market for broadcast BES covered by the statutory license. *Id*. at 120-21.

In addition to adopting a percentage rate from the benchmark agreements, the CARP defined the royalty base in a payment provision lifted from the benchmark agreements. In words very much like current 37 C.F.R. § 384.3(a)(1), the CARP determined that the royalty should simply be 10% "of the Licensee's annual gross proceeds derived from the use in such broadcast

service of the musical programs which are attributable to copyrighted recordings." *Id*. at B-7. The CARP explained that this language "appears in more of the agreements before us than does any other" and was used in agreements with various BES providers. *Id*. at 126-27. The CARP acknowledged that "a few" marketplace agreements provided for "certain deductions from 'gross proceeds' before the royalty percentage is applied." *Id*. at 125. However, in "most" agreements, "there are no deductions from gross proceeds." *Id*.

The *Web I* record showed how the CARP's definition worked in practice. AEI/DMX was a party to agreements with the language the CARP copied. *Id*. at 127. At trial, an AEI/DMX witness explained that, pursuant to these agreements, record companies were paid through pools of money called "marketing funds," which were an "amount of money that we take as a percentage from our revenue, our gross revenue of music sales." Trial Testimony of Barry Knittel in Docket No. 2000-9 CARP DTRA 1 & 2, 8384:5-14 (Sept. 5, 2001) (Ex. C to Decl. of Mary Marshall) [hereinafter "Knittel *Web I* Testimony"]. The Librarian credited this testimony, explaining that "these revenues are generated from all the billings for music" and gross proceeds "is merely the amount the Business Establishment Services receive from their customers for use of the music." 67 Fed. Reg. at 45,268.

Notably, the CARP's consideration of the benchmark agreements led it to specify one and only one allocation formula—for allocating between copyrighted and public domain recordings. The CARP explained that the benchmark agreements allocated proceeds "differently for classical recordings and other titles." *Id*. at 127 n.79. When translating the benchmark royalty base into the statutory license context, the CARP therefore determined that it was necessary to "distinguish the portion of the background company's programs which utilize copyrighted recordings from the

portions which utilize non-copyrighted recordings." *Id*. It adapted the benchmarks' allocation formula for that purpose.[22] *Id*.

In sum, the CARP adopted a royalty rate structure, percent and base that were copied from benchmark agreements. In doing so, the CARP specifically rejected any deductions from gross proceeds, because in "most" agreements, "there are no deductions from gross proceeds." *Id*. at 125. Rather, BES providers simply paid a percentage of their gross revenues from music. The CARP could have built allocation formulae for usage into the royalty base, but it expressly chose not to, instead adopting only one allocation formula (between copyrighted recordings and public domain recordings) that has no bearing on Music Choice's argument.

Music Choice has helped itself to a deduction from gross proceeds when the CARP determined that there should be no deductions from gross proceeds. This is contrary to the benchmark agreements embraced by the CARP, and as a result, contrary to the willing buyer/willing seller rate standard. If willing buyers and willing sellers would agree to a royalty that is a percentage of all the proceeds generated by the use of music in a BES, as the CARP concluded and the Librarian affirmed, there is no reason to believe that a willing seller would agree to exclude the vast majority of those proceeds when copies are used to generate revenue from two services rather than only one. Rather, a willing seller concerned about maintaining revenue from different forms of BES, as Section 112(e)(4)(A) contemplates, would negotiate what the CARP and the Librarian clearly had in mind in *Web I*: BES services should pay a portion of the total gross proceeds they make from the use of music. Music Choice's interpretation must be rejected as contrary to the benchmark agreements and the governing rate standard.

[22] This allocation is currently codified in 37 C.F.R. § 384.3(a)(2).

C. Music Choice's Interpretation is Inconsistent with the Clearly Expressed Intent of the Librarian

Music Choice's interpretation of 37 C.F.R. § 384.3(a) attributes to regulatory language crafted in the Librarian's review of the *Web I* CARP decision an intention to make a major change in the CARP decision that was not expressed in the Librarian's decision and is contrary to the Librarian's expressed intention to "to expand on the CARP's approach." *See* 67 Fed. Reg. at 45,268.

The Librarian largely *affirmed* the CARP's decision concerning BES rates. Specifically, and as described above, the Librarian affirmed the CARP's decision to set a rate for a blanket license covering all ephemeral copies used to provide a BES, 67 Fed. Reg. 45,263; the Librarian approved the CARP's reliance on existing BES direct license agreements as benchmarks, *id.* at 45,243, 45,265; and the Librarian agreed that "the definition [of gross proceeds] may be as simple as the CARP's characterization of the term." 67 Fed. Reg. at 45,268.

The Librarian disagreed with the CARP's conclusions about BES rates in only one respect relevant to this proceeding—the specificity of the regulations as to whether gross proceeds include in-kind payments. This issue arose at the urging of RIAA, not AEI/DMX. RIAA objected to the CARP's statement of the BES royalty as 10% "of the Licensee's annual gross proceeds derived from the use in such broadcast service of the musical programs which are attributable to copyrighted recordings," *Web I* CARP Report at B-7, "arguing that the provision fails utterly to define the term in any meaningful way." 67 Fed. Reg. at 45,268. The Librarian mostly rejected RIAA's argument.

RIAA persuaded the Librarian only that the CARP's regulatory language "does not necessarily appear to capture in-kind payments of goods, free advertising or other similar payments for use of the license." *Id*. As a result, the Librarian decided "to expand on the CARP's approach

and adopt a definition of 'gross proceeds' which clarifies that 'gross proceeds' shall include all fees and payments from any source, including those made in kind, derived from the use of copyrighted sound recordings to facilitate the transmission of the sound recording pursuant to the section 112 license." *Id*.

The specific regulatory language adopted by the Librarian was very similar to the first sentence of current 37 C.F.R. § 384.3(a)(2). And, of course, it differed from the Librarian's description of that language quoted above due to the insertion of the word "solely," which is what has given rise to the present dispute. However, the stated purpose of the Librarian's new language was to *expand* rather than *contract* the CARP's approach, and simply to capture in-kind payments. It flies in the face of the Librarian's reasoned decision to attribute to the word "solely" the effect of drastically refiguring the CARP's decision *sub silentio*. Because the Librarian affirmed the CARP's decision to set a rate for a blanket license covering all ephemeral copies used to provide a BES, it makes no sense to think that the Librarian intended the word "solely" to unravel that blanket and create the mini-licenses the CARP rejected. Because the Librarian approved the CARP's reliance on existing BES direct license agreements as benchmarks, it makes no sense to think that the Librarian intended the word "solely" to adopt a rate structure with usage-based royalty allocations not contemplated by those agreements. And because the Librarian agreed that the CARP's payment provision might be workable, it makes no sense to think that the Librarian intended the word "solely" to make that provision mean something radically different than what the CARP intended.

CONCLUSION

For the foregoing reasons, the Judges should issue an order clarifying that 37 C.F.R. § 384.3(a) requires BES providers to calculate royalties using their total gross proceeds derived

from the use of copyrighted recordings in a BES, regardless of whether operation of the BES involves copies or channels that are also used as part of a PSS.

Dated: May 6, 2022

Respectfully submitted,

By: */s/ Steven R. Englund*

Steven R. Englund (D.C. Bar No. 425613)
senglund@jenner.com
Previn Warren (D.C. Bar No. 1022447)
pwarren@jenner.com
Mary E. Marshall (D.C. Bar No. 1739058)
mmarshall@jenner.com
JENNER & BLOCK LLP
1099 New York Avenue, N.W., Suite 900
Washington, DC 20001
Tel.: 202-639-6000
Fax: 202-639-6066

Counsel for SoundExchange, Inc.

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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 SoundExchange's Opening Legal Brief Concerning the Meaning of 37 C.F.R. § 384.3(a) to the following:

Music Choice, represented by Margaret L. Wheeler-Frothingham, served via E-Service at mwheelerfrothingham@mayerbrown.com

Sirius Satellite Radio, represented by Bruce G. Joseph, served via Email

XM Satellite Radio Inc., represented by R. Bruce Rich, served via Email

Signed: /s/ Steven R. Englund