UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress

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

DISSENT IN PART RE BENCHMARK

The Copyright Royalty Judges (Judges) sit as a panel in all determination proceedings. *See* 17 U.S.C. § 803(a)(2). A majority of two Judges is sufficient to issue a determination. *See* 17 U.S.C. § 803(a)(3). If any Judge dissents from the majority determination, that dissenting Judge may issue a dissenting opinion and file it with the majority's determination. *Id*. The Judges accept this same standard with regard to their issuance of the present Initial Ruling and Order after Remand (Initial Ruling).

The undersigned Judge, author of this dissent in part (Benchmark Dissent) respectfully dissents[1] from the Initial Ruling of the majority (Remand Majority) on the issue of adopting as a benchmark for current rates and terms the rates and terms adopted after a settlement by the parties to the preceding phonorecords proceeding.[2] It should be noted that the Remand Majority adopts the rate structure from *Phonorecords II*, but retains the headline percent-of-revenue rate adopted in the Determination.[3]

I. Areas of Concurrence

A. Background Statements

[1] The dissenting Judge does not fault the economic analysis of the Remand Majority on this issue. The dissenting Judge is not the Judge selected for "a significant knowledge of economics." *See* 17 U.S.C. § 802(a)(1). This Benchmark Dissent is based on a broader reading of the requirements of section 801 of the Copyright Act, *viz.* "to make determinations of reasonable terms and rates…" consistent, of course, with the record evidence and sound legal and economic analysis. The role of the Judge is to weigh evidence; two Judges might rightfully and respectfully disagree on where that scale balances. The Remand Majority's analysis led those Judges to conclude that they were bound to re-introduce the rate structure devised in the *Phonorecords II* proceeding. The Benchmark Dissent concludes that the economic analysis outlined in the Initial Ruling supports, but does not dictate, that result, but that the goal of reasonableness can be met with different structure(s). The Benchmark Dissent does not construct or propose a detailed, different structure. To do so would be an inefficient application of judicial resources at this late stage of this proceeding. The Benchmark Dissent finds, however, that both licensor and licensee participants agreed in this proceeding that a less complex rate structure is warranted.

[2] The preceding proceeding, referred to as *Phonorecords II,* consisted of a final rule adopting the participants' settlement agreement as regulatory terms and rates. *See* Final Rule, Adjustment of Determination of Compulsory License Rates for Mechanical and Digital Phonorecords, Docket No. 2011-3 CRB Phonorecords II, 78 Fed. Reg. 67938 (Nov. 13, 2013), Technical Amendment at 78 Fed. Reg. 76987 (Dec. 20, 2013). In this partial dissent, references to *Phonorecords II,* PR II, and PR II-based benchmark are references to this final rule.

[3] *Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, 84 Fed. Reg. 1918 (Copyright Royalty Board Feb. 5, 2019) (final rule and order) (Determination); *See also* Final Determination, 16-CRB-0003-PR (2018-2022) (Nov. 5, 2018).

The Benchmark Dissent adopts the statements regarding the background and procedural posture of this remand proceeding. *See* Initial Ruling at 1-2.

B. Percent of Revenue Rate

The Benchmark Dissent agrees with the Remand Majority's retention of the headline percent-of-revenue rate and its phase-in over the period at issue.

C. Definition of Service Revenue for Bundled Offerings

For the reasons articulated in the Initial Ruling and the reasoning of the judge dissenting from that portion of the Initial Ruling, the definition of Service Revenue for bundled offerings contained in the Initial Determination must be adopted. *See* Initial Determination (Jan. 27, 2018). Adoption of the *Phonorecords II* (PR II) rate structure requires that the original definition pertain.

II. Area of Dissent

The first function of the Judges is "to make determinations … of reasonable terms and rates of royalty payments…." 17 U.S.C. § 801(b)(1). Under the statute in effect during the captioned proceeding, the rates shall be calculated to achieve four statutory objectives. *Id.* The terms of payment of the rates, however, are not subject to any particular statutory restrictions or guidelines. *See, e.g., Live365 v. Copyright Royalty Bd.,* 698 F. Supp. 2d 25, 29-30 (D.D.C. 2010) ("In performing their duties, the [Judges have] broad discretion to … impose regulations governing the rates and terms of copyright royalties….").[4]

In general, in promulgating regulations the Judges aim to effect efficient and effective payment of royalty license fees. Regulations relating to license royalty rates describe the rates the Judges determine to be reasonable, whether presented by agreement of the affected parties or after adjudication. The regulations include, where necessary, methods of calculation of the payable royalties. The regulations also include such provisions as recordkeeping requirements, late fee assessments, and audit authority. As the Remand Majority points out, simplicity and clarity were not among the statutory factors applicable to determining royalty rates in the captioned underlying proceeding. Simplicity and clarity should, however, be paramount among the Judges' considerations in governing rate payment procedures.

In recent proceedings, the Judges have emphasized that the statute requires that they set both rates and terms. At the end of a different royalty rate proceeding, having been confronted with competing proposed regulations, or even with largely agreed regulatory terms, upon which the parties had proffered no evidence, the Judges cautioned counsel in this proceeding:

> Please be reminded that the Judges have an obligation to set both rates and terms. ... In any proceeding, just because a regulation is in the current Code of Federal Regulations does not mean that the Judges are adopting that term…. The Judges cannot determine rates or terms without an evidentiary record. … The Judges cannot adopt any terms of royalty administration unless the parties present evidence to support their proposed terms.

Tr. 03/08/2017 (Barnett, J.) While chapter 8 of the Copyright Act encourages settlement, the

[4]The Judges' regulations are, of course, subject to approval by the Librarian of Congress. 17 U.S.C. § 802(f)(A)(i); *see Live365 v. Copyright Royalty Bd.,* 698 F. Supp. 2d 25, 29-30 (D.D.C. 2010).

Judges are not mandated to adopt parties' settlements if they find they face opposition that discounts reasonableness or if the proposed regulations are contrary to law. *See, e.g., Determination of Royalty Rates and Terms … (Phonorecords IV),* 87 Fed. Reg. 18,342, 18,347, 18,349 (Mar. 30, 2022).

In the proceeding underlying the Determination, the parties proffered a variety of proposed regulations.[5] Copyright Owners contended that the extant rate structure "should be modified and simplified." Copyright Owners' Amended Proposed Rates and Terms (5/17/2017) at 2. Copyright Owners argued that the ten different rate categories should be "no longer applicable" as Copyright Owners proposed application of the same rates and rate structure to "all interactive streams and/or limited downloads [except bundles], regardless of the business model employed." *Id.* at 3. Copyright Owners' rate proposal hinged on a per-unit calculation across the board: the greater of a per-play amount or a per end user amount.

Amazon proposed retaining the PR II rate structure. *See* Proposed Findings … of Amazon (May 13, 2017) ¶ AM-F-25. Amazon argued that the PR II rate structure "enabled Amazon to develop a varied assortment of services…." *Id.* Amazon contended that the different royalty rates permit price discrimination by the Services. *Id.* ¶¶ AM-F-47, 49. Amazon conflates price discrimination with provision of heterogenous musical tastes and preferences. *Id.* ¶ AM-F-48. Amazon's proposal mimicked the regulations adopted by agreement in the immediately prior proceeding.

Apple proposed a per-play rate calculation, which would render the PR II rates and rate structure obsolete. Notwithstanding the different structure, however, Apple offered valid criticisms of the PR II rate structure. Apple termed the PR II rate structure "problematic." *See* Apple Inc.'s Findings … and Conclusions … (May 11, 2017) at 30. Apple argued that the PR II rate structure was "overly complex, economically unsound, and unpredictable." *Id.* ¶ APL-F65. Apple acknowledged that these shortcomings resulted in "a loss of trust and overall dissatisfaction with interactive streaming among songwriters…." *Id.*

Apple noted that across the ten rate categories in the PR II rates, "there are roughly 79 different calculations that can be made." *Id.* ¶ APL-F67. Apple argued that the PR II rate structure was "not transparent or easy to understand" for copyright owners and created "uncertainty for services, who may find it difficult to predict which prong … will kick in in any given month." *Id.* ¶¶ 68-69. Apple opined that, rather than encouraging new business models, the PR II rate structure "tends to stifle innovation around new pricing or distribution models, as services are incentivized to create businesses that fit into the ten pre-defined 'boxes.'" *Id.* ¶ 70. Apple further argued that the PR II rates were economically unsound because they are based on revenue, which is unrelated to demand for a given copyright owner's song. *Id.* ¶ 71.

Google's proposal, from which the Majority derived the uncapped TCC rate prong of the Determination, contended that the "fragmented service categories are unnecessary under [its] proposal…." Google, Inc.'s Proposed Findings … and Conclusions… (May 11, 2017) ¶ GPFF58. Google acknowledged questions regarding the complexity of the PR II rate structure. Google, therefore proposed a rate structure that would both streamline the regulations and protect

[5] Spotify, as the only pure-play service, offered simplified regulations, but only because it did not propose any rates or terms for bundled or locker services. Spotify advocated elimination of the per-subscriber stop-gap alternative in the greater-of percent-of-revenue/percent-of-TCC calculation.

Copyright Owners' concerns regarding Services' revenue deferment and displacement. *Id.* ¶ GPFF57.

In the captioned underlying proceeding, the Judges heard little evidence offered in resounding support or vehement objection to the regulations the parties proffered. No party argued or supported the proposition that the PR II rate structure was the only way, or even the best way, to achieve license fee payment.[6]

In this remand proceeding, no party argued against the all-in approach to rate calculation. The parties disagreed regarding retention of "mechanical floors" for configurations for which the Services must pay mechanical royalties both to Copyright Owners in this proceeding under section 115 and to Performing Rights Organizations (PROs) according to the determinations of the "Rate Court."[7] The parties disagreed over imposition of a cap on the TCC prong[8] in the greater-of percent-of-revenue calculation. They also disagreed over retention or elimination of the per subscriber sub-minima that were featured in the PR II rates.

The Remand Majority cites with approval the remand parties' criticism of the simplified rate structure in the Determination*, viz.,* that it is "virtually as complex as" the PR II rate structure. *See* Services' Joint Opening Brief (Apr. 1, 2021) at 39. This characterization is a bit of hyperbole. The rate structure in the Determination is an all-in rate with "mechanical floors" where those are warranted. Except for the fundamentally different configurations included in subpart B, it does not set out separate calculations for different delivery configurations. On remand, the Remand Majority chooses to reinstate the PR II rate structure in its entirety, with all of its 79 permutations, changing only the headline percent-of-revenue rate and adding a cap on the TCC rate prong (which is an element of the structure itself). The Benchmark Dissent does not dispute the necessity and propriety of the increased headline percent-of-revenue rate or the cap on the TCC rate prong. Indeed, as noted in the Remand Majority, the D.C. Circuit endorsed the rate increase as well-reasoned and determined well within the Judges' discretion. The D.C. Circuit also found fault with "yoking" the TCC rate alternative to sound recording royalty rates, not subject to the Judges' control, without reins. The basis of this Benchmark Dissent is simply that the regulatory scheme is not efficient, transparent, or mandated by credible evidence; nor is the structure necessary to achieve the purposes of reasonableness and equity.[9]

A. Acceptance of *Phonorecords II* Settlement as a Proper Benchmark

This is a Dissent in Part. The undersigned Judge does not disagree with the headline rate being retained at 15.1% or with the imposition of a TCC cap, for the reasons elucidated by the

[6] The Benchmark Dissent does not argue that the PR II rate structure did not achieve its purpose. Indeed, the all-in, greater-of, lesser-of scheme with payment minima and mechanical floors achieved the goals of (1) supporting increased absolute revenue through downstream price discrimination and (2) protecting creators from potential loss resulting from licensees' revenue deferral or displacement. The Judges have never denied the value of price discrimination in these or other rate setting proceedings.

[7] The District Court of the Southern District of New York determines performing rights royalties. Parties to those rate proceedings refer to that court, when engaged in the rate-setting cases, as the "Rate Court."

[8] "TCC" refers to a streaming services' costs of content, referring in this proceeding to the cost of sound recording royalties the streaming services pay to record companies.

[9] As part of the Judges' discretion to promulgate regulations to effect license rate collection, the Majority reorganized the regulations in part 385. This reorganization was completed to further the goal of clarity and conciseness. No party objected to or sought to overturn that reorganization of the regulations. Apparently, the perceived sanctity of the PR II rate structure is not unassailable. Reorganization can perhaps be seen as a first step to toward clarity, transparency, and simplicity for licensors and licensees.

Remand Majority. Nonetheless, the Benchmark Dissent continues to disagree with adoption of the entirety of the rate *structure* adopted by *Phonorecords II.* As noted above, the Judges solicited evidence to support adoption of regulatory language to effect payment of the rates they established. Copyright Owners, Google, and Apple submitted rate proposals that greatly simplified the rate structure. Their rate structure regulation proposals were crafted to support their varying approaches to rate calculations not adopted by the Judges. Their criticisms of the PR II rate structure are valid, nonetheless, and support the Benchmark Dissent's analysis.

In the underlying proceeding, the Majority declined to label the rate structure and resulting rates incorporated in the regulations promulgated after the *Phonorecords II* proceeding (rates and rate structure) as a benchmark, or starting point, for determination of new rates and terms in that proceeding. In the Determination in the extant proceeding, the Majority alluded to reasons they found the PR II rates to be inadequate to serve current circumstances.[10] The D.C. Circuit noted that appellate counsel offered further explanation on appeal for the rejection of the PR II rates and rate structure as a benchmark. *See Johnson v. Copyright Royalty Board,* 969 F.3d 363, 387 (D.C. Cir. 2020). Nevertheless, the D.C. Circuit faulted the Majority for not providing adequate explanation of their rejection of a PR II-based benchmark in the first instance. *See id.* Indeed, the D.C. Circuit found the Majority's reasoning on the issue in the Determination to be "muddled." *Id*. at 386-87.

Copyright Owners argue that the D.C. Circuit's remand for further explanation did not equate to finding error in the Judges' rejection of the PR II-based benchmark. *See* Initial Remand Submission of Copyright Owners (Apr. 1, 2021) 1, 10 (CO Initial Submission). Notably, the Services did not address the question of a finding of error, but proposed on remand a rate structure substantially similar to that in PR II and offered a benchmark analysis therefor. *See* Services' Joint Opening Brief (in Services' Joint Written Direct Remand Submission at Tab D) (Apr. 1, 2021) at 19 (Services' Initial Submission).

While the Copyright Owners' parsing of *Johnson* might be technically correct, the Benchmark Dissent nonetheless accepts the wisdom of revisiting the analysis of the PR II rates and rate structure, focusing on the intricacies of the structure that ultimately come into play in determining the amount of royalty payable. The Benchmark Dissent disagrees that the record in this case demands adoption of the PR II rate structure as a suitable benchmark. The Benchmark Dissent hereby provides a full analysis of this issue, which includes a fuller explanation of the conclusions in the Determination and supports and justifies rejection of the *Phonorecords II* rate structure.

B. Attributes of a Useful Benchmark

As repeated by the parties in the initial proceeding and in their remand submissions, for an exemplar to serve as a useful benchmark, it must be compared to the target market. The hallmarks of a useful benchmark are: 1) unity of products, 2) unity of sellers, and 3) unity of buyers. In addition, 4) economic circumstances and market conditions can influence the value of a benchmark. *See* Services' Initial Submission at 20 (citing *Determination of Royalt[ies] for Transmission of Sound Recordings…*, 83 Fed. Reg. 65,210, 65,214 (Dec. 19, 2018) (*SDARS III*).

[10] The D.C. Circuit found that the Majority articulated a reasoned and reasonable rejection of the negotiated rates applicable to the categories of phonorecords included in "Subpart A" of the regulations as a benchmark in this proceeding. The issue on remand is articulation of a reason for not using the other subparts of 37 C.F.R. 385 as a benchmark in this proceeding. *See Johnson v. Copyright Royalty Board,* 969 F.3d 363, 386 (D.C. Cir. 2020).

In the Remand Majority opinion, the Judges argue that the PR II rate structure meets "most of the requisites for a useful benchmark. *See* Initial Ruling, section III. C. 3. Assuredly, in the real world one is unlikely to find a perfect benchmark; consequently, the Judges in these proceedings look to the best available benchmark(s) and make adjustments to compensate for their shortcomings when compared to the attributes and circumstances of the target rates. The Benchmark Dissent is not so sanguine about one's ability to reconcile the PR II rate structure with current market circumstances pertaining to music streaming (including participants and volumes of sales) almost a decade after the parties agreed to that structure. Because of the recognized gulf in market conditions between *Phonorecords II* and this *Phonorecords III* proceeding, the Benchmark Dissent rejects attempts to fit that square peg into the current round hole.

1. Unity of Products – the Same Rights

The PR II rates regulated "sales" of the same licensing rights as those at issue in the current underlying proceeding, *viz.*, the statutory license to utilize musical works embodied in the sound recordings that are the lifeblood of the music streaming services. This factor was not and is not in controversy. In this respect, the Judges could look to the PR II rates as a benchmark.

2. Unity of Sellers - Rightsholders

The songwriter or songwriters own the copyright for musical works, that is, the musical notes and lyrics. In general, songwriters sell or license their works to publishers who fix the works to a physical medium, for example, piano rolls or sheet music. Music publishers also market the musical works licenses to record companies for their sound recordings. In today's market, publishers and songwriters exist in a symbiotic relationship. Without new works, the publishers have no new product to market.[11] To ensure a flow of new product, publishers often subsidize songwriters by providing working space or monetary advances on future sales of licensed work, or publishers might purchase outright the songwriters' copyrights. Whether the rightsholder is a writer, composer, or publisher, the rights are the same, those derived from 17 U.S.C. § 106 and limited by 17 U.S.C. § 115. *See* 17 U.S.C. § 106(1), (3) (exclusive rights); § 115 (compulsory licensing). The sellers' interests are aligned.

3. Unity of Buyers – Streaming Services

The Services argue unity of rights and sellers between the time of the PR II rates and the current proceeding. With respect to buyers, the Services allege that the current buyers are "the same or similar…." Services' Initial Submission at 20. The Services argue that the PR II rates involved "either the same type of buyers or the very same buyers as this proceeding." *Id.* The license delimits the users it binds. It is axiomatic that current licensees are "of the same type" as licensees in 2012. Describing participants as "similar to those currently in the market" or "of the same type" as current participants is sufficiently imprecise to call into question the unity of buyers required to give great weight to a potential benchmark

The Services allege that "[m]ost of the participants in Phonorecords III were either directly involved in the Phonorecords II settlement or operated in the market at the time of the

[11] Publishers may retain rights to songs no longer considered "new" or "popular" that might nonetheless still be subject to the section 115 license. The Services' revenue is driven, however, by streaming new music. They understand that reselling older music, even in new packaging (covers) would lower their desirability and decrease the sources of revenue, their end users.

settlement." *Id.* "Most of the participants" does not reveal which participants were active in *Phonorecords II* or the reasons for their participation. Amazon began an MP3 digital music service in 2004; it launched steaming in mid-2014. *See* Written Direct Testimony of Jeffrey Eisenach (Nov. 3, 2016) (Eisenach WDT) ¶ 51. Tab. 2. Apple launched its streaming service in 2019. During the Phonorecords II negotiations, Apple's primary interest was digital downloads from the iTunes store. According to one of its witnesses, Google was, at the time of the Phonorecords II negotiations, "planning to launch a store, a locker, and a subscription service." Google's participation in the Phonorecords II negotiations was "primarily designed to make sure that our interests were met in -- for our forthcoming music service." 3/8/17 Tr. 157:2-158:2 (Zahavah Levine).

Although the Services argue that the buyers in the current market are the same as, or similar to, buyers at the time of adoption of the PR II rates, the Services then and now advocate differing rate calculations for each music delivery configuration. Indeed, between 2008 and 2012, the delivery configurations multiplied and the parties negotiated different rate structures for those multiple configurations. Acknowledging participation by a service with one configuration—or a plan to launch one configuration—is insufficient to establish a unity of buyers for purposes of rate setting. Almost a decade after the effectuation of the 2012 rates, with new businesses tacking music streaming onto their digital ecosystems, the development of new and different delivery configurations continues to evolve.[12] Nonetheless, the Services would have the Judges adopt a rate structure that specifies current delivery configurations but excludes some current innovations and cannot encompass the next innovations, whatever form they might take.

The Benchmark Dissent acknowledges that buyers of the musical works for which licenses are at issue in this proceeding are of the "same type" as the *Phonorecords II* buyers. In some instances, they are the same participants. In the current landscape, however, the interests of those buyers are vastly different. The extent to which Apple, Amazon, and Google, were involved in Phonorecords II negotiations bears no resemblance to the interests of those services and their current service configurations. Without greater unity of buyers, the Benchmark Dissent must discount the viability of the PR II rates or rate structure as a useful benchmark in this proceeding.

4. Economic and Market Conditions

The Services argue that the music streaming industry in 2018 was essentially unchanged from 2008 or 2012.[13] *See* Services' Initial Submission at 20-21. The evidence in this proceeding compels a contrary conclusion. In 2008, musical works distribution consisted primarily of sound recordings reproduced in physical formats (vinyl and CDs) and digital downloads. *See* Eisenacht WRT ¶33 (Feb. 13, 2017). The record reflects that in 2008, of record labels' revenues 96% were derived from sales of physical and digitally downloaded sound recordings; 2.5% from interactive streaming.[14] By 2012, at the inception of the rates that were re-adopted as the PR II rates, musical works sales were beginning to shift from physical media to

[12] Some services offer different levels of access to consumers using their proprietary devices, *e.g.,* Amazon Echo. Some (non-satellite) music streaming services are now available directly via a button on a vehicle dashboard.

[13] The PR II rates and rate structure were the product of a negotiated settlement that began and ended with reference to the negotiated rates adopted in 2008. Some additional categories of service were added to the 2008 structure, *e.g.* locker services. Of those categories added in 2012, few remain a significant part of the current streaming industry.

[14] The difference is attributable to sound recording revenues from non-interactive streaming.

digital forms. In 2012, 8.1% of record label revenues were attributable to interactive streaming. *Id.* By 2015, evidence available in this proceeding showed that record labels' revenues from digital downloads approximately equaled revenues from streaming and digital sales were more than double the sales of physical configurations, such as vinyl and CDs. *Id.* ¶¶ 44-45 and accompanying tables.

Spotify, the dominant pure play streaming service in the U.S., did not enter the U.S. market until mid-2011. *See* CO Initial Submission, at 20-21 (Apr. 1, 2021) *and evidence cited therein*. Spotify did not participate in the negotiations leading up to the adoption of the 2012 musical works royalty rates. *See* Eisenacht WRT ¶ 35, n.38. In fact, the record contains evidence that music streaming was not a major factor in setting mechanical license rates in 2008 or 2012.[15] *See* CO Initial Submission at 19-21, *and evidence cited therein.* As more and larger streaming services entered the market, music consumption changed in character. Music consumption in the 2018 market had changed character completely from an ownership model to an access model. *See* Determination at 6.

Further, three of the Services participating in the current proceeding are not pure play streaming services but are multidimensional marketing firms for whom music streaming is only one small facet of the business. From the perspective of those current licensees, the music streaming license is relatively insignificant to their overall financial health. The Judges must, therefore, value the license objectively to assure the conglomerate licensees do not manipulate their revenues so as to reduce music streaming rights below what is fair and reasonable to the rightsholders.

The Services further advocate use of the PR II rates and rate structure as a benchmark because they assert that the multifaceted rate structure is reflective of the Services' own price discriminatory services. The Majority noted the Services' price discrimination as a way to optimally monetize segments of the market with a lesser willingness to pay.[16] Greater accommodation of users less willing to pay results in more streaming and more revenue for the Services at minimal to no marginal cost. A rate determined as a percentage of a service's revenue allows that price discrimination to continue, resulting in additional royalties. The Benchmark Dissent contends, however, that the Judges need not adopt a rate structure with ten different service categories to allow the Services to continue their price discriminatory downstream sales. The payable royalties are a percent of revenue. If the Services receive relatively less revenue by marketing a family plan, for instance, that reduced revenue is the basis for the royalty calculation. Nothing in a simplified rate structure would inhibit price discriminatory service plans. The PR II rates' multi-category structure might encompass the price discrimination the Services employ, but that does not make it a mandatory benchmark for current rates, especially if the target rate structure permits the same flexibility.

C. Adoption of PR II Rates and Rate Structure in Direct Licenses

The Services assert that the PR II rates and rate structure have been adopted in negotiated direct licenses they have signed with rightsholders rendering those rates and that rate structure a

[15] The Services argue that only Mr. Israelite testified that the 2008 and 2012 rates were "experimental" and that the market is significantly changed since 2012. The Majority found, based upon the totality of the evidence, that Mr. Israelite's testimony was credible and accorded it due weight.

[16] The adopted *Phonorecords III* rate regulations acknowledged price discrimination by, *inter alia,* permitting Services to account for discounted subscriptions in different ways. *See* Determination at 34.

valuable benchmark. The Services' witnesses analyzed direct licenses and concluded that the *rates* closely matched the rates in the PR II regulations. [redacted][17] Analysis of direct licenses executed belie the Services' assertion that the PR II rates *structure* is embraced by rightsholders.[18]

D. Additional Shortcomings of PR II Rates as a Benchmark

The D.C. Circuit dismissed the Majority's argument on appeal that (1) the PR II rates were too low and (2) the PR II rates were outdated. The D.C. Circuit noted that these two reasons might support the Majority's conclusions, but they could not be asserted in the first instance on appeal. *See Johnson* at 386.

1. Rates Too Low

The D.C. Circuit found that the Judges' finding that the PR II rates were too low was not fully articulated until the matter was on appeal. As a result, the D.C. Circuit could not evaluate that reason as support for the final rates. Indirectly, however, the D.C. Circuit nonetheless accepted that underlying reason for the rate changes when it approved the higher rates themselves. *See Johnson* at 384-86. The adopted rates were soundly grounded in the record evidence. *See id.* By implication, acceptance of increased rates means the PR II rates were too low to be continued. With or without the "too low" rationale, the final adopted rates prove the point.[19]

2. Rate Structure Outdated

In the Determination, the Majority cited several factors that implied the inadequacy of the PR II rates and rate structure as a compelling benchmark for *Phonorecords III*. As discussed above, the music streaming industry in 2018 was completely transformed from 2008 or 2012.

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[17] The [redacted] direct licenses reportedly adopt the rates in section 385, which open-ended adoption could indicate acceptance of both rates and rate structure.

[18] [redacted] *See* AWDT Leonard ¶¶ 63-64 [redacted] *See* Leonard AWDT ¶ 70-71

[redacted] *See* AWDT Leonard ¶ 54. (calculation is "effectively simplified").

[redacted]

[redacted]

[19] The Services argue that an agreed continuation of the Subpart A (now Subpart B) rates for, *inter alia,* physical phonorecords and permanent downloads, proves that the Phonorecords II rates are appropriate. *See* Services' Initial Submission at 30. This argument asserts a false equivalency. Physical Phonorecords and permanent downloads are fundamentally different in character from streamed music. Further, the evidence indicates that the prominence of streaming access over ownership of recordings is waning. The parties' agreement to maintain the *Phonorecords II* rates for this declining segment of the market does not equate to a mandate to adopt the entirety of the PR II rate structure.

Both the buyers and the economic market conditions were markedly changed. Referring to the PR II rates as "outdated" encompasses both a temporal element and a structural component.

a. Significance of the passage of time

Music streaming in the earlier rate setting periods was in its infancy. Listeners had not yet fully embraced the subscribed access model for music consumption. By 2018, listeners could choose from "a diverse array of streaming offerings." *See* WDT of Rishi Mirchandani ¶ 63. Such industry shifts alone could render the PR II rates "outdated."

b. Clarity and simplicity

Another salient factor the Majority addressed is the rate structure itself. To understand the PR II rate structure, one needed ten separate full-page flow chart diagrams, each featuring three formulae for calculating greater-of and lesser-of rate components. *See* Trial Ex. 846. The rates for some consumption configurations included a per-subscriber "mechanical floor" as a failsafe against overreaching by PROs, should the Rate Court increase their rates to an extent that all of the section 115 all-in percent of revenue royalty be consumed by the PROs. *See, e.g.,* [FORMER] 37 C.F.R. §§ 385.13(1) (Standalone non-portable subscription—streaming only [$.15 per subscriber]); [FORMER] 385.13(2) (Standalone portable subscription—mixed use [$.50 per subscriber]) (2018).[20] Other consumption configurations included "minima;" that is a lesser-of calculation comparing a percent of sound recording license costs (TCC) and a per subscriber amount. *See, e.g.,* [FORMER] 37 C.F.R. §§ 385.13(b) (2018). Further, rate calculations differed depending upon, for example, whether the listener streamed on a portable device or a non-portable device; or whether the listener purchased access to the music alone from a pure-play streaming service or as part of a bundled offering, such as "free" streaming for a limited period included in the purchase price of the streaming device.[21]

The rationale for these convoluted rate calculation differences is unknown.[22] They were the product of confidential negotiations among the parties involved in the music streaming business in the first decade of the 21st century. One side of the negotiating table sought reconsideration of those rates. The current licensees are not the same as those who negotiated the 2012 rollover of the 2008 rate scheme. Music streaming business models have witnessed significant growth and change. Meanwhile, the business models employed by songwriters and publishers remain largely unchanged—and not realizing a proportionate capture of the stream of dollars realized by the Services' monetization of ever-more consumption configurations. The

[20] The Majority reintroduced these "mechanical floor" safeguards, notwithstanding a lack of evidence to explain, let alone justify, the difference between $0.15 and $0.50 per subscriber (the latter being 300% greater than the former) simply because one consumer listened to a song on a standalone non-portable device and another consumer listened to a song on a standalone portable device.

[21] The Services have not offered convincing, substantive evidence or argument to support the fractured structure of the PR II rates. Tellingly, the user's choice of consumption device is not a factor in license rates for other services. *See, e.g.,* 17 C.F.R. § 380.10 (Webcasters rates differentiate between commercial and non-commercial licensees, not based on users' reception devices); §§ 382.3, 382.12 (rates for satellite radio and pre-existing subscription services do not differentiate based on users' reception devices).

[22] Prof. Katz asserted that "economic analysis" indicates that varying rates based on the characteristics of the service "facilitates continuing innovation, experimentation, and differentiation in means of making music accessible to consumers." Katz WDT ¶ 85. Prof. Katz did not identify that economic analysis. He asserted that the fractured rates allow services to benefit despite different consumers' willingness to pay. Nothing in the PR III rate structure at issue in any way inhibited services adapting to meet consumers' willingness to pay. The rates are, in the main, revenue based—even if the services choose to market the service at a lower rate to a particular segment of the market.

marginal cost to the Services of additional streams, regardless of the business configuration or the user's reception device, is zero. The Services, therefore, are in a position to capture increased revenue without an increase in cost of goods sold.

In the end, a sound recording embodying a licensed musical work is being delivered to an end "user": one song; one listener. The calculation of what royalty the songwriter is entitled to should not rest on the medium of transmission or the location of the listening. *See* WDS Steve Bogard ¶34 ("Streaming music anytime, any place, on any device is the way today's music fans want to enjoy their music. Notwithstanding that the inherent value of a song is the same whether the consumer chooses to buy an album, permanently download an album or a single, or stream music on demand…."). The incremental difference in value to the listener of hearing a song in the car as opposed to through earbuds during a workout is not likely measurable. Certainly, no participant in this proceeding presented any evidence of the relative value of a song to a listener depending on the delivery configuration.[23]

In the interest of making government more transparent and accessible to interested citizens, less is more. Opaque systems and formulae are or should be, in a word, outdated. The fact of settlement does not cure or even address the unnecessary complication of paying a royalty for the use of a statutory license under the PR II rates structure. More importantly, owners of the copyrights being licensed should be able to comprehend, calculate, and verify the sources and amounts of their royalty payments.

3. Not business model neutral

The Services contend that the PR II rate structure is preferable as it is business model neutral. Nothing in the record supports that assertion. In fact, Apple argued that the PR II rate structure stifled innovation as streaming services sought to fit any new business into a business model already defined as one of the ten identified models in the *Phonorecords II* regulations. The statute does not require that rate structures be business model neutral. The reasonableness requirement demands, however, that the Judges find and adopt *reasons* for differentiation in rates based on business models.

4. No Evidence of Settling Parties' Subjective Intent

Copyright Owners participating in the current proceeding argued that the Judges should consider the subjective intent of the parties in agreeing to "roll over" the 2008 rates and rate structure into the PR II regulations. The Services countered that subjective intent is irrelevant, as the product of those negotiations serves as objective evidence of the parties' intents. On this

[23] The Remand Majority dubs analysis of value based on the cost of production rather than willingness to purchase as old-fashioned economic analysis. So it may be. In the modern economist's widget market, if buyers are unwilling to pay enough to cover the cost of widget components, then widget production ceases. But in the old-fashioned creativity market, the goods are not fungible. The inputs to a hit song are ephemeral; sometimes plentiful, sometimes elusive; they either coalesce or they do not. Songwriters will persevere because they cannot do otherwise. The demand for music continues to grow with each new innovation in delivery methods. The United States Constitution provides for protection of art and the creators of art. U.S. Const. art. I, § 8. Congress has specified how to protect, *inter alia,* the copyrights of songwriters. The Judges' small part in that effort is to continue to assure that royalty rates are reasonable—for both creators and exploiters. In the music streaming industry, the evidence supports devoting a greater share of licensees' increased wealth to the "widget makers." The Dissent contends that the increase in the percent-of-revenue headline rate is a good step forward, but only the first step to assuring equity in the market. Streamlining, simplifying, and generally "cleaning up" payment calculations would go a long way in the right direction by removing twists and turns and confusing signals along the path of the royalty dollar from end user to creator.

question, the Services are correct. The negotiated rates show, objectively, that the negotiating parties agreed to a certain rate structure. The D.C. Circuit criticized the Majority for not including in the Final Determination an explanation of why the subjective intent of the parties to the settlement was a "prerequisite" to adoption of that settlement as a benchmark. *See Johnson* at 387. The Judges need not, however, accept that objective evidence uncritically.

Negotiating parties' subjective state of mind can serve as convincing evidence of the economic circumstances and the state of the market at the time of the negotiations. While ascertaining the parties' subjective intent in reaching the settlement is not a "prerequisite" to examination of the terms as a benchmark, the Benchmark Dissent finds subjective intent informative and useful as one factor in weighing the value of the settlement as a benchmark.

E. Statutory Factors

The Services argued to the D.C. Circuit that the Majority's rejection of the PR II rates and rate structure was erroneous because the Majority failed to evaluate that structure and those rates under the statutory factors delineated in 17 U.S.C. § 801(b)(1). Evaluation under § 801(b)(1) is required by the statute applicable to this proceeding.[24] Nothing in § 801(b)(1) compels the Judges to evaluate compliance with the statutory factors of every proposed potential rate or rate structure. Neither are the Judges required to evaluate every potential benchmark or past rate structure under § 801(b)(1). The Judges are obliged to evaluate any rate structure they intend to adopt against the requirements of § 801(b)(1). If the Judges' promulgated rate structure meets the § 801(b)(1) standard, then the promulgated rate structure can be adopted. Whether other possible proposals might also meet the § 801(b)(1) standard is not at issue in a proceeding.

1. Maximize the availability of creative works to the public.

The Services argue that the PR II rates and rate structure support and contribute to the maximization of musical works. As evidence, they cite the growth of music streaming overall, the profitability of all segments of the music industry.[25] It is beyond question that music consumption has grown exponentially since the co-incident introduction of portable devices and streaming services. Growth continues as those devices and services become increasingly easy to actuate in vehicles.

No participant alleged, however, that music industry success is caused by or even correlated to the PR II rate structure. Coincidence is not probative evidence.

2. Assure fair return to copyright owner and fair income to the licensee.

The Services argued they were receiving a fair income and copyright owners were receiving a fair return under the PR II regulations. Although the Services argued that overall music royalties absorbed an inordinate portion of their revenues, none expressly laid that lack of available revenue at the door of mechanical royalties. Amazon's witness, Dr. Glenn Hubbard described a growing increase in streaming industry revenues and forecasts of continuing growth. *See* WRT of Glenn Hubbard (Feb. 15, 2017) ¶ 2.23-24 (Hubbard WRT). Dr. Hubbard deconstructed Amazon's increased revenues and concluded that the growth in streaming

[24] With the passage of the Orrin G. Hatch – Bob Goodlatte Music Modernization Act, Congress eliminated the four statutory factors for evaluating license royalty rates. *See* 115 Pub. L. No. 115-264, 132 Stat. 3676 (2018) (codified in scattered sections of title 17, U.S.C.

[25] According to the Services, all segments of the music industry are thriving [redacted]

services' revenue resulted in increased royalty payments to music publishers and other rights holders. *Id.* ¶ 3.10. When royalty rates are calculated on a percent-of-revenue, the royalty payments increase when revenues increase.

The difficulty with this tautological argument is that revenue growth as between services and rightsholders has not been proportional. And, as Copyright Owners have argued, the *rate* at which the services share with mechanical rightsholders is the issue in this proceeding. The Judges are not called upon to set annual royalty payment dollar amounts; rather they are mandated to set the rates that drive those dollar amounts. And to adopt regulations that most closely effectuate actual payment to rightsholders, minimizing revenue deferral and other such loopholes. For all of the reasons provided in the Determination and in this Benchmark Dissent, the PR II-based rates and the controlling rate structure do not balance the section 115 fair income-fair return scale appropriately and reasonably.

3. Weigh relative roles of licensors and licensees in making the works available to the public.

No participant presented evidence to elucidate specifically the relative roles of the parties relating to musical works. Economic evidence assumed that the marginal cost of streaming more music is minimal. This does not discount the services' sunk costs, such as the original technological or capital investments. With respect to the contributions of the copyright owners, the contribution is clear. It all begins with a song. Without new music, the Services could continue by streaming unregulated works, new arrangements or covers of existing works, and non-music content. Whether they would continue to enjoy the growth they have enjoyed over the last decade is unknown. The PR II rates might be a contributing factor to both stability and growth of the industry, but based on the totality of the evidence, the Dissent concludes that with regard to musical works, the relative role of the creator of the musical works, and to a lesser extent, the music publisher, is undervalued.

4. Minimize Disruption.

The language for the fourth statutory factor requires the Judges to establish a rate structure in such a way as "[t]o minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices." [FORMER] 17 USC 801(b)(1)(D). The Services argue that the change in rate structure determined by the Majority in this proceeding is massively, and potentially fatally, disruptive to music streaming services.

Ironically, the music industry has been in a constant state of disruption since the introduction of digital music. From peer-to-peer sharing, to purchased permanent downloads, to interactive and non-interactive streaming, the history of modern music consumption has been a model of disruption. Entry into the streaming market by multifaceted digital ecosystem providers is just the latest significant change in music delivery to consumers. Innovation in music delivery is constant.

Allegedly to minimize disruption, the Services advocated retention of the PR II rates and rate structure.[26] While every aspect of the music industry is experiencing explosive growth, maintenance of the inadequate rates for mechanical licenses is unfathomable. Some change, phased in over time, might be uncomfortable for the licensees, but failure to change rates to

[26] Tellingly, on remand, the Services did not pursue any argument that the changes in the rates or rate structure in the Determination were disruptive.

acknowledge the music delivery revolution is not an option. With such a dynamic history and uncertain future, a change in mechanical license rates is not just inevitable, but mandatory.

Indeed, the Benchmark Dissent's approach in this proceeding advances the notion that streamed music is streamed music. This is certainly true from the viewpoint of the songwriters and publishers, and of music consumers. Rather than introduce separate rate structures for each new delivery technology or streaming business model, the Judges need to establish a rate that will fairly compensate Copyright Owners for the use of their works and permit a fair return to licensees, regardless of what next technological disruption they might choose to introduce to the industry. In the captioned proceeding, the Majority declined to label the rate structure and resulting rates incorporated in the regulations promulgated after the *Phonorecords II* proceeding as a benchmark, or starting point, for determination of new rates and terms in this proceeding.

In the Determination, the Majority alluded to reasons they found the PR II rates to be inadequate to serve current circumstances.[27] Nevertheless, the D.C. Circuit faulted the Majority for not providing adequate explanation of their rejection of the PR II benchmark in the first instance. *See Johnson* at 386-87. Indeed, the D.C. Circuit found the Majority's reasoning on the issue in the Determination to be "muddled." *Id.*

F. Rate Structure

For all of the reasons outlined above, the Remand Majority's acceptance and adoption of the *Phonorecords II* rate structure results in a rate structure in this proceeding that suffers from the same deficits the Benchmark Dissent believes to be inherent in that rate structure. Changing the headline rate and capping the TCC rate prong do not cure the ills of the rate structure itself. True, the PR II-based rates permit price discrimination, which increases revenue, and therefore royalties, in absolute terms. Reinstatement of minima in the TCC prong introduces a failsafe to runaway TCC-based rates. The mechanical floors adopted in the Determination continue, protecting mechanical license rightsholders from runaway performance royalties.

The Benchmark Dissent maintains that all these goals could be met equally well with a streamlined, transparent, fair, and reasonable rate structure, as several of the participants in this proceeding advocated.

III. CONCLUSION

This Dissent in part is issued as a RESTRICTED document. Within 30 days of the date of issuance, the participants shall file a version of this Dissent with agreed redactions to permit viewing by the public.

Digitally signed by Suzanne Barnett
Date: 2022.07.01 11:07:12 -04'00'

Suzanne M. Barnett
Chief Copyright Royalty Judge

Dated: ____________________

[27] The D.C. Circuit found that the Majority articulated a reasoned and reasonable rejection of the negotiated rates applicable to the categories of phonorecords included in [FORMER] subpart A of the regulations as a benchmark in this proceeding. The issue on remand is articulation of a reason for not using the other subparts of 37 C.F.R. § 385 as a benchmark in this proceeding. *See Johnson* at 386.

Proof of Delivery

I hereby certify that on Monday, August 01, 2022, I provided a true and correct copy of the Dissent in Part re Benchmark (PUBLIC) to the following:

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Signed: /s/ Scott Angstreich