

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)**

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FINAL DETERMINATION AFTER REMAND

On October 26, 2020, the United States Court of Appeals for the D.C. Circuit (D.C. Circuit) issued its mandate vacating and remanding in part the original Determination¹ issued by the Copyright Royalty Judges (Judges) in the captioned proceeding. *See Johnson v. Copyright Royalty Board*, 969 F.3d 363 (D.C. Cir. 2020). In its ruling on appeal, the D.C. Circuit found that in the original Determination, the Judges (1) failed to give adequate notice to participants of their overhaul of the royalty rate structure combined with significantly increased and uncapped rates for section 115 licenses; (2) failed to explain why they rejected a benchmark based on a past settlement agreement² in lieu of overhauling of the rate structure and significantly increasing rates; and (3) failed to identify their legal authority to redefine a material term after they promulgated a definition of that term in the original Initial Determination circulated to the participants. *See Johnson*, 969 F.3d at 367, 381; Initial Determination, *Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, 16-CRB-0003-PR (2018-2022) (Jan. 27, 2018).

After receipt of the D.C. Circuit's ruling and mandate, the Judges consulted with the parties to the appeal and established procedures for the remand proceeding. *See Order Adopting Schedule for ... Remand* (Dec. 23, 2020).³ Each side offered opening submissions, responsive submissions, additional evidentiary filings, and further supplemental briefing requested by the Judges. The parties' submissions included legal briefing and incorporated evidence from the original proceeding as well as evidence newly developed for the remand proceeding. After preliminary deliberations, the Judges asked for supplemental briefing from the parties responsive to a proposed alternative rate structure. *See Notice and Sua Sponte Order Directing the Parties to*

¹ *Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, 84 Fed. Reg. 1918 (Feb. 5, 2019) (final rule and order) (original Determination); *see also* Final Determination, 16-CRB-0003-PR (2018-2022) (Nov. 5, 2018). The original Determination was issued by two of the Judges (Majority) and was accompanied by a dissenting opinion (Dissent) authored by the third Judge. The Dissent is appended to and part of the same document as the original Determination.

² The referenced settlement agreement formed the basis for regulatory terms relating to section 115 musical works royalties and was adopted as a final rule in *Adjustment [or] Determination of Compulsory License Rates for Mechanical and Digital Phonorecords*, Docket No. 2011-3 CRB Phonorecords II, 78 Fed. Reg. 67938 (Nov. 13, 2013). *See also* Technical Amendment at 78 Fed. Reg. 76987 (Dec. 20, 2013).

³ Following the original remand scheduling order, the Judges amended the remand proceeding schedule by, *e.g.*, permitting additional briefing, changing due dates, and seeking additional input with regard to specific issues. *See, e.g.*, *Order ... Modifying Scheduling Orders* (Dec. 13, 2021) (eCRB no. 25973).

Provide Additional Materials (Dec. 9, 2021). With respect to redefinition of the material term Bundled Revenue, the Judges also sought legal analysis from the parties relating to the D.C. Circuit's directive that the Judges either provide "a fuller explanation of the agency's reasoning at the time ..." or take "new agency action accompanied by the appropriate procedures." *See Johnson*, 969 F.3d at 392 (citing *Department of Homeland Security v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1908). On February 9, 2022, the Judges invited additional briefing on the Bundled Revenue definition issue, specifically permitting the parties to offer additional analysis of possible characterization of the Copyright Owners' motion for clarification following the Determination as a motion for rehearing under the Copyright Act, title 17, United States Code at § 803(c)(2). *See Sua Sponte* Order Regarding Additional Briefing (Feb. 9, 2022).

At the request of the parties, the Judges agreed to forego live testimony. On March 8, 2022, all parties were afforded an opportunity to present oral argument on all remand issues.⁴ On July 1, 2022, the Judges issued an Initial Ruling and Order after Remand (Initial Ruling)⁵ – applying *Johnson* and considering the entire record developed pre-remand and post-remand.

In the Initial Ruling, the Judges directed the parties to attempt to submit jointly agreed-upon regulatory provisions implementing the Initial Ruling for the Judges to consider. The Judges further ruled that, if the parties could not agree on all the regulatory language, they should make separate submissions regarding regulatory provisions in dispute. *See* Initial Ruling at 114.

The parties agreed to many regulatory provisions but disagreed as to several such provisions. Accordingly, they filed separate submissions and respective replies regarding the regulatory provisions. Services' Joint Submission of Regulatory Provisions (July 18, 2022); Copyright Owners' Submission of Regulatory Provisions to Implement the Initial Ruling (July 18, 2022); Services' Joint Response to Copyright Owners' Submission of Regulatory Provisions (Aug. 5, 2022); Copyright Owners' Response to Judges' July 27, 2022 Order Soliciting Responses Regarding Regulatory Provisions (Aug. 5, 2022).

The Judges considered those submissions and entered an order addressing the disputed regulatory provisions. *See* Corrected Order regarding Regulatory Provisions Following Initial Ruling and Order (after Remand) (Nov. 10, 2022) (November 10th Order).⁶

On November 30, 2022, the parties filed a Joint Submission in which they provided joint regulatory language no longer in dispute that applied the binding rulings of the Judges and the

⁴ Copyright Owners and Services divided the time for oral argument. George Johnson dba GEO Music Group waived oral argument.

⁵ The Initial Ruling (eCRB no. 26938) is included as Appendix A. The findings and conclusions in the Initial Ruling were adopted by a majority of the Judges, but two Judges filed separate opinions. *See* Initial Ruling at 2 n.5. One Judge, former Chief Judge Suzanne Barnett, dissented from the Majority's conclusion in the Initial Ruling regarding the *Phonorecords II* rate structure (section II of the Initial Ruling), though not from the exception to that benchmark with regard to the headline rate of 15.1% and the imposition of a cap on the TCC rate prong. *See* Dissent in Part re Benchmark (July 1, 2022) (eCRB no. 26943). The other opinion was issued by Judge Strickler, who dissented from the *reasoning* relating to the adoption of the definition of Service Revenue (section V), but concurred in the *adoption* of that definition. *See* Dissent in Part as to Section IV of the Initial Ruling and Order after Remand . . . (July 1, 2022) (eCRB no. 26965).

⁶ The November 10th Order corrected an otherwise substantively identical order issued two days earlier, on November 8, 2022, which had inadvertently included a small amount of text. *See* November 10th Order at 1 (eCRB no. 27312).

D.C. Circuit.⁷ However, the parties identified the single issue in dispute that relates to the “Total Content Cost” (“TCC”) rates for nine offerings made by interactive streaming services. Joint Submission ... Regarding Regulatory Provisions Following Initial Ruling and Order (after Remand) (Nov. 30, 2022) (Joint Submission) (eCRB no. 27337).

Having considered the parties’ submissions (including the Joint Submission), the Initial Ruling, and all other pertinent material, the Judges adopted the several TCC rates set forth in the Phonorecords II-based benchmark as proposed by the Services. *See* Order 43 on Phonorecords III Regulatory Provisions (eCRB no. 28210).⁸

Based on the entirety of the record, the Judges adopt *in toto*⁹ the Initial Ruling and the Order 43 on Phonorecords III Regulatory Provisions which are appended hereto. Accordingly, those two documents are incorporated by reference in this Final Determination After Remand. Additionally, the regulatory terms that will codify this Final Determination After Remand are appended hereto.¹⁰

On the basis of the foregoing, the Judges propound the rates and terms described in this Final Determination After Remand for the period January 1, 2018, through December 31, 2022.¹¹ No participant having filed a timely petition for rehearing, the Judges have made no substantive alterations to the body of the Initial Determination After Remand. The Register of Copyrights may review the Judges’ Final Determination After Remand for legal error in resolving a material issue of substantive law under title 17, United States Code. The Librarian shall cause the Judges’ Final Determination After Remand, and any correction thereto by the Register, to be published in the Federal Register no later than the conclusion of the Register’s 60-day review period.

Dated: June 22, 2023.

David P. Shaw,
Chief Copyright Royalty Judge.

David R. Strickler,
Copyright Royalty Judge.

Steve Ruwe,
Copyright Royalty Judge.

⁷ The Judges largely adopt the regulations in the Joint Submission, which reflect the substance of the Judges’ post-remand rulings, the substance and formatting that the Judges had adopted in the pre-remand Final Determination that were not raised as issues on appeal, and updates to references to subparagraphs of Section 115 to conform to statutory amendments made pursuant to the Music Modernization Act in 2018. Any differences in language or style are made for ease of reference, consistent with the parties’ post-remand joint filings.

⁸ The Judges also found good cause to adopt a joint proposal for modified language regarding late fees, in 37 C.F.R. §385.3. Order 43 on Phonorecords III Regulatory Provisions at 9.

⁹ *But see* Judge Strickler’s Dissent, cited at n.5 *supra*, in which – although he agrees with the Majority as to the definition of a Service Revenue Bundle – he disagrees as to the legal reasoning supporting that conclusion.

¹⁰ The appended documents are: Initial Ruling and Order After Remand, designated as Appendix A; Order 43 on Phonorecords III Regulatory Provisions, designated as Appendix B; Dissent in Part as to Section IV of the Initial Ruling and Order after Remand by Judge David R. Strickler, designated as Appendix C; Dissent in Part re Benchmark, designated as Appendix D; and regulatory terms that will codify this Final Determination after Remand, designated as Appendix E.

¹¹ The regulations applicable to the period 2018 through 2022 will appear in the C.F.R. as an appendix to the current regulations.

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(2018–2022) (Remand)****INITIAL RULING AND ORDER AFTER REMAND**

On October 26, 2020, the United States Court of Appeals for the D.C. Circuit (D.C. Circuit) issued its mandate vacating and remanding in part the Determination¹ issued by the Copyright Royalty Judges (Judges) in the captioned proceeding. *See Johnson v. Copyright Royalty Board*, 969 F.3d 363 (D.C. Cir. 2020). In its ruling on appeal, the D.C. Circuit found that in the Determination, the Judges (1) failed to give adequate notice to participants of their overhaul of the royalty rate structure combined with significantly increased and uncapped rates for section 115 licenses; (2) failed to explain why they rejected a benchmark based on a past settlement agreement² in lieu of overhauling of the rate structure and significantly increasing rates; and (3) failed to identify their legal authority to redefine a material term after they promulgated a definition of that term in the Initial Determination circulated to the participants. *See Johnson*, 969 F.3d at 367, 381; Initial Determination, *Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, 16-CRB-0003-PR (2018–2022) (Jan. 27, 2018).

After receipt of the D.C. Circuit’s ruling and mandate, the Judges consulted with the parties to the appeal and established procedures for the remand proceeding. *See Order Adopting Schedule for ... Remand* (Dec. 23, 2020).³ Each side offered opening submissions, responsive submissions, additional evidentiary filings and further supplemental briefing requested by the Judges. The parties’ submissions included legal briefing and incorporated evidence from the original proceeding as well as evidence newly developed for the remand proceeding. After preliminary deliberations, the Judges asked for supplemental briefing from the parties responsive to a proposed alternative rate structure. *See Notice and Sua Sponte Order Directing the Parties to*

¹ *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) (citations to the Determination and to the Dissent in this Initial Ruling and Order after Remand (Initial Ruling) are found in this document). The Determination was issued by two of the Judges (Majority) and was accompanied by a dissenting opinion (Dissent) authored by the third Judge. The Dissent is appended to and part of the same document as the Determination.

² The referenced settlement agreement formed the basis for regulatory terms relating to section 115 musical works royalties and was adopted as a final rule in *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 Initial Ruling, references to *Phonorecords II*, PR II, and PR II-based benchmark are references to this final rule.

³ Following the original remand scheduling order, at the request of parties or on their own motion, the Judges amended the remand proceeding schedule by, e.g., permitting additional briefing, changing due dates, and seeking additional input with regard to specific issues. *See, e.g., Order ... Modifying Scheduling Orders* (Dec. 13, 2021).

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Provide Additional Materials (Dec. 9 Order). The Judges also sought legal analysis from the parties relating to the D.C. Circuit’s directive that the Judges either provide “a fuller explanation of the agency’s reasoning at the time ...” or take “new agency action accompanied by the appropriate procedures.” *See Johnson*, 969 F.3d at 392 (citing *Dep’t of Homeland Sec. v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1908 (*Regents*)). On February 9, the Judges invited additional briefing on the service bundle definition issue, specifically permitting the parties to offer additional analysis of possible characterization of the Copyright Owners’ motion for clarification following the Determination as a motion for rehearing under the Copyright Act, title 17, United States Code (Act) at § 803(c)(2).

At the request of the parties, the Judges agreed to forego live testimony. On March 8, 2022, all parties were afforded an opportunity to present oral argument on all remand issues.⁴ Following oral argument, the Judges deliberated and now issue this Initial Ruling after Remand.

After due consideration of all of the evidence and oral argument of counsel, the Judges⁵ determine⁶:

- (1) With regard to the applicable rates and rate structure, the percent-of-revenue all-in headline royalty rate for the mechanical license shall be set at 15.1%, phased-in, as set forth below:

2018-2022 All-In Headline Royalty Rates

	2018	2019	2020	2021	2022
Percent of Revenue	11.4%	12.3%	13.3%	14.2%	15.1%

In all other respects, the rates and rate structure of the *Phonorecords II*-based benchmark proposed by the Services (as that benchmark is defined herein) shall constitute the rates and rate structure for the *Phonorecords III* period.⁷

To be clear: the 15.1% headline percentage rate substitutes for the headline percentage rates in subparts B and C of the Services *Phonorecords II*-based benchmark, and the definition of “Service Revenue” for bundles shall be the definition contained in 37 C.F.R. § 385.11 (subsection (5) for the “Service Revenue” definition) as proposed in the Services’ *Phonorecords II*-based benchmark.

- (2) The Services’ *Phonorecords II*-based benchmark is the better of the benchmarks proposed by the parties and satisfies the requirements of 17 U.S.C. § 801(b)(1) in all respects. However, as noted *supra*, to be consistent with this statutory section and the

⁴ Copyright Owners and Services divided the time for oral argument. George Johnson dba GEO Music Group waived oral argument.

⁵ The findings and conclusions in this Initial Ruling are adopted by a majority of the Judges. One Judge dissents from the adoption of the entirety of the *Phonorecords II* rate structure (section II), though not from the exception to that benchmark with regard to the headline rate of 15.1% and the imposition of a cap on the TCC rate prong. One Judge dissents in part from the reasoning relating to adoption of the definition of Service Revenue (section V), but not from the adoption of that definition.

⁶As addressed *infra*, the Judges also order that the participants in this remand proceeding prepare and submit regulatory provisions consistent with this ruling. *See* Footnote 163.

⁷ The Services include in their Joint Rate Proposal a chart summarizing the proposed rates for their offerings. That chart is attached as Appendix A to this Initial Ruling.

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decision in *Johnson*, the royalty rate of 10.5% in that benchmark shall be replaced with the 15.1% rate set forth in paragraph (1) above.

(3) To reiterate for clarity, consistent with the adoption of the *Phonorecords II*-based benchmark, and for the reasons more fully developed herein, the Judges adopt the definition of “Service Revenue for Bundled Services” as it appeared in the Initial Determination in the underlying proceeding. Following are the Judges’ analysis and ruling after remand.

I. Preliminary Issue: Burden of Proof

As a preliminary matter, the Judges address the issue of burden of proof raised by both parties. Pursuant to the Administrative Procedure Act (APA), “the proponent of a rule or order has the burden of proof.” 5 U.S.C. § 556(d). *See also* Initial Remand Submission of Copyright Owners at 48 (Apr. 1, 2021) (“CO Initial Submission”) (citing § 556(d) of the APA as setting forth “a basic rule of these rate-setting proceedings that a participant is required to provide evidence establishing the propriety of all aspects of its own proposed rates and terms, including all aspects of the participant’s proposed rate structure.”). Accordingly, it is clear to the Judges that the Services should continue to bear the burden of proof regarding the sufficiency of their proffered *Phonorecords II*-based benchmark in this remand proceeding. And, in like fashion, because on remand Copyright Owners have assumed the mantle of pursuing the vacated rate structure and rates, they bear the burden of proof with regard to their proposal.

However, Copyright Owners assert that it is *the Services* who bear the burden of proof as to Copyright Owners’ proposal regarding the appropriateness, *vel non*, of an uncapped TCC rate prong. According to Copyright Owners, this burden falls on the Services because “only the Services ... proposed TCC prongs at the hearing,” in the form of the mix of capped and uncapped TCC prongs contained in the Services’ *Phonorecords II* benchmark. *Id.* at 47. The Judges find that the fact that the *Phonorecords II*-based benchmark advanced by the Services contains this mix of capped and uncapped TCC prongs does not bear on Copyright Owners’ duty, under 5 U.S.C. § 556(d), to satisfy the burden of proof with regard to the rates and rate structure they are advancing on this remand. Moreover, the D.C. Circuit has already held that the fact that some of the Streaming Services’ proposals contemplated continued use of an uncapped total content cost prong for some categories “does not mean they anticipated that the [Judges] would uncap the total content cost prong *across the board* ... [which] is quite different.” *Johnson*, 369 F.3d at 382. The difference, according to *Johnson*, is that “[u]ncapping the total content cost prong across all categories leaves the Streaming Services exposed to potentially large hikes in the mechanical license royalties they must pay.” *Id.*

Accordingly, the Judges find that Copyright Owners indeed do bear the burden of proof with regard to the appropriateness of uncapped rate structure and rates they are proposing on remand and the Services bear the burden of proof with regard to the appropriateness of the *Phonorecords II*-based benchmark they are continuing to advance on remand.

II. Rate Structure and Rates

A. Relevant Rulings in *Johnson*

In establishing a royalty rate structure and the rates within it in the context of this remand proceeding, the Judges are guided by the rulings in *Johnson*.

1. Percent of Revenue Prong

The D.C. Circuit noted that the Judges found the royalties in the *Phonorecords II* period were too low and that record companies were receiving a disproportionate share of the sum of the mechanical and sound recording royalties. *Johnson*, 969 F.3d at 384-85. The D.C. Circuit acknowledged that “[t]he Judges ... then carefully analyzed the competing testimony and drew from it rates that were grounded in the record and supported by reasoned analysis.” *Id.* at 385. The D.C. Circuit found that the Judges acted well within their discretion and not arbitrarily, relying on substantial evidence in establishing the “zone of reasonableness” for the rates. *Id.* As the D.C. Circuit noted, the Judges’ process was “the type of *line-drawing and reasoned weighing of the evidence* [that] falls squarely within the [Judges’] wheelhouse as an expert administrative agency.” *Id.* at 385-86 (emphasis added).

2. Uncapped TCC Prong

The D.C. Circuit found fault, however, in the Judges’ determination to establish an uncapped and increased percentage-based total content cost (TCC).⁸ *Id.* at 380. This approach “removed the only structural limitation on how high the [TCC] ... can climb.” *Id.* The D.C. Circuit reasoned that uncapping the TCC alternative rate prong across all categories of service exposed the Services to potentially large hikes in the overall mechanical royalties they must pay. *Id.* at 382. The D.C. Circuit noted: “As the [Judges] acknowledge, sound recording rightsholders have considerable market power *vis-à-vis* interactive streaming service providers The interactive streaming services are ... exposed to the labels’ market power and record companies could, if they so chose, put those services out of business entirely [B]y virtue of their oligopoly power, the sound recording copyright holders have extracted ‘inflated’ royalties” *Id.* (cleaned up).

While the Services had advocated uncapping the TCC alternative rate prong for some categories of service, that “does not mean they anticipated that the [Judges] would uncap the total content cost prong *across the board*. That is quite different.” *Id.* at 382. The D.C. Circuit found that the Judges “failed to provide adequate notice of the drastically modified rate structure [they] ultimately adopted.” *Id.* at 381. The D.C. Circuit emphasized that the failure to provide adequate notice of their intentions “is no mere formality [because] [i]nterested parties’ ability to provide evidence and argument ... not only protects the parties’ interests, it also helps ensure that the [Judges’] ultimate decision is well-reasoned and grounded in substantial evidence.” *Id.* at 381-82.

To support their adoption of an uncapped TCC rate prong, the Judges “predicted that the sound recording copyright owners’ royalty rates would naturally decline in the course of their negotiations with interactive streaming services.” *Id.* at 372. The Judges found persuasive the rebuttal testimony of one of Copyright Owners’ economic expert witnesses, Professor Watt, that an increase in mechanical royalties payable by the Services would lead to a corresponding decrease in the Services’ sound recording royalty obligations. *See Determination* at 73-74 (“[S]ound recording royalty rates in the unregulated market will decline in response to an

⁸ “TCC” refers to “Total Content Cost,” and is defined as “a percentage of the royalties paid by the service ... to sound recording copyright holders.” *Johnson*, 969 F.3d at 370; *see also Determination* at 13 n.38 (“TCC” is an industry acronym for “Total Content Cost,” a shorthand reference to the extant regulatory language describing generally the amount paid by a service to a record company for the section 114 right to perform digitally a sound recording.”).

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increase in the compulsory license rate for musical works [and] Professor Watt’s bargaining model predicts that the total of musical works and sound recordings royalties would stay “almost the same” in response to an increase in the statutory royalty.”). The Services painstakingly criticized this “see-saw” theory.

The D.C. Circuit concluded that, on remand, if and when the Judges consider the “uncapped” rate structure, they shall address all substantive challenges to that approach raised by the Services, including the issue of whether “an increase in mechanical license royalties would lead to a decrease in sound recording royalties.” *Id.* at 383.

Thus, the D.C. Circuit held, the Judges erred procedurally in adopting an uncapped TCC alternative rate prong. The D. C. Circuit therefore instructed the Judges to provide the parties with the opportunity to fully address the issues regarding the uncapped TCC prong, and for the Judges to address the “substantive challenges” raised by the Services.

3. Four Itemized Statutory Objectives

The statutory standard found in section 801(b)(1) instructs the Judges to set rates that are not only “reasonable,” but also reflective of four itemized objectives, or factors, which, as the D.C. Circuit stated, set forth “competing priorities.” 17 U.S.C. § 801(b)(1)(A)-(D); *Johnson*, 969 F.3d at 387.⁹ With regard to these four priorities, the D.C. Circuit found that the Judges properly analyzed and applied the first objective (Factor A). *Id.* at 387-88. In particular, the D.C. Circuit did not disturb the Judges’ ruling that an increase in the royalty rates for mechanical licenses was necessary in order to satisfy Factor A. *Johnson*, 369 F.3d at 387-88. According to *Johnson*, in making this finding, the Judges had engaged in a “reasonable reading of the record” and had relied on “substantial evidence.” *Id.* at 388. Thus, Factor A (when considered without regard to the other three objectives) indicated that the statutory rate needed to be higher than it was during the *Phonorecords II* period.¹⁰

With regard to the other three objectives, *Johnson* stated that “[t]he question whether the [Judges] adequately addressed factors B through D ... is intertwined with the nature of the rate structure ultimately imposed by the [Judges].” *Id.* at 389. Accordingly, the D.C. Circuit concluded that it “need not ... address whether the [Judges] adequately considered these remaining factors.” *Id.*¹¹

Within the parameters of the holdings in *Johnson*, the Judges consider the record facts and the arguments made in this remand proceeding, together with the pertinent facts and arguments made in the original proceeding.

⁹ These competing objectives are: (A) To maximize the availability of creative works to the public; (B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions; (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication; and (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices. *Id.*

¹⁰ However, as the D.C. Circuit also noted, because the four § 801(b)(1) objectives reflect “competing priorities,” *id.* at 387, the holding that Factor A militates toward a higher rate is not ultimately dispositive. Rather, it must be weighed with the other statutory factors.

¹¹ The phrase “intertwined with the nature of the rate structure” requires emphasis because the Majority independently considered how to weigh Factors B and C specifically as to the 15.1% revenue rate, without regard to the overall rate structure, as discussed *infra*.

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B. Rate Evidence for the 33-Months from January 2018 through September 2020

After the Determination was issued, from its effective inception on January 1, 2018, through September 30, 2020—a 33-month period—the parties operated under the rates and rate structure set forth in that ruling. In light of the D.C. Circuit’s decision in *Johnson*, as of October 1, 2020, the parties reverted to the *Phonorecords II* rates. The Services have asserted in this remand proceeding that, during the 33-month period when the Majority’s new and higher *Phonorecords III* rates were in effect, [REDACTED]

[REDACTED] By contrast, Copyright Owners, on remand, looking at the same data over this 33-month period, aver that they prove the existence of the seesaw theory.

1. Services’ Position

According to the Services, [REDACTED]

[REDACTED] Moreover, according to the Services, [REDACTED]

[REDACTED] The Services further maintain that, [REDACTED]

The Services make the [REDACTED]

[REDACTED] And, [REDACTED]

[REDACTED] Id. ¶¶ 5, 9-13, 16-19, 22-23, 26-27.

The Services claim that [REDACTED]

[REDACTED] More particularly, [REDACTED]

[REDACTED]

The Services’ economic experts rushed to judgment upon learning of these facts, claiming that they disproved the seesaw theory. *See* Katz WDRT ¶¶ 25-27 (relying on testimonies cited *supra* and concluding that seesaw theory was disproved, based on [REDACTED]

[REDACTED]); Marx WDRT ¶¶ 48-

51 (relying on same testimonies and likewise finding because [REDACTED]

[REDACTED]; Leonard WDRT ¶ 17 ([REDACTED]

[REDACTED]).

2. Copyright Owners' Position

Copyright Owners analyzed the royalty data over the same 33-month period (January 2018 through September 2020) and reach the opposite conclusion. One of their economic expert witnesses, Dr. Jeffrey Eisenach, testified that [REDACTED]

[REDACTED] Moreover, he opined that [REDACTED]

[REDACTED] See Eisenach RWRT §2(A) & appx. C.

Based on this analysis, Professor Watt declares empirical vindication of his seesaw theory. Watt RWRT ¶¶ 41-42, 46 (“The [Judges’] bargaining theory insights about the relationship between royalty rates were correct [REDACTED]

[REDACTED]”).

3. Analysis and Decision Regarding Evidence of Post-Determination Rates

The Judges are perplexed by the willingness of the expert economic witnesses on both sides to opine that the rate changes from January 2018 through September 2020 can serve as confirmation of their clients’ respective positions. The issue to be considered empirically was whether the sound recording rate would decrease in response to the increase in the mechanical rate. That is, if the record labels had previously set royalties at a level that would allow the Services merely to survive, would the record labels agree to lower their sound recording rate if more of the Services’ surplus were acquired by Copyright Owners? To answer this question, the economists on both sides applied sophisticated bargaining models and critiques to explain the nature of the negotiations that would ensue.

In the process, the economists lost track of an obvious, elementary point: The *Phonorecords III* rates were being challenged by the Services’ appeal, and might not persist. Indeed, the rates were ultimately vacated and the parties returned in October 2020 to the *Phonorecords II* rates.¹² Now, the rates will be changed again by this post-remand Determination, and going forward may be subject to further potential change, consistent with the provisions of title 17. In light of such ongoing fundamental uncertainty, why would any economist or businessman assume that the sound recording companies would agree to adjust their rates in response to a change in the mechanical rate? The Judges are amazed that the

¹² There also was uncertainty as to the effective inception date of the *Phonorecords III* rate period, because the Services had appealed (ultimately unsuccessfully) the CRB Judges’ finding that the period commenced, retroactively, as of January 1, 2018.

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economic experts neglected even to raise this uncertainty as a complicating issue, let alone a dispositive one.¹³

Moreover, no party called as a witness any representatives of the Majors, or subpoenaed their testimony or documents, to provide the Judges with evidence of how these record companies perceived the seesaw issue, whether as a permanent phenomenon or as an uncertain matter, given the pendency of the legal proceedings regarding the ultimate mechanical rate. Any of the parties could have requested that the Judges subpoena a sound recording industry witness to give testimony and produce documents as to this issue, pursuant to 17 U.S.C. § 803(b)(6)(C)(ix), but none did so. Further, Copyright Owners, who are representing the music publishing interests of *inter alios*, Sony, Universal, Warner, and Merlin, likely could have produced such sound recording witnesses without the need for a subpoena. Witnesses from these entities who negotiated with the Services after the *Phonorecords III* rates and rate structure became effective certainly would have knowledge relevant to the testimony of the Services' witnesses [REDACTED] who claimed that [REDACTED]

Simply put, the period from period from January 2018 through September 2020 was a time the Judges construe as "33-months of uncertainty," *see* 3/8/22 Tr. 87, 91 (Closing Argument) when no party could ascertain with any assuredness the ultimate *Phonorecords III* rates and rate structure. Thus, for the economists and the parties to claim vindication for their arguments by reliance on how the record labels did or did not respond to the challenged and ever-shifting rates during this "33 months of uncertainty" reflects the elevation of adversarial zeal over objective judgment.

Accordingly, the Judges place no weight on the purported changes or stability of the sound recording rates during the *Phonorecords III* rate period.

C. Percent-of-Revenue Rate Prong

1. Copyright Owners' Position

In their initial remand submission, Copyright Owners provided no new evidence to support any aspect of the 15.1% revenue-based rate (or for that matter, any new evidence to support the rates or rate structure in the Determination), and elected to rely on the pre-remand record. In fact, in their initial remand submission, Copyright Owners do not so much as mention the 15.1% revenue rate derived by the Judges. However, in their reply remand submission (which the Judges found also to constitute, in part, a substantive *initial* submission¹⁴) Copyright Owners do address the 15.1% revenue rate. In the reply submission, Copyright Owners simply stated: "[T]he Circuit affirmed the Board's derivation of rate percentages, including raising the revenue rate to 15.1%." Copyright Owners' Reply Brief on Remand (in Reply Remand

¹³ To place this point in the economic context of this proceeding, the Judges characterize the ongoing "legal uncertainty" as another "independent variable" to add to the economic experts' list of such variables, discussed *infra*, that affect the "dependent variable," *viz.*, the sound recording rate.

¹⁴ *See* Order Denying in Part and Granting in Part Services' Motion to Strike Copyright Owners' Expert Testimony and Granting Services' Request to File Supplemental Testimony and Briefing at 11 (Oct. 1, 2021) (Oct. 1st Order) (The Judges found that "with one exception ... the challenged testimonial evidence of Copyright Owners' economic expert witnesses serve the dual purposes of direct and rebuttal statements" and, as a consequence, "provide[d] the Services an opportunity to file supplemental testimony and briefing in opposition.

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Submission of Copyright Owners, Vol. 1) at 64, n.48 (July 2, 2021) (“CO Reply”). In a subsequent submission, Copyright Owners added that “[t]he narrow mandate on this Remand does not allow for reopening the rate percentage determination in the [Determination.]” Copyright Owners’ Motion for Reconsideration or Clarification at 15 & n.10 (Dec. 17, 2021) (emphasis added) (Dec. 17th Motion).

Thereafter, Copyright Owners asserted that the D.C. Circuit’s affirmance of the [Judges’] revenue percentage rate calculation was “strong[]” and “detailed.” Copyright Owners’ Reply in Further Support of Motion for Reconsideration or Clarification at 4 (January 5, 2022). Moreover, Copyright Owners took note that the Services had relied on substantively identical language in *Johnson* to support their argument that other statements in that D.C. Circuit decision should be deemed affirmed. *See id.* at 4-5 (noting Services’ reliance on *Johnson*’s description of the Judges’ rulings regarding student and family discounts (“grounded in substantial record evidence ... based on the weight and credibility of the evidence [and] squarely within the Judges’ expertise”) as demonstrating that the D.C. Circuit had affirmed those rulings) (emphasis added); *see also* Copyright Owners’ Brief in Response to the Additional Materials Orders at 2, 6-7 (Jan. 24, 2022) (“CO Additional Submission”) (again asserting that “the 15.1% revenue rate ... was specifically affirmed in detail by *Johnson*.”).

2. Services’ Position

In their initial submission after the remand, the Services objected to any continued application by the Judges of the 15.1% revenue rate because, “as the Majority acknowledged, this particular division of revenues will never happen in the real world because of the complementary oligopoly power of the record labels.” Services’ Joint Opening Brief (in Services’ Joint Written Direct Remand Submission at Tab D) at 52 (“Services’ Initial Submission”) (Apr. 1, 2021). More particularly in this regard, the Services note that Professor Marx’s Shapley Value Model,¹⁵ which served as an input for the generation of the 15.1% revenue rate, also indicated that only █% of the interactive streaming revenue should be paid out as royalties to the sound recording rightsholders, with the remaining █% of these revenues retained by the interactive streaming services. *Id.* (“Both Professor Marx’s and Professor Watt’s models show lower combined royalties being paid by the services than are currently paid in the marketplace The discrepancy in total royalties between the models and the real world is explained, in part, by the absence of supranormal complementary oligopoly profits in the Shapley model, and the presence of those profits in the actual market.”). *Id.* (quoting *Phonorecords III*, 84 Fed. Reg. at 1952).

By this approach, the Services maintain, “the Majority awarded the Copyright Owners the full 15.1% of revenue dictated by its model (phased in over time), and left it up to the Services to convince the complementary oligopolist major labels to dramatically lower sound recording rates.” *Id.* at 54-55. The Services argue that, instead, the Majority should have applied to Professor Marx’s █% total royalty obligation what they characterize as “any of the[]

¹⁵ Generally, a Shapley Value Model is a game theory analysis. It models a hypothetical bargain that assigns each “player” the average marginal value it contributes to the bargain and (after accounting for the costs that each “player” would need to recover) the remaining “surplus” is allocated among the players according to their relative contributions. *See Johnson*, 969 F.3d at 372. For the reasons discussed *infra*, in the present case, the Shapley surplus from the streaming revenue is split essentially equally by the owners of the sound recording and musical works owners *inter se*, but the royalty rates themselves that would result from their bargaining would be different as between these two inputs, because of their differing costs. *See, e.g., Gans WDT ¶ 73.*

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real-world ratios in place of the [REDACTED] ratio taken from “Professor Gans’ “Shapley-inspired” model. *Id.* at 54. According to the Services, these lower ratios would have reduced the revenue percentage rate well below 15.1%. *Id.*

Alternatively, the Services propose, through Professor Marx’s post-remand written testimony, that the Judges now adopt “a more balanced, burden-sharing approach” to address what she described as the Majority’s “imbalance” problem. *Id.* at 57; *see also* Marx WDRT ¶¶ 52-63.¹⁶ Essentially, her proposal begins with an assumption, based on record evidence, that labels typically take specific shares of service revenue, including shares of [REDACTED]%, [REDACTED]% and [REDACTED]%.¹⁷ These shares are significantly higher than the [REDACTED]% that Professor Marx generated from her Shapley model. Next, Professor Marx’s post-remand burden-sharing approach uses as inputs the 15.1% of service revenue and the [REDACTED]% of service revenue that would be retained by the musical works owners and the Services respectively.¹⁸ Putting these two factors together, she sets forth the basic math: Using her [REDACTED]% sound recording share as an example, she notes that there is not enough revenue for the labels to take this [REDACTED]% share, if the musical works owners also receive 15.1% and the Services also retain the [REDACTED]% derived from her model ($[REDACTED]\% + 15.1\% + [REDACTED]\% = [REDACTED]\%$, an irrational result). *See* Services’ Joint Opening Brief at 57.

Professor Marx engages in an analysis based on the following math and logic (again, using the [REDACTED]% sound recording rate as an example of the fixed amount taken by the labels): (1) [REDACTED]% of the streaming revenues remain available to be split between the services and the musical works copyright owners; (2) adding the 15.1% revenue rate and her [REDACTED]% revenue retention percentage equals [REDACTED]%; and (3) the 15.1% revenue rate, as a percent of this [REDACTED]%, is [REDACTED]%; and (4) [REDACTED]% of the [REDACTED]% available for splitting between the services and the musical works copyright owners is [REDACTED]% (rounded). *Id.* at fig.8.

Thus, she identifies her version of a “fair” result: The Services and Copyright Owners would split the residual revenue remaining after the labels have exercised their complementary oligopoly power to take an outsized fixed share—with the split proportional to the 15.1%-to-[REDACTED]% revenue amounts calculated respectively by the Judges (the 15.1% musical works rate) and Professor Marx (the [REDACTED]% service revenue retention). *Id.* 59, table. 8.¹⁹

In their final post-remand submission, the Services also flatly state: “[T]he D.C. Circuit did not “affirm” the 15.1% rate—it vacated that rate.” Services’ Joint Rebuttal Brief Addressing the Judges’ Working Proposal at 2 (Feb. 24, 2022) (“Services’ Additional Submission”). However, the Services do not support that quoted statement with any citation to *Johnson*. *See id.*

¹⁶ Claiming consistency with the Majority’s analysis, Professor Marx appears to maintain that her “burden-sharing” approach generates the statutorily-required “reasonable” rate as well as a rate that satisfies the “fair return”/“fair income” objectives of statutory Factor B. *See* Marx WDRT ¶ 52 (introducing her correction of the alleged “imbalance” problem by noting that “the “right” mechanical royalty rate is one that is “reasonable” and achieves the four objectives laid out in Section 801(b)(1).”

¹⁷ *See* Marx WDRT, fig. 7 ([REDACTED]).

¹⁸ The [REDACTED]% of revenue that the services would retain is based on one of Professor Marx’s “Shapley Value Models.” Shapley Value modeling is discussed *infra*.

¹⁹ Using the same logic and calculation method, Professor Marx finds that the services would retain $[REDACTED]\% \div [REDACTED]\%$, which equals [REDACTED]%. Assuming again that [REDACTED]% of the streaming revenue is available to split (because the labels have appropriated [REDACTED]%), the services would retain [REDACTED]% ([REDACTED]% rounded) of the streaming revenue. *Id.*

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Further, the Services assert that the 15.1% revenue rate is not immune from post-remand review and reduction because “the D.C. Circuit withheld judgment “on whether that final percentage satisfies factors B through D of Section 801(b)(1)” *Id.* at 3.

3. Analysis and Decision Regarding 15.1% Revenue Rate Prong

The Judges determine that they are clearly bound by the D.C. Circuit’s decision in *Johnson* to maintain the 15.1% revenue rate, as phased-in by the Determination. Several reasons support this decision.

First, the Judges conclude that the D.C. Circuit’s decision in *Johnson* is conclusive and unambiguous regarding the revenue percentage rate. The D.C. Circuit rejected the Services’ assertion that the Judges acted “arbitrarily” as to this particular issue, noting that the Services had misstated the relevant facts. *Johnson*, 969 F.3d at 385-86 (responding to Services’ misdescription of Judges’ analysis and explaining what Services described as “not what happened.”). Moreover, the D.C. Circuit held that with regard to the construction of the 15.1% revenue rate, the Judges had “engaged in the type of line-drawing and reasoned weighing of the evidence [which] falls squarely within the [Judges’] wheelhouse as an expert administrative agency.” *Id.* at 386. The D.C. Circuit further noted that the Judges “proceed[ed] cautiously” to set the 15.1% revenue rate by establishing a “zone of reasonableness” for the revenue rate. *Id.* at 385. Indeed, with regard to each aspect of this revenue rate analysis, the D.C. Circuit found that the Judges’ decision making was “grounded in the record and supported by reasoned analysis” and that “[s]ubstantial evidence supports [their] judgment.” *Id.* at 385.

Second, when the D.C. Circuit reviewed the Determination, it applied “the same standards set forth in the Administrative Procedure Act, 5 U.S.C. § 706.” *Id.* at 375 (noting that 17 U.S.C. § 803(d)(3) cross-references 5 U.S.C. § 706); *see also id.* (“[W]e will set aside the [] Determination ‘only if it is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law, or if the facts relied upon by the agency have no basis in the record.’”).

Here, the D.C. Circuit explicitly found that the Judges’ analysis and findings in connection with the 15.1% revenue rate are *not* arbitrary and capricious, and that the facts relied upon by the Judges have a sufficient basis in (are “grounded in”) the record. It seems beyond dispute that the D.C. Circuit affirmed the Judges in their setting of the 15.1% revenue rate as a rate that is reasonable, and thus satisfies that aspect of the section 801(b)(1) standard.²⁰ Indeed, it would border on the Orwellian to misconstrue the D.C. Circuit’s unequivocal and obvious affirmance of the reasonableness of the 15.1% revenue rate as a vacating of that finding.

Third, the Judges note that *Johnson* conspicuously declines to identify the Judges’ setting of the 15.1% percent-of-revenue rate as one of the findings to be revisited on remand. Rather, *Johnson* states that the three overarching issues for resolution on remanded are the Majority’s failure: (1) “to provide adequate notice of the rate structure it adopted,” (2) “to explain its rejection of a past settlement agreement as a benchmark for rates going forward; and (3) “[to] identif[y] the source of its asserted authority to substantively redefine a material term after publishing its Initial Determination.” *Johnson*, 369 F.3d at 367. The Majority’s finding that the

²⁰ The CRB Judges intentionally distinguish between the “reasonable” rate standard in the initial body of section 801(b)(1) and the objectives set forth as Factors A–D of section 801(b)(1). A rate can satisfy the statutory “reasonable rate” requirement yet require adjustment (higher or lower) to reflect the balancing of the four additional factors. Accordingly, the Judges defer to a subsequent section, *infra*, a discussion of how Factors A-D should be addressed on this remand.

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15.1% royalty rate is “reasonable” was not identified by the D.C. Circuit as a finding that was vacated and subject to further review and, indeed, as noted *supra*, the appellate panel credited what it characterized as the Majority’s careful analysis and line-drawing in arriving at that finding.

The clarity of the D.C. Circuit’s affirmance of the royalty rate of 15.1% for the percent-of-revenue prong moots the issue of whether Professor Marx’s attempt, described *supra*, to correct the so-called “imbalance” problem has merit. However, the Judges note that, even if this issue had not been conclusively decided in *Johnson*, they would reject her approach as futile. That is, Professor Marx fails to acknowledge that any surplus that her approach would appear to provide to the Services would be siphoned off by the Majors, given their complementary oligopoly power.

More particularly, the sound recording royalty rates she posits (■%, ■% and ■%) are all functions of the sound recording companies’ understanding of the Services’ non-content costs (costs that the Services must recover out of retained revenues in order to remain in operation, *i.e.*, to “survive”) and the then-existing musical works content (royalty) costs (comprised of the mechanical rate and the performance rate). If, as Professor Marx contemplates, the mechanical rate is reduced so that Copyright Owners “share the burden” of the complementary oligopoly effect on sound recording rates, that “burden sharing” would increase the revenues retained by the Services (that is the purpose of Professor Marx’s approach!). But such an increase would raise the Services’ revenue above their “survival” rate, as understood by the record labels. Thus, the record labels, given their complementary oligopoly power, would increase the Services’ royalty rate above what it otherwise would have been.

Alternately stated, when Professor Marx hypothesizes a given sound recording royalty rate in column 1 of Figure 8 in her WDRT, that rate is assumed, by the logic of the complementary oligopoly theory, to have already allowed the services to cover only their non-content costs and musical works royalties, as understood by the record labels. So, her assumed rate in column 1 is not a fixed parameter, but rather an independent variable, which is a function of, *inter alia*, the costs incurred by the services, *i.e.*, their non-content costs plus their musical works royalty costs.²¹ If those service costs decreased (for example, in an attempt to reduce the services’ burden of bearing the full brunt of the labels’ complementary oligopoly power as in Professor Marx’s attempt to correct the imbalance problem), the percentage in column 1 of Figure 8 would increase, as the labels siphoned off that surplus over the services’ survival revenue requirements. To find otherwise would be to refute the logic of the dynamics of the complementary oligopoly effect.²²

Moreover, the defect in Professor Marx’s attempt to remedy the so-called “imbalance” problem is a consequence of the statutory licensing and royalty scheme. To recap, the licensing of content used by the interactive services is bifurcated. The sound recording royalties paid by

²¹ The interactive services also pay a separate royalty for the performance license necessary to transmit a song. However, under the Judges’ “All-In” royalty structure, that performance royalty is deducted from the “All-In” calculation to determine the mechanical royalty. Also, the performance royalty paid to the largest Performing Rights Organization (PROs) are subject to determination by federal judges in the Southern District of New York (the so-called “rate court”).

²² To be clear, the Judges are not stating that the Services’ retention of only enough revenue to allow them to cover their noncontent costs and thus merely “survive” is indicia of an effectively competitive (or even healthy) market – but are merely acknowledging the state of affairs given the unregulated nature of the sound recording royalties and the complementary oligopoly power that exists in that market.

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the interactive services to the record labels are not regulated, and complementary oligopoly power exists in that market, inflating sound recording royalty rates above an effectively competitive level. *See* Determination at 73 (“[T]he existence of complementary oligopoly conditions in the market for sound recordings” is the basis for “the record companies’ ability to obtain most of the available surplus” generated by interactive streaming.)²³ However (and to state the obvious), the mechanical rate paid by the interactive services for musical works is regulated, pursuant to 17 U.S.C. § 115 and, until the 2018 enactment of the Music Modernization Act,²⁴ according to the rate standards in 17 U.S.C. § 801(b)(1). Thus, there is no statutory or regulatory impediment to prevent record labels from responding to a decrease in the mechanical rate by increasing the unregulated sound recording rate if such an increase is in their economic interest.²⁵

Accordingly, any attempt by the Judges to reduce the mechanical royalty rate in order to allow the Services to retain more of the surplus would fail; it would be like pouring water into a bucket with a siphon at its base. More water would not remain in the bucket, but rather would accumulate wherever the siphon leads—in this case, to the record labels. The Judges could keep mechanical royalty rates depressed and allow this to occur, but that would harm Copyright Owners while providing no relief to the Services. And despite the old adage that “misery loves company,” the Judges detect no directive under section 801(b)(1) that they harm Copyright Owners without providing a gain for the interactive streaming services—and that they provide a windfall for the record labels, to boot.

Although Professor Marx’s attempt to reduce the Services’ “misery” by sharing it with Copyright Owners is unavailing, the statutory scheme and market forces do appear to combine to mitigate the burden created by the complementary oligopoly power of the sound recording companies. If interactive streaming revenue were to grow over the rate period,²⁶ then the phase-in to the 15.1% rate will reflect fixed annual percentages of a larger base, allowing services to retain a higher dollar level of the interactive streaming revenues.²⁷ [REDACTED]

²³ As the Judges have consistently noted, this complementary oligopoly power is generated by the concentration of ownership of sound recording licenses for “Must Have” repertoires among the three Majors (Sony Music Group, Warner Music Group and Universal Music Group), plus Merlin (a consortium of Indies sometimes referred to as “the fourth Major”), as indicated by their reported collective 85% share of Spotify’s streams in 2018, the first year of the rate period at issue here. *See* <https://www.midiaresearch.com/blog/smaller-independents-and-artists-direct-grew-fastest-in-2020>

²⁴ In subsequent rate periods, the rate remains regulated, but is subject to a different standard – the “willing buyer-willing seller marketplace standard,” for shorthand) under 17 U.S.C. § 115.

²⁵ The inverse relationship between changes in the mechanical royalty rate and changes in the sound recording royalty rate has been characterized as the “seesaw” effect, which is discussed in further detail *infra*, with regard to the uncapped TCC rate prong.

²⁶ Because this proceeding was appealed and remanded, the Judges have the benefit of knowing the “future” (beyond 2017), during which U.S. interactive streaming revenues have continued to grow, a fact that is undisputed, and as to which the Judges take administrative notice. *See, e.g.*, RIAA 2018 Year-End Music Industry Revenue Report (available at <https://www.riaa.com/wp-content/uploads/2019/02/RIAA-2018-Year-End-Music-Industry-Revenue-Report.pdf>); RIAA 2020 Year-End Music Industry Revenue Report (available at <https://www.riaa.com/wp-content/uploads/2021/02/2020-Year-End-Music-Industry-Revenue-Report.pdf>) (interactive streaming revenue increased within this rate period from (approximately) \$1.6 billion in 2018 to \$7.7 billion in 2019 and \$8.8 billion in 2020).

²⁷ For example, if a royalty is set at a flat rate of 15.1% when a revenue base is \$1,000, then the royalty is \$151, leaving \$849 in revenues to cover other costs which, for this example, are held constant. If the revenue base doubles to \$2,000, the same flat 15.1% royalty rate generates \$302 in royalties, leaving \$1,698 in revenues to cover other costs which, if constant, allow for the additional revenue (\$1,698 - \$849 = \$849) to generate profits.

See, e.g., Diab WDRT ¶¶ 10-11 (Google agreements); Mirchandani WDRT ¶¶ 16-17 (Amazon agreements); Bonavia WDRT ¶¶ 8; 14-19 (Spotify agreements); White WDRT ¶¶ 6; 8-14; 19; 24; 27-28 (Pandora agreements). Additionally, the Services' headline sound recording rates [REDACTED]. *Services' Joint Remand Reply Brief* at 40 (and record citations therein). Thus, assuming no increase in non-content costs (or increases smaller than the increases in streaming revenue), the Services will realize increased revenue above and beyond what they needed to survive.

The Services and Copyright Owners recognize the mitigation of harm to the Services generated by these facts (although they may well disagree with the Judges' application of these facts). During colloquy with counsel for Pandora and Spotify during closing arguments on remand, the Judges asked why they should in essence apply the "misery loves company" adage:

[JUDGE STRICKLER] [T]he problem is ... the sound recording [rates] are unregulated in the interactive market Congress did not want that to be controlled at all. So every time I see ... the services' argument about how we have [to] set a rate that's fair even though there's this ability of the sound recording [companies] to take more, my margin note is always this: "Are they arguing that 'misery loves company?'" [W]hy shouldn't that misery be shared with Copyright Owners? ... Isn't that really Professor Marx's argument in her proposed split ... using the 15.1 percent figure ...?

[COUNSEL] [Regarding] Judge Strickler['s] ... "misery loves company" issue. ... I think ... the way [Judge Strickler] put it during the trial was, even if I thought rates needed to come down, how would that help you; wouldn't the labels just take all that surplus for themselves based on their complementary oligopoly power? I want[] to address it right off the bat in open session.

Relat[ed] to ... the seesaw ... our point is that *these label rates are sticky* in both directions. If you see an increase in musical works rates, *you do not see a quick decrease in label rates, and the opposite is true. These rates are sticky.*

...
There's a lot of friction with respect to the ability of label rates to change quickly in response to the dynamic marketplace or the dynamic for business reasons or because of regulatory changes in musical works rate. *These are multi-year contracts. They take a long time to negotiate. They are complex, et cetera.*

So, I do think it's right that at a minimum you can buy time where the ratio is more aligned with the 801(b) factors. In other words, you don't have to worry that the labels will take it all right away, even if you believe they will ultimately take that.

[JUDGE STRICKLER] *So you are saying we have something that reduces misery for a period of time until the misery returns?*

[COUNSEL] *That's right. And I think that would have been true in 2018 when you were sitting drafting the decision. It's even more true today in 2022 when the label rates, as I mentioned, are effectively set, bought and paid for.*

3/8/22 Tr. 29-30, 43-46 (Closing Argument) (emphasis added).

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Similarly, on this topic, Copyright Owners' counsel accurately characterized the Judges' adoption of the static 15.1% Shapley-based rate as the inevitable consequence of "regulatory lag," that requires a regulator to keep a rate constant over the statutory term because there is no sufficient data to project future rates. *Id.* at 273-75; *see generally* A. Kahn, 2 *The Economics of Regulation* at 48 (1971) "The regulatory lag [is] the inevitable delay that regulation imposes in the downward ... [and] upward adjustments" to rate levels, and "thus is to be regarded not as a deplorable imperfection of regulation but as a positive advantage [because] companies can for a time keep the higher profits they reap from a superior performance....".²⁸

4. Consideration of Factors A-D in Section 801(b)(1)

Finally, the Judges consider the impact of Factors A-D of section 801(b)(1) in connection with the setting of the revenue percentage rate of 15.1%.²⁹ Regarding Factor A, it cannot be gainsaid that the D.C. Circuit has left this issue unresolved. Rather, *Johnson* unambiguously affirmed the Majority's finding that an increase in the mechanical royalty rate was warranted. Specifically, *Johnson* states that the Majority's decision in this regard met the "test" that it be "supported by substantial evidence [and] reflect a reasonable reading of the record." *Johnson, supra*, at 388. Moreover, with regard to the level of the increase, the D.C. Circuit did not disturb the finding by the Majority that "[t]he rates determined by the Judges represent a 44% increase over the current headline rate, and thus satisfies the Factor A objective" Determination at 85.³⁰

With regard to Factors B and C,³¹ even if *Johnson* were construed as permitting the Judges to revisit this issue, they would not adjust the 15.1% revenue rate on the basis of these

²⁸ The Judges emphasize two points that mitigate any negative impact on Copyright Owners from the static nature of the 15.1% revenue rate. First, as a percent-of-revenue rate, it generates more royalty revenue in a growing market, so the quantum of revenue is not static. Second, Copyright Owners' own economic expert witness, Professor Gans, testified that the data in the "market observations" from the Goldman Sachs Report on which he relied were the result of "negotiated rates in the free market and thus "presumed to ... fully consider[] ... expectations of future costs and revenues incorporate[ing] expectations of future values." Gans WRT ¶¶ 37-38. On this issue, it is noteworthy that both the Majority and the D.C. Circuit credited Professor Gans's reliance on these projections. *See* Determination at 70 ("The Judges ... find Professor Gans' reliance on financial analysts' projections for the respective industries to be reasonable."); *Johnson*, 969 F.3d at 386 (holding that "[t]he CRB Judges' finding that Gans's ... reliance on Goldman Sachs' profit projections" was "reasonable" and the) ... type of line-drawing and reasoned weighing of the evidence [that] falls squarely within the [Copyright Royalty Board's] wheelhouse as an expert administrative agency.")

Thus, dynamic changes going forward in the rate term are embodied in the 15.1% revenue rate, and dynamic market expectations are incorporated in the modeling data used to establish that rate.

²⁹ The D.C. Circuit ruled, with regard to the "*nature of the rate structure*," that because it had "vacat[ed] and remand[ed] ... for lack of notice" "[t]he question whether the [Judges] adequately addressed factors B through D is bound up with the [Judges'] analysis of sound recording rightsholders' likely responses to the new rate structure." *Johnson, supra*, at 389. However, the 15.1% revenue rate, viewed separately, is not bound up in the "rate structure" issue, which relates to the uncapped TCC prong and how the 15.1% revenue rate may be "intertwined" with that second rate prong. As explained *infra*, the Judges are not adopting an uncapped TCC rate prong, so the 15.1% rate is no longer "bound up" with the vacated and remanded "rate structure" issue, making moot the argument that a new post-remand analysis of Factors B through D is necessary or appropriate. However, on remand, Copyright Owners have placed in issue the "disruption" element of Factor D, claiming that the Services have not proven that the uncapped TCC rates and rate prong have or will cause disruption.

³⁰ The 44% figure cited by the Majority reflects the percentage increase of the headline rate, from 10.5% to 15.1%.

³¹ Factors B and C are typically considered jointly, because of the overlap in the objectives of providing a "fair return" and a "fair income" to the licensors and licensees respectively (the Factor B objectives) and reflecting their relative roles in making the streamed music available to the public (the Factor C objectives). *See Johnson*, 969 at 388 (noting without criticism the joint consideration of Factors B and C; Determination at 85-86 (noting without criticism the several experts' joint consideration of Factors B and C).

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two factors. In this regard, the Judges note that the Majority found that the 15.1% revenue rate was not only “reasonable,” but also a “*fair* allocation of revenue between copyright owners and services.” Determination at 87 (emphasis added). The Majority thus found explicitly that “with regard to Factors B and C ... there is no basis to depart from [its] determination of the reasonable ... rate structure and rates as set forth *supra*.” *Id.* More particularly, the Majority calculated the 15.1% rate by utilizing the total royalty percentage revenue of only █% as calculated by Spotify’s economic expert witness, Professor Marx, whose economic modeling intentionally reflected a conception of fairness by reducing the effect of the labels’ complementary oligopoly market power. *See* Determination at 67-68 (noting that Professor Marx testified that this aspect of her model “represents a *fair outcome* in the absence of market power [and] ... eliminates ... market power” which ... if left in the economic analysis would “render[] ... the analysis incompatible with the objectives of *Factors B and C* of section 801(b)(1).”) (emphasis added).³²

Accordingly, the Judges find it would be substantively unwarranted to engage in any new consideration on remand of the impact, if any, of Factors B and C on the otherwise reasonable 15.1% revenue rate.³³

The final itemized statutory factor – Factor (D) – instructs the Judges to consider the “competing priority” of “minimiz[ing] any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.” 17 U.S.C. § 801(b)(1)(D). As with Factors B and C, even if Johnson were construed to allow the Judges to revisit this issue on remand with respect to the 15.1% revenue rate, the Judges would not change the Majority analysis or findings. In the Determination, the Judges adopted the following interpretation of this standard set forth in previous determinations:

[T]he Judges reiterated their understanding of Factor D, concluding that a rate would need adjustment under Factor D if that rate directly produces an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for either [party] to adequately adapt to the changed circumstance produced by the rate change and, as a consequence, such adverse impacts threaten the viability of the music delivery service currently offered to consumers under this license.

Determination at 86 (emphasis added).

Also, in order to minimize any economic disturbance to the Services’ businesses, the Majority decided to phase-in the 15.1% rate over the five- year rate term, setting annual percent-

³² Additional facts support the Majority’s finding that the 15.1% revenue rate is fair. The record evidence indicates that the headline percent-of-revenue sound recording rate was between approximately █% to █% in 2017. *See* Marx WDRT ¶ 58, fig 7. When the 15.1% mechanical rate is added to that rate range, the range of the total royalty obligation (based on headline rates) is █% to █%. (Plus, given the phase-in of the rates expressly to avoid disruption, the total royalty obligation would be even lower before 2022, at current sound recording rates.) The evidence pre-remand indicated that the Services were “surviving” while incurring noncontent costs of approximately █% of revenue, leaving about █% of revenue available to pay royalties while still remaining in business. *See* Eisenach WRT ¶ 79 (Copyright Owners’ expert economic witness); McCarthy WDT ¶¶ 28-29 (Spotify’s Chief Financial Officer). Thus, even if the Judges were to engage in a *de novo* analysis of the potential applicability of Factors B and C to the 15.1% rate, they would not find any basis sufficient to warrant a downward rate adjustment, beyond the phase-in adopted in the Determination.

³³ However, the Judges take note of their further observation, discussed *supra*, that the combined impact of “sticky” sound recording royalty rates and the inevitable regulatory lag provide an additional modicum of fairness with regard to the mechanical royalty rate.

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of-revenue rates as follows: 11.4% in 2018; 12.3% in 2019; 13.3% in 2020; and 14.2% in 2021, before the full 15.1% rate became effective in 2022 the final year of the rate term. *Id.* at 87-88.

On remand, the Services have not made any argument that the rate structure or rates set by the Majority were “disruptive under this standard.”³⁴ In sum, there is insufficient basis for the Judges to change the Majority’s application of Factor (D) to the 15.1% revenue rate finding by the Majority.³⁵

5. Conclusion Regarding the 15.1% Revenue Rate

For the forging reasons, the Judges do not disturb the Majority’s finding that the percent-of-revenue rate at 15.1%, phased-in annually over the rate period, constitutes a “reasonable” rate under section 801(b)(1) to be used as the statutory rate for the 2018 to 2022 period.³⁶

D. Uncapped TCC Rate Prong

1. Two Post-Remand Rationales for Uncapped TCC Rate Prong

The Determination set forth the following two primary reasons for adopting a “greater-of” rate structure that also included an uncapped TCC rate prong:

First, the use of an uncapped TCC metric is the most direct means of implementing a key finding ... by the experts for participants on both sides in this proceeding: the ratio of sound recording royalties to musical works royalties should be lower

³⁴ The Judges further discuss the Factor D “disruption issue *infra* in connection with their analysis of the uncapped TCC prong.

³⁵ Additional facts further support the Majority’s finding that the 15.1% revenue rate is would not be disruptive under Factor D. The record evidence indicates that the headline percent-of-revenue sound recording rate was between approximately █% to █% in 2017. *See* Marx WDRT ¶¶ 14, 19. When the 15.1% mechanical rate is added to that rate range, the range of the total royalty obligation (based on headline rates) is █% to █%. (Plus, given the phase-in of the rates expressly to avoid disruption, the total royalty obligation would be even lower before 2022, at current sound recording rates.) The evidence pre-remand indicated that the Services were “surviving” while incurring noncontent costs of approximately █% of revenue, leaving about █% of revenue available to pay royalties while still remaining in business. *See* Eisenach WRT ¶ 79 (Copyright Owners’ expert economic witness); McCarthy WDT ¶¶ 28-29 (Spotify’s Chief Financial Officer). Thus, even if the Judges were to engage on remand in a *de novo* analysis of the potential applicability of Factor D to the 15.1% rate, they would not find any disruption sufficient to warrant a downward rate adjustment, beyond the phase-in adopted in the Determination.

³⁶ The Services’ assert that the Judges previously found that the reasonableness of the 15.1% rate was subject to revision on remand. In support of this position, the Services cite to the Judges’ Order Granting in Part and Denying in Part Copyright Owners’ Motion for Reconsideration or, in the Alternative, Clarification at 3, 4 n.7 (January 6, 2022) (Jan. 6th Order). But the Judges said in that interlocutory proposal merely that Copyright Owners were incorrect in their extreme assertion that the Judges could not make an “alternative rate and rate structure finding ... except for the re-adoption of the vacated rate and rate structure approach in the *Phonorecords III Determination* [because] ... [t]hat ... would ... be inconsistent with *Johnson* [and] ... would render the D.C. Circuit’s vacating and remanding of the proceeding without force or effect.” *Id.* at 4, n.7. That did not mean that certain elements of the D.C. Circuit’s ruling could be ignored. Further, when the Judges provided the parties with the Judges’ *explicitly tentative* “Working Proposal,” they did not declare that the 15.1% revenue rate calculation could be revisited. Rather, the Judges “express[ed] a *concern*, not that the foregoing calculations could be *overridden*, but rather that this analysis ... is ‘incomplete’” Jan. 6th Order at 6 (emphasis added). The parties’ submissions in response to the Judges’ “Working Proposal” demonstrated that the 15.1% revenue rate calculation was not “incomplete” in the manner that had raised the Judges’ concern. Nothing the Judges said in this interlocutory and tentative “Working Proposal” constituted a definitive statement regarding the Judges’ view of what was and was not subject to review on remand. *See generally merriam-webster.com (defining the adjective “working” in this context as “assumed or adopted to permit or facilitate further work or activity ... a working draft.”)*. Indeed, a primary purpose of the “Working Proposal” was to allow the Judges and the parties to address potential issues and resolutions, without prejudice going forward.

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than it is under the current rate structure. Incorporating an uncapped TCC metric into the rate structure permits the Judges to influence that ratio directly.

Second, an uncapped TCC rate prong effectively imports into the rate structure the protections that record companies have negotiated with services to avoid the diminution of revenue.

Determination at 35-36.³⁷

2. Copyright Owners' Position

Copyright Owners claim that the uncapped TCC prong should be adopted. They contend that the D.C. Circuit remand was merely “procedural” rather than substantive, and the Judges thus are not precluded from readopting the uncapped TCC prong in this remand proceeding. CO Initial Submission at 35-38 (and record citations therein).

They further contend that the uncapped TCC prong was adopted to provide protection against revenue deferment and displacement occasioned by the Services choosing to elevate the growth of subscribers and other listeners over revenue maximization. *Id.* at 38-43 (and record citations therein). The uncapped TCC prong was first proposed by Google to persuade the Judges to reject Copyright Owners’ proposed “greater-of” rate structure containing a per-play prong and a per subscriber prong. *Id.* at 43-46 (and record citations therein).

Copyright Owners argue that the uncapped TCC prong should be adopted because: (1) the Services have not shown any actual or threatened “disruption” or other harm resulting from the uncapped TCC prong during the 33-month period; (2) the Services actually experienced “unprecedented growth and profit” during this period; and (3) the Services paid lower percentages of revenues in mechanical and total royalties when the uncapped TCC prong was in effect. Copyright Owners’ Reply Brief on Remand at 34-48 (and record citations therein).

Relatedly, according to Copyright Owners the Services’ argument that the “see-saw” effect is unsupported by empirical evidence has collapsed, given the evidence relating to market performance. Further Copyright Owners maintain that this argument is irrelevant to the rate structure issue. *Id.* at 48-50 (and record citations therein).

3. Services' Position

The Services argue on remand that the uncapped TCC rate prong must be rejected. The Services reject the “seesaw” theory claiming it is disproved by the experience of the parties during the 33-month period. Services’ Joint Opening Brief at 48-49; Services’ Joint Supplemental Brief at 7-13 (Nov. 15, 2021) (and record citations therein). The Services further contend that Copyright Owners have disavowed the “seesaw” theory as understood by the

³⁷ The Majority added two other reasons that are not germane to this remand. In particular, the Majority stated that, compared to the *Phonorecords II* benchmark proposed by the Services, the “greater-of” structure with the uncapped TCC rate prong was “simpler” to understand than the “Rube Goldberg-esque” nature of the *Phonorecords II* rate structure. *Id.* at 36. This issue apparently was not raised on appeal, as it was not mentioned in *Johnson*, and Copyright Owners have not raised the issue on remand. See CO Initial Submission, *supra*. (However, the Judges do consider this issue in their analysis of the PR II-based benchmark, *infra*.) The final reason provided by the Majority was that its adoption of an uncapped TCC rate prong was supported by evidence of Google’s agreements with labels that included an uncapped rate structure, on which Google had relied to propose, post-hearing, the same greater-of rate structure. *Id.* However, the D.C. Circuit found that Google’s proposal was distinguishable, as it was based on a far lower TCC rate (15%) as well as a far lower percent-of-revenue rate (10.5%). The D.C. Circuit thus declined to rely on the Google-based approach as support for the uncapped TCC rate prong. *Johnson*, 969 F.3d at 383.

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Majority. The Services allege that Copyright Owners now claim that the theory was nothing more than “a nod” to certain “core principles” of bargaining theory, rather than a specific prediction of a commensurate inverse relationship between increases in the mechanical royalty rate and decreases in the sound recording royalty rate. Services’ Joint Supplemental Brief at 2, 5-7 (and record citations therein).

With regard to the uncapped TCC rate prong, the Services assert that Copyright Owners have not even attempted to demonstrate—nor could they demonstrate—that the uncapped TCC rate prong is consistent with all four statutory objectives set forth in section 801(b)(1). Services’ Joint Reply Brief at 1, 3-4, 33-34 36 (July 2, 2021) (“Services’ Reply”); *see also* Services’ Joint Opening Brief at 44-64 (and record citations therein). The Services claim that “yoking” the mechanical rate to the “complementary oligopoly rates extracted by the labels is plainly unreasonable.” Services’ Joint Opening Brief at 44-46. The Services argue that the existence, *vel non*, of any “disruptive impact” arising from the uncapped TCC rate prong, is misguided and not dispositive, because it is only one of the four separately itemized factors and, as this factor relates to Copyright Owners’ proposed uncapped TCC prong, they bear the burden of proof. Services’ Reply at 35-37.

Finally, the Services contend that Copyright Owners have failed to explain their self-contradictory pre-remand argument that “an uncapped TCC prong ‘does nothing to protect Copyright Owners from the Services’ revenue displacement and deferment.’” Services’ Reply at 43.

4. Application of *Johnson* Findings Regarding Uncapped TCC Rate Prong

The Judges conclude that the D.C. Circuit affirmed the Majority’s *derivation and calculation* of the 26.1% TCC rate, but vacated and remanded the Judges’ *application and inclusion* of that rate prong in the rate structure. The D.C. Circuit noted that, on appeal, the Services contended that “it was arbitrary and capricious for the [Judges] to rely on information drawn from different expert analyses in calculating the mechanical royalty rates.” *Johnson*, 969 F.3d at 384. Thus, the Services were making the same “information”-based argument in opposition to the calculation of both aspects of the mechanical royalty rates – the revenue percentage prong and the TCC prong. *See also id.* (“the Streaming Services separately leveled objections to the particular percentages adopted by the Copyright Royalty Board to calculate the revenue *and total content cost prongs*.”) (emphasis added)

In fact, both rate prongs were indeed derived from the same analyses. *See* Determination at 75 (table) (showing that both 15.1% revenue rate and 26.2% TCC rate derived from same data—Professor Marx’s model showing total royalties as high as █% [Majority’s lower bound] and Professor Gans’s “Shapley-inspired” model showing TCC percent should be █%).³⁸

It is also clear from *Johnson* that the D.C. Circuit found that the Majority had reasonably derived and calculated the 26.2% TCC rate:

When it came to ... the ratio of sound recording to musical work royalties that Gans derived from his analysis the [CRB Judges] specifically found ... reasonable Gans’ equal value assumption [for dividing the Shapley surplus ... between sound recording and musical works owners] and his reliance on Goldman Sachs’ profit

³⁸ The reciprocal of Professor Gans’s █ ratio of sound recording:musical works royalties is █, or █%.

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projections. *That type of line-drawing and reasoned weighing of the evidence falls squarely within the Board's wheelhouse as an expert administrative agency.*

See *Johnson*, 969 F.3d at 385-86 (cleaned up) (emphasis added). Accordingly, because the identical analysis was performed by the Judges to derive the 26.2% TCC rate as was done to derive the 15.1% revenue rate, the Majority's finding with regard to the *derivation and calculation* of the TCC rate likewise is not subject to further consideration on remand by the Judges.

However, it is equally clear that the D.C. Circuit *vacated* and remanded the Majority's *application and inclusion of the 26.2% TCC rate* in a separate "greater-of" TCC prong. The defect that generated the vacating on this issue was *procedural*—"the Streaming Services had no notice that they needed to defend against and create a record addressing such a significant, and significantly adverse, overhaul of the mechanical license royalty scheme...." *Id.* at 382. The consequence of the D.C. Circuit's action, however, was *substantive*. The D.C. Circuit stated:

This is no mere formality. Interested parties' ability to provide evidence and argument bearing on the essential components and contours of the [Judges'] ultimate decision not only protects the parties' interests, it also helps ensure that the [Judges'] ultimate decision is well-reasoned and grounded in substantial evidence.

...

The Streaming Services separately challenge the uncapped rate structure as *arbitrary* and *capricious*. In particular, they argue that the rate structure formulated by the [Judges] failed to account for the sound recordings rightsholders' market power. They also object that the [Judges] failed to provide a 'satisfactory explanation, or root in substantial evidence, [their] conclusion that an increase in mechanical license royalties would lead to a decrease in sound recording royalties [the "inverse relationship" a/k/a the "seesaw" effect].

Id. at 381-83 (cleaned up) (emphasis added). Thus, the D.C. Circuit explicitly declined to address these substantive issues, because of the deficient procedure. Instead, the D.C. Circuit remanded these substantive issues back to the Judges. *Id.* Simply put, *Johnson* found that the absence of notice here could be outcome-determinative. Thus, the Judges categorically reject Copyright Owners' assertion that the remand as to the uncapped TCC rate structure was merely "procedural." The Judges do not accept the notion that the Majority simply committed some ministerial *faux pas* that could be summarily corrected so that the uncapped TCC rate structure could be rubber-stamped on remand. Rather, the Judges' error rendered it impossible for them to consider the pros and cons of such a rate structure without the necessary input from the Services (and, for that matter, Copyright Owners as well).

Because the procedural infirmity precluded the D.C. Circuit from deciding whether the Majority's decision was "well-reasoned and grounded in substantial evidence," there also can be no substantive presumption of the appropriateness of the uncapped TCC rate prong, as suggested by Copyright Owners. To the contrary, the D.C. Circuit's opinion makes it clear that on remand the Judges must engage in a fresh consideration of the statutory appropriateness, *vel non*, of the uncapped TCC rate prong, by weighing and contextualizing the *competing* evidence and testimony entered into the record both before and after the remand.

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Accordingly, although Copyright Owners correctly assert that *Johnson* did not find the uncapped TCC rate structure to be “unfair, unreasonable or inequitable,” *Johnson* just as clearly did *not* find that structure to be “fair, reasonable or equitable.” Rather, the purpose of the remand was for the Judges to make these determinations. Accordingly, the Judges next examine whether setting the statutory mechanical rate as an uncapped TCC rate is “reasonable,” as required by section 801(b)(1).³⁹

5. Determining Whether Uncapped TCC Rate Prong is “Reasonable”

a. Rejection of First Rationale for Including Uncapped TCC Rate

Two substantive issues are implicated raised with regard to the issue of reasonableness: (1) whether the “seesaw” theory is valid; and (2) if it is valid, whether there exist sufficient data to support the phased-in 26.2% uncapped TCC rate.⁴⁰ To demonstrate that this uncapped TCC rate prong and the (phased-in) 26.2% rate are reasonable, Copyright Owners rely on the combined application of two economic models—the Shapley Value model and a Nash Bargaining Model. Accordingly, it is necessary to consider how these two models relate to each other and how these models and their interrelationship impact the setting of the statutory rate.

The D.C. Circuit described the Shapley Value Model methodology:

The Shapley methodology is a game theory model that seeks to assign to each market player the average marginal value that the player contributes to the market. This methodology first determines the costs that each player should recover, then divides the “surplus” among the players in proportion to the value of their contributions to the worth of the hypothetical bargain that would be struck.

Johnson, 969 F.3d at 372. The Judges provided a consistent but more detailed definition:

The Shapley value gives each player his average marginal contribution to the players that precede him, where averages are taken with respect to all potential orders of the players. The Shapley value approach models bargaining processes in a free market by considering all the ways each party to a bargain would add value by agreeing to the bargain and then assigns to each party their average contribution to the cooperative bargain. The idea of the Shapley value is that each party should pay according to its average contribution to cost or be paid according to its average contribution to value. It embodies a notion of fairness. The Shapley model is a game theory model that is ultimately designed to model the outcome in a hypothetical ‘fair’ market environment. It is closely aligned to bargaining models, when all bargainers are on an equal footing in the process.

Determination at 62-63 (cleaned up).

³⁹ The Judges consider *infra* whether any of the four itemized statutory factors require an adjustment to this analysis.

⁴⁰ As noted *supra*, in the Judges’ recitation of the parties’ remand arguments regarding the uncapped TCC rate prong, they make other arguments as well, specifically regarding: (1) whether it would be necessary and/or appropriate to adopt this uncapped TCC rate prong to offset revenue deferral and/or displacement by the Services; (2) whether this rate prong has caused, or would cause, economic “disruption” to the Services (under Factor D of section 801(b)(1)); (3) whether the uncapped TCC rate prong would satisfy Factors B and C of section 801(b)(1); and (4) whether this rate prong improperly imports the complementary oligopoly power of sound recording licensors. The Judges consider these issues after addressing the issues relating to the “seesaw” theory.

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To apply a Shapley Value Model in a rate proceeding, the economic modeler must obtain usable cost and revenue data to be inputted into the model. More particularly for this proceeding, the modeler must identify the parties' input costs, including the Services' non-content costs, and the revenue derived from interactive streaming.⁴¹ The difference between these revenues and the Services' noncontent costs represents the Shapley "surplus" that can be shared among the Services, the sound recording companies and Copyright Owners.

(i) The Shapley Approach of the Parties' Economic Expert Witnesses

(a) Professor Gans's "Shapley-Inspired" Model

Professor Gans, Copyright Owners' expert, utilized royalty and profit interactive streaming data for record companies and music publishers that he obtained from "a [then] recent music industry equity analysis report," namely, a Goldman, Sachs Equity Research report dated October 4, 2016 entitled "Music in the Air, Stairway to Heaven." Gans WDT ¶ 76 & n.39. As the Majority summarized Professor Gans's approach, "[h]e found that, for the music publishers to recover their costs and achieve profits commensurate with those of the record companies under his approach, *the ratio of sound recording royalties to musical works royalties derived from his Shapley-inspired analysis was* [REDACTED] (which attributes equal profits to both classes of rights holders and acknowledges the higher costs incurred by record companies compared to music publishers)." Determination at 69 (citing Gans WDT ¶ 77 tbl.3) (emphasis added).

Regarding Professor Gans's Shapley-inspired analysis, the Majority stated:

[T]he Judges find the *ratio* of sound recording to musical work royalties that Professor Gans derived from his analysis to be informative. Professor Gans computed this ratio based on an assumption of equal Shapley values between musical works and sound recording copyright owners. The Judges find this assumption to be reasonable^[42]

Determination at 70. This is part and parcel of the "line-drawing" undertaken by the Majority that the D.C. Circuit affirmed. Thus, on remand, the Judges do not find cause to reconsider the Majority's limited adoption of Professor Gans's Shapley-inspired analysis.⁴³

(b) Professor Marx's Shapley Value Model

Professor Marx constructed two Shapley Value Models, one of which was relied upon by the Majority. In the model credited by the Majority, Professor Marx assumed one collective owner of sound recording copyrights and one collective owner of musical works. She also assumed the presence of a single interactive service. *See* Determination at 64-68. That approach

⁴¹ Identifying useful data is a vexing problem. As one of Copyright Owners' expert economic witnesses, Professor Watt, has written: "[T]he main problem with the Shapley approach ... a particularly pressing problem [is] that of data availability." R. Watt, *Fair Copyright Remuneration: The Case of Music Radio*, 7 Rev. Econ. Rsch Copyright. Issues at 21, 27 (2010).

⁴² The assumption of equal Shapley values is based on the understanding that a sound recording license and a musical works license are both necessary (i.e., perfect complements) in order for a service to stream a song. Determination at 69 & n.122 therein.

⁴³ Because the ratio of sound recording to musical works royalties that Professor Gans derived from the data and other evidence was the only portion of his testimony on which the Majority relied, and because that reliance was affirmed by the D.C. Circuit, the criticisms of other aspects of Professor Gans's modeling are no longer relevant.

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yielded a total royalty obligation for sound recordings and musical works ranging between ■% and ■% of the hypothetical service's revenue. Dissent at 133.

Copyright Owners criticized Professor Marx's decision to assume in her model only one interactive streaming service, rather than the multiple services that actually existed. They contend that assumption reduced the market power of the licensors in her model. According to Copyright Owners' economic experts, Professor Marx's approach was a misuse of the Shapley Value Model. They aver that the Shapley Value approach is intended only to eliminate from the rate derivation the bargaining ability of a "Must Have" input supplier (like the sound recording companies and Copyright Owners) to "hold-out" and thus squeeze licensees for higher royalties. By modeling every possible "arrival ordering," they contend, the "hold-out" problem is avoided. They further contend that Professor Marx misconstrued the purpose of the Shapley approach by wrongly modeling market participants in a manner that significantly reduced the actual market power of these "Must Have" input suppliers. Determination at 66-67.

The Majority agreed with Professor Marx. The two Judges in the Majority found that her modeling reasonably "attempts to eliminate a separate factor—market power—that she asserts renders a market-based Shapley Analysis incompatible with the objectives of Factors B and C of section 801(b)(1)." *Id.* at 68.

Although the Majority ultimately relied upon Professor Marx's modeling in this regard, the Majority found that her data inputs were problematic. Determination at 65. Specifically, Professor Marx relied on 2015 data from Warner/Chappell and Warner Music Group for music publisher sound recording company noncontent costs, respectively. The Majority found that 2015 data was less probative than 2016 data and understated the percentage of revenue to be paid to the two classes of content providers. However, the Majority ultimately found only that this one-year older data served to "understate" the allocation of surplus to the upstream content providers, and thus rejected only her lower ■% bound for total royalties. The Majority did decide to adopt her upper bound of ■% value for total royalties, which could (and ultimately did) "constitute a lower bound for total royalties in computing a royalty rate," applied by the Majority in order to make a downward adjustment to offset the complementary oligopoly effect of "Must Have" inputs. *Id.* at 73, 75.

(c) Professor Watt's Criticisms of and Adjustments to Professor Marx's Shapley Modeling

Professor Richard Watt was called by Copyright Owners as a rebuttal witness at the hearing, for the purpose of reviewing Professor Marx's WDT. Watt WRT ¶ 3. He concluded that Professor Marx's Shapley Value Model contains important methodological and data flaws which, in his opinion, caused her to significantly understate the mechanical and overall (musical works + sound recording) royalty rates to be paid by interactive services pursuant to a proper Shapley analysis. *Id.* at ¶ 5.

Professor Watt also criticized her Shapley Value Model for failing to incorporate the fact that "the different interactive streaming companies – Spotify, Apple Music, Rhapsody/Napster, Google Play Music, Amazon, etc. – do all compete (and rather fiercely) among themselves, offering (perhaps perfectly) substitutable services." *Id.* at ¶ 25. Even more strongly in this vein, Professor Watt relied on the following description of the substitutability of the streaming services, *inter se*:

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Each [interactive streaming] service in the increasingly crowded field is working frantically to overcome the perception that the main distinction among the uniformly priced \$9.99 a month offering is little more than font style, quirky playlist title and color scheme. ... [M]usic platforms have long fought against the perception that they're ... selling a nearly interchangeable product ... You're getting sold the same car [with] just got a different lick of paint on it.”).

Id. at ¶ 32 n.19.

Professor Watt claimed that incorporating this downstream competition into the model would reduce the Shapley values of the Services and increase the Shapley values for the input suppliers, by recognizing which players provide “essential inputs” and which are in competition with other suppliers of substitutable inputs. *Id.*

He further criticized Professor Marx for including in her model “other distributors” who are not interactive streaming services. *Id.* at ¶ 27. According to Professor Watt, these other distributors “do not belong in a properly constructed Shapley Value Model because their presence would “show up” in the model as lower revenues for interactive services as their subscribers or listeners left for these other distributors (such as noninteractive services). *Id.*

Additionally, because he criticized Professor Marx’s use of 2015 data (as noted *supra*), Professor Watt re-worked Professor Marx’s model by examining how the use of 2016 data, as opposed to her 2015 data, would “better reflect[] ... the reality of the market. *Id.* at ¶ 37; *see also id.* at ¶ 44. When using the (higher) 2016 revenues (and making some relatively more minor adjustments he found necessary), Professor Watt estimated that the share of streaming revenues that would be paid out in total royalties (for musical works + sound recordings) in Professor Marx’s model would range from █% to █%. *Id.* at ¶¶ 50-52.⁴⁴

After analyzing these Shapley analyses,⁴⁵ the Majority found that the mechanical royalty rate needed to be increased in order to provide Copyright Owners with a reasonable rate as required by section 801(b)(1). As a matter of arithmetic though, if the mechanical rate increased and the sound recording rate did not decrease by a corresponding amount, then the total royalties paid by the Services would increase. That issue brings the Judges to consideration of Professor Watt’s bargaining model, on which the Majority relied to posit an inverse relationship (the seesaw effect), by which an increase in the mechanical rate would result in a commensurate reduction in the sound recording rate.

(ii) Professor Watt’s Bargaining Model.

⁴⁴ As noted *supra*, when the Majority weighed and credited Professor Watt’s entire Shapley analysis, in which his estimate of total royalties was █%, those Judges contextualized Professor Marx’s █% total royalty calculation as the lower bound of a zone of reasonable rates, and applied it as a measure that, in their analysis, would offset the complementary oligopoly effect of real-world royalties. Determination at 75 (text and tbl.).

⁴⁵ Because his testimony was made in rebuttal, leaving the Services no procedural right to file written testimony in opposition, the Majority gave little weight to Professor Watt’s total royalty projections and no weight to his proffered ratios of sound recordings-to-musical works royalties. Determination at 75.

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Professor Watt's Nash Bargaining Model is the linchpin that connects: (a) the higher mechanical royalty rates generated by the Shapley Value results relied upon by the Majority with (b) the assumed lower sound recording rates—a connection that the Majority found to render “reasonable” and “fair” its uncapped TCC prong. *See* Determination at 73-74 (“As to the issue of applying a TCC percentage to a sound recording royalty rate that is artificially high as a result of musical works rates being held artificially low through regulation, the Judges rely on Professor Watt’s insight (demonstrated by his bargaining model) that sound recording royalty rates in the unregulated market will decline in response to an increase in the compulsory license rate for musical works.”). Alternately stated, Professor Watt’s bargaining model result, *i.e.*, the seesaw effect, if sufficiently supported in the record, is the phenomenon that would allow the Judges on remand to apply the Shapley results by increasing the mechanical rate, without unduly exposing the Services to the risk of higher total royalties.

More particularly, the Majority recognized a potential problem that those Judges would have to resolve before utilizing the Shapley Value approach to create an uncapped TCC prong: “This is problematic because the sound recording rate against which the TCC rate would be applied is inflated . . . both by . . . complementary oligopoly [market] conditions . . . and the record companies’ ability to obtain most of the available surplus due to the music publishers’ absence from the bargaining table.” Determination at 73.⁴⁶ But the Majority found that Professor Watt had provided a rationale which permitted them to resolve the second problem:

As to the issue of applying a TCC percentage to a sound recording royalty rate that is artificially high as a result of musical works rates being held artificially low through regulation, the Judges rely on Professor Watt’s insight . . . that sound recording royalty rates in the unregulated market will decline in response to an increase in the compulsory license rate for musical works. 3/27/17 Tr. 3090 (Watt) (“[T]he reason why the sound recording rate is so very high is because the statutory rate is very low. And if you increase the statutory rate, the bargained sound recording rate will go down.”).

Determination at 73-74; *see also* Watt WRT ¶ 23 n.13 (“[I]n my Appendix 3, I show that . . . if the musical works rate is increased to what would be a realistically fair and reasonable rate, then the negotiated fee for sound recordings would decrease almost dollar for dollar . . .”); *see also id.* at ¶ 36 (“The statutory rate for mechanical royalties . . . is significantly below the predicted fair rate, and the statutory rate effectively removes the musical works rightsholders from the bargaining table with the services. Since this leaves the sound recording rightsholders as the only remaining essential input, bargaining theory tells us that they will successfully obtain most of the available surplus.”).⁴⁷

⁴⁶ The other problem the Majority needed to resolve was how to deflate the market-based sound recording royalty rates to mitigate the complementary oligopoly effect in those rates. *Id.* As discussed *supra*, the Judges resolved this problem by applying the low total royalty payment sum, █%, from Professor Marx’s Shapley Value Model.

⁴⁷ In full detail, Professor Watt concluded:

[F]or every dollar that the statutory rate for musical works undercuts a fair and reasonable rate, the freely negotiated rate for sound recordings will increase by an estimated █ cents. That is, if the musical works rate is increased to what would be a realistically fair and reasonable rate, then the

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To repeat: *This inverse relationship is what has been described as the “seesaw” effect.* The question in this regard on remand is whether the record proves that the seesaw theory is valid and measurable going forward. Alternately stated, does the record prove that Professor Watt’s bargaining model serves as the linchpin that would allow the Judges to apply the Shapley results by increasing the mechanical rate, without unduly exposing the Services to the risk of higher total royalties?

To resolve this issue, the Judges examine this bargaining model dispute in detail, as it bears on whether the uncapped TCC rate structure can be incorporated into the statutory rate.

(a) Bargaining Model Dispute

Professor Watt utilized a general Nash Bargaining Model.⁴⁸ In his particular application, Professor Watt modeled the streaming services and the labels each as a “single unit,” asserting (as is common in Shapley analyses) that this single-unit modeling was done “for simplicity.” Watt WRT, appx. 3 at 10. Applying this and other modeling assumptions, Professor Watt posited: “If there were to be no successful deal, then each of these two bargainers [the assumed “single” interactive service and “single” label] would earn 0, since in that case the interactive streaming service could not operate.” *Id.*

In his *oral* testimony at the hearing, Professor Watt did not opine as to whether changes in variables *other than musical works royalties* would also have an impact on the level of sound recording royalty rates, even as higher musical works rates would otherwise place virtually 1:1 downward pressure on the sound recording rate. However, in his *written* rebuttal hearing testimony, *i.e.*, his WRT, Professor Watt *did* make varying assumptions regarding the changes in the Services’ non-content costs, by which he did change the total revenue share for content providers. Watt WRT ¶¶ 50-52. He concluded from this varying replication of Professor Marx’s Shapley model “*that the results that it delivers are very dependent upon the amount of total*

negotiated fee for sound recordings would decrease almost dollar for dollar, with only a minor change in the total royalty rate for all copyrights combined.

Id. at ¶ 23, n.13; see also *id.*, appx. 3 at 12.

⁴⁸ The Nash Bargaining Model is one type of game-theoretic approach used by economists to model the distribution of “gains from trade” between two parties “in a manner that reflects ‘fairly’ the bargaining strength of the different agents. Marx WDRT ¶ 28 n.33 (citing A. Mas-Colell, M. Whinston, and J. Green, *Microeconomic Theory* 838 (1995)). To understand the parties’ modeling dispute, it is necessary to appreciate the essential elements of the Nash Bargaining Model, as previously summarized by the Judges:

In the Nash Framework three fundamental factors determine how two firms would “split a pie” in a hypothetical negotiation: ... (1) the Joint Agreement Profits; (2) each firm’s Threat Point [a/k/a “Disagreement Payoff” or “Disagreement Point”]; and (3) each firm’s bargaining power. Joint Agreement Profits are the combined profits to both the upstream and downstream firms in the market under study from reaching an agreement. ... The Threat Point [a/k/a “disagreement payoff”] for each firm is the profit it would receive when no agreement is reached. The difference between the Joint Agreement Profits and the sum of the firms’ Threat Points is called the “Incremental Profits” which are the profits the firms could earn by reaching an agreement above and beyond the profits they could earn in the absence of an agreement. The profits each firm receives in a bargain equals its Threat Point plus its Bargaining Power times the Incremental Profits.

SDARS III Final Determination, 83 Fed. Reg. 65,210, 65,215 & n.32 therein (Dec. 19, 2018).

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*interactive streaming revenue and the fraction of that revenue that is taken up by downstream non-content costs.” Id. at ¶ 53 (emphasis added).*⁴⁹

The Services had no procedural right under Part 351 of the Judges’ regulations to proffer surrebuttal written testimony from economic witnesses to challenge Professor Watt’s assertion, made for the first time in rebuttal, of the seesaw relationship between changes in the musical works royalty rate and the sound recording royalty rate paid by interactive services. Moreover, the Services and their economists also had no opportunity to weigh in on the Majority’s application of same (which was not revealed until the Judges rendered their decision). See *Johnson*, 969 F.3d at 381 (“Streaming Services had no notice that they needed to defend against and create a record addressing such a significant, and significantly adverse, overhaul of the mechanical license royalty scheme.”).⁵⁰ Now though, on this remand, the Services have been afforded the opportunity to present these criticisms, through their expert witnesses.

(b) Professor Katz’s Principal Criticism

Pandora’s economic expert, Professor Michael Katz, levied several criticisms of the bargaining model proffered by Professor Watt and applied by the Majority. The most important problem with Professor Watt’s analysis, according to Professor Katz, is that the former’s model assumes an “extremely unrealistic” *zero payoff* to the label in the absence of an agreement with a streaming service—an assumption which is “far from ... innocuous.” Written Direct Remand Testimony of Professor Michael Katz (Katz WDRT) ¶¶ 16, 20.

Professor Katz opines that this *zero payoff* assumption is equivalent to assuming, contrary to undisputed market facts, that: (1) subscribers and listeners to an interactive service would not switch to other interactive services if that service failed to reach an agreement with the labels; and (2) the interactive service is a “Must-Have” input supplier. Katz WDRT ¶¶ 17-18. In terms of Nash modeling, according to Professor Katz, Professor Watt’s assumption is thus equivalent to “assum[ing] that the sound recording copyright owners have no *outside option*.” Katz WDRT ¶ 127 (app. A) (emphasis added).

Moreover, not only does Professor Katz assert the indisputability that such substitution would occur, he points out that *Professor Watt himself* acknowledged in his own testimony that such substitution would occur. Katz WDRT ¶ 19.⁵¹

Beyond this purported inconsistency, Professor Katz finds Professor Watt’s no-substitution assumption to be a serious *modeling* error because, in order to quantify accurately each Nash bargainer’s contribution to the net surplus to be divided, the extent of substitutability on each side of the market must be captured by the modeling. Katz WDRT ¶ 20. That is, he

⁴⁹ The Judges take note here of Professor Watt’s presentment of alternative scenarios, because, as discussed *infra*, the Services and their economists accuse Professor Watt of changing his testimony, post-remand, by limiting the scenarios in which his “seesaw” argument would apply in order to salvage the credibility of his bargaining model.

⁵⁰ The Services could have sought leave to file surrebuttal testimony, and could have challenged the Majority’s understanding of Professor Watt’s testimony, after the Initial Determination, by filing a Motion for Rehearing pursuant to 37 C.F.R. § 353.1. However, a party is not required to engage in either of these procedural approaches, but rather may challenge the Determination on appeal, as has occurred here.

⁵¹ The Judges have quoted Professor Watt’s testimony in this regard *supra*.

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opines that “Professor Watt’s assumption that there is no substitution dramatically biases his model toward finding a large seesaw effect and renders his analysis unreliable ... lead[ing] to a prediction that the share of an increase in musical works royalties that will fall on the streaming services is approximately *eight times* larger than Professor Watt’s prediction. *Id.* at ¶ 21.

As a matter of music business dynamics, Professor Katz interprets Professor Watt’s substitutability error as follows.

The assumption that a label receives a zero payoff if it does not reach agreement with a streaming service is equivalent to assuming that, if a streaming service shut down, none of the consumers who would otherwise have used that streaming service will switch to alternative streaming services or other sources of licensed music. The two forms of the assumption are equivalent because, when the services are substitutes, failure to reach an agreement with one service will not drive a label’s payoffs from interactive streaming to zero. It will not result in the loss of all of the benefits that could be enjoyed by reaching an agreement. Instead, many consumers would engage in substitution and choose other streaming services, which will allow the label to earn profits from the additional royalties that would be paid to it by those other services.

Id. at ¶ 18.

Professor Katz attempts to adjust Professor Watt’s Nash Bargaining Model to account for this substitution effect. In his Appendix A, Professor Katz—acknowledging the reality of multiple interactive services—changes Professor Watt’s assumed single label’s payoff (designated as parameter “A” in the Nash Bargaining Model) from a value of zero to a value equal to “the share of revenues that would be diverted to other streaming services” multiplied by “the royalty rate that the label receives from the other interactive streaming services.” *Id.* ¶¶ 119, 127. Professor Katz asserts that the diversion to other streaming services represents an “outside option” available to a label. *Id.* ¶ 127. Professor Katz incorporates this “outside option” in his revised version of Professor Watt’s Nash Bargaining Model.

In addition, Professor Katz asserts that Professor Watt’s modeling is unreliable because “his prediction of the size of the see-saw effect is very sensitive to the assumed values of various other parameters.” *Id.* at ¶ 23. For example, Professor Katz asserts that a change in the royalty rate paid to the labels could materially affect the balance or even the existence of the seesaw effect. *Id.* at ¶ 127. As further support for his opinion, Professor Katz relies on the testimony of one of Copyright Owners’ own economic expert witnesses, who gave testimony clearly indicating that the “seesaw” effect was not at all likely to occur. *Id.* ¶ 24, n.16 (citing Gans WRT ¶ 32).⁵²

⁵² In this regard, Professor Gans testified:

When considering] the general distribution of profit when royalty rates for musical works rightsholders are increased[,] [i]n principle, those funds could come from a decrease in service profit, a decrease in sound recording royalties, or an increase in consumer pricing The general redistribution of profit in response to increased musical works royalties is fundamentally an empirical question

Gans WRT ¶ 32.

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In sum, Professor Katz finds Professor Watt's Nash Bargaining Model to be unusable as a foundation to set royalty rates because, although "there are theoretical reasons to believe that a see-saw effect *may* occur, ... there are complications and it is difficult to predict how big the effect will be." *Id.* ¶24 (emphasis added).

(c) Professor Watt's Rebuttal to Professor Katz

In rebuttal to Professor Katz's criticisms, Professor Watt states that "the record needs to be straight on Nash bargaining theory," in order to explain "the foundational error" committed by Professor Katz. Watt RWRT ¶ 52. This basic mistake, according to Professor Watt, is Professor Katz's erroneous assertion that the bargaining model must account for a label's "outside option." *Id.* ¶ 53. Relying on economic authority regarding bargaining theory, Professor Watt defines an "outside option" as "the best alternative that a player can command *if he withdraws unilaterally* from the bargaining process." *Id.* ¶ 59 (emphasis added); *see also id.* ¶ 53 ("An outside option is a payoff that the label would receive *if negotiations with the service do not result in an agreement.*") (emphasis added).⁵³

Connecting this principle of bargaining theory to economic theory, Professor Watt explains his understanding of the relationship of the "outside option" to the more familiar economic concept of "opportunity cost":

An outside option could also be referred to as an "opportunity cost," since it is the value of what would be foregone should a deal with the service actually be struck. It is ... useful to recognize the equivalence between an outside option and an opportunity cost, because economics in general has a very long history of understanding how opportunity costs weigh in on economic decision making.

Id.

Professor Watt then opines how Professor Katz confused the "outside option" with the disagreement (a/k/a threat) point in the Nash Bargaining Model:

[Professor] Katz claim[s] that the outside option value that the labels would enjoy should they not reach an agreement with the services should be included as part of the "disagreement point" within the bargaining model and reimbursed like a cost prior to bargaining. Doing this can dramatically alter the results of the model. It is also definitively not how such an option should be modelled. [Professor] Katz [is] guilty of misunderstanding the Nash bargaining model, and concretely, the meaning of a "disagreement point," and the way that an outside option should be brought into the model.

Id. ¶ 55.

⁵³ The phrase "outside option" suggests the existence of an "inside option." Indeed, a treatise cited by Professor Watt identifies the "inside option," defining it as "[t]he payoff the [bargainer] obtains while the parties *temporarily* disagree"—contrasting it with the "outside option" as (consistent with Professor Watt's testimony) "the payoff [the bargainer] obtains if she chooses to *permanently* stop bargaining, and chooses not to reach an agreement with [the counterparty]." A. Muthoo, *Bargaining Theory with Applications* at 137 (1999).

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More particularly, according to Professor Watt, these outside options/opportunity costs do not belong in a Nash Bargaining Model, because they are “not the types of status quo actual financial payments that may be modelled as disagreement points.” *Id.* ¶ 57. Rather, he asserts that, as Professor Katz essentially acknowledged, they are “payoffs from *substitution*, [*i.e.*,] an option *instead of* the deal, and they are not actual financial payments, but opportunity costs. *Id.*

Professor Watt then explains that an outside option/opportunity that by definition exists as an alternative to a bargain between two parties lies outside the two parties’ bargain, and is thus out-of-place within a proper Nash Bargaining Model:

In the case at hand, if the parties never stop negotiating and never take up substitute options, then no joint enterprise is offered and there is no surplus to share, so each necessarily gets a payoff equal to 0, just as I assumed in my model.

...

[A]gainst this backdrop, an outside option (a potential payoff that is not directly related to a share of the surplus that is being negotiated) ... comes in [to the model] as a constraint upon the set of feasible deals that could be struck, exactly as an opportunity cost would be treated.

Id. ¶¶ 57-58.

(d) Dr. Leonard’s Criticisms of Professor Watt’s Bargaining Model

According to Google’s economic expert witness, Dr. Gregory Leonard, the Majority wrongly relied on Professor Watt’s bargaining model because it is “highly stylized” and theoretically “simplified” in ways that make it unable to predict that “an increase in the musical works royalty would be offset nearly dollar-for-dollar by a decrease in the sound recording royalties (the “seesaw effect”), thus leaving the services virtually unaffected by the proposed increase in musical works royalties.” Leonard WDRT ¶ 8.

Pointedly, Dr. Leonard criticizes Professor Watt’s bargaining model as comprised of a “veneer of ‘complexity’ ... mathematical formulas and [a] reference to John Nash,” adopted to provide a rationalization for adoption of his Shapley Value modeling that would significantly increase the mechanical royalty rate.” *Id.* ¶ 16. These modeling deficiencies, Dr. Leonard asserts, are not merely “simplifying assumptions [that] better focus on the specific question the model is meant to address,” but rather “simplify away economic characteristics ... entirely abstract[ing] away economic characteristics ... central to the question at hand.” *Id.* ¶ 18.

In particular, Dr. Leonard avers that Professor Watt’s bargaining model materially abstracts away from, *inter alia*: (1) the nature of consumer demand for streaming services and competing forms of music; (2) how services decide to enter or exit the streaming market; (3) the nature of the oligopolistic interaction among the labels; (4) the nature and timing of the

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bargaining between each label and each service; (5) the potential for “hold-up”⁵⁴ by labels that perceive the services to be in a vulnerable bargaining position due to their previous industry-specific investments made under their assumption that the pre-existing statutory structure would be maintained; and (6) the failure of Professor Watt’s bargaining model to grapple with the complementary oligopoly structure of the sound recording market. *Id.* ¶¶ 18, 20.

These factors, he posited, are “important for determining how sound recording royalties would *actually* change in response to a change in the statutory musical works royalty.” *Id.* Professor Leonard concludes that, by not modeling these factors, Professor Watt’s “prediction of a virtual dollar for dollar decrease in sound recording royalties is unreliable as a basis for formulating policy.” *Id.* ¶ 20.

Regarding the complementary oligopoly structure of the market and its impact on the bargaining process, Professor Leonard emphasizes that an important “real-world hurdle” assumed away by Professor Watt’s modeling of a single label entity is that “each label would prefer to have the other labels lower their sound recording royalties while maintaining its own royalties at pre-existing levels” *Id.* ¶ 21. More particularly, Dr. Leonard explains that “even if a label were to recognize that it is more efficient for overall sound recording royalties to be lower, the label may not be willing to lower its royalty rate without assurance that the other labels will do the same,” a result which he asserts “is unlikely to happen absent some form of collusive behavior.” *Id.* Thus, Dr. Leonard maintains that the existence and size of any “seesaw”-induced decrease in sound recording royalties remains indeterminate, and it remains “within the realm of theoretical possibility that the labels do not agree to *any* reduction in sound recording royalties even if a reduction in overall royalties would be economically efficient. *Id.*

(e) Professor Watt’s Rebuttal to Dr. Leonard’s Criticisms

Professor Watt replies with a spirited defense of economic modeling in general and his economic bargaining model in particular. He begins by pointing out that models are not supposed to be “perfect representations of reality [but rather] are intended to isolate what is important, in order to expose a useful insight on some issue of relevance.” Watt RWRT ¶ 105. He adds that economic models (not merely his bargaining model) “*do not necessarily deliver predictions* of situations that are immune to changes in variables outside the model, but rather the results inform conclusions about the relationships between the variables and parameters within the model, [which is] by nature *a crude representation[] of reality*, but the lessons and insights that they provide can be very relevant to real-world applications.” *Id.* ¶¶ 106-07 (emphasis added).

With particular regard to his bargaining model, Professor Watt takes issue with Dr. Leonard’s assertion that in the former’s model the surplus is a “fixed constant.” *See* Watt RWRT ¶¶ 110-111. Rather, Professor Watt avers that his bargaining model assume[s] that when

⁵⁴ A hold-up problem occurs when: (1) parties to a future transaction must make specific investments prior to the transaction in order to prepare for it; and (2) the exact form of the optimal transaction (*e.g.*, how many units if any, what quality level, the time of delivery) cannot be specified with certainty *ex ante*. W. Rogerson, *Contractual Solutions to the Hold-Up Problem*, Rev. Econ. Stud. 777 (1992). Here, the interactive services may need to commit to paying for long-term investments, even though they cannot know the level of their largest costs (content royalties) beyond a single rate term.

the surplus ... *whatever value it takes* ... is to be shared, the parties understand that the amount to be shared is, *at that moment, given.*” *Id.* ¶ 111 (emphasis added).

Turning to Dr. Leonard’s critique regarding the purported distortionary effect of Professor Watt’s modeling assumption of a single label and a single interactive service, Professor Watt responds by acknowledging that, if he had modeled multiple labels and services in the bargaining process, that would be “not particularly enlightening *vis-à-vis* the single bargain setting, as it will not lead to different insights than those distilled by the [Majority].” *Id.* ¶ 113.⁵⁵ Further, Professor Watt characterizes this criticism as “empty,” because under either his two-player Nash model or Dr. Leonard’s posited multi-player (Nash-in-Nash) model, the labels will not respond to a musical works royalty increase *ipso facto* with a reduction in the sound recording royalty (*i.e.*, the seesaw effect will not occur if there is “a change in some other variable.”). *Id.* ¶ 114.

(f) Professor Marx’s Criticisms of Professor Watt’s Bargaining Model

Professor Marx criticizes Professor Watt’s application of the Nash Bargaining Model because, in her opinion, its “precise prediction” of the nearly one-to-one seesaw relationship “depends critically on the assumptions that he makes and the numerical inputs that he uses.” Marx WDRT ¶ 33. First, criticizing his modeling *assumptions*, like Professor Katz, she criticizes his decision to abstract from reality by positing a single label and a single interactive streaming service. She opines that his one label/one service modeling assumption ineluctably leads to his conclusion that each of these two parties “has a ‘disagreement payoff’ of zero [meaning that] each party ends up with nothing in the absence of a deal.” *Id.* ¶ 34. But this zero “disagreement payoff” is merely a product of Professor Watt’s abstraction from reality, according to Professor Marx, because “[i]n reality, if interactive streaming went away, a share of the music listening that had occurred through interactive streaming services would migrate to other forms of music distribution, generating revenues for the label ... *meaning that the disagreement payoff would be positive for the label*.” *Id.* (emphasis added).⁵⁶ Consistent with Professor Katz, she maintains that Professor Watt himself acknowledged the presence of this substitution effect when he testified that “[t]he existing interactive streaming companies do not hold an essential input, as first they compete with the non-interactive services. . . .” *Id.* ¶ 35, n.43 (citing Watt WRT, app. 3).

More particularly, Professor Marx maintains, a record label’s disagreement payoff must be considered realistically “in any accounting of what would happen if record labels and interactive streaming services failed to reach an Agreement” Marx RWDT ¶ 35. And, she

⁵⁵ Professor Watt describes Dr. Leonard’s multiple simultaneous negotiations in a bargaining model as a “Nash-in-Nash” model, but the former does not explain why he concludes that this approach “will not lead to different insights” than those the Majority distilled from his two-party Nash model.

⁵⁶ Professor Marx’s reference to a substitution from a shutdown interactive service to “other forms of music distribution” is different from, but analytically analogous to, Professor Katz’s assertion that the shutdown of any one interactive service would result in migration of its subscribers and other users to the remaining interactive services. These analogous critiques are complementary. See Marx WDRT ¶ 37 (“One would expect the same decrease in the estimated see-saw effect by including a second, competing interactive streaming service in the market instead of just the one that Professor Watt uses. In that case, if no deal is reached, users would migrate to an even closer substitute—a competing interactive streaming service—resulting in an even higher degree of profit migration and thus an even lower estimated see-saw effect”).

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opines, when this real-world substitution effect is taken into account, the seesaw effect that Professor Watt estimates is reduced dramatically, because “[t]he greater ... the substitution between streaming and other forms of distribution, the greater is the revenue that the record label can capture in the event of disagreement and the lower is the estimated see-saw effect.” *Id.*⁵⁷

Professor Marx opines that modeling the bargaining process without these real-world particulars diminishes the value of Professor Watt’s Nash model in several significant ways. First, because his model fails to incorporate the presence of three major record labels, “each with substantial complementary oligopoly power,” it fails to capture the fact that “each record label does not fully internalize the impact of its rates on the viability of the industry.” *Id.* ¶ 39. She points to the Judges’ Final Determination in *Web IV*, where the Judges note how this aspect of complementary oligopoly compromises the value of a rate as a useful benchmark. *Id.* ¶ 39 n.45 (quoting *Web IV* Final Determination). More particularly, she opines that when, as here, “there are multiple negotiations between multiple record labels and multiple services,” sound recording rates can be affected “by the order of negotiations” among the several label:service negotiating pairs—a factor that Professor Watt’s bargaining model fails to capture. Marx WRDRT ¶ 41.

Next, Professor Marx avers that Professor Watt’s bargaining model “does not explain how or over what time frame the market would move to a new equilibrium.” *Id.* ¶ 40. More particularly, she testifies, because interactive services’ “agreements with record labels often contain multi-year terms and can take many years to negotiate ... there may be little incentive or practical ability for both sides to move to a new rate before the contract expires”. *Id.* ¶ 41. She takes note that this point was established at the hearing during questioning of Professor Watt from the bench:

JUDGE STRICKLER: What of the situation . . . that the . . . time period for the existing agreements between the ... labels and the interactive streamers is such that they’ve already locked in a particular rate and then we set a rate that’s higher for the mechanical to reflect the fact that the sound recording royalty should drop, but it’s locked in for a period of time? Are we running the risk, then, of disrupting the market by having a total royalty that’s greater than what is indicated by your Shapley testimony, simply because of the disparity of times in which the rates are ... implemented?

PROFESSOR WATT: That’s a very fair point. And I didn’t even think of that until you’ve mentioned it . . . [T]he model I have done is . . . assuming that . . . the bargained thing happens at the same time as the—or in the same general period of time as a change in the statutory rate. You’re absolutely correct.

3/27/17 Tr. 3091-92 (Watt); *see* Marx WRDRT ¶ 42, n.46

⁵⁷ In the context of the bargaining model, Professor Marx identifies Professor Watt’s choice of “a market structure that is completely symmetric between record labels and services not reflective of the real world” as forcing his model “to attribute[] all the ... surplus division to ... bargaining power ... and none of it to the market structure.” *Id.* ¶ 38.

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Third, Professor Marx points out that Professor Watt’s Nash model does not attempt to capture the effects of the heterogeneous and asymmetric distribution of information relevant to the bargain available to each party at the time of negotiation. *Id.* ¶ 41.

Lastly, Professor Marx avers that Professor Watt’s Nash Bargaining Model fails to address, on a more general basis beyond informational issues, other “asymmetries among record labels and among services.” Marx WDRT ¶ 41.

In sum, Professor Marx concludes that these foregoing real-world points all preclude the Judges from relying on Professor Watt’s testimony to identify a stable relationship between changes in the mechanical royalty rate and the sound recording royalty rate because they all share a common defect—they “lie outside Professor Watt’s model.” Marx WRDT ¶ 41.

To be clear, Professor Marx does not criticize Professor Watt for neglecting to include these points in his bargaining model; rather, she acknowledges that “[t]hese are difficult features to capture in a tractable equilibrium model.” *Id.* Indeed, she urges *the Judges* to appreciate that relying on such a necessarily limited model, as the Majority did, can have “dramatic effects” on the royalty rates derived. *Id.* Professor Marx emphasizes that all of these inherent modeling deficiencies are especially pernicious, if the bargaining model is applied yet again on remand, to set specific rates *over a five-year period*, when other variables will have independent effect on royalty rates. *Id.*

(g) Professor Watt’s Rebuttal to Professor Marx

Because Professor Marx’s criticisms are of a similar nature to Professor Katz’s criticisms, Professor Watt responds to Professor Marx as he did to Professor Katz. To summarize, Professor Watt responds to Professor Marx’s points as follows:

- Her criticism is centered on what he characterizes as her “bogus” argument that he supposedly had predicted almost a “dollar for dollar” sound recording rate reduction in response to an increase in the musical works rate (the seesaw effect). Watt RWRT ¶ 19. Professor Watt finds this argument “particularly disheartening,” because Nash bargaining theory explains why the seesaw would apply to the splitting of the surplus based on the available data, and that “there are quite apparent reasons why available surplus may not decrease even if the musical works rate increased, *because of simultaneous changes to other variables in the model.*” *Id.* ¶ 34 (emphasis added).
- Professor Marx implicitly contradicts her own reliance on the complementary oligopoly power of the Major labels by modifying his bargaining model through the insertion of a lower value for their bargaining power. *Id.* ¶¶ 19, 22-24, 26.
- Professor Marx misconstrues the purpose of his Nash model, which was to serve “as a reply” to Professor Marx’s direct testimony, and “to show bargaining insights that bore upon aspects of the case.” *Id.* ¶ 29.

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- Professor Marx, like Professor Katz, improperly includes in her bargaining model a potential payoff for the label arising from an “outside option,” *i.e.*, from an alternative that the label can choose only if the Nash bargaining terminates. *Id.* ¶¶ 53 - 68.

(h) Professor Marx’s Reply to Professor Watt’s Criticism⁵⁸

In her supplemental remand testimony, Professor Marx challenged several of Professor Watt’s criticisms contained in his remand testimony. First, she takes issue with what he identified as two “core” economic principles of bargaining: (1) that all of the available net surplus will be shared; and (2) that neither of the two bargainers will demand a share such that more than the total net surplus is shared. Marx WSRT ¶¶ 7-8.

As an initial matter, she disputes the notion that these are “core” principles of bargaining. *Id.* ¶ 8. More particularly, she states that, in the present case, because “the label does not know with exactitude the precise maximum that a service would be willing to pay (*i.e.*, its “survival” rate), and the service likewise does not know the exact minimum that the label would be willing to accept,” the simple bargaining model must be expanded to address “the potential for delay and/or bargaining breakdown.” *Id.*

As a further criticism, Professor Marx avers that “[i]n the real world, the negotiated royalty outcomes do not involve just two parties, but rather a sequence of overlapping, interrelated, bilateral bargains involving multiple competing services and multiple record labels with complementary oligopoly power.” *Id.* ¶ 12.⁵⁹ This complication, she opines, exacerbates the informational deficit noted in the immediately preceding paragraph, such that negotiations within the several pairings of labels and services “are affected by uncertainty and private information and ... Professor Watt’s discussion of bargaining theory [thus] does not support any particular real-world see-saw outcome.” *Id.*

(iii) Resolution of the Bargaining Dispute

(a) Professor Watt’s Nash Bargaining Model does not Support Adoption of Uncapped TCC Rate

The purpose of Professor Watt’s Nash Bargaining Model was to allay the Judges’ concern that increasing the mechanical rate would lead to higher total royalties for the Services. His bargaining model was understood by the Majority to show that such higher total royalties would not result, because the model demonstrated the “seesaw” effect, whereby the sound recording rate would fall almost dollar-for-dollar with the increase in the mechanical rate. *See* Determination at 73-74 (“[T]he Judges rely on Professor Watt’s insight ... *demonstrated by his bargaining model* that sound recording royalty rates in the unregulated market will decline in response to an increase in the compulsory license rate for musical works. ... Professor Watt’s

⁵⁸ The Judges found that Professor Watt’s remand testimony, denoted as “rebuttal,” also provided *de facto* “direct” testimony, to which the Services could respond with supplemental testimony and argument. Oct. 1st Order at 11-12. Professor Marx’s response in the following text was set forth in Spotify’s permitted supplemental testimony.

⁵⁹ In like manner, Professor Marx opines that Professor Spulber’s discussion of bargaining theory is irrelevant to any assessment of “the complexities affecting real-world negotiations” and the presence, *vel non*, of a seesaw outcome. *Id.* ¶ 13.

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bargaining model *predicts* that the total of musical works and sound recordings royalties would stay ‘almost the same’ in response to an increase in the statutory royalty.”) (emphasis added).⁶⁰

On the surface, the economic experts on both sides appear to be at loggerheads regarding the existence and applicability of the seesaw relationship. However, as discussed below, on further analysis of their respective positions, in light of Professor Watt’s remand testimony regarding *a key assumption* in his bargaining model, their disagreement narrows considerably and—in an important respect—vanishes completely.⁶¹

To recap: In his WRT, Professor Watt stated

[W]ith an appropriately modelled bargaining analysis ... in my Appendix 3 ... I show that for every dollar that the statutory rate for musical works undercuts a fair and reasonable rate, the freely negotiated rate for sound recordings will increase by an estimated ■ cents.

That is, if the musical works rate is increased to what would be a realistically fair and reasonable rate, then the negotiated fee for sound recordings would decrease almost dollar for dollar, with only a minor change in the total royalty rate for all copyrights combined.

Watt WRT ¶ 23 & n.13. But nowhere in his WRT did he qualify this statement by explicitly acknowledging that in his bargaining model there are certain assumptions lurking, *i.e.*, that his “concrete” analysis is subject to the “*ceteris paribus*” constraint—that all other things are held constant (*i.e.*, equal before and after the change in the musical works rate) other things being equal).⁶²

It is only in his later remand testimony—after the D.C. Circuit’s remand had compelled him to confront criticism from adverse economists—that Professor Watt expresses this assumption overtly, making explicit the “understanding” that he had theretofore only tacitly assumed:

⁶⁰ Copyright Owners note the Majority’s recognition that, regardless of the rate structure, *i.e.*, uncapped TCC or otherwise, Professor Watt’s “insight” from “bargaining theory” would still apply. *See* Determination at 74, n.138. That being the case, the Majority’s first rationale for adopting an uncapped TCC rate is undermined.

⁶¹ This is unsurprising. The difference of opinion among economists often lies in their assumptions, which may be left unstated or opaque (intentionally or not). Once those assumptions are laid upon the table, their differences often evaporate. As the esteemed economist Fritz Machlup noted more than sixty years ago:

The most prolific source of disagreement lies in differences of factual assumptions. It is not customary for experts to state all the assumptions that underlie their conclusions; it would be much too cumbersome. But when they have reached very different conclusions, then we are forced to go back and find out what implicit assumptions they have made.

F. Machlup, *Why Economists Disagree*, 109 Proceedings of the American Philosophical Society 1, 3 (1965). In the modern world of more formal economic modeling as well, the obfuscation of assumptions continues to be an important source of dispute, according to a book written by a leading game theorist upon which Professor Watt relies in his testimony. A. Rubinstein, *Economic Fables* at 20 (2012) (“[T]he model’s formal mantle enables economists ... to conceal from the layman the assumptions the model uses.”); *see* J. Schlefer, *The Assumptions Economists Make* at 29 (2012) ([S]ome assumptions made by economists capture important insights, others are insane. All you have to do is decide which capture insights, which are insane, and in which situations.”)

⁶²In his oral testimony, Professor Watt likewise did not qualify his opinion by taking note of his *ceteris paribus* assumption. *See* 3/27/17 Tr. 3026 *et seq.* (Watt).

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In other words, a model in which only the two copyright rates are permitted to change ... as was the *understanding* in my original model, allows the system to derive a clear relationship between those two rates, and that relationship is that an increase in one leads to a decrease in the other, that is, the ‘see-saw effect.’ But if ... something else changes along with the musical works rate ... then *the net effect does not predict that the negotiated rate of the labels will decrease.*”

Watt RWRT ¶ 35 (emphasis added).

Indeed, as noted *supra*, Professor Watt *did* give a nod to the relaxing of his implied *ceteris paribus* assumption in his WRT, by identifying varying “scenarios” in which he considered the impact of potential changes in service revenues and service non-content costs, leading to different percentages of royalties paid to content providers. Watt WRT ¶¶ 45-52. Professor Watt then used these several assumptions and scenarios to opine as follows: “The message that should be taken from this exercise ... is that the results ... are very dependent upon the amount of total interactive streaming revenue and the fraction of that revenue that is taken up by downstream non-content costs.” *Id.* ¶ 53.⁶³

Professor Spulber, on behalf of Copyright Owners, likewise emphasizes on remand the importance of the *ceteris paribus* assumption in economic modeling:

[A]long with an increase in the compulsory license rate, *all other things being equal*, we would expect to see a decrease in sound recording royalty rates.

...

“All other things being equal” (*ceteris paribus* in Latin), is a central principle for economic modelling. This economic analysis of bargaining highlights an important relationship between two content cost variables. However, that relationship does not exist in a vacuum. *Many other variables affect the bargaining situation and, for any given period, the net effect of all of the different variables may be different than the effect of the modeled variable alone.* Thus, this economic analysis of bargaining will not assure that a streaming service will not face disruption in the real world for any reason.

...

Economic modeling is supposed to simplify the situation in order to distill useful principles and teachings.

Spulber RWRT ¶¶ 26-28 (emphasis added).

⁶³ Further, in his remand testimony, Professor Watt points out that Professor Katz made clear in his testimony that he applied the “all else equal” assumption expressly in his own Nash bargaining analysis at the hearing. Watt RWRT ¶ 20 (quoting Katz WRT ¶ 67).

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The Judges agree that the *ceteris paribus* principle⁶⁴ is a fundamental principle in economic analysis and modeling. Professor Watt succinctly makes this point, quoting the Nobel laureate economist James Buchanan, for the following proposition:

At the heart of any analytical process lies simplification or abstraction, the whole purpose of which is that of making problems scientifically manageable. In the economic system we recognize, of course, that ‘everything depends on everything else,’ and also that ‘everything is always changing.

Watt RWRT ¶ 32 (quoting J. Buchanan, *Ceteris paribus: Some Notes on Methodology*, 24 *So. Econ. J.* 259, 259 (1958)).

However, Professor Watt does not quote another portion of Professor Buchanan’s article that makes a point that looms large in the present proceeding, *to wit*, the *limitations* inherent in applying the necessary *ceteris paribus* condition:

Real problems require the construction of models, and the skill of the scientist is reflected in the predictive or explanatory value of the model chosen. We simplify reality to construct these models, but the fundamental truth of interdependence must never be forgotten. ... [However,] [*few, if any, meaningful results may be achieved by using ceteris paribus to eliminate the study of large numbers of variables.* If such variables are closely related, they must be studied simultaneously; there is no escape route open.

Id. at 259-60 (emphasis added); *see also* A. Rubinstein, *Comments on Economic Models, Economics, and Economists: Remarks on Economics Rules* by D. Rodrik, 55 *J. Econ. Lit.* 162, 167 (2017) “[W]hat matters to the empirical relevance of a model is the realism of its *critical* assumptions”) (emphasis added).⁶⁵

This is not to say that Professor Watt was unaware of this caveat. As noted *supra*, he recognizes the difficulty of extrapolating from a *ceteris paribus* world to the real world. The present panel of Judges likewise recognizes this. However, the Majority missed this distinction in the Determination when it applied Professor Watt’s correct but *ceteris paribus* “insight” for a constant real-world relationship between sound recording and musical works royalty rates. Again, not a single economist made this improper analytical leap or proposed an uncapped TCC rate in order to set a TCC ratio across the entire rate term. Indeed, on careful inspection, no economist states in his or her remand testimony that Professor Watt’s bargaining model provides economic support for the uncapped TCC rate prong.

With the foregoing testimony in mind, the Judges see particularly relevant several additional points in Professor Watt’s *remand* rebuttal testimony that pertain to the appropriateness, *vel non*, of a TCC rate prong. Referring to the application of his bargaining

⁶⁴ The phrase is often translated into English as “all other things *equal*.” However, that is somewhat ambiguous. Equal to what? Not to other things. Rather, every “thing” (*i.e.*, every other independent variable) whose effects are not being measured remain “constant,” or “controlled,” *i.e.*, “equal” to their measure prior to the change of the independent variable being examined. *See* W. Nicholson, *Microeconomic Theory: Basic Principles and Extensions* at 649 (9th ed. 2005) (defining “*ceteris paribus*” as “[t]he assumption that all other relevant factors are held constant when examining the influence of one particular variable in an economic model”).

⁶⁵ The Judges note now that Professor Watt did not claim that his bargaining model generated any *predictions*, but rather that it explained the splitting of the Shapley surplus by the sound recording and musical works copyright owners, respectively, and the impact of that split on royalty rates, *given the assumptions and the data in his model*.

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model to the present case, Professor Watt made these crucial statements regarding the lack of a seesaw effect that would generate decreases in sound recording rates when the mechanical rate is increased:

[T]he actual effects one would expect to see several years later would be based on the actual data at that time. Moreover, I would expect many other variables to have a larger effect on the bargains than the relatively small changes in the musical works rate. ... [U]nderstanding actual market outcomes requires understanding these variables.

...

[A]n attempt to capture all aspects of the real world is too complex for a simple statistical exercise involving an econometric regression. There is no obvious data to actually use for some of the independent variables, such as consumer demand equations, costs of entry and exit, a measure of oligopolistic interaction, different timings of different rate bargains, and the actual values of outside options.

Watt WRWT ¶¶ 6(iv), 118.⁶⁶

Although Professor Watt was hardly transparent in *disclosing* his *ceteris paribus* assumption in his original testimony, it seems clear that he always *understood* its presence, and that, when this assumption was relaxed, “the actual effects ... several years later would be based on the *actual data at that time* [and] *many other variables [with] a larger effect on the bargains than the relatively small changes in the musical works rate.*” *Id.* ¶ 6(iv) (emphasis added).

Professor Spulber likewise opined that the absence of an explicit statement of these assumptions in Professor Watt’s testimony was unremarkable and appropriate:

[A]ll other things being equal’ ... should be generally read into economic modeling conclusions or predictions, whether or not the words are repeated in each instance. Economists do not typically repeat these words in each place where they apply, since it would lead to constant repetition.

Spulber RWRT ¶ 46, n.8.

Regardless of whether economists invariably identify the existence of implicit assumptions lurking in each other’s models, Professor Watt overlooked a cardinal rule of communication: *Know your audience*. Here, his audience is comprised of three Judges, only one of whom is also an economist.⁶⁷ Failing to appreciate Professor Watt’s implied *ceteris paribus* assumption, the Majority transformed his limited (albeit important) “insight” regarding the equal

⁶⁶ In the language of econometrics, Professor Watt describes this problem as the “almost sure[] impossibil[ity] of “introduce[ing] a control variable for each and every possible aspect that could potentially impinge upon the relationship [that] could easily lead to such a low R^2 , and/or statistically insignificant key coefficients, as to make the regression meaningless.” *Id.* ¶ 118.

⁶⁷ The dissenting Judge (the only economist on the panel) warned that the seesaw effect was rife with assumptions that rendered it too speculative to be relied upon to support the uncapped TCC rate prong. *See* Dissent at 7-8.

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split of the Shapley surplus between the two classes of rights holders—and the seesaw effect that would have if the mechanical rate were increased when the split was imposed—into a justification for the imposition of an uncapped TCC rate prong over the five-year rate term. The Majority’s language reveals this point clearly:

As to the issue of applying a TCC percentage to a sound recording royalty rate that is artificially high as a result of musical works rates being held artificially low through regulation, the Judges rely on Professor Watt’s insight ... **demonstrated by his bargaining model** that sound recording royalty rates in the unregulated market **will decline in response to an increase in the compulsory license rate for musical works.** See 3/27/17 Tr. 3090 (Watt) (“[T]he reason why the sound recording rate is so very high is because the statutory rate is very low. And **if you increase the statutory rate, the bargained sound recording rate will go down.**”)

Professor Watt’s bargaining model *predicts* that the total of musical works and sound recordings royalties would stay “almost the same” in response to an increase in the statutory royalty. *Id.* at 3091.

Determination at 73-74 (emphasis added).

Making the point ever so plainly, Professor Watt *now* expressly acknowledges that his “‘see-saw effect’ was never really a ‘prediction’ at all! Watt RWRT ¶ 117. Rather, he now cautions the present panel of Judges, that, “to make the jump from the model to the actual real-world effects, one cannot ignore the words that are omnipresent in all economic modeling, that predictions about causal relationships are understood to be “all else equal.” *Id.* ¶ 32.

Without the benefit of these caveats regarding an extrapolation of the “seesaw” theory to the real-world, and with absence of an explicit statement of the *ceteris paribus* assumption, the Majority misapplied his testimony as a basis to adopt a fixed TCC rate, based upon data from a snapshot in time (2016) to cement that rate relationship for the entire five-year period.⁶⁸ The Majority misapplied Professor Watt’s *correct* insight from bargaining theory regarding the use of a fixed ratio for the equal division by two “Must Have” input suppliers of the Shapley surplus to set royalty rates in a period, by using that insight *incorrectly* to establish a fixed ratio of royalty rates over the rate term.⁶⁹

⁶⁸ The importance of Professor Watt’s failure to make explicit the *ceteris paribus* assumption in his WRT is demonstrated by his need to make it explicit in his RWRT. But even now, rather than acknowledge that the Majority missed the point, he claims that the Services’ are wrongly blaming the Majority for failing to understand this assumption: “The Services’ testimony on this remand seems primarily focused on creating a “straw man” argument ... accus[ing] the [Majority] of something that the [Majority] did not do—that is, rely on a guarantee of a particular decrease in sound recording royalty rates—and the Services then attack the Board’s determination by claiming that the decrease did not occur.” Watt RWRT ¶ 5. As shown *supra*, however, this is precisely how the Majority interpreted Professor Watt’s “insight.” The Judges understand that, as a matter of tact and tactics, Copyright Owners may be reluctant to acknowledge that the error lies in the combination of their witness’s opaque testimony and the Majority’s lack of understanding of the assumptions economists make. Copyright Owners might prefer to cast the Majority as the victims of the Services’ incorrect accusation. But the plain language of the Determination belies Copyright Owners’ characterization as to how the confusion arose.

⁶⁹ The forgoing analysis as applied to the uncapped TCC rate needs to be contrasted with the application of Professor Watt’s bargaining model to increase the percent of-revenue rate to 15.1%. That higher rate was set by the Majority after its consideration of the same Shapley approaches, pursuant to the Judges’ combination of inputs from Professor Gans model (his [REDACTED] round recording-to-musical works ratio) and the Shapley Value Model of Professor

continued on next page

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Additionally, an examination of the expert economists' testimony reveals that their facial disagreements vanish once the necessary assumptions are laid bare. Professor Watt and the Services' three economists all identify the following independent variables that will impact the relative levels of sound recording and musical works rates paid by interactive services:

- (1) the level of downstream consumer demand;
- (2) entry costs;
- (3) exit costs;
- (4) oligopolistic interaction;
- (5) the timing of sound recording agreements *vis-à-vis* statutory rate setting; and

Professor Watt and the three Service economists agree with regard to the relevancy of these six independent variables. *Compare* Watt RWRT ¶¶ 6(iv), 118 (identifying all five independent variables) *with* Leonard WDRT ¶ 18 (identifying independent variables 1-4 above); Marx WDRT ¶¶ 4-5, 42; (identifying independent variables 1-5 above); Katz WDRT ¶¶ 127, 134 n.115 (identifying independent variables 4 and 6 above). Accordingly, the remand record shows a consensus as to the lack of modeling of independent variables that would be important to estimate an uncapped TCC royalty ratio that could be utilized by the Judges to lock-in a ratio over the rate term.

Indeed, as noted *supra*, a careful reading of the remand testimony by Copyright Owners' economists, Professors Watt and Spulber, reveals that neither of them actually testifies that there is sufficient theoretical and empirical evidence to support the uncapped TCC rate prong and the 26.2% TCC rate phased in on that prong. Rather, those two witnesses testify to something far narrower: the alleged correctness of Professor Watt's "seesaw" theory as demonstrating an equal splitting of the surplus between the two "Must Have" input suppliers, and the effect of that split when all other relevant independent variable are held constant.

In this regard, it is noteworthy that none of Copyright Owners' several economic experts in this proceeding (Dr. Eisenach, Professor Gans, Dr. Rysman, or Professor Watt) ever *proposed* an uncapped TCC rate prong in any form, let alone within a greater-of formulation. Such a proposal would have been improper, because, as the expert testimony described above makes clear, the *ceteris paribus* assumption, reasonable for modeling purposes to provide insight as to the surplus split, lacks the input of the omitted variables that the experts on both sides find relevant to the application of economic modeling in this proceeding. A further review of

Marx that adjusted for complementary oligopoly power by establishing a lower total royalty level (■%). But the difference is that the 15.1% revenue rate was set by applying the Shapley results *based on actual and projected market data*, see Gans WRT ¶ 38, whereas the uniform uncapped TCC rate (26.2%) was based on the *ceteris paribus* assumption that held constant the actual data regarding the aforementioned independent variables. As explained above though, Professors Watt and Spulber make it clear that the "insight" from bargaining theory did not have implications to allow for a "prediction" of rates in future periods.

Thus, when the Majority engaged in its analysis and "line-drawing" to apply the data and market projections relied upon by Dr. Gans's data, the Majority was operating – to use the D.C. Circuit's phrase – in its "wheelhouse," making a finding that withstood appeal. *Johnson, supra*, 969 F.3d at 385-86; *see also* Determination at 69-70 ("Professor Gans utilized data from projections in a Goldman Sachs analysis to identify the aggregate profits of the record companies and the music publishers, respectively. ... The Judges also find Professor Gans's reliance on financial analysts' projections for the respective industries to be reasonable.").

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Copyright Owners’ economic expert witness testimony on remand—the first time any of them had occasion to weigh-in on the appropriateness of the uncapped TCC prong—reveals that they also *have not endorsed* the uncapped TCC rate prong as a proper form of rate setting. To be sure, they strongly endorse the insight first described by Professor Watt in his WRT that the Nash surplus would be split essentially evenly between the two suppliers of essential content, given his simplifying assumptions. But such endorsement is hardly the same as endorsement of the uncapped rate prong itself.

For these reasons, the Judges find erroneous the Majority’s identification of a fixed relationship between the sound recording and mechanical royalty rates that could serve as a basis for the Majority’s first rationale for yoking the mechanical rate to an uncapped TCC rate prong.

(b) The Services Have Not Rebutted Copyright Owners’ *Prima Facie* Showing that Professor Watt’s Model Demonstrates a More Limited “Seesaw” Effect

The foregoing analysis and decision related to the absence of a fixed relationship between the sound recording and mechanical royalty *rates*. A *separate* fixed relationship—the one Professor Watt has clarified he was demonstrating all along—is that if the Judges increase the mechanical royalty rate, the Shapley surplus realized by the labels will decrease almost dollar-for-dollar with the increase in the mechanical rate. The Services’ economists aver that even this version of the seesaw is defective.

According to Professors Katz and Marx, the Nash Bargaining Model constructed by Professor Watt is deficient because it fails to properly characterize the “disagreement payoff” to the sound recording company when it and an interactive service fail to reach an agreement. More particularly, as explained *supra*, they assert that Professor Watt’s model omits the value of “outside options” available to the sound recording company. This criticism relates to the issue of whether the seesaw effect would occur as posited in Professor Watt’s model. That is, the increase in the sound recording company’s “disagreement payoff” (a/k/a “threat point”) would lead to a higher royalty in the Nash bargain between the sound recording company and the interactive service than needed to generate the seesaw effect to offset the higher mechanical royalty rate.

As the several experts’ positions in this regard, discussed *supra*, make clear, however, each side has a different understanding of whether an “outside option” is properly included in the definition and calculation of the “disagreement payoff.” On the one hand, Professors Katz and Marx claim that the existence and value of “outside options” should be included in the “disagreement payoff.” However, they provide no economic authority for that assertion.

By contrast, Professor Watt cites to multiple economic game theory publications and authorities for the proposition that the presence and value of “outside options” are not to be included in the “disagreement payoff” contained in a Nash Bargaining Model. *See* A. Muthoo, *Bargaining Theory with Applications* at 105 (1999) (“I thus emphasize that *the outside option point does not affect the disagreement point.*”); M. Osborne & A. Rubinstein, *Bargaining and Markets* at 88 (1990) (“it is definitely *not* appropriate to take as the disagreement point an outside option...”); K. Binmore, A. Rubinstein & A. Wolinsky, *The Nash Bargaining Solution in Economic Modeling*, 17 RAND J. Econ. 176, 185 (1986) (“An outside option is defined to be

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the best alternative that a player can command if he withdraws unilaterally from the bargaining process.”).

According to Professor Watt and these authorities, the reason for excluding “outside options” from the Nash Bargaining Model is fundamental to the nature of the model itself. In the Nash approach, the negotiating parties are bargaining with each other only over the surplus *their deal* can generate, and they are attempting to agree upon an allocation of that surplus that exists within the bounds of their respective “disagreement payoffs.” Each may have “inside options,” which are alternatives available to them *while bargaining is ongoing and they temporarily disagree*. See *Muthoo, supra*, at 137. However, “outside options” are available to a Nash bargaining party *only* in lieu of continuing the Nash bargaining with the original counterparty if it “withdraws” from the Nash bargaining process. See *Binmore et al., supra*. Professor Watt characterizes the distinction as follows:

[T]he Nash bargaining model [is] designed as [a] self-contained portrayal[] of negotiating behavior.... Given a surplus to share, the Nash model ... provide[s] allowance for *financial* payments that a party is *actually* receiving, only while negotiations are *ongoing, without* walking away for another option, and that would cease as a result of the deal, to be factored into modelling as a cost in some situations.”)

...

[A]n outside option (a potential payoff that is not directly related to a share of the surplus that is being negotiated) ... comes in as a constraint upon the set of feasible deals that could be struck”

Watt RWRT ¶¶ 56, 58.⁷⁰

The Services never sought to introduce further testimony regarding this important dispute. This is particularly striking because the Services filed a motion to strike certain portions of the CO Reply, or for leave to file supplemental testimony responsive to those itemized portions. The portions the Services identified in their motion *did not include Professor Watt’s criticisms as to the inclusion of “outside options” in their experts’ Nash modeling*. Further, after the Judges granted the Services’ motion by providing them leave to file supplemental testimony—consistent with the designations in their motion—the supplemental testimonies did not address this “outside options” issue.

In the course of discussions among the parties and the Judges regarding remand procedures, the Judges invited the parties to produce witnesses for a hearing, at which one or more of the Services’ economic expert witnesses could have addressed this “outside options” issue. However, the Services (and Copyright Owners) waived the opportunity to produce witnesses at a hearing. Rather, they offered, and the Judges agreed, that they would stand on their written testimonies and proceed to closing arguments by counsel.

⁷⁰ Professor Marx in fact cites several of these authorities (for other points), without noting the distinction they make between the appropriate inclusion of “inside options” and exclusion of “outside options” in Nash modeling. See *id.* ¶ 59.

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In the closing arguments, each side argued numerous points of controversy and provided the Judges with dozens of demonstrative aids summarizing record evidence and the parties' arguments, but none of those arguments or demonstrative aids so much as mentioned this "outside options" dispute. Moreover, when the Judges inquired during closing arguments as to whether Services' counsel would be addressing any of the experts' "modeling disputes," counsel said that they were resting on their papers. 3/8/22 Tr. 86-87 (Closing Argument). Similarly, when the Judges inquired of Copyright Owners' counsel whether he would be addressing the modeling "dust-up" between Professors Watt and Katz, counsel demurred, stating that although he would "love to engage on it but ... "there would be too many slides" *Id.* at 262-64.

Simply put, the Services' economic experts made an assertion regarding the need for Professor Watt to have included "outside options" in his Nash Bargaining Model, but Professor Watt presented authority clearly stating that such inclusions would be improper. Thus, Copyright Owners made a *prima facie* showing that in a Nash Bargaining Model, the surplus generated by the streaming surpluses acquired by the content providers would be split equally as between the sound recording licensors and musical works licensors, and that, *ceteris paribus*, an increase in the mechanical rate to provide Copyright Owners more of the surplus (per the Shapley-based results relied on by the Majority) would be essentially offset through a nearly 1:1 reduction in the sound recording rate. In response to Copyright Owners' *prima facie* case, the Services stood mute in response to the rebuttal argument claiming that their experts misapprehended the Nash modeling distinctions between "inside options" and "outside options."⁷¹

⁷¹ The third economic expert for the Services, Dr. Leonard, did not utilize the "outside option" phraseology to describe his critiques. Rather, he first criticized Professor Watt for assuming the existence of a "fixed surplus." Leonard WDRT ¶ 16. However, as discussed *supra*, that assumption came from the Majority's extrapolation from Professor Watt's hearing testimony. His explicit statement regarding the *ceteris paribus* assumption makes clear that he was not assuming a "fixed surplus." Watt RWRT ¶¶ 110-11. (Again, the only "fixed" surplus was not "assumed," but rather *quantified*, in order to establish the Majority's percent-of-revenue prong royalty rate of 15.1%.)

Dr. Leonard next claims that Professor Watt's assumption that the labels would bear virtually the entirety of an increase in the statutory rate, because they previously "have captured almost all" [the] surplus," has been contradicted by the evidence. Specifically, he refers to the 33-month period in which the Phonorecords III rates were effective (January 2018 through September 2020). Leonard WDRT ¶ 16. However, as the Judges find in this Determination, that 33-month period was marked by significant uncertainty with regard to the ultimate rates and rate structure (and the rates were being phased-in), so no findings could reliably be made based on sound recording rate changes during that period.

The remainder of Dr. Leonard's critique concerns issues that would make a fixed TCC ratio inappropriate over the rate term. The Judges agree with those criticisms as previously discussed, but they do not pertain to this narrower issue of whether the *surplus* generated by interactive streaming would be split in a manner consistent with Professor Watt's Nash Bargaining Model.

Accordingly, the Judges find that the Services' criticisms in this regard are insufficient to rebut Copyright Owners' *prima facie* showing that Professor Watt's Nash Bargaining Model properly identified and valued the "disagreement payoff."^{72, 73}

b. Rejection of Second Rationale for Including Uncapped TCC Rate Prong

In the Determination, as noted *supra*, the Majority also justified the adoption of the uncapped TCC rate prong because it had the effect of "import[ing] into the rate structure the protections that record companies have negotiated with services to avoid the undue diminution of revenue through the practice of revenue deferral." Determination at 36; *see also Johnson*, 369 F.3d at 372 ("By pegging the mechanical license royalties to an uncapped total content cost prong, the Board sought to ensure that owners of musical works copyrights were neither undercompensated relative to sound recording rightsholders, *nor harmed by the interactive streaming services' revenue deferral strategies....*") (emphasis added).

(i) Parties' More Specific Arguments

Copyright Owners likewise argue that the uncapped TCC rate structure should be "adopted to provide protection against revenue deferment and displacement in a revenue-based rate structure." CO Initial Submission at 38; *see also id.* at 40 (describing uncapped TCC rate prong as "critical backstop in a revenue-based rate structure.").

Whereas Copyright Owners echo the Majority, the Services adopt the reasoning of the Dissent. They argue as follows:

⁷² To be clear, the Judges' ruling is narrow; they make no finding beyond crediting this *prima facie* showing and the failure of the Services to rebut sufficiently that showing. It might be the case that the existence and definition of "outside options"—and their relationship to "inside options"—have other implications *vis-a-vis* a Nash Bargaining Model applied in the context of a rate setting proceeding. However, the Judges may not introduce and rely on analytical approaches not developed by the parties. *See Johnson*, 969 F.3d at 381 (the Judges must not "procedurally blindside[]" the parties with an "approach ... first presented in the determination and not advanced by any participant."). *See generally* P. Wald, *Limits on the Use of Economic Analysis in Judicial Decisionmaking*, 50 J. L. & Contemporary Problems 225, 228 (1987) ("judicial analysis, economic or otherwise, takes place only in the context of lawsuits between two or more parties imposes a practical constraint on the judge's ability to use economic analysis.").

⁷³ Professor Katz also criticizes Professor Watt's assumption that "a label's non-content costs are proportional to licensing revenues." Katz WDRT ¶ 22. More particularly, Professor Katz claims that this is not "plausible" because "the royalty rate does not directly affect the sound recording copyright owners' non-content cost." *Id.* ¶ 133. The effect of eliminating this assumption, according to Professor Katz, is to reduce the seesaw effect in Professor Watt's model of [REDACTED] slightly further away from a 1:1 ratio, to .92. *Id.*

In rebuttal, Professor Watt says this criticism is inconsistent with Professor Katz's own analysis, because the latter also "sets the cost equal to a fraction of revenue" Watt ¶ 82 n.31 (referring apparently to a comparison of Katz WDRT ¶ 129 with *id.* ¶ 133). Professor Watt concludes that not only does "[Professor] Katz's own model contain the same feature that he is critical of in my model," it is also "not a flaw in the bargaining model." Watt ¶ 82. As a substantive matter, Professor Watt defends the assumption that non-content costs would rise with royalty income, because "[g]reater revenue should be directly equated with a larger scale of business" and "the additional royalty income would have to be managed (*i.e.*, distributed to those who need to be paid from it, such as artists), implying higher administration costs." *Id.* ¶ 79.

The Judges find that the common use by both experts of this assumed proportionality of a label's non-content costs to licensing revenues alone blunts Professor Katz's criticism of Professor Watt's modeling. Further, Professor Watt reasonably posits that higher revenue would imply a larger scale of business with associated general cost increases. (But the Judges do not agree that it was reasonable for Professor Watt to assume that distribution and administrative costs in particular would increase merely because of an increase in royalty rates; simply paying more money, *ceteris paribus*, is not self-evidently associated with an increase in costs.)

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[A] rate structure with a capped TCC prong, like the *Phonorecords II* settlement, achieves the same goal of protecting the Copyright Owners from any potential revenue deferral through a “structure that provides alternate rate prongs and floors, below which the royalty revenue cannot fall,” ... and does so *without allowing Copyright Owners to impermissibly share in the labels’ complementary oligopoly power*. ... [T]he streaming industry has twice concluded, after extensive negotiations, that the appropriate way to address any concerns regarding revenue deferral is to have a rate structure that includes a capped TCC prong. *Phono I*, 74 Fed. Reg. 4510; *Phono II*, 78 Fed. Reg. 67,938.

Services’ Joint Opening Brief at 62 (quoting *Dissent*, 84 Fed. Reg. at 1990) (emphasis added).

In their Reply, Copyright Owners argue that the Majority maintained the benefits of price discrimination contained in the prior *Phonorecords II* framework, but balanced that goal with added protection against Service revenue deferral and displacement. Copyright Owners’ Reply Brief on Remand at 49 (“In adopting a rate structure with [an uncapped] TCC for all service offerings, the [Majority] balanced its concerns about fostering price discrimination while also protecting against proven revenue diminution by the Services.”).

The Services, in their Reply, take note that pre-remand, Copyright Owners had strenuously objected to any yoking of the mechanical royalty rate to the sound recording rate, maintaining that, although the Copyright Owners now advocate for an uncapped TCC rate to protect against revenue displacement and diminution:

[I]n their [pre-remand] reply proposed findings, the Copyright Owners had expressed a very different view, arguing that an uncapped TCC prong “does nothing to protect Copyright Owners from the Services’ revenue displacement and deferment” [and] Copyright Owners have not even tried to explain away their complete about-face on this issue.

Services’ Reply at 43.

(ii) Analysis and Decision Regarding Revenue Diminution or Deferral

The Judges find that the second rationale put forth to support an uncapped TCC rate does not justify the adoption of that rate prong. Several reasons support this finding.

First, there is insufficient evidence to show how the sound recording companies contractually structure their own royalty rates, which would constitute the rate base for an uncapped TCC rate for the mechanical royalty. The sound recording royalty rate, when proffered for use as a mechanical royalty rate base, is analogous to pegging the value of a foreign currency to the U.S. dollar. That is no mere benchmark. The Judges must have the benefit of sufficient record evidence to demonstrate that the pegging (or, to use the D.C. Circuit’s word in *Johnson*, “yoking”) of a statutory rate to an unregulated rate serves the statutory purposes for the rate at issue, here, the mechanical rate.

But Copyright Owners presented virtually no evidence regarding how the sound recording companies structure their interactive service royalties. Indeed, in the hearing, Dr. Eisenach acknowledged that the “relative value of sound recording [to] musical works licenses

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may depend on a variety of factors,” but he intentionally eschewed unnecessary “assumptions, complexities and uncertainties associated with theoretical debates” as to why the particular market ratios existed. *See* Determination at 44. Indeed, the Majority found fault with Dr. Eisenach’s willful ignoring of these issues, agreeing with the Services’ criticism that Dr. Eisenach’s “use of sound recording royalties paid by interactive services embeds within his analysis the inefficiently high rates that arise in that unregulated market through the complementary oligopoly structure of the sound recording industry and the Cournot Complements inefficiencies that arise in such a market. *See* Determination at 47. The uncapped TCC rate advocated now by Copyright Owners suffers from the same affliction.

The only reference to such sound recording rate formulae in Copyright Owners’ voluminous PFF after the hearing was its statement that the effective revenue calculations in two of the Major labels’ agreements with the services was based on [REDACTED]. *See* Copyright Owners’ PFF ¶¶ 72, 91 (cited post-remand at Copyright Owners’ Motion for Reconsideration or Clarification at 25, n.14). On remand, the Services have provided a further summary of the types of [REDACTED]. *See* White WDRT ¶¶ 6-7, 14-15, 20, 24-26, 28-29 ([REDACTED]); Bonavia WDRT ¶¶ 15-17 ([REDACTED]); Mirchandani WDRT ¶¶ 16, 21-24 ([REDACTED]). Clearly, the levels of [REDACTED] would have to be weighed and the impact of complementary oligopoly power would need to be identified in order to adjust the rate prongs to account for that power. But the record is devoid of such details.

Second, compounding this problem, because the uncapped TCC rate is embedded in a “greater-of” rate structure, the labels can exploit their complementary oligopoly power when creating *the switching points that toggle royalty payments between and among rate prongs*. As the Judges have explained previously, in declining to import a “greater of” structure from the unregulated interactive market, this structure[it] is based on “agreements [which] were all negotiated in a market characterized by the lack of effective competition, and that *the lack of competition would affect the structure* as well as the level of rates.” *SDARS III*, 83 Fed. Reg. 65,210, 65,228 (Dec. 19, 2018) (emphasis added). Further, the Judges held therein that the “advantageous” nature of a “greater-of” structure to sound recording licensors “may well represent an example of what licensors can and would obtain when they exploit their “must have” status for a special competitive advantage.” *Id.*; *see also* Dissent at 47 (in absence of testimony explaining how greater-of structure is consonant with effective competition, use by licensor suggests a game of “heads I win tails you lose.”)

Thus, there is insufficient evidence or testimony that would permit the Judges to make any adjustment for the complementary oligopoly power that may be built into each prong of the sound recording royalty rate structures.

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Third, as the Services note, Copyright Owners pre-remand, opposed the *identical rate structure*—consisting of a percent-of-revenue prong and an uncapped TCC prong—before Copyright Owners were in favor of it, post-remand.⁷⁴ Although Copyright Owners took a 180-degree turn on this issue, they never stated they were wrong to oppose it previously. Indeed, the *Dissent* relied upon Copyright Owners’ strenuous objection to an uncapped TCC rate, quoting it verbatim:

Copyright Owners rightly note that they obtain no legal protection under such a TCC prong. In making this argument regarding displacement and deferral of revenue, Copyright Owners lay out comprehensively *all the problems* inherent in an uncapped TCC prong set in a greater of rate structure, such as adopted in the majority opinion:

The notion that [the] TCC prong will provide protection from revenue gaming, deferral and displacement, and other revenue prong problems is unsupported and speculative. **Relying on just the TCC to solve those admitted problems leaves the Copyright Owners’ protection from such problems entirely outside the statute** the per-user rates in the label deals are what protects the Copyright Owners from price-slashing by the services. **What is left unanswered ...is ... how can it be reasonable to ask the Judges to set a rate that does not itself provide for a fair return ... but simply puts the Copyright Owners’ fair return in the hands of the labels to negotiate terms that will adequately protect the publishers and songwriters as well? The labels do not have a mandate to ensure that the Services provide a fair return to the Copyright Owners, and cannot be directed to ensure such.** Indeed, labels may not have the same incentives as songwriters and publishers to negotiate such protections in their deals. To wit, a label could make an agreement with a service that includes only a revenue prong in exchange for equity or some other consideration that it may never include in the applicable revenue subject to the TCC. ... [W]hat if Google purchased one or more record labels and did not have to pay **any** label royalties? Or what if Spotify chose to avail itself of the compulsory license to create its own master recordings embodying musical works—which it is already doing ... and chose to compensate itself for its use of the master recordings on a sweetheart basis (or not at all)? Or what if one or more labels decided to enter the interactive streaming market and did not have to pay themselves royalties? In each case, the Copyright Owners’ protection—the protection that the Services admit the Copyright Owners need and is provided by the TCC—would be gone.

⁷⁴ When Copyright Owners opposed the concept of an uncapped TCC rate prong in a greater-of structure, the proposed uncapped TCC rate was Google’s 15% (and its proposed percent-of-revenue rate was 10.5%). Determination at 13. But after the Majority set the uncapped TCC rate at 26.2%—a 75% increase over the 15% TCC rate—Copyright Owners became zealous converts to the concept of an uncapped TCC rate proper.

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Dissent at 5-6 (quoting Copyright Owners' RPFF-Google at 39-41) (emphasis added). To make the identical point post-remand, *but from the Services' perspective*, Pandora's economic expert witness, Professor Katz, simply utilizes Copyright Owners' verbatim language (bolded above), but substitutes the word "Services" for "Copyright Owners" (and "income" for "return") to highlight how reliance on the sound recording royalty rate is improper:

What is left unanswered ...is ... how can it be reasonable to ask the Judges to set a rate that does not itself provide for a fair income ... but simply puts the Services' fair income in the hands of the labels to negotiate terms that will adequately protect the Services as well? The labels do not have a mandate to ensure that the Copyright Owners provide a fair income to the Services, and cannot be directed to ensure such.

Katz WDRT ¶ 71.

The Judges find this argument persuasive, both in its own right and in the fact that it has been advanced by Copyright Owners and the Services alike.⁷⁵

Fourth, the Judges note that the Majority did not find that revenue diminution, via displacement, deferral, or otherwise was pervasive, as Copyright Owners aver. *Compare* CO Initial Submission at 40 ("The record overwhelmingly established that the percent of revenue prong *often* results in musical works royalties that are too low ... drive[n] [by] revenue deferral [and] revenue displacement") *with* Determination at 21 ("The Judges agree that there is *no support for any sweeping inference that cross-selling has diminished the revenue base.*") (emphasis added) *and* 36 ("The Judges find that the present record indicates that the Services do seek to engage *to some extent* in revenue deferral in order to promote their long-term growth strategy.") (emphasis added).

Given that the Majority found revenue diminution through displacement and/or deferral exists only "to some extent" and is not a "sweeping" issue, the Judges on remand find that the uncapped TCC rate structure creates the potential for unbalanced harm. As noted *supra*, the only protection against runaway mechanical rates, the seesaw hypothesis, cannot justify yoking the mechanical rate to a fixed ratio with the *unregulated* sound recording rate.⁷⁶ By contrast, and as

⁷⁵ At Closing Arguments on remand, Judge Strickler queried counsel for Copyright Owners regarding their prior *rejection of an uncapped TCC prong* within a "greater-of" rate structure. Counsel's response was that an uncapped TCC doesn't provide *enough* protection against revenue diminution: "It provides more than the *Phonorecords II* rates, but not as much as we want," although "still better than" the negotiated *Phonorecords II* approach. 3/8/22 Tr. 240-41(Closing Argument). But Copyright Owners have neither distinguished nor disavowed their persuasive legal point quoted in the text above, to wit that an uncapped TCC rate would be unreasonable if the "protection" it affords lies "entirely outside the statute." Whether the "protection" relates to Copyright Owners' concern over revenue diminution or to the Services' concern over uncapped mechanical rates, the legal defect is the same – the unreasonableness of leaving the purported protection "entirely outside the statute."

⁷⁶ Even Google, the party that, post-hearing, broached in its PFF the idea of an uncapped TCC prong, candidly identified the risk arising from an uncapped TCC: "Having no cap on TCC ... leaves the services exposed to the labels' market power, and *would warrant close watching if adopted*" Google PFF ¶ 73 (emphasis added). But as the *Dissent* noted, there is no satisfactory way to monitor an uncapped TCC rate prong:

Who would do the "watching"? *When* would such watching occur? Congress directed the Judges to be the "watchers," and Congress instructed that the "watching" should occur only through rate proceedings

Dissent at 4 (emphasis in original).

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discussed *infra*, the *Phonorecords II*-based benchmark approach, despite its own imperfections, is superior in this regard, because its series of alternate rate prongs and floors represents a negotiated compromise (negotiated by trade associations with countervailing power) between the potential for revenue diminution that would harm Copyright Owners, on the one hand, and the potential for runaway mechanical rates (yoked to the sound recording companies' complementary oligopoly power) that would injure the Services, on the other.

(iii) Distinction between the “Reasonable” Rate Statutory Standard and the Factor (D) Objective to Minimize “Disruptive Impact”

The Judges next consider an issue emphasized by Copyright Owners: whether the Services have demonstrated that the uncapped TCC rate prong would cause a “disruptive impact” as set forth in Factor (D) of section 801(b)(1).⁷⁷

Section 801(b)(1) provides that one of the competing priorities of the Judges in setting the mechanical rate is:

To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

17 U.S.C. § 801(b)(1)(D). In *Johnson*, the D.C. Circuit did not identify any argument by the Services that was predicated on a claim that this statutory form of “disruption” had occurred, or was likely to occur, as a consequence of the Majority’s rates and rate structure. Additionally, the D.C. Circuit did not ground its decision to vacate and remand the Judges’ uncapped TCC rate and rate structure rulings based on the potential that these rulings would be disruptive to the Services, let alone would cause a statutory “disruptive impact.”

After the D.C. Circuit’s ruling, an argument regarding “disruption” was first made by Copyright Owners, not the Services. Copyright Owners argued that the vacated rates should nonetheless be maintained as interim rates, during the pendency of the remand proceeding. Motion of Copyright Owners to Adopt Interim Rates and Terms Pending the Remand Determination, *passim* (Nov. 2, 2020). Copyright Owners argued that reverting to the rates that existed before the Determination would constitute a “disruption” and self-servingly predicted that the Services would attempt to argue that the uncapped TCC rate and rate structure were themselves “disruptive.” Copyright Owners opined that such an argument would be a “hollow

⁷⁷ Separate and apart from the “disruptive impact” argument made by Copyright Owners, there is no need to consider how this prong would relate to Factor D, because the Judges find the uncapped TCC rate prong with the (phased-in) 26.2% rate to be “unreasonable.” If it were necessary to separately consider the four itemized factors, the Judges would confirm that Factor A is satisfied, because, as the D.C. Circuit found, the Majority reasonably found that rates should increase from the *Phonorecords II* period, and the 15.1% revenue rate represents a 44% increase. The Judges would also find Factors B and C to be satisfied without a separate uncapped TCC rate prong. The reason is that, under the section 801(b)(1) standard, the “reasonableness” standard filters out more statutorily infirm rates than the fairness objectives. By contrast, when a rate does satisfy the “reasonableness” standards under section 801(b)(1), the Judges must also consider the rate through the finer “fairness” filter. Cf. Determination at 68 & n.120 (distinguishing between: (1) a Shapley Value analysis that filters out *unreasonable* rates by reducing licensors’ ability to *abuse* market power by threatening or exercising their refusal to license (“hold-out or “hold-up” power); and (2) a Shapley Value analysis that further filters out *unfair* rates by going beyond eliminating *abuse* of market power to also make a “market power *adjustment*” explicitly to address Factors B and C). Finally, as the text *infra*, explains, the Judges also find no basis under Factor D to alter their analysis

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exercise.” *Id.* at 12, n.5; *see id.* at 2-3, 9 (claiming absence of disruption from uncapped TCC rate and structure despite absence of such argument by Services).

In response to that motion, the Services did *not* assert that the Majority’s uncapped TCC rates and rate structure would constitute disruption or have disruptive impact, whether under statutory Factor D or otherwise. *See* Services’ Opposition to the NMPA and NSAI’s “Interim Rates Motion” (Nov. 18, 2020). In reply, Copyright Owners shifted from anticipating a “disruption” argument to misinterpreting *Johnson*, asserting, *without citation*: “With respect to the TCC prong, *the remand directs only that services be given opportunity to offer evidence of disruption* from rates that have now been in effect for three years without any disruption.” Copyright Owners’ Reply in Support of Motion to Adopt Interim Rates at 7-8 (Nov. 25, 2020) (emphasis added).

On December 10, 2020, the Services submitted to the Judges their Proposal for Remand Proceedings, in which they made *no argument* that the uncapped TCC rates and rate structure (or, for that matter, any aspect of the Determination) would cause disruption or have a disruptive impact, whether under statutory Factor D or otherwise. By contrast, in their remand proposal, Copyright Owners reference twelve times that, for the Judges to reject the uncapped TCC rates and structure, the Services must show the presence of “disruption” arising from the Majority’s uncapped TCC rates and structure. Copyright Owners made this argument notwithstanding that the “reasonable” rate standard is separate from the “disruptive impact” issue, which is an itemized objective (one of four) to be considered as an adjustment to what would otherwise constitute a “reasonable” rate. *See* Proposal of Copyright Owners for the Conduct and Schedule of the Resolution of the Remand at 2, 7-8, 22-24 (Dec. 10, 2020).⁷⁸

In the CO Initial Submission, Copyright Owners assert, *without citation to any of the Services’ filings*: “The Services contend that, had they been given such an opportunity [at the hearing], they supposedly could have established that an “uncapped” TCC *is disruptive* because the market for sound recordings is not effectively competitive.” *Id.* at 5. Copyright Owners further aver that the Services must “provide evidence, consistent with the [CRB Judges’] well-established disruption standard, that because of the labels’ supposed market power, the TCC structure adopted by the Board has *actually, substantially, immediately and irreversibly* threatened the continued viability of the interactive streaming industry” in a manner that will “threaten the viability of the music delivery service currently offered to consumers under [the] license.” *Id.* at 7, 56 (citations omitted).

Copyright Owners then assert that *the Services* bear the burden of proving disruption under Factor D from the uncapped rates and rate structure embodied within the rate proposal (even though only Copyright Owners are pursuing this approach on remand). Further, Copyright Owners assert that the Services’ objection to the uncapped rates and rate structure must fail

⁷⁸ When Copyright Owners do address an argument that the Services *actually* made (on appeal) regarding the uncapped TCC rates and structure, they note *not* that the Services had made a “disruption” argument, but rather that “the Services appealed for the reversal of the TCC prong as *substantively unreasonable*.” *Id.* at 22 (emphasis added). But Copyright Owners then assert, coyly, that “this request was not granted by the Circuit” (citing *Johnson*, 969 F.3d at 383), when in actuality, the D.C. Circuit did not rule against the Services on this point, but rather stated only that it was not addressing substantive arguments made by the Services “[b]ecause we have vacated the rate structure devised by the [Judges] for lack of notice” *Id.*

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unless they can show that such a disruptive impact occurred during the 33-month period (from January 2018 through September 2020) when the *Phonorecords III* rates were in effect. *Id.* at 56.

In their initial substantive remand briefing, the Services once more *did not* assert that the Determination's uncapped TCC rates and structure would cause disruption pursuant to Factor D of section 801(b)(1), or even assert a non-statutory disruption arising therefrom. Rather, the Services directly attacked this rate approach as inconsistent with the statutory "reasonable" rate requirement, maintaining that "[t]ying the mechanical rates directly to the complementary oligopoly sound recording rates in the manner of the Majority's uncapped TCC rates and rate structure is plainly *unreasonable*." Services' Joint Opening Brief at 46 (Apr. 1, 2021) (emphasis added). The Services also asserted that the uncapped TCC rates and rate structure are "unreasonable" because they do not promote the statutory objectives of Factor B ("fair income" to the copyright user) and Factor C (reflecting the copyright users' itemized role in making the musical works "available to the public."). *Id.* at 45, 50-51, 55.⁷⁹

In the Services' Reply, the Services attack Copyright Owners' "singular focus on the disruptive impact of the uncapped TCC prong." Services' Reply at 35. In particular, the Services argue:

1. they have maintained and demonstrated that Copyright Owners' uncapped rates and rate structure are "*unreasonable*," separate and apart from demonstrating that this uncapped approach also fails to satisfy the four itemized statutory factors;
2. the burden of proof with regard to Factor D disruption lies with Copyright Owners, because they are the ones who are advocating for the uncapped TCC rates and rate structure;
3. the presence of Factor D disruption, *vel non*, is not dispositive, because section 801(b)(1) and *Johnson* require the Judges to apply the entirety of the statutory standard (which consists of the "reasonable rate" requirement and consideration of all four itemized Factors; and
4. the "full extent of the disruption to the Services from an uncapped TCC prong was never tested in the marketplace [because] [t]he Majority set escalating rates,

⁷⁹ The Services' only references to the concept of "disruption" relate to their argument that their own benchmark premised on the prior *Phonorecords II* rate structure and rates would not be disruptive. *Id.* at 4, 24, 29-30. That argument is properly made by Services in this context, because a party seeking to persuade the Judges to adopt its proposal bears the burden of proof, pursuant to section 556(d) of the APA, regarding the consonance of its proposal with all the standards contained in section 801(b)(1). The Judges do note that one of the Services' expert witnesses, Professor Katz, found the Majority's attempt to avoid disruption by phasing-in the new rate provisions insufficient "to mitigate the risk of short-term market disruption". That testimony does not constitute a direct reliance by the Services on the statutory disruption objective in Factor D, but rather emphasizes the Majority's own concern with such disruption and the witness's concern that the phase-in did not prevent the disruptive effect that the Majority itself had contemplated. In any event, Professor Katz, as an economist, cannot make a *legal* argument regarding the applicability of the Factor D objective, the Services did not rely on his testimony in that regard and, as noted, the Services made no legal Factor D "disruption" argument on remand. Thus, the Judges do not give any weight to Professor Katz's testimony in this regard.

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and the [] Determination was vacated before the significant hike in rate levels was fully implemented.”

Id. at 35-36.

In their Remand Reply, with regard to the issue of “disruption,” Copyright Owners assert:

1. The Services have “completely abandoned” their appellate argument asserting disruption, and admit to having no evidence that the Board’s adopted rate structure has any materially disruptive impact. Copyright Owners’ Reply Brief on Remand at 5 (July 2, 2021).
2. The Services have not even attempted to show any Factor D related effect or other disruption from the adopted rates and structure. *Id.* at 15, n.9.
3. The failure of the Services to provide evidence of disruption or to pursue the argument that disruption had occurred was inconsistent with their prior assertions that the uncapped TCC rates and rate structure created “a real risk of economic harm” and the “impact” or “harm” that the uncapped approach generated. *Id.* at 35.
4. Each of the Services, in response to Copyright Owners’ discovery requests, acknowledges that it was not offering new evidence regarding the “impact” of the Phonorecords III rates and rate structure. *Id.* at 36-38.
5. The Services did not merely suffer no disruption, they experienced unprecedented growth and profit under the uncapped TCC rate prong. *Id.* at 45.⁸⁰
6. The Services on remand have attempted to replace their prior “disruption” assertion with a claim of “unreasonableness.” *Id.* at 50, n.36.

(iv) Analysis and Decision Regarding “Disruption” Issue

The full Factor D “disruption” standard, as set forth by the Judges, states that an adjustment is warranted by Factor D if the rate analysis made by the Judges would otherwise:

directly produce[] an adverse impact that is substantial, immediate and in the short-run because there is insufficient time for either [party] to adequately adapt to the

⁸⁰ The Judges allowed the Services to make a supplemental filing in response to Copyright Owners’ remand reply, because those papers contained direct as well as reply materials. In their supplemental filing, the Services argued that they had not “thrived,” that the financial data on which Copyright Owners’ relied did not isolate revenue attributable to interactive services, was not limited to U.S. generated revenue, and used changes in the market capitalization of Amazon and Alphabet (Google’s parent corporation) as a proxy for the economic fortunes of their interactive services. Services’ Joint Supplemental Brief at 13-15. As explained *supra*, the Judges find the permanency of the *Phonorecords III* rate structure during the 33-month period from January 2018 through September 2020 to have been in question, pending the appeal that resulted in the vacating and remanding of the Determination and the reversion back to the *Phonorecords II* rates and rate structure. Given that uncertainty, the Judges find it wholly inappropriate to draw any conclusions from the change or stasis in the sound recording rates or the total royalty payments by a Service over that period.

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changed circumstance produced by the rate change and, as a consequence, such adverse impacts threaten the viability of the music delivery service currently offered to consumers under this license.

Determination at 87. Factor D is not applicable, particularly as proposed by Copyright Owners. Thus, the Judges reject Copyright Owners' assertion that the uncapped TCC prong should be adopted because of the absence of evidence of "disruptive impact" proffered by the Services. This rejection is based on several findings of fact and conclusions of law.

First, the issue of "disruptive impact" pertains here to the proposal advanced by Copyright Owners, not the Services. Thus, the burden of proving that this uncapped TCC rate prong proposal satisfies the elements, including Factor D, of the section 801(b)(1) standard in a sufficient manner lies with Copyright Owners, not the Services. *See* 5 U.S.C. § 556(d). Accordingly, the fact that the Services did not affirmatively assert an argument of "disruptive impact" is of no consequence. Moreover, as the review of the Services' filing makes clear, *the Services never abandoned that argument, because they never made it*. Rather, they have consistently argued that the uncapped TCC rate prong was *unreasonable*, not that it was statutorily "disruptive" as that standard has been applied by the Judges.

Second, Copyright Owners did not demonstrate with sufficient evidence or testimony that the uncapped TCC rate would be consistent with Factor D. To be clear, by this the Judges do not mean that Copyright Owners were obliged to prove a negative. Rather, they needed to prove, and indeed attempted to do so, that it was unlikely that their rates would cause a "disruptive impact."

In this regard, as an *empirical* matter, Copyright Owners proffered the testimony of an economic expert witness, Dr. Eisenach, who opined that the Services' [REDACTED]

[REDACTED] . Eisenach WRT ¶¶ 12-41 ([REDACTED]); CO Reply at 40-41. However, as the Judges discuss *supra*, that period reflected "33 months of uncertainty," during which no one could predict the final mechanical rate and structure that would be adopted by the Judges and/or the D.C. Circuit after appeals. Accordingly, that factual evidence is unpersuasive.

Further, as a *theoretical* matter, Copyright Owners rely on Professor Watt's testimony regarding the "seesaw" effect. In that regard, and as discussed *supra*, the Majority took comfort in what it understood to be Professor Watt's "prediction" that increases in mechanical royalties would be offset almost dollar-for-dollar by reductions in the sound recording royalty. However, as also discussed *supra*, Professor Watt has now clarified on remand that he never made such a "prediction," and that his testimony regarding the so-called "seesaw" was limited to shifts in the share of the surplus to Copyright Owners and from sound recording companies as a consequence of an increase in the mechanical rate, holding all other factors unchanged (the *ceteris paribus* assumption).

Moreover, Professor Watt further explained that many other factors would likely impact the sound recording rate together with an increase in the mechanical rate, including "a measure

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of oligopolistic interaction, different timings of different rate bargains, and the actual values of outside options.” Watt RWRT ¶ 118. Professor Watt candidly acknowledged that he has not modeled these independent variables, and he further notes that the data may not exist to allow for such modeling. *Id.* But the inability to model the impact of independent variables does not mean that their potential to cause disruption can be ignored.

In particular, the purpose of the “seesaw” contention was that it prevented economic harm to the Services in connection with a rise in the mechanical rate. Although not of Professor Watt’s design, that connection is intentionally built into the Majority’s uncapped TCC rate. *See* Determination at 35 (“Incorporating an uncapped TCC metric into the rate structure permits the Judges to influence that ratio directly.”) But the “measure of oligopolistic interaction” referenced by Professor Watt was the very concern expressed by the Dissent, which cautioned that there was no evidence that the sound recording companies would be compelled to maintain the same industry structure and accept the loss of substantial royalty income. *See* Dissent at 4 (“[T]he record companies may decide to keep their rates high despite the increase in mechanical rates, or decide it is in their interest to avoid a reduction in royalty revenue by creating a completely different paradigm for streaming, by which the record companies move the streaming service in-house and effectively destroy the existing services.”).⁸¹

Also, the “different timings of different rate bargains,” another independent variable identified in Professor Watt’s remand testimony, was an issue raised to him at the hearing by Judge Strickler. Professor Watt candidly agreed that the Judge was “absolutely correct” that there is a “risk, then, of *disrupting the market* by having a *total royalty* that’s greater than what is indicated by your Shapley testimony, simply because of *the disparity of times* in which the rates are ... implemented.” 3/27/17 Tr. 3091-92 (Watt) (emphasis added). However, this *admitted risk of disruption* was not addressed by sufficient record evidence.⁸²

Third, disruption in the narrow sense of Factor D as applied by the Judges previously is not relevant to the present problem. An increase in total royalties is not a short-run immediate issue, but rather an ever-present possibility that the seesaw analysis does not sufficiently address. Rather, the uncapped nature of the TCC rate prong renders it unreasonable rather than narrowly disruptive.

⁸¹ The Dissent noted that this risk was speculative in nature because there was no evidence proffered at the hearing regarding the reactions of the sound recording companies. But no such evidence was forthcoming in the remand proceeding either, and, as noted *supra*, the burden of proof in this regard falls on Copyright owners as the proponents of the uncapped TCC rate prong. In fact, because the major publishers who are members of the NMPA (a constituent of Copyright Owners) are part of the same corporate structure as the sound recording Majors, the burden of producing evidence would fall on Copyright Owners as well regarding the sound recording companies’ reaction to the “seesaw” effect.

⁸² As noted *supra*, Copyright Owners did not call any sound recording industry witnesses, or provide evidence from sound recording companies, indicating that labels would even be amenable to considering such renegotiated rate reductions. Instead, at the hearing, Professor Watt merely *speculated* that the sound recording companies might renegotiate their rates downward to reflect the seesaw effect when mechanical rates increased. Tr.3/27/17 3093-94 (Watt) (“I’m not able to comment on how, you know, how possible it is to take an agreement that’s in force and then change it.”). Not only was that mere speculation, it was provided by an economist who is neither a music industry executive nor an attorney, and the witness did not testify that he had spoken to anyone who would have industry knowledge regarding whether a label would even be amenable to considering such rate reductions.

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Balancing the foregoing considerations, the Judges find that Copyright Owners' disruption-based argument lacks merit.

6. Conclusion Regarding Uncapped TCC Rate Prong

For the foregoing reasons, the Judges decline to adopt the uncapped TCC rate tier proposed on remand by Copyright Owners.

III. Rejection of *Phonorecords II* Settlement as a Benchmark

A. D.C. Circuit Ruling

Each of the Streaming Services advanced somewhat different rate plans, but all four proffered a benchmark that “broadly sought to maintain the *Phonorecords II* rate structure,” while lowering or eliminating the mechanical floor.⁸³ *Johnson*, 969 F.3d at 371. With regard to the Services' proposed benchmark based on the *Phonorecords II* rates, rate structure, and terms (hereinafter, PR II-based benchmark),⁸⁴ the Judges are guided by several rulings in *Johnson*.

In particular, the D.C. Circuit found the Judges' treatment of the PR II-based benchmark to be “muddled.” *Johnson*, 969 F.3d at 387. The D.C. Circuit emphasized that the Judges “failed to explain” their rejection of the PR II-based benchmark. *Id.* at 367. *See also id.* at 376 (Judges “failed to “reasonably explain” rejection).

In the appeal, Copyright Owners attempted to defend the Judges' reliance on the absence of evidence of the settling parties' subjective intent in reaching the *Phonorecords II* terms. *Id.* at 387. The D.C. Circuit dismissed Copyright Owners' *post hoc* attempt, noting that “nowhere does the [] Determination explain why evidence of the parties' *subjective intent* in negotiating the *Phonorecords II* settlement is a prerequisite to its adoption as a benchmark.” *Id.* at 387 (emphasis added).

The D.C. Circuit also criticized the attempt by the Judges' appellate counsel to “change tack” and argue that their rejection of the PR II-based benchmark was reasonable because: (1) evidence showed that the prior rates had been set far “too low” and (2) it was “outdated”. The D.C. Circuit found that those arguments also were “nowhere to be found in the [] Determination's discussion” of the appropriateness of the *Phonorecords II* settlement as a potential benchmark. *Id.* at 387 (emphasis added).⁸⁵ In the end, the D.C. Circuit agreed with the Streaming Services that, *inter alia*, the Judges failed to reasonably explain their rejection of the

⁸³ The “mechanical floor” refers to an alternative rate calculation. “If the All-In Rate calculation results in a dollar royalty payment below the stated Mechanical Floor rate, then that floor rate would bind.” Determination at 26 n.59.

⁸⁴ *See* Services' Joint Rate Proposal (in Services' Joint Written Direct Remand Submission at Tab C) (Apr. 1, 2021). According to the Services, their rate proposal in this proceeding is meant to “update the *Phonorecords II* terms to include terms of the Determination, as amended during the implementation of the Music Modernization Act, that were upheld in *Johnson* ... including terms relating to student and family plan products, or that were not challenged by either the Copyright Owners or the Services.” *Id.* at 2. The Services include in their Joint Rate Proposal a chart summarizing the proposed rates for their offerings. That chart is attached as Appendix A to this Initial Ruling.

⁸⁵ In the present remand ruling, the Judges do not rely on their appellate counsel's *ad hoc* arguments that the D.C. Circuit found to be absent from the Determination. The Judges note though (as discussed in more detail *infra*) that in this Initial Ruling they are increasing the 10.5% royalty rate in the *Phonorecords II* rates by 44% to 15.1% (as phased-in by the Determination), thus addressing appellate counsel's *ad hoc* assertion that the *Phonorecords II* rates were “too low.” Similarly, as discussed *infra*, the Judges address the notion that the PR II-based benchmark is outdated.

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benchmark and, for all of the reasons cited, vacated and remanded the adopted rate structure and percentages for further proceedings. *Id.* at 381.

B. Remand Procedure Regarding the PR II-Based Benchmark

On December 15, 2020, subsequent to the D.C. Circuit’s decision, the Judges entered an Order Regarding Proceedings on Remand, in which the Judges stated:

The Judges accept the parties’ proposals to resolve the issues concerning the use of the Phonorecords II settlement as a benchmark....

...

The Services and Copyright Owners also agree that the Judges should resolve this issue based on the existing record, after receiving two rounds of additional briefing from the parties.

Remand Order at 1-2.

Based on the ruling in *Johnson* the Judges reject Copyright Owners’ position that they need not engage in a full analysis of the issue. The Judges conclude that they must engage in, and fully articulate, a reasoned analysis that adequately addresses “*the issues concerning the use of the Phonorecords II settlement as a benchmark.*” *Id.* (emphasis added). If the Judges determine that the Majority properly rejected the Services’ proposed use of the PR II-based benchmark, the rejected portions will play no part in the Judges’ remand ruling. On the other hand, if the Judges find, after engaging in that analysis, that the PR II-based benchmark was not properly rejected then, as a matter of law and logic, the Judges must weigh the Services’ PR II-based benchmark for application, in whole or in part.

The Judges reject Copyright Owners’ reading of *Johnson* as holding that the Judges cannot fully consider the PR II-based benchmark on remand. Copyright Owners argue that the D.C. Circuit “did not suggest the [Judges] substantively erred” in rejecting that benchmark, or that they “needed to reconsider [their] decision,” but had “merely remanded for a ‘reasoned analysis’ ... as to why it did so.” CO Initial Submission at 10; *see also* Copyright Owners’ Reply Remand Brief at 7-8. Because *Johnson* ruled that the Majority’s reasoning was muddled, indiscernible, unexplained and lacking in reason, the D.C. Circuit obviously neither accepted nor rejected the Majority’s disregard for the PR II-based benchmark – thus requiring the CRB Judges to take a comprehensive look at that benchmark. In this regard, the Judges agree with the Services that, pursuant to apposite case law, if the outcome of the remand as to this issue was preordained pending the further “reasoned analysis,” the D.C. Circuit would have expressed a desire simply to remand *without vacating* as to this issue. Services’ Joint Remand Reply Brief at 7-8 (citing *Allied-Signal, Inc. v. NRC*, 988 F.2d 146, 150-51 (D.C. Cir. 1993) (“The decision whether to vacate depends on the seriousness of the order’s deficiencies (and thus the extent of doubt whether the agency chose correctly) and the disruptive consequences of an interim change that may itself be changed.”)).⁸⁶

Because *Johnson* held that the Majority’s reasoning was muddled, indiscernible, unexplained, and lacking in reason, the D.C. Circuit obviously neither accepted nor rejected the

⁸⁶ However, the Judges note that section 803(d)(3) may require the D.C. Circuit to remand rather than reverse when the issue concerns more than rates alone. Thus, the statute appears to require a remand in order for the Judges to apply their statutory authority and expertise *in toto*.

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Majority's disregard for the PR II-based benchmark. Thus, the Judges take a comprehensive look at that benchmark's rates and rate structure to evaluate its usefulness in this proceeding.

Relatedly, the Judges also reject Copyright Owners' assertion that the Judges can only consider on remand the *Phonorecords II* rates, and cannot consider on remand the relative strengths and weaknesses of the *structure* in which those rates are embedded. See Copyright Owners' Reply Brief on Remand at 14. This distinction is impractical and unworkable. If the (non-"headline" rates⁸⁷) themselves can be reviewed and found acceptable (as they are *infra*) into what structure would they be placed? There are multiple provisions in the *Phonorecords II* rate structure providing for different rates, designed to balance (1) the ability of services to attract consumers with a low Willingness-to-Pay and/or a low Ability-to-Pay (the price discriminatory and differentiated features⁸⁸) with (2) the revenue diminution protections for which Copyright Owners had successfully negotiated. Moreover, the D.C. Circuit has vacated the Determination, and in doing so did not make any rulings critical of the rate structure in the *Phonorecords II*-based benchmark that would suggest the cramped review advocated by Copyright Owners. Indeed, the D.C. Circuit explicitly stated, *without distinguishing between rates and structure*, that it "agree[s] with the Streaming Services that the [Judges] ... failed to reasonably explain [their] rejection of the Phonorecords II settlement as a benchmark ..." See *Johnson*, 969 F.3d at 376; see also *id.* at 389 (issues relating to "rates" and "rate structure" are "intertwined").

Further, the Judges emphasize that the rate structure of the PR II-based benchmark provides protection *sought by Copyright Owners* against revenue diminution by the Services—*protection they would otherwise lose*—because in this Initial Ruling the Judges are not adopting the vacated uncapped TCC prong for which Copyright Owners are now advocating, and which they claim would have protected them in that regard. Cf. CO Additional Submission at 4-6 (acknowledging PR II-based benchmark provided some TCC provisions, allowing for protection against revenue diminution). Thus, the Judges' remand rulings on the PR II-based benchmark rates and on the uncapped TCC rate prong are inextricably interlaced. See *Johnson*, 969 F.3d at 381 (absence of "reasoned explanation" for rejecting PR II-based benchmark was problematic because it occurred "*when*" Judges adopted an alternative proposal that called for "setting ... total content cost and revenue rates.") (emphasis added).

The Judges weigh each benchmark's *intrinsic* strengths and weaknesses, as well as its *comparative* advantages and disadvantages *vis-à-vis* other proffered benchmarks. On remand, the interrelationships of the competing benchmarks are of particular importance, given Copyright Owners' need for the aforementioned protections against revenue diminution via price discrimination.⁸⁹

⁸⁷ As explained elsewhere in this Initial Ruling, the Judges are increasing the "headline" rate from 10.5% to 15.1%.

⁸⁸ Specifically, the PR II-based benchmark would incorporate the price discriminatory features for product differentiation as between: (1) subscription vs. ad-supported services; (2) portable and non-portable services; and (3) unbundled vs. bundled services. See Determination at 10; Dissent at 26. The third category—bundled vs. unbundled—is discussed *infra* in the context of the Bundled Revenue definition.

⁸⁹ The Judges categorically reject Copyright Owners' assertion that the PR II-based benchmark cannot be considered because the parties agreed in the *Phonorecords II* settlement that any future statutory mechanical rate determination would make "*de novo*" *vis-à-vis* that settlement determination. In fact, the industrywide representatives (NMPA and DiMA) who entered into the settlement conspicuously did not agree that the existing rate structure or rates could not be considered as the bases for future rate determinations. By contrast, the *Phonorecords I* settlement agreement

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Through this approach, the Judges ultimately may adopt only one of the parties' benchmarks or other methodologies, or they may modify the proposals by combining them, provided such a modification is "within a reasonable range of contemplated outcomes ... piecing together a rate structure, the economic and policy consequences of which had already been explored and developed by the parties in the record." *Johnson*, 369 F.3d at 382.

In their consideration of the PR II-based benchmark, the Judges are not suggesting that this benchmark is the optimal tool to use in order to identify rates and terms among all approaches that *might* have been proffered (but were not). But the Judges are cabined by the evidence they receive. *See* 17 U.S.C. §803(a)(1) ("the Judges shall act ... on the basis of a written record"); *see also* P. Wald, *supra*, (noting that parties' economic proposals made in an action "impose[] a practical constraint" on judge who will, "for the most part, be limited by what the parties serve up to her."). Based upon the available record evidence, the Judges find that the Services' PR II-based benchmark – although not necessarily perfect – is more than sufficient to satisfy the legal requisites for application, as well as a practical benchmark, when used in conjunction with the 15.1% headline revenue rate advocated by Copyright Owners. *See generally Nat'l Cable Television Ass'n v. Copyright Royalty Tribunal*, 724 F.2d 176, 182 (D.C. Cir. 1983) (rate-setting is an intensely practical affair).

C. Parties' Remand Arguments Regarding PR II-Based Benchmark⁹⁰

1. Services' Arguments

The Services maintain that their PR II-based benchmark satisfies the "reasonable" rate requirement and is consistent with the four itemized factors set forth in section 801(b)(1). They make several arguments in favor of this position.

expressly stated "[s]uch royalty rates shall not be cited, relied upon, or proffered as evidence or otherwise used in the [Phonorecords II] Proceeding." Trial Ex.6013, *Phonorecords I* Agreement at § 3. *Compare* Trial Ex. 6014, *Phonorecords II* Agreement at § 5.5 (omitting clause precluding reliance on evidentiary value of *Phonorecords II* royalty rates and including full-integration clause). This change objectively demonstrates that the parties to the 2012 settlement understood the evidentiary value of the *Phonorecords II* settlement in the next section 115 proceeding, *i.e., this proceeding*. *See* Dissent at 15-16.

On the other hand, the Judges reject the Services' argument that the *Phonorecords II* rates and structure should be retained merely because the Services relied on their continuation to make investments in their business models. As Copyright Owners note, the applicable regulations provide that "[i]n any future proceedings the royalty rates payable for a compulsory license shall be established *de novo*." 37 C.F.R. § 385.17; *see also* 37 C.F.R. § 385.26. A party may feel confident that past is prologue and that the parties will agree to roll-over the extant rates for another period; a party could be sanguine as to its ability to make persuasive arguments as to why the rates should remain unchanged; a party might even conclude that the mechanical rate is such a small proportion of the total royalty obligation that its increase would be unlikely to alter long-term business plans. But for sophisticated commercial entities to claim that they *simply assumed* the rates would roll-over—without the reasonable possibility of significant adjustment or outright abandonment—strikes the Judges as so irrational and reckless as to raise serious doubts about the credibility of that position. (If the Services had made a persuasive argument that certain fixed cost investments were "sunk" and had useful lives that substantially exceeded the five-year rate term, then such costs could be considered under Factor C of section 801(b)(1), but they did not make a persuasive argument in this regard. *Cf. SDARS II*, 78 Fed. Reg. 23,054, 23,069 (Apr. 17, 2013) (adjusting rates downward under Factor C, and distinguishing *internet* music transmissions, to reflect that—because Sirius XM needed to make "unique and substantial" investments in the form of "sunk" costs paid for satellites with a useful life of 12-15 years—"it is not unreasonable for Sirius XM to expect to recoup a certain amount of those costs over the expected useful life of the [s]atellites," which exceeded the five-year rate term.)

⁹⁰ The parties made arguments both in the original hearing and in this remand proceeding regarding the Services' proffer of the PR II-based benchmark. Each party's pre-remand and post-remand arguments overlap to some extent. Examination of the pre-remand arguments is also necessary because of the findings in *Johnson* and because the parties agreed that the evidentiary record on this remanded issue would not be enlarged.

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First, they aver that their PR II-based benchmark possesses all the characteristics of an “ideal” benchmark. Services’ Joint Opening Brief at 19. In this regard, they argue that their proffered benchmark “involves the same sellers, the same or similar buyers, and the same rights as at issue in this proceeding,” and that there has been “no material change in the economic circumstances of the marketplace that would warrant adjusting the rate levels or rate structure in the benchmark.” *Id.* at 20.

Applying the facts to these benchmark characteristics, the Services assert that the first three elements – same sellers (here, licensors), same buyers (here, licensees) and same rights (the mechanical license for interactive streaming) are satisfied. In particular, they note that the majority of the participants in the present proceeding either directly participated in the *Phonorecords II* settlement process or were active in the market contemporaneous with that settlement. *Id.* at 20-21.

Turning to the next benchmark characteristic – the absence of a “material change in the economic circumstances of the marketplace that would warrant adjusting the rate levels or rate structure in the benchmark” – they emphasize that the PR II-based benchmark contains different rate levels for different product offerings, to account for (a) consumers’ varying willingness-to-pay (WTP) and (b) the zero marginal physical cost of digital reproductions of sound recordings containing musical works. *Id.* at 21-22 (citing multiple experts).

Next, the Services point to the fact that the “headline”⁹¹ royalty rate is based on a percent-of-revenue, so that revenue growth (or decline) on this rate prong allows for royalty payments to directly adjust in tandem. *Id.* Further, the Services assert that the importance of streaming as “the future of the music industry” was known to the *Phonorecords II* negotiators, as evidence by the then-recent launch in the United States of the popular Spotify service. *Id.* at 23.

Beyond these benchmark requisites, the Services also emphasize that the PR II-based benchmark is the product of a settlement whose *negotiated* features burnish the value of this benchmark as reflective of effective competition. Specifically, they note:

- The settlement was negotiated in the same statutory context, concerning the identical rate standard and factors as applicable to the present proceeding.
- Neither side would have accepted a deal materially worse than what it expected from a section 115 proceeding applying the Section 801(b)(1) considerations.
- The statutory alternative diminishes any additional licensor-side negotiating power arising from “Must-Have” complementary oligopoly of the licensors of the musical works publishers.

Id. at 22. Moving from the negotiating context to market performance under this standard, the Services aver that this approach has borne fruit for the industry as a whole. They point to the

⁹¹ The Judges and the parties characterize the percent-of-revenue of revenue rate as the “headline” rate. *See Johnson*, 969 F.3d at 383 n.10.

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evidence of the licensors' consistent profitability and the licensees' ability to "benefit" from the *Phonorecords II* approach. *Id.* at 23.

The Services also maintain that the *Phonorecords II* structure "addresses any concerns with bundling and the potential for revenue deferment." *Id.* at 24.⁹² They assert that these issues were specifically addressed by Copyright Owners during the *Phonorecords II* negotiation, because "multiproduct firms such as Yahoo and Microsoft" that offered streaming services had the capacity to make bundled offerings to consumers. These concerns were addressed in the *Phonorecords II* rate structure, the Services note, through the use of "multiple rate prongs, minima and floors," ensuring that "the total musical works royalty for certain types of offerings does not fall below a specified level," thereby "mitigat[ing] the effect of any potential revenue deferrals and appropriately address[ing] any concerns with bundling." *Id.*⁹³

Finally, the Services maintain that "[d]irect agreements between Copyright Owners and Services also support adoption of the PR II-based benchmark." *Id.* at 34. In particular, they note that many of the royalty rates (and terms) in these direct agreements apply the *Phonorecords II* rates. Moreover, the Services maintain, because these direct agreements are in the nature of blanket license of a publisher's entire catalog, they provide an added "access" value in the form of full-repertoire licensing. These direct agreements do not include a rate above *Phonorecords II* levels; thus, the Services contend, they underscore the reasonableness of the *Phonorecords II* rates. *Id.*⁹⁴

Finally, the Services aver that the PR II-based benchmark satisfies the itemized four Section 801(b)(1) factors. With regard to Factor A, they maintain that: (1) the *Phonorecords II* framework has corresponded with an increase in the supply of musical works; (2) the PR II-based benchmark will increase the likelihood that the Services will increase subscriber counts, generating profitability, which will make streaming available to more listeners; and (3) the price discriminatory aspects of this royalty rate structure allows the Services to afford to offer streamed music to listeners with a low willingness (or ability)-to-pay, at lower rates or through ad-supported services. Services' Joint Opening Brief at 25-27.

Regarding Factors B and C (the "fair return" and "relative contributions" objectives), the Services emphasize that the PR II-based benchmark satisfies these statutory elements because it: (1) was the result of negotiations between industrywide representatives who had every incentive to obtain a "fair" return and to receive recompense for their "contributions" to streaming; and (2) allowed interactive streaming to become "a significant means for consumers to listen to music" while simultaneously generating growth in annual royalties for Copyright Owners." *Id.* at 27-29.

⁹² The issue of bundling is addressed in this Initial Ruling *infra*, in connection with the Judges' definition of Service Revenue generated through the offering of sound recordings as part of a bundle containing other goods or services.

⁹³ The Services also reiterate their pre-remand argument that the *Phonorecords III* settlement of subpart A rates for sales of physical and digital download phonorecords (now reorganized in subpart B) confirms the appropriateness of the *Phonorecords II*-based benchmark. However, any further reliance by the Services on that argument is moot, because the D.C. Circuit affirmed the Majority's analysis of the subpart A rates. *Johnson*, 969 F.3d at 386 (noting that the Majority adequately explained treatment of the subpart A rates as "'at best' a floor" below which the mechanical royalty rates paid by the Services for interactive streaming could not fall).

⁹⁴ Under section 115—prior to the effective date of the 2008 Music Modernization Act—an interactive service was required to serve a "Notice of Intent" to use the copyright license (NOI) with the owner of a copyright for each musical work before streaming the sound recording embodying that musical work. By contrast, a direct license with a publisher covers more than an individual musical work by providing "access" value to an entire catalog, without the transaction cost burden of filing multiple individual NOIs.

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Lastly on the subject of the statutory factors—regarding Factor D (minimizing disruptive impact)—the Services make a succinct argument: “By renewing the rate levels and structure of *Phonorecords II*, there is minimal risk of disruption.” *Id.* at 29-30.

The Services also address several further criticisms of the PR II-based benchmark contained in the Determination. Focusing first on an issue specifically addressed in *Johnson*, they assert the irrelevancy of the “subjective intent” of the parties that negotiated the *Phonorecords II* settlement – a factor on which the Majority relied in deciding not to adopt the PR II-based benchmark. In this regard, the Services are also responding to the D.C. Circuit’s concern regarding this issue. *See Johnson*, 969 F.3d at 387 (“In rejecting that settlement as a possible benchmark, the [Judges] faulted the Streaming Services for failing to explain why the parties to the *Phonorecords II* settlement agreed to the rates in that settlement ... [b]ut nowhere does the [] Determination explain why evidence of the parties’ subjective intent in negotiating the *Phonorecords II* settlement is a prerequisite to its adoption as a benchmark.”).

The Services note that no benchmark evidence presented by any party is proffered with supporting evidence of the subjective intent of the bargainers who negotiated the benchmark. Moreover, they note that the Majority in fact acknowledged that “[r]elying on a benchmark as *objectively* useful without [the need for] further inspection” is “typical and appropriate for the benchmarking method.” *Id.* at 35 (quoting Determination at [55] & n.106 (emphasis added)).

With regard to other criticisms of the Majority’s failure to use the PR II-based benchmark, the Services argue that the Majority misapplied their previous rulings that they “cannot and will not set rates to protect any particular streaming service business model.” *Id.* at 37 (quoting *Phonorecords III*, 84 Fed. Reg. at 1945). The Services find this principle inapposite, because their point is that the multiple price-discriminatory aspects of the *Phonorecords II* approach made it “a valuable benchmark ... because it had allowed for different service types to emerge and grow, which benefits the entire market.” *Id.* at 37. The Services also take issue with the Majority’s assertion that the *Phonorecords II* rate structure was too complex, deriding it as a “Rube-Goldberg-esque” contraption. *Id.* at 38. Rather, the Services maintain that the structure was as complex as necessary to effectuate the parties’ needs, particularly the price discriminatory features and the protections against revenue diminution. *Id.* at 38-39. Further, the Services note that the record is devoid of any testimony or evidence indicating any actual confusion caused by the *Phonorecords II* rate structure. *Id.* at 39. Finally in this regard, the Services maintain that the rate structure adopted by the Majority is essentially as complex as the structure in *Phonorecords II*, with the only major change being the replacement of the capped TCC rates with uncapped TCC rates.⁹⁵ *Id.*

The Services address another criticism—that the rates in the PR II-based benchmark are too low. This issue is largely moot, as the D.C. Circuit’s affirmance of the Majority’s expert “line-drawing” and “reasoned weighing of the evidence” confirmed that a rate increase was necessary. In this Initial Ruling, the Judges have acknowledged specifically the appropriateness

⁹⁵ As discussed *infra*, the relative complexity or simplicity of the rate structure is not a statutory factor, nor is it a decisive element of a reasonable rate structure, when the details of that structure effectuate price discriminatory configurations that would increase the availability of music and streaming revenues and otherwise satisfy the statutory criteria.

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of the 15.1 % revenue rate—a 44% increase over the 10.5% headline rate in the PR II-based benchmark.⁹⁶

2. Copyright Owners' Arguments

Copyright Owners assert that the record evidence overwhelmingly supports the Judges' rejection of the PR II-based benchmark. At the outset, they maintain that the Judges found—and the D.C. Circuit affirmed—that a rate increase was required in the *Phonorecords III* terms. CO Initial Submission at 13. (As noted, an increase in the headline rate by 44%, to 15.1%, is adopted in this Initial Ruling.)

Next, Copyright Owners maintain that the evidence established that “market conditions” were “radically different” at the time of the *Phonorecords III* proceeding compared with when the parties entered into their 2012 industrywide agreement in *Phonorecords II*. *Id.* at 17. In particular, Copyright Owners point to testimony describing the streaming industry as “nascent” in 2012, with fewer streams, subscribers, services, and choices of music; operating in a consumer environment when download purchases and Pandora’s noninteractive service were the predominant means for consumers to listen digitally to music. *Id.* at 18-21. In sum, Copyright Owners maintain, that streaming was “economically insignificant” to the music industry when the PR II provisions were adopted. *Id.* at 20.

Copyright Owners particularly emphasize the substantial increase in streaming revenue during the *Phonorecords II* period. They point out that while “total streaming revenue had ranged from approximately \$150 million in 2005 to \$212 million in 2010, ... after 2012[,] annual [streaming] revenue exploded to reach approximately \$1.6 billion by 2015.” *Id.* at 23. Further, they note there is no evidence that the music publishers or anyone else had predicted this substantial rise in streaming and the revenues it generated, and that in no way could it be inferred that those rates had “baked-in” future growth. In fact, Copyright Owners assert at the hearing that the PR II rates were merely “experimental”—consistent with the relatively nascent stage of the streaming industry. *Id.* at 25.

Additionally, Copyright Owners maintain that the identities of the parties involved in the *Phonorecords III* proceeding are different from those who established the *Phonorecords II* framework. Although they acknowledge the presence of current interactive services Spotify and Rhapsody in this market prior to the *Phonorecords II* framework agreed to by the trade associations for the interactive services and the music publishers, they point out that “[n]one of the other participants in this proceeding even entered the streaming business until after the *Phonorecords II* settlement.” *Id.* at 21.

Next, Copyright Owners assert that the Services’ evidence is inadequate to support a finding that the rates in their PR II-based benchmark are suitable for use in setting royalty rates in this proceeding. First, they echo the Determination, which stated that the Services (1) did not examine in detail the particular rates within the existing rate structure; (2) relied on the 2012

⁹⁶ The Judges characterize this issue as largely moot because the PR II-based benchmark includes on its “lesser of” prongs price discriminatory rates, discussed *infra*. But those “lesser of” rates are overridden by the “greater” 15.1% rate. As also discussed *infra*, Mechanical Floors continue to bind at lower mechanical royalty levels (without reducing the songwriters’ “All-In” musical works royalty that includes the performance royalties), because these floors were retained in the Determination and were not the subject of appeal.

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rates as objectively useful without further inspection; and (3) did not call witnesses to testify regarding the 2012 settlement negotiations. *Id.* at 27 (citing Determination, 84 Fed. Reg. at 1944 & n.106). Because of the absence of the foregoing evidence, Copyright Owners assert that the Services were left with “no evidence explaining how the particular rates and percentages in those settlements were calculated or derived, how they were negotiated, or how they were reasonable in light of the explosive growth in the streaming marketplace between the time of those settlements and the *Phonorecords III* proceeding.” *Id.* at 28. The absence of such evidence, according to Copyright Owners, meant that the Services had failed to carry their burden of proof under 5 U.S.C. § 556(d) with respect to their proposal, a burden Copyright Owners assert the Services acknowledged they bore. *Id.* at 29-30.

Additionally, Copyright Owners claim that the D.C. Circuit found “validity” in Copyright Owners’ assertion that the subjective intent of the parties to the *Phonorecords II* settlement is relevant because it would have revealed whether the agreed-upon rates were based on economic realities or instead were driven by other considerations. *Id.* at 30-31 (citing *Johnson*, 969 F.3d at 387). However, Copyright Owners acknowledge that, because this was not a reason given by the Majority, it carried no weight with the D.C. Circuit on appeal. *Id.* at 31.

3. Analysis and Decision Regarding PR II-Based Benchmark⁹⁷

a. PR II-Based Benchmark Meets Most of the Requisites for a Useful Benchmark

The four classic characteristics of an appropriate benchmark are:

- (1) the degree of comparability of the negotiating parties to the parties contending in the rate proceeding,
- (2) the comparability of the rights in question,
- (3) the similarity of the economic circumstances affecting the earlier negotiators and the current litigants, and
- (4) the degree to which the assertedly analogous market under examination reflects an adequate degree of competition to justify reliance on agreements that it has spawned.

In re Pandora Media, 6 F.Supp.3d 317, 354 (S.D.N.Y. 2014, *aff’d sub nom Pandora Media Inc. V. ASCAP*, 785 F.3d 73 (2d. Cir. 2015). As discussed below, the PR II-based benchmark meets criteria (1), (2) and (4), but requires adjustment to fully satisfy criterion (3).

⁹⁷ The setting of statutory royalty rates involves to a significant degree the application of economic analysis. Accordingly, the Judges find it appropriate to set forth certain key aspects of microeconomics that guide the application of the section 801(b)(1) standard in the present proceeding. That guidance is set forth more fully in the Dissent at 29-39.

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First, the PR II-based benchmark obviously pertains to the same rights at issue in this proceeding, as it reflects the licensing provisions from the immediately preceding mechanical license proceeding.

Second, the licensors (songwriters and music publishers) and licensees (interactive streaming services) are comparable (albeit not identical). While Copyright Owners emphasize the different identities and market involvement of the licensees, particularly the greater market penetration of Amazon, Apple, and Google, the Services note that even prior to the more significant entry of these three entities, similar multiproduct firms, such as Yahoo and Microsoft, were active licensees. The Judges find that the changing identities of the large multiproduct technology firms does not demonstrate the absence of comparability between and among such firms in the *Phonorecords II* and *Phonorecords III* rate periods. The shifting market entries, exits, strategies, successes and setbacks of otherwise comparable firms are expected occurrences in a dynamic capitalist market system and are not factors that materially diminish the necessary comparability of the parties for benchmarking purposes.

Third, important economic fundamentals of the marketplace are sufficiently similar in crucial respects. First, the heterogeneity of the willingness-to-pay among subscribers and listeners in the downstream market continues to support price discrimination and thus differentiated royalty rates upstream pursuant to the concept of “derived demand.” *See* Determination at 19 (and record citations therein) (“Weighing all the evidence and based on the reasoning in this Determination, the Judges conclude that a flexible, revenue-based rate structure is the most efficient means of facilitating beneficial price discrimination in the downstream market.”); Dissent at 32, 51, 86, 121, 126 (and record citations therein).⁹⁸ Second, the items being licensed for transmission—“second copies” of sound recordings (with embedded musical works)—have a marginal physical cost of zero, a critical economic point on which the experts for both parties concur, and as to which the Majority and the Dissent repeatedly and significantly rely. *See* Determination at 18, 21, 36, 59, 80 (and record citations therein); Dissent at 30-31, 33-34, 37, 47, 49-50, 59, 122, 127-128 (and record citations therein).⁹⁹

Copyright Owners are clearly correct, however, in noting a substantial change in economic circumstances that distinguished the *Phonorecords II* negotiations from the current proceeding; *viz.*, *the dramatic growth of interactive streaming revenues*.¹⁰⁰ The economic impact of this revenue growth is incorporated into the experts’ Shapley Value Models and the

⁹⁸ The Determination asserts that it includes a price discriminatory feature because a revenue percentage-based rate is itself price discriminatory, in that it does not set royalties on a per-play basis. Determination at 35 n.71. But that “blunt” form of price discrimination does not capture the granular discriminatory features that the parties had negotiated. There is no sufficient basis for the Judges to substitute their own blunt conception of the appropriate form and extent of price discrimination for the structure generated in negotiations by the market participants. *See* Dissent at 37.

⁹⁹ It bears emphasis that the fact “second copy” reproductions are physically costless does not even suggest that the market price should be zero. Rather, in this “second-best” economic context, pricing above marginal physical costs is imperative in order for Copyright Owners to recover their “first copy” costs, avoid “opportunity costs,” and earn profits. *See* Dissent at 36-38.

¹⁰⁰ Copyright Owners also cite data demonstrating the increase in listeners and the number of streams. The Judges find those data to be causal for the key point in rate setting in this proceeding—the significant increase in revenues.

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Judges' analysis of same. This analysis has generated the 44% increase in the headline royalty rate, from 10.5% to 15.1% (as phased-in by the Majority and again in this Initial Ruling).¹⁰¹

Simply put, three economic principles co-exist. First, the downstream interactive streaming market remains differentiated among listeners with different willingnesses and abilities to pay, based on varied preferences (utility) and disparities in income. Second, streaming of the “second copy” of the sound recordings (with embedded musical works) remains physically costless (but generates potential “opportunity costs”). But, third, streaming revenues have grown substantially. There is no incompatibility or inconsistency in the simultaneity of these economic principles. Each of them must be taken into account and they are in this Initial Ruling.

This economic context refutes the arguments made during oral argument at the D.C. Circuit that the PR II-based benchmark should be rejected *in toto* because it was supposedly “outdated.” The heterogeneity of the downstream demand of listeners and the zero physical cost of “second copies” are enduring features that affect the upstream market via the principle of derived demand. The substantial growth of streaming revenues, however, necessitated an increase in the headline rate from 10.5% to 15.1% (as phased-in), for the reasons discussed in the Judges' analysis in this Initial Ruling of the interrelationship among: (1) Shapley Value modeling; (2) Nash Bargaining; (3) complementary oligopoly power; and (4) effective competition.

Further, the foregoing analysis also undermines the pre-remand argument made by Copyright Owners that the PR II-based benchmark reflects a market that was not yet “mature,” or was only “experimental.” Markets are not “mature” as opposed to, say, “adolescent.” Indeed, the metaphor is strained because all economic models are subject to revision if the salient facts have changed, without rendering the prior models mere “experiments.” Markets simultaneously exhibit enduring characteristics—here, heterogeneous customers and zero marginal physical costs and dynamic change—here, significant revenue increases.¹⁰²

And yet, Copyright Owners seek to deny the idea that these principles could exist simultaneously. In an attempt to disqualify the application of the PR II-based benchmark, Copyright Owners complain:

¹⁰¹ At first blush it may seem that the increase in interactive revenues is not an economic fundament that would support an increase in a percentage-of-revenue based royalty formula. However, as more fully discussed herein, under the Shapley Value approach, the increase in revenues has generated an increased “Shapley Surplus” (roughly analogous to interactive streaming industry profits), which the two “Must Have” input suppliers (record companies and Copyright Owners) will essentially split equally. If this surplus increases faster than the interactive services' non-content costs (or if those costs remain stable or fall), the increased revenues would flow disproportionately to these input suppliers, thus causing the increase in revenues to support an increase in the royalty rate, all other things held constant. And, because the “Must Have” input suppliers have complementary oligopoly power, the Majority relied on a Shapley model constructed by Spotify's expert, Professor Marx, that adjusted for this market power.

¹⁰² If one were to indulge the “maturity” metaphor, the ongoing creative destruction in the streaming industry has only reinforced the fact that, according to one of Copyright Owners' own economic expert witnesses, the interactive streaming market (as of the *Phonorecords III* hearing) was not yet mature, but rather remained “a relatively new enterprise.” Watt WRT ¶¶ 39-40. Thus, it is hardly clear from the record that interactive streaming has “matured” in a manner that would render anachronistic the enduring marketplace characteristics.

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[W]hile streaming activity and revenues grew under the Phonorecords II royalty rates, the [REDACTED]

[REDACTED] For example ... [REDACTED]

CO Initial Submission at 15-16 (emphasis added).

But as the Services explained, the economic defect in Copyright Owners' analysis, is that it ignores the principle of price discrimination and its beneficial effects:

[A]s [Professor] Hubbard explained, it is "meaningless" to compare growth in streams to growth in royalties in the context of Prime Music in particular because the record showed that Prime Music brings "new people into the market." ... If not for the flexibility (and beneficial price discrimination) the existing Service Provider Revenue definition and rate structure facilitated, the Copyright Owners "would have gotten zero" from those new listeners. ... "So they're better off by that amount" of royalty growth. ... The undisputed fact that [REDACTED] —reflects that the existing rule enables beneficial price discrimination that expands the total royalty pool and benefits Copyright Owners.

Services' Reply at 58-59.

This rebuttal by Professor Hubbard is an example of the important distinction between "increases in demand" (when the demand curve shifts outward) and movements "down the demand curve" (when sellers use price discrimination to generate more revenue without additional cost to attract buyers with a lower willingness or ability to pay). The parties' otherwise dueling economists agreed on this point. *Compare* 4/3/17 Tr. 4373-74 (Rysman) (Copyright Owners' witness acknowledging that under the current rate regime overall revenues might be increasing because of movements "down the demand curve" (*i.e.*, changes in quantity demanded in response to lower prices), rather than because of, or in addition to, an outward shift of the demand curve (*i.e.*, increase in demand at every price) *with* 3/13/17 Tr. 701 (Katz) (the Services' witness who likewise noted that the present structure enhances variable pricing that allows streaming services "to work[] [their] way down the demand curve.").

Moreover, Copyright Owners baldly cherry-pick the data they present. [REDACTED]

[REDACTED] CO Initial Submission at 15-16. So, by their own data, presented in their own brief, they acknowledge that [REDACTED]

See [REDACTED]

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Services' Reply at 57-58 (Copyright Owners have proven the "opposite" of what they intended). This is precisely what beneficial price discrimination is designed to accomplish.¹⁰³

The appropriateness of adopting the price discriminatory rate provisions of the PR II-based benchmark is further underscored by Copyright Owners' candid acknowledgement at the hearing that they were essentially urging the Judges to adopt what is known as the "Bargaining Room" approach to rate setting. *See* Dissent at 24 (and record citations therein).¹⁰⁴

In the present proceeding, the appropriateness, *vel non*, of the Bargaining Room approach boils down to the following:

Copyright Owners emphasize the inability of the Judges (or anyone) to identify present market rates precisely, let alone over the five-year rate period because the compulsory license set by the Judges cannot possibly contemplate every single business model that may develop in the ensuing time.... If the statutory rate is set *below* market rates, then the parties will *never* negotiate upward toward the market rates, because the licensees will always prefer to invoke the right to use the licensed work at the below-market statutory rates. However, if the Judges set the statutory rate *above* what they find to be market rates, different licensees who each have a maximum willingness to pay (WTP) *below* such a statutory rate would seek to negotiate lower rates with the licensors. In response to such requests to negotiate, according to this argument, Copyright Owners would respond by negotiating various lower rates for those licensees, provided lower rates were also in the self-interest of Copyright Owners.

Dissent at 24-25 (and record citations therein).

The Judges find no reason to depart from the policy decision in *Phonorecords I* that the rate setting policies made explicit in section 801(b)(1) are best discharged if the Judges eschew the Bargaining Room approach and continue to identify rate structures and rates that reflect the standards set forth in the statutory provision. To supplant the statutory factors with a Bargaining Room approach would essentially be to adopt a purely market-based rate-setting approach that is inconsistent with section 801(b)(1) and with the Judges' application of that statute to set rates, rate structures, and terms consonant with effective competition.

¹⁰³ Further, [REDACTED] because: (1) the marginal physical cost of "second-copy" streams is zero; (2) royalties were calculated [REDACTED]; and (3) Copyright Owners' original proposed a per-play (*i.e.*, per-stream) metric, which was rejected by all three of the Judges.

¹⁰⁴ The Bargaining Room approach was first proposed for incorporation into the statutory license standard in 1967 by the NMPA, to be included in the predecessor section, later reorganized in § 801(b)(1) that governs this proceeding. *See* Dissent at 22-24 (and citations therein). Ultimately, Congress punted on the Bargaining Room approach, and adopted into law the four-factor language set forth in section 801(b)(1). A subsequent attempt by NMPA to have the Copyright Royalty Tribunal (CRT) (a predecessor to the Judges) adopt the Bargaining Room theory was rejected by the CRT, a rejection that was affirmed on appeal. *See Recording Industry Ass'n. of America v. Copyright Royalty Tribunal*, 662 F.2d 1, 37 (D.C. Cir. 1981), *aff'g* Adjustment of Royalty Payable under Compulsory License for Making and Distributing Phonorecords, 46 Fed. Reg. 10,466, 10,478 (1981). *See generally*, F. Greenman & A. Deutsch, *The Copyright Royalty Tribunal and the Statutory Mechanical Royalty: History and Prospect*, 1 Cardozo Arts & Ent. L.J. 1, 53, 64 (1982).

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With this background in mind, the Judges turn specifically to the interrelationship between the price discrimination aspects of the rates in the PR-II benchmark and the Bargaining Room approach.

Copyright Owners have demonstrated (albeit tacitly) their understanding that, if the statutory provisions did not contain a price discriminatory rate structure to reflect the varying WTP, *they would have to invent it*. This finding is apparent from their advocacy for the adoption of a Bargaining Room approach to rate-setting. *See, e.g.*, 4/3/17 Tr. 4390, 4431 (Rysman) lauding bargaining room approach as reflecting “economical element of *price discrimination*... the [licensor] is picking its prices carefully.”) (emphasis added); *id.* at 4431 (explaining that under this approach, when negotiating with Spotify regarding a rate for ad-supported service, “Must Have” music publishers would “have the right ... to set that price.”); 4/4/17 Tr. 483-45 (Eisenach) (acknowledging Copyright Owners’ approach was consistent with Bargaining Room theory because they were seeking rates so high as to force would-be licensees to negotiate for the “Must Have” mechanical license.).

Thus, the Judges find there to be no real dispute as to *whether* there is a market-based need for an upstream discriminatory rate structure.¹⁰⁵ Rather, the parties appear to be in disagreement as to *who* shall be in control of the setting of rates, the Judges, through their application of *law*, or Copyright Owners, through the exercise of their complementary oligopoly *power*. The resolution of this choice is clear; the Judges, not the licensors, are statutorily-charged with establishing provisions that are reasonable and otherwise properly reflect the itemized objectives of section 801(b)(1).

Fourth, the PR II-based benchmark reflect a rate structure with an adequate degree of competition, because there was a balance of bargaining power between the two negotiating industrywide trade associations, offsetting the complementary oligopoly effects in place when a “Must Have” licensor bargains separately with each licensee. Recently, the Judges discussed in detail how the presence of countervailing bargaining power generates royalty rates at effectively competitive levels. *See Web V*, 86 Fed. Reg. 59,452, 59,457 (Oct. 27, 2021).

Further with regard to this fourth point, the parties have been operating over the past ten years under this basic rate structure, with profits accruing to the licensors and admittedly tolerable losses befalling the licensees. Moreover, after experience with these rates and this rate structure in the *Phonorecords I* period, they renewed and expanded this structure for use in the

¹⁰⁵ The *Majority* recognized this point as well when – regarding the “increase the total revenue that price discrimination enables – they ask (and answer) rhetorically: “How could Copyright Owners and their economic experts argue against a rate structure that inures to their benefit as well? The answer is: They do not. ... [T]hey advocate for a rate set under the bargaining room theory, through which mutually beneficial rate structures can still be negotiated, but not subject to the “reasonable rate” and itemized factor analysis required by law.” Determination at 85 & n.153. The Judges also note that Copyright Owners’ acknowledgement that they too would set price discriminatory rates and structures is not simply a feature of *this* market. Rather, “discriminatory pricing ... is the normal attribute of equilibrium ... in a broad range of market types and conditions where consumers can be separated into distinct groups with different demand elasticities.” W. Baumol, *Regulation Misled by Misread Theory: Perfect Competition and Competition-Imposed Price Discrimination* at 2 (2002). *See also* Dissent at 38, n.74. Given the ubiquity of discriminatory pricing, the Judges also find that the adoption into the statutory license of such pricing is not – as Copyright Owners contend – simply the inappropriate favoring of a particular business model, but rather a necessary reflection of the fundamental nature of market demand, particularly, the varied WTP among listeners.

Phonorecords II period, when the alternative of a statutory rate proceeding was available to licensors and licensee alike. Their mutual willingness to continue in this manner is important evidence of the workability and reasonableness of this approach.

b. Evidence of Subjective Intent not Prerequisite to Partial Adoption of the PR II-Based Benchmark¹⁰⁶

The Judges rely on the PR II-based benchmark as an *objective* benchmark. Thus, the absence of testimony regarding what went through the minds of the negotiators of the *Phonorecords II* agreement (and the predecessor *Phonorecords I* agreement) does not diminish the objective value of this benchmark. The Judges view the provisions of the PR II-based benchmark as they would any benchmark, in the context of the requisite benchmarking elements identified and discussed *supra*. This approach allows the factfinder to analyze the benchmark through the lens of its service in the marketplace as an objective model for the market at issue, the *Phonorecords III* market. See, e.g., 3/13/17 Tr. 550-51, 566 (Katz) (knowledge of why parties negotiated specific provisions is unnecessary, because objective results demonstrate satisfactory performances of market).

Both Professors Katz and Hubbard noted that the current rate structure remains useful, not based on consideration of the parties' subjective understandings at the time of its creation, but because the market has not since changed in a manner that would create a basis for departure. Katz WDT ¶ 80 ("My analysis has identified no changes in industry conditions since then [2012] that would require changing the fundamental structure of the percentage-of-revenue prong."); 4/13/17 Tr. 5977-78 (Hubbard) (changes in market are "not uncorrelated with the structure that was in place" in 2012).¹⁰⁷

In this regard, it bears emphasis that Copyright Owners' own witness, Dr. Eisenach, relied on several potential approaches that the Majority characterized as benchmarks for his rate analysis, without attempting to examine the subjective intent of the parties who negotiated those agreements. Indeed, the Majority found that the PR II Rates were properly considered as an objective benchmark, in the same manner as Dr. Eisenach's proffered benchmarks:

The Services do not examine in detail the particular rates within the existing rate structure. Rather, they treat the rates within that structure as benchmarks, *i.e.*, generally indicative of a sufficiently analogous market that has "baked-in" relevant economic considerations in arriving at an agreement. Dr. Eisenach did not analyze *why* he chose the levels for the rates and ratios on which he relied as benchmarks

¹⁰⁶ At the outset, the Judges reject Copyright Owners' contention that the D.C. Circuit found "validity" in their assertion that there was merit in Copyright Owners' assertion of the "subjective intent issue." Rather, on this issue, *Johnson* first held: "[N]owhere does the [] Determination explain why evidence of the parties' subjective intent in negotiating the *Phonorecords II* settlement is a prerequisite to its adoption as a benchmark." *Johnson*, 969 F.3d at 387. Then, when Copyright Owners' appellate counsel attempted to cure that failure by making their own "subjective intent" argument, the D.C. Circuit responded to that "subjective intent" argument with a single word: "*Perhaps.*" *Id.* (emphasis added). This does not in any way suggest that *Johnson* found "validity" in the "subjective intent" argument, but rather was a non-committal response, consistent with the D.C. Circuit's ruling finding that the Determination had not explained this point.

¹⁰⁷ As noted *supra*, the relevant material change since the *Phonorecords II* agreement was reached is the significant growth in streaming revenues. That change is reflected in the Judges' application of the Shapley Value analyses, by which the Judges increased the headline royalty rate by 44%, from 10.5% to 15.1% (phased-in).

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or consider the subjective understandings of the parties who negotiated his benchmarks. Similarly, the Services' economists elected to rely on the 2012 rates as objectively useful without further inspection.

This point is not made to be critical of Dr. Eisenach's approach, but rather to show that the Services' reliance on the 2012 settlement as a benchmark shares this similar analytical characteristic, typical and appropriate for the benchmarking method. (The factual wrinkle here is that, hypothetically, the Services could have called witnesses and presented testimony regarding the negotiations that led to the 2012 (and 2008) settlements, but did not, rendering the 2012 benchmark similar to other benchmarks taken from other markets.)

Determination at 55 & n.106.¹⁰⁸

Copyright Owners also aver that they entered into the *Phonorecords II* settlement simply to avoid litigation costs. Copyright Owners' Reply Brief on Remand at 29. At the hearing, this assertion was presented by David Israelite, NMPA's President. Israelite WRT ¶ 28; 3/29/17 Tr. 3649-52 (Israelite) (claiming NMPA lacked financial position to fund rate litigation). The Services countered by noting that there was no evidence to support Mr. Israelite's testimony in this regard, or how it may have impacted the NMPA decision to participate. And, the Services pointed out, notwithstanding his testimony regarding financial constraints, NMPA had incurred the expense of a year-long negotiation with the Services to seek higher rates, create new service categories in Subpart C, and change the TCC calculations. *Id.* at 159, 161-64; 3/29/17 Tr. 3856 (Israelite).

Further, as a general principle, a party's mere assertion that the *Phonorecords II* approach was the product of a settlement that was predicated on the avoidance of litigation costs savings does not invalidate its use as a benchmark in proceedings before the Judges, especially because, by statute, the Judges are authorized to consider such agreements. *See Music Choice v. Copyright Royalty Board*, 774 F.3d 1000, 1014-15 (D.C. Cir. 2014) (testimony alleging agreement was reached to avoid litigation costs does not invalidate evidentiary use of that agreement for rate setting purposes, absent other evidence demonstrating settlement was involuntary or otherwise unreasonable.). Thus, the Judges find that the evidentiary record does not support Copyright Owners' position that this "litigation cost avoidance" assertion constituted a separate, idiosyncratic value that diminishes the Judges' partial reliance on the PR II Rates in this Initial Ruling.

¹⁰⁸ Copyright Owners do not deny that they did not offer evidence of subjective intent for Dr. Eisenach's benchmarks. Rather, they assert Dr. Eisenach's reliance on benchmarks without examining the subjective understandings of the negotiators of the benchmarks is irrelevant because: (1) Copyright Owners were not seeking the adoption *in toto* of the rates contained in any specific benchmark cited by Dr. Eisenach; (2) Dr. Eisenach analyzed multiple benchmarks to derive a reasonable range of rates; (3) his benchmarks were not adopted; and (4) his benchmarks are not at issue on this remand. Copyright Owners Reply Brief on Remand at 28 n.19. But Copyright Owners confuse evidentiary *standards* with evidentiary *application*. Benchmarks are subject to the same evidentiary standards, regardless of the breadth of purpose for which they are proffered and regardless of whether they were adopted or rejected. Further, the fact that Dr. Eisenach's chosen benchmarks are "not at issue on this remand" does not render Copyright Owners' reliance on purely objective benchmarks uninformative as to their own understanding of the irrelevancy of the subjective thoughts of benchmark negotiators. *See generally Web IV*, 81 Fed. Reg. at 26,370 (proposed benchmark adjustment based on alleged "additional value" should be supported by "record evidence ... to provide a basis for such for such an adjustment.").

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Copyright Owners also mistakenly rely on the fact that the Services bore the burden of proof regarding the absence of any subjective idiosyncratic factors that hypothetically could have diminished the useful value of the PR II-based benchmark. *Id.* at n.21. The Services indeed bore the burden of *proof* (i.e., *persuasion*) with regard to their proffered benchmark PR II Rates, and they presented adequate objective evidence and testimony that this approach has worked in the marketplace to serve as *prima facie* proof to support the Judges' (partial) use of this benchmark in this remand proceeding. And, as explained above, such subjective intent was not a necessary element of their benchmark proofs. But, with regard to Copyright Owners' *rebuttal* to those proofs, Copyright Owners bore the burden of *production*, to present sufficient evidence and/or testimony that the Judges could rely on to reject the (partial) use of the PR II-based benchmark. This Copyright Owners failed to do.¹⁰⁹

In fact, given Copyright Owners' reliance on the subjective intent of the parties to a benchmark, the Judges attempted to identify potential subjective evidence of how the capped TCC rates in the PR II-based benchmark¹¹⁰ were derived, during the examination of Dr. Eisenach at the hearing:

[JUDGE STRICKLER] Do you discuss, Dr. Eisenach, ... in your written direct or written rebuttal testimony how the parties arrived ... at the ratios for sound recording to musical works in [witness interrupts]

[DR. EISENACH] That process is opaque to me, Your Honor.

[JUDGE STRICKLER] Did you [witness interrupts]

[DR. EISENACH] I know -- I know there was a 2008 negotiation. I know there was a 2012 negotiation. I wasn't ... present, and I'm not privy to any of the details.

[JUDGE STRICKLER] You were not informed by your client or by any other source of information as to how they arrived at those particular ratios?

[DR. EISENACH] *When I've asked the question, I've found people chuckle* and -- and there doesn't seem to have been too much system-- systematic thought that went into it, *but I don't really know that*. I just -- when I ask the question, people say: *Nobody really knows*. ... Someone may know, but that's what I've been told.

4/4/17 Tr. 4611 (Eisenach) (emphasis added). The Judges find it perplexing, to say the least, that Copyright Owners would “chuckle” when asked by their expert witness for the very subjective evidence which they claim to be relevant. But of perhaps greater relevance is Dr. Eisenach's further testimony, quoted above, that he was also told by Copyright Owners that “nobody really knows” how the parties arrived at those rate ratios. Copyright Owners' “chuckle,” in response to its expert's critical inquiry as to the derivation of rates—and that expert's understanding that his client *simply did not know how those rates were derived*—undercut Copyright Owners' claim

¹⁰⁹ As described in this Initial Ruling, the Judges identified this same distinction between the burden of proof and the burden of production to find in favor of Copyright Owners' proffered expert testimony in support of their Nash Bargaining analysis, testimony which constituted *prima facie* proof that was not adequately rebutted by the production of sufficient testimony from the Services' expert economic witnesses.

¹¹⁰ The “capped” TCC rates are elements of the *Phonorecords II* rates.

that subjective understanding of those rates could undermine their usefulness in the benchmark.
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c. Substantial Evidence Demonstrates that PR II Rates, other than the Headline Rate, are Not “Too Low”

As noted *supra*, one reason the D.C. Circuit vacated and remanded the Determination was because it declined to entertain the argument made only by appellee’s counsel that “the prior rates had been set far too low, thus negating the usefulness of the prior settlement as a benchmark.” *Johnson*, 969 F.3d at 387. The Judges have noted throughout this Initial Ruling their adoption of the Shapley Value modeling analysis undertaken by the Majority, and raised the headline royalty rate by 44% from 10.5% to 15.1% (as phased-in), rendering moot appellate counsel’s suggestion regarding the rate level.

Here, the Judges further consider whether other rates within the PR II-based benchmark are reasonable, not only because they are part and parcel of the workable structure of that benchmark, but also to determine if they are supported by record evidence. To put this issue in context, those rates would apply on the second prong of the “greater-of” rate structure in the PR II-based benchmark. The first prong in the PR II-based benchmark rates is the 10.5% revenue rate—increased to 15.1% (as phased-in) by this Initial Ruling. The second prong consists of the “lesser of” a TCC rate or a per subscriber rate.¹¹² For certain delivery configurations, these rates also cannot fall below any applicable Mechanical Floor. *See Johnson*, 969 F.3d at 370.¹¹³

The Services describe the key feature of these non-headline rates as the fostering of beneficial price discrimination, *i.e.*, the adoption of “different rate levels for different product offering,” in order [t]o account for consumers’ different willingness to pay [WTP] for music. Services’ Joint Opening Brief (on Remand) at 21. As an example of how these price discriminatory rates impacted the market, the Services compare and contrast two Amazon offerings, Amazon Music Unlimited (for Echo) and Amazon Prime Music.

Amazon Music Unlimited, with more than 30 million available songs as of the *Phonorecords II* proceeding period, *see* Mirchandani WDT ¶ 41, [REDACTED]

¹¹¹ The Judges also find Copyright Owners’ assertion that they did not know how those rates were established is not credible, given that they and their representatives negotiated those rates.

¹¹² This second prong contains only a TCC rate (*i.e.*, an uncapped rate) for: (1) the ad-supported the service, because there are no subscribers to such a service; and for (2) bundled subscription service, for which there is a \$0.25 per month floor but no per-subscriber cap, and Service Revenue for such bundles is calculated pursuant to 37 C.F.R. § 385.11 (“Service Revenue” definition, ¶ 5).

¹¹³ As *Johnson* explained, the CRB Judges “retained the mechanical floor” because, like so much of the PR II-based benchmark, it “‘appropriately balances the [streaming service providers’] need for the predictability of an All-In rate with publishers’ and songwriters’ need for a failsafe to ensure that mechanical royalties will not vanish[.]” *Id.* at 371-72. It is noteworthy that Copyright Owners urged the Judges (successfully) to maintain the Mechanical Floor provisions, which are the product of the *Phonorecords II* (and *Phonorecords I*) negotiations. Thus, it seems apparent that Copyright Owners as well as the Services consider provisions from the negotiated rates and rate structure to be in the nature of benchmarks, although differing as to which elements such be included or excluded. (The Services unsuccessfully argued for the elimination of the Mechanical Floors.) This perspective underscores the correctness of the Judges’ decision on remand to treat the PR II-based benchmark as useful.

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██████████.¹¹⁴ By contrast, Amazon Prime Music, calculated as a “bundled subscription” configuration, makes available only an abridged repertoire of 2 million songs, see Mirchandani, *supra*, and ██████████. *See id.* at § 385.13(a)(4).

Thus, Amazon pays ██████████ for listening by the more casual consumers who use the limited catalog Prime Music service at no additional charge beyond their Prime membership fee, compared to consumers who want the full repertoire provided by Amazon Music Unlimited on their Echo devices. *See Services’ Joint Opening Brief* at 71. These royalty obligations demonstrate the combination of price discrimination, product differentiation and “derived demand” in action; that is, the ██████████ are derived from the lower demand of consumers of the limited Amazon Prime Music service compared with subscribers to Amazon Music Unlimited on their Echo devices, which in turn drive higher revenues.

It is also important to note that these differential rates on the second prong of the “greater-of” structure of the PR II Rates are overridden by the revenue percentage rate on the first prong if that first prong rate generates more revenue. For example, ██████████, *see Dissent* at 29 (Table) and 116; *see also* ██████████

With the headline rate now increased on a phased-in basis, the price discriminatory royalty generated by this ██████████

It is noteworthy that *Johnson* affirmed the Majority’s setting of other price discriminatory features, *e.g.*, the family and student plan provisions, based on the Judges’ reliance on the Services’ expert testimony regarding the benefits of “having a way ... where low willingness to pay consumers can still access music in a way that still allows more monetization of that provision of that service.” *Johnson*, 969 F.3d at 392-93. In similar fashion, the multi-tiered rates in the PR II-based benchmark likewise were supported by the same type of testimony; indeed, from expert testimony proffered by both parties, as considered below.

First, Professor Katz notes that the existing rate structure captures two important aspects of the economics of the interactive streaming market: (1) the variable WTP among listeners; and (2) the corollary variable demand for streaming services. *See* 3/13/17 Tr. 586-87 (Katz); *see also* Marx WRT ¶ 239 *et seq.*; 4/7/17 Tr. 5568 (Marx) (noting that the present structure serves differentiated products offered to customer segments with a variety of preferences and WTP). In more formal economic terms, Professor Katz notes that the present structure enhances variable pricing that allows streaming services “to work [their] way down the demand curve,” *i.e.*, to engage in price discrimination that expands the market, providing increased revenue to the Copyright Owners as well as the Services. 3/13/17Tr. 701 (Katz).

¹¹⁴ ██████████

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Second, in similar testimony, Professor Hubbard captures the interrelationship between the economics of this market and the existing rate structure:

[F]rom an economic perspective, you can think of this market and this industry as being composed of different customer segments by tastes and preferences and willingness to pay. And so no rate structure can really work without understanding that, and no business model can really work without understanding that.

[I]n terms of rate structures, the *Phonorecords II* framework from the previous proceeding does offer a benchmark to start because it provides for differences in distinct product categories in terms of music service offerings, pricing possibilities, and so on. And it has encouraged a very diverse digital music offering set from actual competitors.

3/21/17 Tr. 2175-76 (Hubbard). Moreover, Professor Hubbard

4/13/17 Tr. 5978 (Hubbard); *see also* Hubbard WDT ¶4.7 (the 2012 rate structure provides the “necessary flexibility to accommodate the underlying economics of Amazon’s various digital music service offerings.”). *See also* 3/15/17 Tr. 1176 (Leonard) (notwithstanding changes and growth in the streaming marketplace over current rate period, underlying economic structure of marketplace, which made percent-of-revenue based royalty appropriate, has not changed).

Third, the Services’ experts further assert that the multiple pricing structures necessary to satisfy the WTP and the differentiated quality preferences of downstream listeners relate directly to the upstream rate structure to be established in this proceeding. For example, Professor Marx opines that the appropriate *upstream* rate structure is derived from the characteristics of downstream demand. 3/20/17 Tr. 1967 (Marx) (agreeing that rate structure upstream should be derived from need to exploit willingness to pay of various users downstream via percentage of revenue because downstream listeners have varying willingness to pay that should be exploited for mutual benefit of copyright licensees and licensors). Professor Marx further acknowledged that this upstream:downstream consonance in rate structures represents an application of the concept of “derived demand,” whereby the demand upstream for inputs is dependent upon the demand for the final product downstream. *Id.* Moreover, Dr. Leonard notes that reliance on the Services to identify segmented demand and develop price discriminatory approaches is appropriate because “the downstream company is going to have a lot more information about ... the business, about what makes sense.” 4/6/17 Tr. 5238 (Leonard).

Regarding a comparison of revenue growth to streaming growth, Professor Hubbard dismisses as economically “meaningless” Copyright Owners’ argument that they have suffered *relative* economic injury under the current rate structure simply because the increase in their revenues from interactive streaming has been proportionately less than the growth in the number of interactive streams, leading mathematically to a lower implicit or effective per stream royalty rate. That is, he notes there is no evidence to rebut this *prima facie* indication of beneficial price discrimination, *i.e.*, no contrary evidence indicating that, if the Services had sought to increase the price of the services available to these low to zero WTP listeners because of higher royalties,

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they would have paid the higher price, rather than declined to utilize a royalty-bearing interactive streaming service. *See* 4/13/17 Tr. 5971-73 (Hubbard); *see also Dissent* at 52.

The Services also link their price discrimination argument to the fact that the marginal physical cost of streaming is zero to the need for a flexible rate structure such as now exists. In this regard, Professor Hubbard notes that, because “[t]he marginal production cost at issue here is – is zero. ... it’s not clear why it’s not better to bring new customers into the market on which royalties would be paid and, of course, zero marginal cost incurred.” 4/13/17 Tr. 5917-18 (Hubbard). *See also* Marx WDT ¶ 97 (“Setting the price of marginal downstream listening at its marginal cost of zero induces more music consumption and variety than per-song or per-album pricing.”).

Professor Marx makes the same argument as to the salutary nature of price discrimination in this context with regard to Spotify’s ad-supported approach. Focusing on the first purpose, Spotify is attracting ad-supported listeners who have a relatively low WTP, whether they have low incomes, (a budget constraint) or low interest in music (low “utility,” in the parlance of economists). These listeners, and the advertising revenue they generate are real and reflect the WTP of a large swath of all interactive listeners. *See* Marx WRT ¶ 115-16 & Fig. 9 (“While I agree that one aspect of the ad-supported service is to provide an on-ramp to paid services, it also has another important aspect, namely to serve low WTP customers Copyright Owners’ economists err in not calculating the impact of the Copyright Owners’ proposal on ad-supported services. Ad-supported services currently make up a majority of subscribers and █% of all streams in the industry.”).

Accordingly, a separate tier for an ad-supported service accounts for the different nature of the downstream listenership, allowing the upstream royalty to be based on that characteristic. This differentiation was essentially acknowledged by Copyright Owners late (*too late*, actually) when they proposed in their post-hearing filing that “if the Judges intend to include the Spotify ad-supported service in the rate structure and rate calculations, that they do so by establishing separate *rates and terms* for the ad-supported service. *See* COPCOL (Corrected) ¶ 228 & n.34. But the PR II-benchmark already incorporates separate rates for free/ad-supported services!”¹¹⁵

Another important evidentiary factor buttressing the need for price discriminatory rates and structures was the testimony of the Services’ survey expert, Mr. Robert Klein, Chair and co-founder of Applied Marketing Systems, Inc. Mr. Klein surveyed 2,101 people (the Klein Survey) who were listeners to streamed music and found, *inter alia*, that: (1) the majority of listeners would not pay for a monthly streaming subscription; and (2) for those who do subscribe, their demand was elastic, with increases in subscription prices causing overall greater percentage reductions in quantity demanded, moving customers to free, ad-supported and non-streaming alternatives. *See Klein* WRT ¶¶ 60-67. By contrast, Copyright Owners did not present any survey testimony. The Determination fully credited the Klein Survey, finding as follows:

¹¹⁵ Copyright Owners also belatedly proposed that the Judges establish specific functionality limits on a separate ad-supported prong to avoid cannibalization of subscriber-based streaming with fuller functionality. *Id.* █

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It is important to note that Copyright Owners' attacks on the Klein Survey are not levelled by any witnesses, nor contradicted by their own survey expert, because Copyright Owners elected not to proffer such an expert in their direct (or rebuttal) cases. Rather, Copyright Owners elected to make a descriptive argument regarding the elasticity of demand among different segments of the market, as opposed to a survey-based or econometric study of price elasticity.

[Although] Copyright Owners attack the Klein Survey on several fronts[,] [t]he arguments made by Copyright Owners are insufficient ... to seriously weaken the probative value of the Klein Survey. In the end, the Judges are not persuaded by the Copyright Owners' revenue bundling arguments not to adopt a flexible, revenue-based royalty rate.

Determination at 22-23 & n.53; *see also* Dissent at 64-67 (including point-by-point rejection of Copyright Owners' non-expert criticisms of Klein Survey).

The Services also note that the existing rate structure has produced generally positive practical consequences in the marketplace. Their joint accounting expert, Professor Mark Zmijewski, testified that the [REDACTED] from the sale of product under (former) Subpart A since 2014 has been [REDACTED] over the same period. Expert Report of Mark E. Zmijewski February 15, 2017 ¶¶ 38, 40 (Zmijewski WRT); 4/12/17 Tr. 5783 (Zmijewski); *see also* 4/13/17 Tr. 5897 (Hubbard) ("the evidence that I reviewed suggests that the copyright holders have actually benefitted from this structure").

More particularly, Professor Zmijewski testified that:

- Total revenues reported by the NMPA for NMPA members from all royalty sources [REDACTED]

[REDACTED] Zmijewski WRT ¶ 41.

- This [REDACTED]

[REDACTED] *Id.*

- The [REDACTED]

[REDACTED] *Id.*

- Mechanical royalty revenue for the sale of downloads and physical phonorecords [REDACTED]

[REDACTED] *Id.* ¶ 38.¹¹⁶

In sum, the foregoing analysis demonstrates the economic reasonableness and appropriateness of the price discriminatory *Phonorecords II* rate structure and its negotiated safeguards to address the real possibility of revenue diminution. As discussed below, the record evidence also supports royalty rates within the PR II-based benchmark.¹¹⁷

The PR II-based benchmark contain several alternate rates explicitly calculated as a percentage of payments made by interactive streaming services to the record companies for sound recording rights. See Appendix A to this Initial Ruling. In the Subpart relating to streaming, the (former) subpart B category, the TCC is 22% for ad-supported services and 21% for portable subscriptions. *Id.*; see also 37 C.F.R. § 385.13(b)(2) and (c)(2). These percentage figures correspond to sound recording: musical works royalty ratios of 4.55:1 and 4.76:1, respectively.

With regard to these ratios, Copyright Owners' economic expert witness, Dr. Eisenach, stated: "In my opinion, the evidence ... indicates that the relative valuation ratios implied by the current Section 115 compulsory license ... represent *an upper bound on the relative market valuations* of the sound recording and musical works rights." *Id.* ¶ 92 (emphasis added). (As an "upper bound," these ratios would represent the *lower bound on the relative market valuations* of the reciprocal percentage of the value musical works rights relative to sound recording rights, again, 22% and 21 %.¹¹⁸) Thus, there appears to be consensus between Copyright Owners' witness and the Services (who advocate for applying these rates on the price discriminatory tier

¹¹⁶ By contrast, Copyright Owners assert that the appropriate approach would only consider interactive service payment of mechanical royalties, and exclude performance royalties. On that basis, revenue for the sale of digital downloads and physical phonorecords mechanical royalty revenue [REDACTED] from [REDACTED] in 2014 to [REDACTED] (as noted in (4) above, whereas mechanical royalty from streaming [REDACTED] from [REDACTED] in 2014 to [REDACTED] in 2015. Thus, the [REDACTED] in mechanical royalty revenue from streaming [REDACTED] in mechanical royalty revenue from the sale of digital and physical phonorecords. The Judges do not agree with Copyright Owners. Performance royalty and mechanical royalty payments made by the Services are for perfect complements – neither license has any value to the Services unless they acquire both. Indeed, that is a critical reason why the mechanical rate is calculated on an "All-In" basis. Thus, it makes sense to make the comparison in the manner undertaken by Professor Zmijewski.

¹¹⁷ Again, to be clear, the Judges are substituting the 15.1% revenue rate for the 10.5% revenue rate as the headline rate in the "greater-of" structure of the *Phonorecords II* benchmark. Thus, the price discriminatory royalty rates discussed below would apply only if they generated a "greater" level of revenue than the headline 15.1% revenue rate. And, although the Mechanical Floor rate is not tied *directly* as an alternative to the "greater-of" revenue rate (now 15.1% as phased-in), it is not a floor that ignores the effect of that "greater of" rate. For example, assume the popular standalone portable subscription streaming service that people access on their mobile phones would pay an "All-In" musical works royalty of 15.1% based on the application of the two "greater-of" prongs. However, assume also the "Performance Royalty" that must be subtracted is 12%. That would leave 3.1% of service revenue attributable to the mechanical right. However, if that revenue rate of 3.1% yielded mechanical royalty revenue that was less than the royalty revenue generated by the applicable monthly mechanical floor of \$0.50 per subscriber, then the mechanical floor would control. This application, like any other application of the mechanical floor, does not diminish the value of the 15.1% right, but rather limits *its reduction* under the "All-In" calculation. Recall also that the Determination, Dissent and *Johnson* do not disturb the All-In and Mechanical Floor features of the *Phonorecords II* benchmark.) And finally, with regard to the actual per subscriber monetary values in the mechanical floors, no party suggested changes from rate levels in the PR II-based benchmark, including in the mechanical floor rates. The Judges recognize, as did Dr. Katz, Pandora's economic expert witness, that alternate values might have been preferable for rates contained in the PR II-based benchmark, but none were in the record. See 4/15/17 Tr. 5056-58 (Katz).

¹¹⁸ $1 \div 4.55 = .219$, or 22% (rounded); $1 \div 4.76 = .210$ (21%).

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of their benchmark) that these rates constitute “relative *market* valuations” (even if they are not Dr. Eisenach’s preferred market valuations within the bounded zone of such values).

Dr. Eisenach’s testimony regarding the “bounds” of useful market valuations is noteworthy because his acknowledgement is consonant with judicial precedent. The Judges’ setting of reasonable rates often requires them to identify a “zone of reasonableness,” within which they identify appropriate statutory rates. *See, e.g., Intercollegiate Broadcasting System, Inc. v. Copyright Royalty Board*, 684 F.3d 1332, 1340 (D.C. Cir. 2012) (The CRB Judges’ rate setting can necessitate the finding of a “zone of reasonableness [because] “[s]tatutory reasonableness is an abstract quality represented by an area rather than a pinpoint.”).

The 21% and 22% TCC rates within section 115 identified by Dr. Eisenach as generating the “lower bound on the relative market valuations” imply certain approximate percent-of-revenue rates, *i.e.*, percent of total service revenue (not percent of sound recording revenue). *See Dissent* at 91, n.133 (sound recording rates clustered between █% and █% of revenue). For example, if the sound recording royalty rate for interactive streaming is █% of revenue, then the musical works rate would be calculated as $0.21 \times \text{█}$, which equals █%, (or as $.22 \times \text{█}$, which equals █%). At the low end of the range, if the sound recording royalty rate is █%, then, applying these TCC figures, the implied musical work royalty rate would be calculated as █% ($.21 \times \text{█}$) or █% ($.22 \times \text{█}$).¹¹⁹

It is important to emphasize and detail the context of these price discriminatory rates. These capped TCC rates are on the “greater of prong” that is compared with the headline 15.1% revenue rate (phased-in) that the Judges are also adopting in this Initial Ruling. As phased in, the headline rate is greater than all the capped TCC-based rates identified in Dr. Eisenach’s testimony, *supra*, █. For 2019, the phased-in headline percentage rate, 12.3%, is █ the █% and █% revenue rates derived if the sound recording rates was █%. For 2018, the phased-in headline percentage rate, 11.4%, is █ all the rates derived from the capped TCC rates Dr. Eisenach identified as “market valuations” (albeit the lower bound in his opinion). But that is of no negative consequence for Copyright Owners, because they would get paid on the “greater-of” metric (capped TCC or headline rate) under the *Phonorecords II*-based rate structure the Judges are adopting (For the portable subscriptions, even though the 80 cents/subscriber “lesser-of” portion of the non-headline prong would apply on that prong if it was lower than the capped TCC rate, the actual rate could not be lower than the phased-in headline rate.)

Dr. Eisenach also examined direct agreements between record companies and interactive streaming services that contain rates for sound recordings and mechanical royalties, respectively. *See, e.g., id.* ¶¶ at 84-91. In such cases, the ratio of sound-recording to musical-works royalties

¹¹⁹ Dr. Eisenach’s identification of the 21%-22% TCC as within the bounds of market valuations may appear surprising at first in light of the higher 26.2% uncapped TCC rate pursued (unsuccessfully) on remand by Copyright Owners. But in the context of his testimony, Dr. Eisenach’s opinion is understandable. The former headline rate of 10.5%, when sound recording rates ranged from approximately █% to █% of streaming revenues, yielded TCC rates between █% and █%. Thus, Dr. Eisenach was identifying a market valuation █ (at his lower bound) between █% (the difference between 21% and █%) and █% (the difference between 22% and █%). Again, for context, this Initial Ruling raises the percentage rate by 44% when fully phased-in (based on the experts’ Shapley analyses, significantly above the TCC rates advocated by Dr. Eisenach, even assuming the █%-█% sound recording rates on which he relied.

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ranged tightly between [REDACTED] and [REDACTED], closely tracking the regulatory ratios implicit in the section 115 TCC. *Id.* ¶ 92. (The [REDACTED] ratio equates to a TCC rate of [REDACTED]%, and the [REDACTED] ratio equates to a mechanical rate of [REDACTED]%). He concluded, as he did with regard to the actual section 115 license rates: “In my opinion, the evidence presented ... indicates that the relative valuation ratios implied by the ... negotiations under [the statutory] shadow – ranging from [REDACTED] [REDACTED]%% to [REDACTED] [REDACTED]—represent an *upper bound on the relative market valuations of the sound recording and musical works rights.*” Eisenach WDT ¶ 92. (emphasis added).

Dr. Eisenach also identified several additional useful benchmarks. First, he identified what was coined the “Pandora Opt-Out Agreement” benchmark,¹²⁰ which reflected a ratio of [REDACTED] of sound-recordings to musical-works in a comparable benchmark setting. This ratio translates to a TCC percent of [REDACTED]%. With sound recording royalty rates of approximately [REDACTED]% to [REDACTED]%, this TCC reflects an effective percentage of total revenue equal to [REDACTED]% to [REDACTED]%.

Second, Dr. Eisenach identified YouTube agreements with music publishers that relate to the combination of a commercial sound recording and a “static image.” The YouTube agreements contain an explicit royalty of [REDACTED].¹²¹ That [REDACTED]% royalty is a denominator in the ratio concept utilized by Dr. Eisenach, and the numerator is the [REDACTED] sound recording royalty paid to the record companies. YouTube had agreed to pay [REDACTED] [REDACTED] of its revenues, and had agreed to pay [REDACTED] and other record companies [REDACTED] of revenues. The [REDACTED] ratio reduces to [REDACTED], implying a TCC ([REDACTED]) of [REDACTED]%. The [REDACTED] ratio reduces to [REDACTED], implying a TCC ([REDACTED]) of [REDACTED]%. *See* Dissent at 101-102.

These additional rates identified in Dr. Eisenach’s testimony further confirm the reasonableness of the non-headline rates within the PR II-based benchmark.

Finally, the Judges look at the effective rates paid by Spotify, the largest interactive streaming service in terms of in terms of the number of subscriber-months and the number of plays. *See* Marx WRT ¶¶ 37-38 & Figs. 8 & 9. Under the PR II based benchmark, Spotify paid on its *subscription* service an effective “All-In” royalty rate of [REDACTED]% of its total revenues. *See* Dissent at 80, 115, 149 (and record citations therein). Spotify paid this effective percent-of-

¹²⁰Pandora was only a noninteractive service at that time, and thus only paid the performance right royalty, not the mechanical right royalty, for the right to use musical works. Because the parties agree that the performance right and the mechanical right are perfect complements, Pandora’s payments for the performance right are thus relevant and probative, as they reflect the full value of the musical works royalty to a noninteractive service. These factors became relevant because major music publishers had negotiated direct licensing agreements with Pandora for its *noninteractive* service covering the period from 2012 through 2018. Eisenach WDT ¶ 103. They negotiated these direct agreements after certain publishers had decided to “opt-out,” *i.e.*, to withdraw their digital music performance rights from PROs, and asserted the right to negotiate directly with a digital streaming service. Pandora thus negotiated several such “Opt-Out” Agreements with an understanding that the rates contained in those direct agreements might not be subject to rate court review and thus could reflect market-based rates. Given this unique circumstance, and given that the markets and parties involved in the Pandora Opt-Out agreements are somewhat comparable to the markets and parties at issue in this proceeding, Dr. Eisenach concluded that *these agreements provided* “significant insight into the relative value of the sound recording and musical works rights in this proceeding.” *Id.* (emphasis added). (The Judges did not adopt Dr. Eisenach’s speculation that this performance royalty would continue to grow after 2018. *See* Determination at 51; Dissent at 102-103).

¹²¹ Dr. Eisenach preferred to use YouTube agreements that included [REDACTED], but the Judges relied on [REDACTED] as more comparative. Determination at 50; Dissent at 102.

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revenue rate [REDACTED]. *See id.* at 29 (Table).

Turning to Spotify’s free/ad-supported offering (and as noted *supra*), Spotify paid royalties under the PR II Rates at an effective “All-In” royalty rate of [REDACTED]%. Spotify paid this effective percent-of-revenue rate [REDACTED]. *See id.* When Spotify’s two tiers are blended and averaged, the effective percent-of-revenue rate is [REDACTED]% of revenue. *See id.* at 116. The average rate has salience in this proceeding because Spotify’s two tiers are interrelated, in that free/ad-supported listeners constitute a pool of potential converts to the subscription tier under this “freemium” model, even as this offering generates royalties under the PR II-based benchmark.

d. Copyright Owners’ Concern Regarding Revenue Diminution is Insufficient to Reject the PR II-Based Benchmark

Copyright Owners argue that what the Services tout as beneficial price discrimination generates an “incredible” level of revenue diminution, including displacement, resulting in a “major problem” that reduces reportable revenues and thus the royalty base. *See, e.g.,* 3/7/22 Tr. 193 (Copyright Owners’ counsel). This argument is based upon documents and evidence that demonstrated the following:

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

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• [REDACTED]

• [REDACTED]

- Copyright Owners' expert, Dr. Rysman, testified that interactive services often elect to forgo current profit maximization, *e.g.*, by charging lower prices, in order to build a customer base and greater long-run profitability or value, from selling music and non-music products or services to its customers.

CO Initial Submission at 40-42 (and record citations herein).

The Services' economic experts do not ignore the fact that there can be revenue attribution problems when interactive streaming is combined with other products or services. They acknowledge that, even absent any wrongful intent with regard to the identification and measurement of revenue, attribution of revenue across product/service lines of various services can be difficult and imprecise. *See, e.g.*, 4/5/17 Tr. 5000 (Katz) (problem of measuring revenue "certainly a factor that goes into thinking about reasonableness.").

However, Professor Katz testified that the existing rate structure agreed to by the parties accommodates these bundling, deferral, and displacement issues via the use of an alternative rate prong that would be triggered if the royalty revenue resulting from the headline rate of 10.5% of streaming revenue fell below the royalty revenue generated by that second prong. Katz WDT ¶¶ 82-83; 3/13/17 Tr. 670 (Katz). Moreover, Professor Katz concluded that, because the marketplace appears to be functioning (in the sense that publishers are earning profits and new and existing interactive streaming services continue to operate despite accounting losses), these revenue-measurement issues are being adequately handled by the alternative rate prong, even if an altered second prong might work better. *Id.* at 738-39. More generally, Professor Katz further noted that, the existing rates within the PR II-based benchmark were performing well, and even if alternative minima might be preferable, no such alternative rates were in the record. *See* 4/15/17 Tr. 5056-58 (Katz) (under the PR II-based benchmark "the industry ... was performing well," but "if someone had a proposal [with] a specific reason why we should adjust this minimum that's something I would have examined,"). But Copyright Owners did not propose alternative rates or minima within the PR II-based benchmark, but instead urged the Judges to disregard the benchmark *writ large*. Accordingly, there were no alternative rates or minima in the record.

Professor Katz further noted that the PR II-based benchmark rates were established when "ecosystem" entities such as Yahoo—akin to Amazon, Apple, and Google—were in the marketplace. 4/5/17 Tr. 5055-57 (Katz); *see also* Determination at 31 (and record citations therein) (noting the presence of Microsoft as well as Yahoo as licensees in the interactive market during the *Phonorecords II* negotiations).

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More broadly, the Services' position regarding the use of the two prongs and their alternate rates to ameliorate the revenue-measurement problems is summed up by Professor Katz as follows:

[T]he primary reason [for the two rate prongs] ... is because of the measurement issues that can come up when having royalties based on a ... percentage of revenues because there can be issues about how to appropriately assign revenues to a service. And so I think the minim[a] can play an important role when those – you know, when those measurement problems are severe, you can turn to the minimum instead. ... [W]hat I have in mind, right, is that what would happen if you could imagine an entrepreneur coming along and saying we want to have a service and have some incredibly low price and not a very good monetization model, where a copyright owner would say -- in an effectively competitive market, would say, wait a minute, I don't want to license to you on those terms. It's -- I just think the possibility of getting a return is so low, I'm not going to do it, even though you, as an entrepreneur, are willing to try this. I as the copyright owner want some sort of, you know, return on it. And that's what the minimum also helps to do.

3/13/17 Tr. 599 (Katz.); *see also* 3/20/17 Tr. 1900-01 (Marx) (minima protect against revenue measurement problems); 4/7/17 Tr. 5584 (Marx) (statutory minima play “two roles” – *protecting the Copyright Owners* from “revenue mismeasurement” by creating the “greater of” prong,” but incorporating per subscriber rate prong in “lesser of” component *to protect services* from the record companies' use of their market power to engage in “manipulation of the sound recording royalties” on which the TCC prong is calculated).

After considering the record, the Judges determine that the Majority had not found – as Copyright Owners claim – that the activities and strategies by the Services were “incredible” or a “major problem. Rather, the Majority's characterization was measured, stating repeatedly that the Services engaged “*to some extent*” in revenue diminution because they “*might* focus on long-term profit maximization to promote their long-term growth strategy, which occurs “even absent wrongful intent.” Determination at 20-21, 36, 90; *accord*, Dissent at 59. In fact, the Majority specifically stated: “The Judges agree that there is *no support for any sweeping inference that cross-selling has diminished the revenue base.*” *Id.* at 21 (emphasis added). The Majority (and the Dissent) thus acknowledged the reasonableness of both sides of this issue, recognizing both the Services' use of price discriminatory approaches that can lower per user or per-stream revenues but grow royalties, market share and revenue, as well as Copyright Owners' concomitant desire to protect themselves from reductions in the royalty revenue base, however limited in extent, that would only serve to diminish royalties.

One way the input supplier can avoid this impact is to refuse to accept a percent of revenue form of payment and move to a fixed per-unit input price. This is what Copyright Owners originally and unsuccessfully sought in this proceeding, subject to a bargaining room approach by which they could switch back to the old approach (or any other approach) through purely market-based negotiations, unbounded by the statutory and regulatory standards of “fairness” and “effective competition.” *See* Dissent at 60.

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The Judges must reconcile the parties’ competing considerations. A way by which they are both accommodated is through a pricing structure with alternate rate prongs and floors, below which the royalty revenue cannot fall. This is precisely the bargain struck between Copyright Owners and services in 2008 and 2012, and that has been the rate structure through 2017. And, because the Majority and the Dissent found that revenue diminution occurred only “to an extent,” rather than in the pervasive (sweeping”) manner averred by Copyright Owners, there is no sufficient reason in the record to depart from the bargained-for multi-tiered rate structure in *Phonorecords II* that allows for price discrimination but tempers its impact on royalties through the use of minima and floors.

e. Copyright Owners’ Claim of “Inherent” Economic Value is Belied by the Record, including their Own Arguments

Pre-remand, Copyright Owners approached this rate setting process with an overarching premise: A musical work has an “inherent value” that must be reflected in the royalty rates. As the NMPA’s president, Mr. Israelite testified, when asked how “inherent” value is defined:

[W]hoever owns an individual copyright is the one to define it. I think that would be the most appropriate definition of it. What someone is willing to license it for would be that inherent value to that owner ... That would be market value.

3/29/17 Tr. 3707 (Israelite).

If the market for musical works was as atomistic as the above quote assumes, the songwriter of an individual musical work could indeed set his or her own royalty rate, and refuse to license to any streaming service or other distributor who refused to pay that royalty. But that is not how the licensing market works.¹²² Songwriters typically assign their licensing rights to music publishers (to avoid ruinous transaction costs). These music publishers control huge “Must Have” repertoires that are offered under blanket licenses to streaming services. (The musical works market of course is subject to a compulsory license, but this is precisely how the unregulated market works for the licensing of sound recordings by labels to interactive streaming services.) It is acknowledged even by Copyright Owners’ own expert witness, Professor Watt that the creation of these large collectives generates market power that necessitates rate regulation. *See* R. Watt, *Copyright and Economic Theory: Friends or Foes* at 163, 190 (2000) (quoted in Dissent at 35).

Further, this “inherent” market value notion is antiquated as a matter of economics. Although an individual Copyright Owner can announce his or her “asking” royalty, that is not sufficient to generate a “market” royalty, unless and until a licensee agrees to pay it. In market-based economics, that is to say, the economic consensus that has governed economics since the “marginal revolution” in the mid to late 19th century, value is ascertained through the intersection of supply and demand, with the price established at the margin representing the market value of

¹²² The record does not include evidence of self-marketing by songwriters through social media or via negotiation of individual royalty contracts by the exercise of overwhelming star power, whether through traditional payment mechanisms or new methods, such as the murky mechanism of non-fungible tokens (NFTs). The absence of incidents of such self-marketing from the record evidence in this proceeding suggests that they likely constitute but a small segment of the songwriter/publisher market. Accordingly, such self-marketing and individual negotiations do not impact the Judges’ setting of statutory rates in this proceeding.

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the good or service bought and sold.¹²³ If there is no demand for a product, be it a musical work or anything else, it has no economic value. Even though costs have been incurred to produce the product, those costs cannot be recovered (or profit earned) absent a sufficient WTP in the market. And, as noted *supra*, the product being offered and at issue here is comprised of “second copies” of sound recordings (with embedded musical works), which are costless to reproduce for streaming purposes. Of course, these “second copies” do have actual value when they are in demand, and the royalties that their licensing generates must cover: (1) the first copy (creative) costs; (2) the “opportunity cost” (measured by the next best alternative for royalty earnings if the “second copies” could have been supplied through another distribution channel that paid higher royalties to attract the end-user/consumer at issue); and (3) profits to induce the creation of musical works.

Second, the fact that Copyright Owners originally proposed a per-subscriber alternative rate to their per-play rate itself belies their conviction that some “inherent” economic value exists. When the metric of value switches from “per-play” to “per-subscriber,” the focus of value likewise shifts from an emphasis on producer value to consumer value. That is, if there is truly an “inherent” value for a product or service, that singular value cannot divide into two distinct values with the “greater-of” the two controlling. Such an argument gives away the game, so to speak, demonstrating, perhaps unsurprisingly, that economic arguments (not unlike legal advocacy) are often situational—designed to support maximalist positions and the exercise of market power, however acquired. *See also* Determination at 28 n.64 (rejecting the “inherent value” argument).

f. PR II-Based Benchmark Not “Too Complex”

Copyright Owners and the Majority complained that the PR II-based benchmark is too complex. *See* Copyright Owners’ PFF ¶ 12 (criticizing complexity of PR II Rates as lacking “transparency”); Determination at 36 (characterizing parties’ negotiated, renewed, and expanded rate structure as Rube-Goldberg-esque in complexity and impenetrability.”)

After considering this issue on remand, the Judges disagree. If some songwriters or lyricists have been confused by their royalty statements, their confusion of course should be resolved. However, one of the benefits of a collective is that it possesses the expertise and resources to identify and explain how royalties are computed and distributed. Moreover, this

¹²³ As one scholar has summarized the 19th century transition from classical to neoclassical economics:

By the early 1870s, economics reached a tipping point, and it ushered in a revolution in thought, signaling the beginning of the “modern,” or “neoclassical” era. Marginalists flipped classical economics on its head. Instead of focusing on the production side of economics, they turned to consumption. It is the satisfaction of the wants of consumers that matters for value, not the labor required for production. What established the overall value of a good is the value fetched by the final unit of that item on the market. As more units of a good are produced, the marginal value of the last unit tends to decrease.... According to marginal utility, the consumer, not the producer, therefore drives the valuation process.

J. Wasserman, *The Marginal Revolutionaries* at 28 (2019). This transformation reflected the abandonment of the “labor theory of value” – the cornerstone of Marxian economics. *See* E.R. Canterbury, *A Brief History of Economics* at 111 (2001) (“Marx’s devotion to a labor theory of value was complete.”). It initially appears as irony that Copyright Owners espouse a Marxian approach to value while preaching the virtues of unregulated markets. The initial whiff of irony dissipates when one appreciates that a collective licensor with the market power of control over a “Must Have” input has every incentive to urge a pricing or valuation method that takes the focus away from the force of consumer demand in an effectively competitive market, which is a hallmark of neoclassical economics.

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claim of complexity cannot serve as a basis to override the multi-part negotiated benchmark that the parties, through their respective trade associations, negotiated and implemented. As the Dissent stated: “There is no good reason why the rate structure that is consonant with the parties’ ten-year history and with the relevant economic model should be sacrificed on the slender argument that “simpler is better than complicated.” Dissent at 88.¹²⁴

Further, section 801(b)(1) does not identify “simplicity” as a statutory goal for the setting of rates, rate structure, and terms. Although there is certainly no need for gratuitous complexity, the price discriminatory structure and the associated levels of rates in the PR II-based benchmark that were eliminated by the Majority (while maintaining all the remaining complexity) were most certainly not gratuitous, but rather designed, after negotiations, to establish a structure that would expand the revenues and royalties to the benefit of Copyright Owners and Services alike, while also protecting Copyright Owners from potential revenue diminution by the Services. Moreover, when the market itself is complex—in that the WTP across consumer groups is heterogeneous and the offerings reflect that fact—it is unsurprising that the regulatory provisions would resemble the complex terms in a commercial agreement negotiated in such a setting. For the Judges to demand simplicity in this context would be to sacrifice the specificity that an effectively competitive market requires. *See* Dissent at 88 (rejecting the simplicity argument by invoking the advice attributed to Albert Einstein that “[e]verything should be made as simple as possible, *but no simpler.*”

g. So-Called Statutory “Shadow” Does Not Diminish Value of the PR II-Based Benchmark Rates

Copyright Owners maintain that the rates in the PR II-based benchmark are infirm because, like any benchmark for which a statutory rate is the default, they are not actual market rates. That is, such a rate is said to exist in the so-called “shadow” of the statutory rate. *See* Dissent at 70 (and citations therein).

The Judges reject this argument for several reasons. First, the argument is undercut by the explicit language of section 115 of the Copyright Act:

In addition to the objectives set forth in section 801(b)(1), in establishing such rates and terms, the Copyright Royalty Judges may consider rates and terms under voluntary license agreements described in subparagraphs (B) and (C).

17 U.S.C. § 115(c)(3)(D). Subparagraphs (B) and (C), respectively, refer to agreements on “the terms and rates of royalty payments under this section” by “persons entitled to obtain a compulsory license under [17 U.S.C. § 115](a)(1)”; and “licenses” covering “digital phonorecord deliveries.” *Id.* Thus, it is beyond dispute that Congress has authorized the Judges, in their discretion, to consider such agreements as evidence, irrespective of—or perhaps because of—the shadow cast by the compulsory license. Thus, the appropriate question is *how much weight* the Judges, in their discretion, should afford such benchmarks in any particular proceeding.

¹²⁴ Copyright Owners’ concern for transparency has apparently evaporated in connection with its eagerness to adopt the proffered uncapped TCC rates. Under that approach, the definition of revenue, the handling of bundled products and the exclusion of certain consideration from the royalty base will remain opaque to songwriters—and to the Judges.

There is no basis to find, as Copyright Owners suggest, that statutorily-based or influenced benchmarks, including specifically the PR II-based benchmark in this proceeding, are *per se* inferior to other benchmarks or alternative economic evidence (e.g., from models, surveys or experiments) that may be unaffected by the shadow. Those other benchmarks or forms of evidence will also be subject to their own imperfections and incompatibilities with the target market and must be identified and weighed accordingly.¹²⁵ Thus, the Judges must not only consider (i) the importance, *vel non*, of any potential so-called “shadow-based” distortionary effects from a benchmark derived from a *regulated* statutory benchmark market, but also (ii) how any such purported “shadow” effects compare to any distortions generated by other proffered benchmarks and competing alternative economic evidence, e.g., distortions based on complementary oligopoly power, bargaining constraints and product differentiation in other benchmarks, models, surveys or experiments.¹²⁶

The Services’ experts discount the foregoing shadow-based criticism. Moreover, the Services laud a statutorily-influenced benchmark in general, and the specific PR II-based benchmark in particular, because the latter reflects more equal bargaining power between licensors and licensees. In this regard, one of the Services’ economic expert witnesses, Professor Katz, points out that rates set voluntarily by the parties in a settlement under the “shadow” provide two important benefits. First, with a statutory rate-setting proceeding as a backstop, large licensors cannot credibly threaten to “hold out” and “walk away” from the negotiations without an agreement, thereby negating their ability to use their “must have” status to obtain rates above effectively competitive levels. Second, when, as here, such negotiations are conducted with *all the parties* at the figurative table—including here, trade associations—no single party has disproportionate market power in the negotiations. *See* 3/13/17 Tr. 661 (Katz).

The Judges agree that settlement agreements reached in the statutory shadow are useful. Although imperfect when considered in *isolation*, in that the statutory proceeding is the default backstop, in *context* they negate the power of any entity simply to refuse to strike a deal. The negation of that power blunts the complementary oligopoly power of licensors of “Must Have” repertoires (whether musical works or sound recordings), making a benchmark agreement reached in the so-called “shadow” advantageous in establishing an effectively competitive rate. *See Web IV, supra*, 26,316, 26,330-31 (May 2, 2016) (noting counterbalancing effect of statutory license in establishing effectively competitive rates). Further, when such settlement agreements are industrywide, they tend to eliminate disproportionate market power, *See Dissent at 72; Web III*, 79 Fed. Reg. 23,102, 23,111 (Apr. 25, 2014), *aff’d Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, Case No. 14–1098 (D.C. Cir. Aug. 11, 2015) (relying on two settlement agreements).

¹²⁵ It has been famously and wisely said that “all models are wrong, but some are useful.” G. Box & N. Draper, *Empirical Model-Building* at 424 (1987). Benchmarks, Shapley, and Nash models, surveys and experiments are all models, in that “[a] model is a representation of something beyond itself ... being used as a representative of that something, and in prompting questions of resemblance between the model and that something ... substitute systems ... directly examined ... to indirectly acquire information about their target systems.”). U. Maki, *Models are Experiments, Experiments are Models*, 12 J. Econ. Meth. 303 (2005).

¹²⁶ It is also important to note that the reasonable rate and rate structure identified under the section 801(b)(1) standard (before considering the four itemized statutory factors) need not be a market-based rate, as discussed *infra*.

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Nonetheless, Copyright Owners are correct to note that, hypothetically, some licenses might have otherwise been negotiated at rates higher than the settlement rate that was affected by the so-called shadow. But that is simply the tradeoff that the statutory scheme makes in its identification of settlement rates as evidentiary benchmarks. Such a theoretical problem cannot serve to override the salutary aspects of benchmark settlement agreements. *See Web IV, supra* at 26,630 (rejecting same argument as speculative and “too untethered from the facts to be predictive or useful in adjusting for the supposed shadow of the existing statutory rate.”).

Lastly, with regard to a benchmark affected by the so-called “shadow,” the Judges find that, with regard to the application of the itemized factors in section 801(b)(1), they have the same duty to independently weigh those factors as they do for all otherwise reasonable rates. Thus, the Judges reject the idea that rates and terms reached through a settlement must be understood to supersede—or can be *assumed* to embody—the Judges’ current thinking as to the application of the statutory elements set forth in section 801(b)(1). The Judges are obliged to conduct the four-factor analysis anew when considering a previously adopted settlement in a subsequent proceeding – and they do so *infra*. Of course, if on such further analysis, the Judges find that the provisions in an otherwise useful benchmark agreement (including those in a benchmark influenced by the so-called “shadow”) *do* appropriately reflect the four itemized statutory factors in section 801(b)(1), then the Judges may adopt the provisions of that settlement without a factor-based adjustment.

h. Conclusion regarding PR II-Based Benchmark

Accordingly, the Judges find the PR II Rates to be a useful benchmark. However, this benchmark is modified by the Judges’ substitution of the 15.1% headline percentage rate for the 10.5% headline percentage rate in the benchmark.

D. Precedent Permits Judges to Apply Elements of PR II Rates, Rate Structure and Terms Even if Those Are Not Proffered as Benchmarks

The D.C. Circuit has previously held that the Judges have the authority to adopt elements from the existing rate provisions, if they find that those prevailing provisions better satisfy the statutory requisites than any other proposed structures and rates discernible from the record evidence. *Music Choice v. Copyright Royalty Bd.*, 774 F.3d 1000, 1009 (D.C. Cir. 2014). This authority exists even when no party has proffered those provisions in the form of a benchmark.

In *Music Choice* (concerning the setting of satellite radio royalty rates under the same section 801(b)(1) standard), the CRB Judges rejected the parties’ proffered benchmarks and instead relied on a percent-of-revenue rate (13%) that was neither a benchmark nor even the prior statutory rate, but merely “a component of a prior determination.” *Id.* at 1009. The licensor-party, SoundExchange, argued, like Copyright Owners here, that this component of a prior rate was “stale,” “outdated,” or “obsolete.” Rejecting this argument as “erroneous,” the D.C. Circuit stated that “the Judges did not consider the 13% rate as a current benchmark,” but rather used it to “bridge the gap” caused by the inadequacies of the parties’ rejected benchmarks. *Id.* In so doing, the D.C. Circuit held that the Judges properly resolved “serious problems” with the licensor’s proposal, even as it had “partially credited it” and also “used permissible indicia of reasonableness to help fix the rate.” *Id.*

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Music Choice is highly instructive. Here, on remand, the Judges adopt a modified version of the prior rate structure and rates in *Phonorecords II*. The fact that it was also proffered as a benchmark, in another modified form by the Services, does not render *Music Choice* inapposite. Rather, because the *Phonorecords II* provisions were proffered as benchmark evidence, these provisions were placed squarely into the record, allowing the parties and the Judges to address the relative merits. *A fortiori*, *Music Choice* underscores the propriety of the Judges approach in this proceeding. That is, even if the Services had not proffered this approach as a benchmark, *Music Choice* allows the *Phonorecords II* approach to serve as a guidepost for establishing the rates and rate structure in this proceeding.

Further, here the Judges are adopting actual elements from the prior rate provisions, rather than, as in *Music Choice*, a mere “component” used to generate the prior rate. *A fortiori* yet again, *Music Choice* allows the Judges to prudently utilize the prior rate and rate structure regulations to synthesize a determination in this proceeding. The analogous nature of *Music Choice* is also seen in the Judges’ use in the present case of the “headline” 15.1% revenue rate proposed by Copyright Owners on remand *combined with* elements from the PR-II regulatory provisions, including its price discriminatory rates. In *Music Choice*, the Judges likewise “partially credited” the licensor’s proposal, which, as noted *supra*, the D.C. Circuit affirmed.

Finally, the Judges take note that *Music Choice* also addressed the Judges’ findings regarding the setting of another statutory license, for Preexisting Subscription Services (PSS), by using a rate in a settlement from a prior period. This context is also analogous here, because Copyright Owners object to the use of the *Phonorecords II* rate structure and rates as the product of a settlement. It is instructive to consider how the arguments of the licensor (SoundExchange) in *Music Choice* mirror those of Copyright Owners in this proceeding:

- SoundExchange notes that this rate “*is the product of settlement negotiations that occurred in SDARS I between Music Choice and SoundExchange.*”
- SoundExchange argues that the Judges arbitrarily rejected ... more recent data points in favor of the “outdated” settlement rate.
- SoundExchange maintains that the Judges conceded that the prevailing rate had limited value, as the settlement rate “was negotiated in the shadow of the statutory licensing system and cannot properly be said to be a market benchmark rate.”
- SoundExchange also argues that simply reciting that “nothing in the record persuades the Judges” that the prevailing rate is unreasonable ... does not show that [it] is reasonable, or that it is supported by the written record.
- [G]iven the lack of creditable benchmarks in the record, the Judges did not err when they used the prevailing rate as the starting point of their Section 801(b) analysis.
- The Copyright Act contemplates that the Judges would ... consider “prior determinations” and rates established “under voluntary license agreements.”

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- [T]he Judges did not err when relying on the settlement rate. The Judges conceded that the settlement rate does not represent a market rate. ... But ... the relevant portion of the Copyright Act does not use the term “market rates,” nor does it require that the term “reasonable rates” be defined as market rates. ... The Act authorizes the Judges to consider rates set “under voluntary license agreements.”
- Music Choice complains that it agreed to a higher rate to avoid litigation costs, but has not introduced evidence that the settlement was involuntary or otherwise unreasonable. It was not arbitrary, then, for the Judges to consider the voluntary settlement rate.

Music Choice, 774 F.3d at 1012-15. These aspects of *Music Choice* are highly instructive, considering the Judges’ parallel findings regarding the same and similar arguments as discussed *supra* regarding prior settlement agreements and the so-called “shadow” of the statutory rates.

In sum, *Music Choice* provides ample support for the conclusion that, even if the Services had not proffered their PR II-based benchmark, the Judges would have acted well within their authority to give the same weight to the PR II rates and structure as they have in this Initial Ruling.¹²⁷

E. Four Itemized Factors in Section 801(b)(1)

The Judges have considered the application of the four itemized statutory factors A through D, in connection with their application of the 15.1% revenue rate and their partial use of the PR II-based benchmark.

1. Factor A

The Judges have explained *supra* that price discrimination is a “win-win” for Copyright Owners and the Services. By serving low WTP listeners, it brings in new listeners and subscribers who increase royalty payments as well as revenues. Any licensor would prefer to increase its royalties, rather than “leave money on the table,” and a rate structure that effects such an increase (through the concept of “derived demand”) is appropriate. Moreover, for purposes of applying Factor A, a rate structure that increases royalties, *ceteris paribus*, would induce more production of musical works, a result that Copyright Owners should desire.

This point appears to raise a question: How could Copyright Owners and their economic experts object to a rate structure that inures to their benefit as well? The answer is: They do not object. They are not economic naifs. As stated *supra*, they advocate for a rate set under the bargaining room theory, through which rate structures can still be negotiated, but not subject to

¹²⁷ This ruling is in no way conflicts with the Judges’ duty to set rates, rate structures, and terms *de novo* in each rate proceeding, as discussed *supra*. The *de novo* process requires the Judges to weigh new evidence regarding potential new rates, rate structures, and terms, but that is not inconsistent with the Judges’ ability, as explicated by the D.C. Circuit in *Music Choice*, to adopt prior rates, rate structures, and terms in whole or in part if, in their discretion, the new evidence is deficient. See *Music Choice*, *supra*, at 1012 (“The Judges were under no obligation to salvage benchmarks they found to have fundamental problems.”).

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the “reasonable rate” and itemized factor analysis required by law. In those negotiations, as Dr. Eisenach candidly acknowledged, Copyright Owners would have a different threat point to use in order to obtain better rates and terms. 4/4/17 Tr. 4845-46 (Eisenach).

Second, given a heterogeneous downstream WTP, it would not be more profitable simply to equate “availability” with a higher rate. As noted *supra*, any product that is priced beyond the WTP of a significant portion of the public is *unavailable* to that segment.¹²⁸ Royalties that are aligned with the varying WTP of different classes of listeners will make downstream price discrimination more affordable to the services, driving new revenue and royalties—precisely as the PR II-based benchmark allows.¹²⁹ In this regard, Copyright Owners have taken a cramped and unrealistic view of such incentives. In particular, the Judges disagree with Copyright Owners’ expert economic witness, Professor Rysman, who startlingly asserted in response to a hypothetical from the bench that even a \$10,000 per month subscription price would increase “availability.” 4/3/17 Tr. 4397 (Rysman).

The Judges find Professor Rysman misapprehends the nature of a price signal. If the price is so high as to eliminate or reduce total revenue to creators, in no way will higher rates simply induce the supply of creative works over time. Indeed, even monopolists do not seek the highest price possible, but rather seek to maximize profits. *See* E. Mansfield & G. Yohe, *Microeconomics* at 362-63 (11th ed. 2004) (“Monopolies maximize profits by producing where marginal cost equals marginal revenue.”). Thus, even monopolists, who have the most market power, are constrained in their pricing by the demand curve and the marginal revenue it creates. Simply put, although a higher royalty *rate* might have an immediate superficial appeal, if the consequence will be lower revenues, the high per-play rate would reveal itself as a form of fool’s gold.

In sum, the Judges find that the Factor A objective of “maximizing the availability of creative works” is furthered by an upstream rate structure that contains multiple royalty rates reflective of and derived from downstream variable WTP, because it will facilitate beneficial price discrimination. Such price discrimination allows for access to be afforded “down the demand curve,” making musical works available to more members of the public. However, there is no evidence to suggest that the price discriminatory rates should be changed, in order to address the connection between price discrimination and the objective of Factor (A). Accordingly, the Judges find no basis to adjust either the rate structure or the rates based on Factor (A).

¹²⁸ The concept of willingness-to-pay (WTP) as used by economists is an antiseptic phrase, because it includes not merely people who do not value a music streaming subscription highly, but also individuals and families who are “income constrained” (yet another antiseptic phrase, read “low income” people and families) who lack the “ability-to-pay” for an interactive subscription. That segment of the population likely reflects a significant portion of the nation, because “40% of Americans would struggle to come up with even \$400 to pay for an unexpected bill,” let alone pay for a music streaming service. *See* <https://www.minneapolisfed.org/article/2021/what-a-400-dollar-emergency-expense-tells-us-bout-the-economy>. When the royalty rates paid by interactive services enable streaming services to satisfy the demand of these low-income consumers (through the principle of “derived demand”) that segment of American society can enjoy the benefits of listening to interactive streamed music, even if the offerings they can afford lack the large catalogs and “bells and whistles” of a pricier service.

¹²⁹ To be sure, royalties will not increase in equal proportions with increases in the number of streams or listeners, but that is a feature of price discrimination, not a bug. The goal is to generate revenues from low WTP listeners who otherwise would be lost as sources of revenues and royalties to both the interactive services and Copyright Owners.

2. Factors B and C

The concepts of “fair income,” “fair return” and recompense for costs and other contributions was considered in connection with the setting of the 15.1% revenue rate. In that context, the Judges analyzed the Shapley Value modeling that was designed to generate “fair” rates that allowed the parties to recover their costs and to share the surplus (over and above costs) in a manner that: (1) prevented the “Must Have” Input Suppliers (the record companies and Copyright Owners) from using the essential aspect of their inputs to engage in hold-up by threatening to withhold their respective repertoires; and (2) allocated surplus shares according to each party’s contribution to the surplus (as calculated though the “arrival orderings” in the Shapley model).¹³⁰

The PR II-based benchmark was the product of an *industrywide* negotiation, with the music publishers represented by the NMPA and the interactive streaming services represented by DiMA, their respective trade associations. As explained in the Dissent, *supra*, at pp. 137-39, when an industrywide settlement is reached, particularly when the default procedure is a contested rate proceeding before the Judges, it contains the same benefits with regard to the avoidance of the “hold-out” effect and the equalizing of bargaining power as produced by Professor Marx’s Shapley value modeling. *See* 3/13/17 Tr. 577 (Katz) (“I think of the shadow as balancing the bargaining power between the two parties.”); Katz CWRT 136, n.236 (“there are market forces that promote the achievement of the statutory objectives in private agreements, such as the 2012 Settlement, when the parties are equally matched (it was an industry-wide negotiation) and the negotiations are conducted in the shadow of a pending rate-setting proceeding that can be expected to set reasonable rates in the event that the private parties do not reach agreement.”).

Accordingly, this benchmark already incorporates the dynamics of a negotiation between parties with mutually countervailing power (although those dynamics required updating of the headline rate to 15.1% to account for the higher revenues, as undertaken by the Majority’s Shapley analysis). *See Web V*, 86 Fed. Reg. 59,452, 59,456 (Oct. 27, 2021) (“the licensor-side complementary oligopoly power could be ameliorated by the “*countervailing power*” of a licensee”).

Therefore, the Judges do not make any adjustment in their application of the PR II-based benchmark pursuant to Factors B and C.

3. Factor D

¹³⁰ As noted elsewhere in this Initial Ruling, Professor Marx, Spotify’s economic expert witness, reduced the relative market power of the input suppliers in her model which she claimed would be consonant with the “fairness” objectives in Factor B. On behalf of Copyright Owners, Professor Watt disagreed, arguing that the Shapley approach takes the existing market power as reflective of the parties’ market contributions, and thus needs no adjustment. The Majority utilized Professor Marx’s Shapley-based calculation of a total royalty payment of █% of service revenue in setting a 15.1% revenue rate (phased-in), which the Judges are adopting in this Initial Ruling. The Majority also used Professor Marx’s calculation to find that Factors B and C were satisfied without further adjustment. *See* Determination at 68 & n.120, 75, 86-87. But this issue is not relevant to the present discussion of Factors B and C with regard to the application of the PR II-based benchmark.

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As noted *supra*, the Judges understand that a Factor D adjustment is warranted if the rate the Judges would otherwise establish

directly produces an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for either [party] to adequately adapt to the changed circumstance produced by the rate change and, as a consequence, such adverse impacts threaten the viability of the music delivery service currently offered to consumers under this license.

Determination at 87.

There is no record evidence to suggest that the Services' PR II-based benchmark, as utilized by the Judges in this Initial Ruling, would create the requisite "adverse impact" to trigger Factor D. The Services certainly do not assert that their own proffered benchmark would be disruptive. With regard to Copyright Owners, the Judges cannot identify any aspect of the PR II-based benchmark that would cause the type of disruption that can serve as an adjustment under the statutory language of Factor D or the Judges' application of same, as quoted above. The Judges understand Copyright Owners' complaint to be principally that [REDACTED] during the *Phonorecords II* period, [REDACTED] the number of musical works streamed via sound recordings performed on interactive services. However, that is most certainly not any sort of disruption, let alone a disruption cognizable under section 801(b)(1) and under the Judges' application of that provision.

F. Subpart C Offerings Covered by Foregoing Analysis

The *Phonorecords II* parties also negotiated several new service types—paid locker services, purchased content locker services, mixed service bundles, music bundles and limited offerings. These service configurations were described in subpart C of 37 C.F.R. § 385 under the *Phonorecords II* regulatory provisions.¹³¹ Parness WDT ¶ 13; Levine WDT ¶¶ 38-39; Israelite WDT ¶¶ 28-30. These negotiations spanned more than a year. *See* 3/29/17 Tr. 3652-55 (Israelite) (involved protracted bargaining, in which NMPA rejected some categories, while others were accepted and became part of subpart C). *Id.* at 3654-56. The parties ultimately agreed on a structure for subpart C that resembled the subpart B structure, including a headline percentage of revenue royalty rate and per-subscriber and TCC minima. Parness WDT ¶ 14; *see also* 37 C.F.R. § 385.22. As with the bundling negotiations relating to subpart B, the parties negotiated and created a bundled service category under subpart C (with certain adjustments to the definition of "revenue.") 3/8/17 Tr. 161-64 (Levine); 37 C.F.R. § 385.21.

Copyright Owners urge the elimination of the subpart C provisions as essentially obsolete because locker services for "purchased content" (new download purchases) and for "paid" downloads (already owned) have largely disappeared, as listeners transitioned away from ownership models to access models. *See* 3/8/17 Tr. 159-160 (Levine); 3/16/17 Tr. 1458-1461 (Mirchandani); Mirchandani WDT ¶ 33; 3/22/17 Tr. 2523 (Dorn). Copyright Owners also re-assert the same arguments with respect to subpart C as they have for interactive streaming in subpart B. *See* CORPFF-JS at p.2.

¹³¹ The interactive steaming (and limited download) provisions that are the principal subject of this proceeding were contained in subpart B of the *Phonorecords II* (and *Phonorecords I*) regulations. (These subparts were reorganized pursuant to the now vacated Determination.)

The Services argue that Copyright Owners do not point to any evidence to show that locker services have *completely* disappeared, emphasizing that Apple and Amazon continue to offer locker service. Joyce WDT ¶ 5; Mirchandani WDT ¶¶ 16-17; 3/22/17 Tr. 2523-25 (Dorn); Ramaprasad WDT, Table 3. More generally, the Services urge the Judges to use the subpart C rate structure as the benchmark for rates in the forthcoming period for the same reasons as they urge the use of the subpart B rates as an appropriate benchmark. *See* Mirchandani WDT ¶¶ 58-62.

The Judges find no reason on remand to treat the subpart C offerings differently than the manner in which they are treating the subpart B interactive streaming offerings, for the reasons set forth in the Dissent at 118-119. That means, however, that the various “headline” rates for these subpart C offerings must also adjust to 15.1%,¹³² whereas the alternative rates (identified in subpart C as “minima” and “subminima”) rates shall remain unchanged.

IV. Change in Definition of Service Revenue for Bundles¹³³

The Judges analyze the definition of “Service Revenue” for bundled offerings in the context of the partial adoption of the PR II-based benchmark. As discussed *supra*, the Judges have found that the PR II-based benchmark is a useful benchmark, particularly because of its features that incentivize beneficial downstream price discrimination that generates more listeners, revenues, and royalties.

A. Background

In their Initial Determination, the Judges adopted a definition of “Service Revenue” (*i.e.*, a royalty base) for a “Bundle”¹³⁴ that provided, in pertinent part:

Service Revenue shall be the revenue recognized from End Users for the Bundle less the standalone published price for End Users for each of the other component(s) of the Bundle ...

Initial Determination, Attachment A at 7 (section 382.2 therein).¹³⁵

¹³² Accordingly, in the PR II-based benchmark, the subpart C “headline” rates that shall adjust to 15.1% are: 11.35% for Mixed Service Bundles; 11.35% for Music Bundles; 10.5% for Limited Offerings; 12% for Paid Locker Services; and 12% for Purchased Content Locker Services. *See* 37 C.F.R. § 385.22(a)(1) (*Step 1*); 385.23(a)(1)-(5).

¹³³ Judge Strickler disagrees with the *procedural* analysis of a different majority by which they readopt the Bundled Revenue definition from the Initial Determination, and he dissents on that specific issue. However, Judge Strickler concurs and joins with the Majority regarding the *substantive* re-adoption of that definition from the Initial Determination. Judge Strickler has drafted a separate opinion on this Bundled Revenue issue.

¹³⁴ For interactive streaming, the Judges’ Initial Determination defined a “bundle” (in pertinent part) as an offering which combined the delivery of streamed music:

together with one or more non-music services ... or non-music products ... as part of one transaction without pricing for the music services or music products separate from the whole offering

Initial Determination, Attachment A at 2 (section 385.2 therein).

¹³⁵ The definition added: “[I]f there is no standalone published price for a component of the Bundle, then the Service shall use the average standalone published price for End Users for the most closely comparable product or service in the U.S. or, if more than one comparable exists, the average of standalone prices for comparables.” *Id.* at 7-8.

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After the Judges issued their Initial Determination, Copyright Owners submitted a Motion for Clarification or Correction of Typographical Errors and Certain Regulatory Terms which disclaimed any intent to seek rehearing, but sought "clarification or correction" of certain regulatory terms to conform them to what Copyright Owners claimed to be the apparent intent of the Initial Determination. (Motion for Clarification).¹³⁶ Copyright Owners purported to bring their motion under the Judges' general regulations governing motions. *See* 37 C.F.R. § 303.3-.4 (formerly codified at 37 C.F.R. § 350.3-.4).

The Motion for Clarification argued, among other things, that the definition of Service Revenue as applied to bundled offerings should be reworked. Copyright Owners argued that defining the revenue as the total price of the bundle, minus the standalone published prices for the non-streaming offerings in the bundle, undervalued the revenue created by the streaming offerings. They proposed that "Service Revenue" for bundled offerings be defined as the standalone price of the offering (or comparable offerings).

The Services objected to Copyright Owners' styling of their motion as something other than a motion for rehearing. The Services also objected that Copyright Owners had not previously proposed a definition of "Service Revenue" for bundled offerings, and that their "late-proposed" definition was unsupported by the record.

On October 29, 2018, the Judges issued an Order concluding neither party had met the exceptional standard for granting rehearing motions,¹³⁷ stating that the parties had failed to present "even a *prima facie* case for rehearing under the applicable standard". Amended Order Granting in Part and Denying in Part Motions for Rehearing (Order on Rehearing) (Jan. 4, 2019).¹³⁸

The Judges explained that they nevertheless found it appropriate to resolve the issues that the parties had raised. Order on Rehearing at 2. The Judges added that, to the extent such resolution could be considered a rehearing under 17 U.S.C. § 803(c)(2), the Judges resolved the motions on the papers without oral argument. *Id.*

Regarding the definition of "Service Revenue" for bundled offerings, the Judges summarized the parties' competing arguments:

Copyright Owners presented evidence that the existing approach led, *in some cases*, to an inappropriately low revenue base—but did so in service to their argument that the Judges should reject revenue-based royalty structures. *They did not present evidence to support a different measure of bundled revenue* because their rate proposal was not revenue-based. The Services rely on the fact that the approach to bundled revenue in the extant regulations is derived from the 2012 Settlement. The Judges have, however, *declined to rely on the 2012 Settlement as a benchmark*, as the basis for the rate structure, or, therefore, as regulatory guidance.

¹³⁶ Streaming Services submitted a motion for rehearing that was limited to fixing clerical errors and clarifying existing ambiguities in the proposed regulatory terms appended to the Initial Determination.

¹³⁷ The standard is set forth in the Order on Rehearing at 2 n.3. The Judges discuss and apply this standard *infra*, pursuant to *Johnson*, and in the context of this remand proceeding.

¹³⁸ Judge Strickler, who had dissented from the Initial Determination and the Determinations, did not join in this Order on Rehearing.

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The Services have observed *correctly* that the evidentiary records in *Web IV* and *SDARS III* differ from the record in this proceeding.¹³⁹

Order on Rehearing at 17 (emphasis added).

Despite these arguments, the Judges found that neither party presented evidence adequate to support the approach advocated in post-determination filings, because “the ‘economic indeterminacy’ problem inherent in bundling” remained unresolved.” *Id.*¹⁴⁰ The Judges stated that the Services were the party in possession of the relevant information, and concluded that the Services bore the burden of providing evidence that might mitigate the “indeterminacy problem” inherent in bundling. Because the Judges concluded that the Services had not met that burden, they ruled that they must adopt an approach to valuing bundled revenue that is in line with what the Copyright Owners proposed. As a result, the Judges discarded the formula in the Initial Determination and ruled, instead, that streaming service providers will use their own standalone price (or comparable) for the music component (not to exceed the value of the entire bundle) when allocating bundled revenue. *Id.* at 16-18.

Consistent with the Judges’ Order on Rehearing, the Judges’ replaced the definition of “Service Revenue” for a “Bundle” that they had included in the Initial Determination with a new definition in the Determination. The final definition provided, in pertinent part:

Service Revenue shall be the lesser of the revenue recognized from End Users for the bundle and the aggregate standalone published prices for End Users for each of the component(s) of the bundle that are Licensed Activities...[or] if there is no [such] standalone price, then the average standalone ... price ... for the most closely comparable product or service ... or ... the average of standalone prices for comparables.

Determination, Attachment A at 8.

The Services, Copyright Owners and George Johnson appealed the Judges’ Determination to the D.C. Circuit. *See Johnson*, 969 F.3d 363. The Services challenged both the Judges’ legal authority and the substantive soundness of the decision to reformulate the definition of “Service Revenue” for bundled offerings, after the Judges had issued the Initial Determination.

The D.C. Circuit examined several authorities under which the Judges may revisit and amend a determination. It addressed the three ways identified in the statute: “(i) order rehearing

¹³⁹ In *Web IV* and *SDARS III*, unlike under the Phonorecords II-based benchmark, there were no minima or floors to provide licensors with royalties in the event bundled offerings would otherwise fail to generate royalties.

¹⁴⁰ The “economic indeterminacy” problem was described in *SDARS III*:

[S]uch bundling is a common form of price discrimination that increases revenue. ... [S]ellers can induce buyers/subscribers to reveal their Willingness to Pay (WTP) and pay more through bundling. [If] retailers pay for their inputs on a per unit basis, bundled retail pricing is benign, because input suppliers would be indifferent to downstream pricing and bundling. However, when the input supplier, as here, is paid as a percent of retail revenue, and the bundled revenue consists of some revenue attributable to the royalty base and other revenue excluded from the royalty base, the economic indeterminacy of the revenue attributable to each bucket creates a measurement problem, absent further information regarding the WTP of buyers/subscribers to the bundle.

SDARS III, 83 Fed. Reg. at 65,264. As discussed in this Initial Ruling, this indeterminacy problem was addressed by the Phonorecords II-based benchmark through negotiated alternative royalty provisions for bundled offerings.

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‘in exceptional cases’ in response to a party's motion, 17 U.S.C. § 803(c)(2)(A); (ii) correct ‘technical or clerical errors,’ *id.* § 803(c)(4); and (iii) ‘modify the terms, but not the rates’ of a royalty payment, ‘in response to unforeseen circumstances that would frustrate the proper implementation of [the] determination.’” *Johnson*, 969 F.3d at 390. The D.C. Circuit found that the Judges’ reformulation of the definition of "Service Revenue" fit none of those categories.

The D.C. Circuit noted that the Judges were explicit that they did not treat the Motion for Clarification as a motion for rehearing under 17 U.S.C. § 803(c)(2). *Id.* Furthermore, the D.C. Circuit noted the Judges’ own findings that the Motion for Clarification did not meet the exceptional standard for granting rehearing motions under section 803(c)(2) and that the Copyright Owners failed to make even a *prima facie* case under the rehearing standard.

In *Johnson*, the D.C. Circuit found that the change to the definition of Service Revenue for bundled offerings was not an exercise of the Judges’ authority under section 803(c)(4) to "correct any technical or clerical errors in the determination[.]" 17 U.S.C. § 803(c)(4). The D.C. Circuit observed the substantive nature of the change to the definition and determined that there was nothing technical or clerical about the amendment. The D.C. Circuit found that the Judges did not even purport to modify the terms in response to unforeseen circumstances that would frustrate the proper implementation of the Initial Determination. The D.C. Circuit observed that the Judges never mentioned section 803(c)(4) or unforeseen circumstances as the basis for revamping the Service Revenue definition.

Beyond the explicit statutory authorities for amendments to determinations, the D.C. Circuit addressed arguments for inherent authority to make *sua sponte* any appropriate substantive or fundamental changes after the Initial Determination. The D.C. Circuit foreclosed reliance on inherent authority, finding that Congress's decision to limit rehearing to exceptional cases, and to confine other *post hoc* amendments to cases involving technical or clerical errors, would be a nullity if the Judges also had plenary authority to revise their determinations whenever they thought appropriate. The D.C. Circuit noted that the Judges’ decision to amend the definition said nothing of the sort, and prior decisions are silent on that topic.

In sum, the D.C. Circuit found that the Judges failed to explain the legal authority for reformulating the definition of "Service Revenue." In relevant part, the D.C. Circuit ruled

we must vacate the [] Determination's bundled offering Service Revenue definition and remand for the [Judges] ... either to provide ‘a fuller explanation of the agency's reasoning at the time of the agency action[.]’ or to take ‘new agency action’ accompanied by the appropriate procedures.

Id. at 392 (citing *Regents*, 140 S.Ct. at 1908).

Because the D.C. Circuit determined that the Judges failed to identify any legal authority for adopting the new Service Revenue definition, it found no occasion to address the Streaming Services' separate argument that the definition was arbitrary, capricious, or unsupported by substantial evidence. *Id.*

The Services and Copyright Owners agreed that the Judges should resolve the definitional issue based on the existing record, after receiving two rounds of additional briefing

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from the parties.¹⁴¹ See Services' Proposal for Remand Proceedings (Dec. 10, 2020) (Services' Proposal) at 5-6, 9-10; Proposal of the Copyright Owners for Conduct and Resolution of the Remand (Public) (Dec. 10, 2020) (Copyright Owners' Proposal) at 4-6. The Judges issued an Order Regarding Proceedings on Remand, which, in part, opened briefing on the issue of the adoption of a revised definition of "service revenue" for bundled offerings between issuing the Initial Determination and the Determination. Order Regarding Proceedings on Remand (Dec. 15, 2020). The Judges received the following relevant briefing.

- CO Initial Submission
- Services' Initial Submission
- CO Reply
- Services' Reply

On December 9, 2021, the Judges requested additional briefing. Dec. 9 Order. The Dec. 9 Order sought additional briefing setting forth the parties' views on whether this proceeding constitutes the type of new agency action addressed by the D.C. Circuit, which would allow adoption of a Service Revenue definition without limitation to the definition expressed in the Initial Determination. Additionally, the Judges requested additional evidence that the parties might offer to support adoption of the Service Revenue definitions expressed in either the Initial Determination or the Determination. In response to the Dec. 9 Order, the Judges received the following relevant briefing.

- CO Additional Submission
- Services' Additional Submission

On February 9, 2022, the Judges solicited further briefing on "Whether the D.C. Circuit's *Johnson* decision permitting the Judges to engage in new agency action in this remand proceeding allows the Judges to engage in new agency action through a reconsideration of Copyright Owners' February 12, 2018 Motion for Clarification as a Motion for 'rehearing' pursuant to 17 U.S.C. § 803(c)(2)(A) and 37 C.F.R. § 353.1." *Sua Sponte* Order Regarding Additional Briefing (Feb. 9 Order). In response to the Feb. 9 Order, the Judges received the following relevant briefing.

- Copyright Owners' Brief Responding to Judges' February 9, 2022 *Sua Sponte* Order Regarding Additional Briefing on New Agency Action Question, and Replying to Services' New Agency Action Arguments in their Joint Supplemental Brief Addressing the Judges' Working Proposal (in Additional Materials Rebuttal Submission of Copyright Owners at Tab B) (Feb. 24, 2022) ("CO Further Briefing")
- Services' Joint Response to the Judges' February 9, 2022 *Sua Sponte* Order Regarding Additional Briefing and Rebuttal Regarding "New Agency Action" (Feb. 24, 2022) ("Services' Further Briefing")

B. Authority for Modification to the Initial Determination

1. Copyright Owners' Position

¹⁴¹ As indicated below, during the remand proceedings, the Judges solicited two rounds of additional briefing addressing specific issues.

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Copyright Owners assert that this remand proceeding offers a straightforward path to take new agency action and that the law makes clear that new agency action can consist of issuing a new determination on remand. CO Initial Submission at 71. Copyright Owners maintain that:

[T]he new agency action here is a determination after remand proceedings, the Board is largely free to chart its own procedural course, and the Board has done so in its December 15 Order. The Board is not required to undertake any of the procedural steps set forth in 17 U.S.C. § 803(b) in order to take such “new agency action.” See 17 U.S.C. § 803(d)(3) (requiring only that on remand further proceedings be taken “in accordance with subsection (a)”); 37 C.F.R. § 351.15; *Intercollegiate Broad. Sys., Inc.*, 796 F.3d at 125 (“[N]either the Copyright Act nor the Board’s regulations prescribe any particular procedures on remand.”) The Circuit’s instruction that the action be “accompanied by the appropriate procedures[.]” *Johnson*, 969 F.3d at 392, does not dictate what those “appropriate procedures” must be but instead plainly refers to these flexible rules. See also *Oceana, Inc.*, 321 F. Supp. 3d at 136 (explaining that when remanding to an agency, a court generally “may not dictate to the agency the methods, procedures, or time dimension, for its reconsideration”).

CO Initial Submission at 71, FN 33.

Copyright Owners acknowledge the Services’ position that the asserted procedural error is an “absence of authority” that can never be cured. *Id.* at 74 (citing Services’ Proposal for Remand Proceedings at 10). They note that the D.C. Circuit did not say the Judges lacked the authority to revisit the service revenue definition for bundles on remand. Nor, they observe, did it say the Judges have no authority to review the record evidence and the parties’ arguments and reach the same conclusion or a different conclusion on remand. Copyright Owners opine that if the only possible outcome were for the Judges to reinstate a definition that lacked any explanation or evidentiary support solely because it was present in the Initial Determination, then the D.C. Circuit would not have remanded the issue but would have simply reversed and reinstated the Initial Determination definition. But instead, they note, the D.C. Circuit remanded and said the Judges could take new agency action precisely to cure the asserted procedural defect. Copyright Owners assert that the remand allowed the parties to present the record evidence and their arguments so that the Judges can address the definition “afresh” in the remand determination. *Id.* at 74.

Copyright Owners argue that 17 U.S.C. § 803(d)(3) states only that proceedings on remand must be in accordance with 17 U.S.C. § 803(a). They contend that remand proceedings need not be confined to procedures the Services claim are too late in the game for the Judges to follow. The Copyright Owners point to the D.C. Circuit’s ruling in *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, that “neither the Copyright Act nor the Board’s regulations prescribe any particular procedures on remand.” 796 F.3d 111, 125 (D.C. Cir. 2015) (citing 17 U.S.C. § 803(a), (d)(3)). Accordingly, they argue, the Judges can reaffirm the adopted bundled service revenue definition following their review of the parties’ submissions without regard to section 803(c)(2) or 803(c)(4). CO Reply at 65-66.¹⁴²

¹⁴² Copyright Owners reiterate this argument in the CO Additional Submission. Copyright Owners added that the parties in this remand were afforded the opportunity for further briefing and, if they wished, to submit additional

continued on next page

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Copyright Owners further argue that the Judges may properly justify the changed definition under section 803(c) as a fuller explanation of the agency’s reasoning at the time it was made. They urge that the Judges could explain that, especially in light of the evidence of how the Services misused the prior definition to make service revenue completely disappear, carrying over the prior bundle service revenue from *Phonorecords II* into the Initial Determination was unintended and inadvertent.¹⁴³ CO Reply at 69. Copyright Owners also assert that the Judges could explain that Copyright Owners had, in their Motion for Clarification, identified an “exceptional case” under section 803(c)(2) because the prior definition failed to comport with Judges’ precedent and economic principles, and was unsupported by evidence.¹⁴⁴ In addition,

Copyright Owners note that the Judges reheard the evidence and legal arguments as presented in the parties’ briefs on the issue and, as a result, may choose to adopt the revised definition. Copyright Owners maintain that for the Judges to do so would not be impermissible *post-hoc* reasoning, because the D.C. Circuit remanded precisely because the Judges did not provide any reason in the Determination for revising the bundle revenue definition. CO Reply at 69-71.

2. Services’ Position

The Services assert that the D.C. Circuit found only “three ways in which the Board can revise Initial Determinations” and that the Judges had failed to establish that the change to the service revenue definition fit any of those three categories. Services’ Initial Submission at 64-65 (citing *Johnson* at 390).

According to the Services the *first* way the Judges may revise an Initial Determination is to “order rehearing ‘in exceptional cases’ in response to a party’s motion, 17 U.S.C. § 803(c)(2)(A).” Services’ Initial Submission at 65 (citing *Johnson* at 390).¹⁴⁵ The Services argue that the D.C. Circuit held in *Johnson* that the Judges’ “material revision of the ‘Service Revenue’ definition for bundled offerings does not fall within the Board’s rehearing authority under section 803(c)(2)(A)” because “the Board itself . . . was explicit that it ‘did not treat the [Copyright Owners’] motion[]’ . . . ‘as [a] motion[] for rehearing under 17 U.S.C. § 803(c)(2).’” The D.C. Circuit also noted that “as the Board found, the Copyright Owners’ motion did ‘not meet [the] exceptional standard for granting rehearing motions’ under section 803(c)(2).” *Id.* (citing *Johnson* at 390). The Services assert that the Judges were not able to make “a volte-face” and justify on appeal their revision to the definition as an exercise of rehearing authority. As the D.C. Circuit held, agency action must be justified by “reasons invoked by the agency at the time

evidence on this issue, thus providing broader opportunity for submission than in *Fisher v. Pension Benefit Guaranty Corp.*, 994 F.3d 664, 670 (D.C. Cir. 2021), in which the D.C. Circuit upheld new agency action after remand even though the agency did not provide appellant the opportunity to submit new briefing or exhibits. CO Additional Submission at 35-36; 38.

¹⁴³ Copyright Owners assert that the definition in the Initial Determination conflicted with, the Board’s findings in the Initial Determination, including its findings that the adopted rates and terms would afford copyright owners a fair return for their creative works, thereby satisfying factor B of the 801(b) standard and thus needed to be revised so as to not “frustrate the proper implementation of” the Final Determination. CO Reply at 69 (citing 17 U.S.C. §§ 801(b) and 803(c)(4)).

¹⁴⁴ In response to an Order by the Judges, Copyright Owners provided additional briefing regarding reconsideration of the motion for clarification as a motion for “rehearing” which is addressed separately *infra*.

¹⁴⁵ In response to an Order by the Judges, the Services provided additional briefing regarding reconsideration of the motion for clarification as a motion for “rehearing” which is addressed separately *infra*.

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it took the challenged action,” and post-hoc rationalizations are insufficient. *Id.* (citing *Johnson* at 390).

The Services add their view that the Judges cannot revisit the decision to deny rehearing without engaging in impermissible *post-hoc* reasoning. They note that the Supreme Court has explained that, while an agency may “elaborate later” on its “initial explanation” of the reason (or reasons) for its action, it “may not provide new ones.” Services’ Initial Submission at 66 (citing *e.g., Regents*, 140 S. Ct. at 1908). The Services offer that the Judges, having stated that they did not consider the Copyright Owners’ motion to revise the definition to be a motion for rehearing, cannot now conclude that the motion qualified as one for rehearing and that the Judges in fact engaged in rehearing. *Id.*

The Services add that under section 803(c)(2)(A), the Judges can only use their rehearing authority “‘in exceptional cases’ in response to a party’s motion.” *Id.* (citing *Johnson* at 390). The Services argue that the Motion for Clarification cannot be found to have satisfied that standard. The Copyright Owners did not argue that their motion satisfied the “exceptional cases” standard before the Judges or the D.C. Circuit, and have therefore waived that argument. *Id.*

According to the Services, the *second* way the Judges may revise an Initial Determination, *viz.* action to correct a technical or clerical error under section 803(c)(4), cannot be used now to justify any modification of the Service Revenue definition in the Initial Determination. The Services note that The D.C. Circuit held specifically that the Judges’ change to the Service Revenue definition could not be construed as correcting a technical or clerical error because it involved a substantive rewrite of the Service revenue definition. *Id.* at 67 (citing *Johnson* at 391).

The Services aver that the *third* way the Judges may revise the terms in an Initial Determination is in response to unforeseen circumstances that would frustrate the proper implementation of the determination. *Id.* at 67. The Services note that the D.C. Circuit held in *Johnson* that this authority did not justify the Judges’ change to the Service Revenue definition because the Judges did not invoke this authority and “the need to ground the original definition in the record” could not credibly be described as “an unforeseen circumstance.” *Id.* (citing *Johnson* at 391).

The Services also note that the D.C. Circuit rejected the argument that the Judges have “inherent authority” to make changes to the Initial Determination. The D.C. Circuit explained that the specific restrictions Congress placed on the Judges’ authority in section 803 “would be a nullity if the Board also had plenary authority to revise its determinations whenever it thought appropriate.” *Id.* (citing *Johnson* at 391-92). The Services add that even if the Judges offered a new source of authority capable of justifying substantive changes to the Service Revenue definition now, the Judges would be unable to rely on this “uninvoked authority” without engaging in impermissible *post-hoc* reasoning. *Id.*

The Services counter Copyright Owners’ position that the Judges need not respond to the error the D.C. Circuit identified with this aspect of the Determination and that the Judges’ “new agency action” may consist of issuing a new determination on remand. The Services argue that failure to address the legal and factual issues on which the D.C. Circuit remanded would violate the D.C. Circuit’s order and would result in a second remand. The Services surmise that the issue of authority to make the changes to the Initial Determination are particularly important in this context, where the D.C. Circuit recognized that the Copyright Act places limits on the

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Judges' authority to alter an initial determination by defining conditions for rehearing and the types of changes that are permitted absent a rehearing. In this regard, the Services maintain that the Judges cannot do on remand what they lacked authority to do in the first instance. The Services assert that the Judges must resolve the legal question whether there is authority to alter the revenue definition in the Initial Determination. They urge that the remanded issue is not what the substance of the service revenue definition should be as a matter of first impression, but instead is whether the Judges have properly exercised authority to alter the Initial Determination's definition. Services Reply at 52-54.¹⁴⁶

The Services assert that the Judges have two paths available to them: (1) to provide a "fuller explanation" of the prior conclusion that the Judges had legal authority to revise the Service Revenue definition in the Initial Determination or (2) answer that threshold question through new agency action. The Services maintain that, if they pursue the "fuller explanation" path, the Judges are limited to elaborating on what they said previously, and that they cannot add new reasons they did not initially provide. With regard to what may constitute new agency action, the Services assert that path gives the Judges freedom to consider new reasons that the Copyright Act provided the Judges with the authority to make this change to the Initial Determination. The Services argue, however, that undertaking a new agency action does not, as Copyright Owners claim, obviate the need for the Judges to identify proper legal authority before substantively changing the Initial Determination, such authorities being limited to the authority of section 803(c)(4) or the rehearing authority of section 803(c)(2). *Id.* at 54-55.

The Services address Copyright Owners' position that if the only possible outcome were for the Judges to reinstate a definition that lacked any explanation or evidentiary support solely because it was present in the Initial Determination, then the D.C. Circuit would not have remanded the issue but would have simply reversed and reinstated the Initial Determination definition. The Services urge that the D.C. Circuit could not reverse because the Department of Justice raised for the first time on appeal new justifications for the Judges' decision to change the Initial Determination. Instead, the Services maintain, the D.C. Circuit had to remand and give the Judges the opportunity to address the Department of Justice's new justifications in the first instance, as the D.C. Circuit could not rule them out given the posture of the appeal. *Id.* at 56.

In the Services' Additional Submission, they concede that this remand proceeding is new agency action and that the Judges have provided the parties with sufficient procedural opportunities to present any new evidence and raise any additional arguments regarding the question the D.C. Circuit remanded. Services' Additional Submission at 38. But the Services still insist that the Judges may not alter the Service Revenue definition without first identifying legal authority in the Copyright Act for modifying the Initial Determination. In the Services' view the new agency action avenue provided by the D.C. Circuit merely offers a singular path beyond the Judges' ability to offer a "fuller explanation" of their previous reasoning for revisiting the definition in the Rehearing Order. According to the Services' argument, the new agency action provided for in this remand only offers the additional opportunity to offer new reasons supporting any legal authority for altering the Initial Determination's Service Revenue definition, beyond those that were raised in the appeal. Services' Additional Submission at 38-42

¹⁴⁶ The Services agree that this remand proceeding qualifies as "new agency action" but again urge that failure to address the legal and factual issues on which the court remanded would nonetheless violate the D.C. Circuit's order. Services' Additional Submission at 38-42.

C. Reconsideration of Motion for Clarification as Motion for “Rehearing”¹⁴⁷

1. Copyright Owners’ Position

Copyright Owners argue that the Judges have the authority to engage in new agency action in this remand proceeding through a reconsideration of the Motion for Clarification as a motion for rehearing, pursuant to 17 U.S.C. § 803(c)(2)(A) and 37 C.F.R. § 353.1. Copyright Owners urge, however, that proceeding in that fashion would add an entirely unnecessary and complicating step. They again suggest that there is no need to reconsider or recharacterize the Motion for Clarification as a motion for rehearing because the remand itself affords the opportunity for the Judges to take new agency action, which, as in a rehearing, permits them to reconsider evidence and arguments, but, unlike a rehearing, is not limited by the constraints of section 803(c)(2). CO Further Briefing, Tab B at 7-8.

Copyright Owners posit that if the Judges engage in new agency action to reconsider the Motion for Clarification as a motion for rehearing under 803(c), and to decide that motion based on all of the evidence in the record supporting the adopted bundle revenue definition and showing the prior bundle revenue definition to be unsupported and unreasonable, they may properly do so. They assert that the while they did not make a request for rehearing on the face of the Motion for Clarification, that is not the same as a finding that the standard could not have been met. The Judges may consider whether, based on the evidence in the record, the rehearing standard has been satisfied on this remand. In Copyright Owners’ view, the Judges could conclude, revisiting on remand the question of whether the rehearing standard has now been met, that Copyright Owners have satisfied the “exceptional case” standard for granting rehearing motions under section 803(c)(2). Copyright Owners note that if the Judges do engage in new agency action that reconsiders the Motion for Clarification as a motion for rehearing, the Judges should fully explain their reasoning. *Id.* Tab B at 8-10.¹⁴⁸

2. Services’ Position

The Services assert that the Judges cannot invoke their rehearing authority by construing the Motion for Clarification as a rehearing motion. They maintain that the D.C. Circuit expressly found that the revision of the Service Revenue definition for bundled offerings does not fall within the Judges’ rehearing authority under section 803(c)(2)(A). The Services assert that Copyright Owners did not satisfy either prong of section 803(c)(2)(A), which authorizes rehearing only “upon motion of a participant” and “in exceptional cases.” They note that the D.C. Circuit agreed with the Judges’ decision not to treat Copyright Owners’ motion as one for rehearing and that the D.C. Circuit also agreed with the Judges’ further finding that “Copyright Owners’ motion did not meet the exceptional standard for granting rehearing motions.” Services’ Further Briefing at 7 (citing *Johnson* at 390).

¹⁴⁷ The Judges consider the briefs filed in response to the Feb. 9, 2022 Order only to the extent that they are responsive to the Feb. 9, 2022 Order, which requested briefing on the specific matter of whether the D.C. Circuit’s *Johnson* decision permitting the Judges to engage in new agency action in this remand proceeding allows the Judges to engage in new agency action through a reconsideration of Copyright Owners’ February 12, 2018 Motion for Clarification as a Motion for “rehearing,” pursuant to 17 U.S.C. § 803(c)(2)(A) and 37 C.F.R. § 353.1.

¹⁴⁸ With regard to the obligation to fully explain their reasoning for any reconsideration, the Copyright Owners point to *United Food & Com. Workers Union, Loc. No. 663 v. U.S. Department of Agriculture*, 532 F. Supp. 3d 741, 769 (D. Minn. 2021) (“When an agency takes a new course of action, it must ‘display awareness that it is changing position’ and ‘show that there are good reasons for the new policy.’”), quoting *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (emphasis in original).

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The Services add their view that the Judges are bound by the D.C. Circuit's conclusions on this issue. They maintain that because the Judges' section 803(c)(2)(A) rehearing authority is among the grounds that *Johnson* addressed and determined, the Judges cannot rely on that authority on remand. *Id.* at 8-9. The Services urge that the Judges already correctly concluded that the Motion for Clarification was not a motion for rehearing, and note that Copyright Owners never presented their motion as one for rehearing. The Services add that because Copyright Owners did not challenge that decision on appeal, it is too late for them to do so now.¹⁴⁹ *Id.* at 9-10.

The Services argue that Copyright Owners' Motion did not make any attempt to satisfy the exceptional cases standard set out in 17 U.S.C. § 803(c)(2)(A). They argue that Copyright Owners did not purport to identify any new evidence, new legal authority, or even a substantive error in the Judges' reasoning in the Initial Determination, but instead the motion asserted that the Judges' inclusion of the definition of service revenue in the Initial Determination was supposedly inadvertent. The Services add that Copyright Owners did not identify any specific evidence in the *Phonorecords III* record or any aspect of the Initial Determination that suggested the inclusion of this definition was a mistake. *Id.* at 10.

The Services point out that Copyright Owners' motion did not comply with the procedural requirements for a motion for rehearing. They then urge that the Judges cannot invoke their section 803(c)(2)(A) authority by rewriting a participant's motion to say it is seeking rehearing when that participant specifically and unambiguously disclaimed any intent to seek rehearing. *Id.* at 11.

The Services note that the Judges previous conclusion that even if the Motion for Clarification had requested rehearing, that motion would not and does not meet that exceptional standard for granting rehearing and failed to make even a *prima facie* case for rehearing. The Services observe that the Judges apply a strict standard to rehearing motions to prevent parties from using the rehearing process to seek a second bite at the apple by advancing theories and arguments that could have been advanced earlier during the proceeding. *Id.* at 12. The Services reiterate their view that Copyright Owners' motion did not point to any evidence in the *Phonorecords III* record at all, and, that the only evidence in the *Phonorecords III* record concerning bundles supports the longstanding definition of Service Revenue which has been effective in encouraging the Services to offer bundles that benefit Copyright Owners by growing the market for music streaming services. *Id.* at 14.

The Services finally assert that this is not an extraordinary case where a party has identified an error that, if left uncorrected, would result in manifest injustice. *Id.* at 15-16. The Services conclude by urging that given this procedural history and the unchanged state of the record since the initial hearing, any claim that Copyright Owners have somehow now satisfied the exceptional case standard would be clear error. *Id.* at 17.

D. Record Evidence Regarding Definition of Service Revenue

1. Copyright Owners' Position

¹⁴⁹ In fact, the issue of whether to recharacterize the Motion for Clarification as a motion for rehearing is not one raised by Copyright Owners, but by the Judges *sua sponte*. The Services' estoppel argument as to the Copyright Owners cannot apply to the Judges' action.

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Copyright Owners assert that the prior bundle revenue definition (published in the Initial Determination) failed to address the “‘economic indeterminacy’ problem inherent in bundling” appropriately and in a way consistent with Judges’ precedent. CO Initial Submission at 75 (citing Order on Rehearing at 16-18). Copyright Owners proceeded to cite several portions of testimony from the Services’ economic experts who acknowledged this problem. *Id.* They then point to hearing testimony in which Copyright Owners repeatedly raised the “‘economic indeterminacy’ problem and demonstrated what they characterized as the absurd results to which the prior definition had led. *Id.* at 76. They point out that under the prior definition, service revenue for bundled subscriptions started with revenues recognized from the bundle (*i.e.*, the price paid by the subscriber) and subtracted “the standalone published price” for all non-music components of the bundle. [REDACTED]

Id.

Copyright Owners point out that the Judges already found with respect to other licenses that such an approach is not only fundamentally unfair, but “absurd.” *Id.* (citing 81 Fed. Reg. 26,316, 26,382 (May 2, 2016) (webcaster licenses)); *see also* 83 Fed. Reg. 65,210, 65,264 (Dec. 19, 2018) (SDARS licenses) (rejecting proposed deductions by service for bundle revenues because of the “‘acknowledged ‘economic indeterminacy’ problem inherent in bundling”). The Copyright Owners concur with the Judges’ correct conclusion that the same reasoning applies to *Phonorecords III*. *Id.* at 76-77 (citing Order on Rehearing at 18) (“the ‘economic indeterminacy’ problem inherent in bundling is common to all three proceedings.”). The Copyright Owners offer that Spotify conceded to this flaw in the definition in the Initial Determination, but offered an alternative that contained the same loophole. *Id.* at 77-78.

Copyright Owners point out that the proponent of a term bears the burden of proof as to adoption. The Judges made clear that the licensee who wishes to offer bundles must bear the burden of providing evidence that might mitigate the acknowledged economic indeterminacy problem inherent in bundling, because any such evidence would be in its possession, not in the possession of the licensors. *Id.* at 79 (citing *SDARS III* Determination, 83 Fed. Reg. 65,210, 65,264) (“bundling [is] undertaken to increase [the Services’] revenues and it would be reasonable to assume that [the Services have] information relevant to the economic allocation of the bundled revenue.”). The Copyright Owners contend they presented un rebutted evidence showing the unreasonableness of the Services’ proposed definition while the Services offered no evidence to support their definition. *Id.* at 78, 79 (citing Order on Rehearing at 18). Copyright Owners maintain that no Service offered evidence concerning the separate values of the constituent parts of the bundles, or any other evidence concerning the economic allocation of bundled revenue, let alone the reasonableness of the definition in the Initial Determination. *Id.* at 80. Copyright Owners assert that in the absence of evidence to support the proposed definition, the Judges may adopt or fashion a definition of service revenue for bundled offerings that comports with the record evidence, which is precisely what the Judges did and can, through new agency action, do again. *Id.* at 81.

Copyright Owners dispute the Services’ assertion that there is support for the *Phonorecords II* approach to bundles in the record of this proceeding. Instead, Copyright Owners argue, the Services’ purported evidence at most supports the benefits of the practice or strategy of bundling. They maintain that the strategy of bundling covered music services with other products or services has nothing to do with whether the Services should be free to reduce the revenue allocable to music to zero. They offer that the definition in the Initial Determination

has nothing to do with such benefits, and that those benefits may be equally served by a definition that ensures value is apportioned to the music component in the bundle. CO Reply at 73-76.

2. Services' Position

The Services argue that the evidence in the existing written record addressing bundles shows both that this definition is supported by the *Phonorecords II* benchmark and that it has proven, industry-wide benefits. Services' Initial Submission at 68. They offer that the Copyright Owners did not propose an alternative definition of service revenue until after the Judges issued the Initial Determination and that any definition they propose now would fail the basic requirement that the Judges must adopt rules "on the basis of a written record." *Id.* (citing 17 U.S.C. §§ 803(a)(1) and § 803(c)(3)).

Addressing the merits of the definition contained in the Initial Determination, the Services argue that it best serves the goals of the Copyright Act; that as a bright-line, easily administered rule, it continues the broad industry agreement from *Phonorecords II*. The Services contend the prior definition increases output and incentivizes beneficial price discrimination to reach listeners who would otherwise not pay for music. They argue that the record evidence confirms that the prior treatment of bundles enabled experimentation and variation in the distribution of music with long-term benefits for all parties. They state that Copyright Owners' argument that Services [REDACTED] also demonstrates the broad benefits of the definition of Service Revenue in *Phonorecords II* because the record showed that arrangement enabled funneling of many of listeners into full-priced, full-catalog services—such treatment of bundles enabled the flexibility and price discrimination that yielded beneficial growth of the royalty pool.¹⁵⁰ The Services allege that Copyright Owners also ignore the extensive royalties that were generated. They add that with the per-subscriber minimum guarantees that the Copyright Owners will still be paid a fair royalty. The Services then cite several portions of testimony from various Services' economic experts who point out the realization of an expanded royalty pool, which the Services offer as proving a functioning marketplace. *Id.* at 68-74.¹⁵¹

The Services then assert that no other definition of service revenue for bundles that has been before the Judges combines both the administrative simplicity of the Initial Determination's definition and the broad price discrimination benefits of promoting discounted bundles. They maintain that while neither the Services nor Copyright Owners submitted evidence specifically addressing the way that customers, Services, or Copyright Owners might value the component parts of bundles, such subjective valuations are unnecessary for the Judges to find ample support for the *Phonorecords II* approach to bundles in the record. *Id.* at 75-76.

The Services also argue that while the Judges' decision in *SDARS III* did involve valuation of the music and non-music components of a bundle, the resolution in *SDARS III* is

¹⁵⁰ Notably, the Services do not deny that the former definition did, in fact, [REDACTED].

¹⁵¹ The Services' Reply reiterates this point and offers that the testimony cited by the Copyright Owners also shows why the Initial Determination's Service Revenue definition works for bundles and grows royalties. Services Reply at 57-58.

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inapposite because, here, the rate structure has a way of ensuring that Copyright Owners are fairly compensated for bundles: the statutory minimum payment. Services Reply at 62.

E. Analysis and Conclusions Regarding Definition

1. Remand Proceeding as New Agency Action

Having considered the entirety of the record of this proceeding, a majority of the Judges (Definition Majority) conclude that this remand constitutes “new agency action” and meets all of the criteria to qualify as new agency action. The Judges thus have the opportunity to consider the issue afresh consistent with their procedural rules regarding remands.

The Definition Majority finds that it is unnecessary to attempt to distinguish new “agency action” from “new agency action.” Neither approach is endorsed clearly by the varied judicial interpretations of a new agency action. See R.J. Krotoszynski, Jr., *Administrative Law Discussion Forum: “History Belongs to the Winners”: the Bazelon-Leventhal Debate and the Continuing Relevance of the Process/Substance Dichotomy in Judicial Review of Agency Action*, 58 Admin. L. Rev. 995 (Fall 2006). As noted by Judge Bazelon, the D.C. Circuit “believed in process-based review, [but] he argued that it was improper for judges to prescribe specific procedures.” *Id.* at 1001. Judge Bazelon’s remand orders focused on providing “genuine opportunities to participate in a meaningful way” and “genuine dialogue” with interested parties, while leaving the agency “free to decide which specific procedures to undertake.” *Id.*

Several reported cases point to new action as an alternative to a fuller explanation. But few define “new agency action” other than to say, as did the *Johnson* court, that the agency must take it “accompanied by the [unspecified] appropriate procedures.” *Johnson*, 969 F.3d at 392. Parties to the original action, already familiar with the issue and the factual and legal background, recognized that the D.C. Circuit identified the adoption of a modified definition in the Determination as one of three issues on remand. In repeated rounds of remand submissions, both the Services and the Copyright Owners included the definition issue. The Judges were not satisfied with the parties’ lack of focus on the issue, however, and ordered expressly further briefing on the new agency action issue and sub-issues relating to the adoption of a definition of Service Revenue as it relates to bundled service offerings. See (Dec. 9 Order) at 4; *Sua Sponte Order Regarding Additional Briefing* (Feb. 9, 2022).

New agency action is not synonymous with justification, or confirmation, of the prior action. New agency action is a procedural mechanism for reconsideration of the record, reopening the record for additional evidence and argument, and adoption of a conclusion based on the expanded record. In this instance, the presentations, written and oral, of participants on remand, together with a re-examination of the original record, support reversion to the definition originally announced in the Initial Determination. Ultimately, given repeated opportunities for legal analysis on the issue, both sides agreed that the remand proceeding itself, with ample notice and multiple opportunities for input was sufficient to constitute new agency action. See CO Further Briefing at 3, 7.

The Services argued, however, that notwithstanding this appropriate new agency action, the Judges remained without authority to adopt the revised definition as a term governing the royalty rates determined in this proceeding. Their arguments regarding procedures undertaken in

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the Determination are superseded by the Judges' conduct of extensive remand proceedings.¹⁵² The gravamen of the Administrative Procedure Act is transparency in agency¹⁵³ rulemaking. Agencies must publish notice of their intentions, provide opportunities for interested parties to comment and object, and finalize regulations only after reconciling objections with the policies and purposes of proposed regulations. The adjudication of this remand proceeding was conducted openly. Interested parties had ample opportunity to object, to comment, and to brief legal and factual issues relating to the Judges' approach to promulgating an appropriate definition of bundled service revenue.

The present analytic approach merely takes the position that the Judges engaged in new agency action by conducting a fully open and broadly explored remand proceeding. Unlike a rehearing or exercise of continuing jurisdiction, this remand proceeding is not limited by the constraints of sections 803(c)(2) or 803(c)(4). Contrary to the Services' assertion, the Judges address the issue on which the D.C. Circuit remanded, the need to exercise authority within the lines drawn by the authorizing statute. This remand proceeding does not, therefore, violate the D.C. Circuit's order.

The *Johnson* opinion clearly states the two paths by which the Judges may address the issues presented to them on remand; they may either (1) provide "a fuller explanation of the agency's reasoning at the time of the agency action[,] or (2) to take "new agency action" accompanied by the appropriate procedures. *Johnson*, 369 F.3d at 392. The Judges chose to pursue the second option: this new agency action. The Judges reiterate: the Services concede that, through this proceeding the Judges have provided the participants with adequate procedural opportunities to present any new evidence on the proper Service Revenue definition for bundles. The Judges also acknowledge, but disagree with, the Services' position that that they must return to the issues as they were presented after issuance of the Initial Determination, regardless of the admittedly complete and valid remand procedure, which constitutes new agency action.

The Judges (the majority on this issue) determine that any confining action on remand to the provisions of sections 803(c)(2)(A) or 803(c)(4) would misconstrue the clear expression of the "new agency action" alternative presented by the D.C. Circuit,¹⁵⁴ as well as chapter 8 of title 17. As the Copyright Owners correctly observed, in a remand proceeding, the Judges are not required to undertake any of the procedural steps set forth in section 803(b) nor are the Judges compelled to consider or be limited by sections 803(c)(2)(A) or 803(c)(4). The statute only requires that the Judges' remand proceedings are in accordance with section 803(a).¹⁵⁵

¹⁵² Furthermore, the issue of the Judges' authority to take an action in issuing the Determination is moot. The Judges, after new agency action, have chosen not to defend the definition in the Determination but rather to conclude, following that new agency action, that the definition in the Initial Determination is more appropriate in these circumstances. Whether the Judges had the authority in the first instance is not at issue, as they are not repeating the former action.

¹⁵³ The proceedings of the Copyright Royalty Board (CRB) are subject to the standards of the Administrative Procedure Act. *See* 17 U.S.C. § 803(a)(1).

¹⁵⁴ The case that the D.C. Circuit points to for the new agency action path clarifies that "An agency taking this [new agency action] route is not limited to its prior reasons but must comply with the procedural requirements for new agency action." *Regents*, 140 S. Ct. at 1908).

¹⁵⁵ "The court [United States Court of Appeals for the District of Columbia Circuit] may also vacate the determination of the Copyright Royalty Judges and remand the case to the Copyright Royalty Judges for further proceedings in accordance with subsection (a)." 17 U.S.C. § 803(d)(3)

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The D.C. Circuit observed that the Judges have "considerable freedom to determine [their] own procedures." *SoundExchange v. CRB*, 904 F.3d 41 at 61. The D.C. Circuit also cautions that such flexibility must be exercised within the lines drawn by the authorizing statute. Here, the Judges operate within the lines drawn with respect to remand proceedings set forth in chapter 8 of title 17.

2. “Fuller Explanation” of Modification to Initial Determination

Case law regarding development of a “fuller explanation” of an agency’s action emphasizes that the agency cannot adopt *post hoc* reasoning on the same record. *See, e.g., SEC v. Chenery Corp.*, 332 U.S. 194, 201 (1947) (after remand, agency bound to “deal with the problem afresh”). Certainly, adopting a *post hoc* argument of appellate counsel, just because it offers a rationale for the agency’s original action is impermissible.¹⁵⁶ On the other hand, if the record in the initial proceeding is sufficiently robust to support a reinterpretation or additional reasoning, the agency may justify its initial action with that “fuller explanation” without considering any new evidence. *See, Fisher v. Pension Benefit Guar. Corp.*, 468 F.Supp.3d 7, 20 (D.C.D.C. 2020), *aff’d Fisher v. Pension Benefit Guar. Corp.*, 994 R.3d 664 (D.C. Cir. 2021), rehearing *en banc denied, Fisher v. Pension Ben. Guar. Corp.*, 2021 U.S. App. LEXIS 18793 (D.C. Cir., June 23, 2021) (requirement of new evidence a “novel proposition of law” without precedent). On remand, an agency may elaborate on its prior reasoning, but it may not provide new reasons for the original decision. *Fisher*, 994 F.3d at 669. If the Judges had chosen in this remand to rest on their Determination regarding the service revenue definition, they might have done so only if they could elaborate on the existing record.¹⁵⁷ In the alternative, the Judges issue a new decision after new agency action. *Id.*

The Judges, having engaged in new agency action to settle on the definition of service revenue for bundled offerings, do not find a need to address the statutory avenues or the confines that are provided for rehearing or continuing jurisdiction, nor do the Judges pursue the propriety of reconsideration of the Motion for Clarification as a motion for rehearing.¹⁵⁸

3. Substantive Analysis of Dueling Definitions of Bundled Revenue

The fundamental difference between the impact of the two alternative definitions is simply stated:

Under the Initial Determination:

downstream bundling and its price discriminatory effect *would* be incentivized by a royalty structure that reflects the lower WTP of consumers who subscribe by paying for a Bundle;

Under the Determination:

¹⁵⁶ A rationalization is not *post hoc* simply because it is iterated by counsel. Denomination of a rationalization as *post hoc* is a matter of timing, not of the offeror.

¹⁵⁷ In this instance, had the Judges decided to keep the definition in the Determination, they probably could have given a fuller explanation based on the record in the underlying proceeding. Because the Judges have opted to rely on the fresh-look approach in the “new agency action” alternative and because the prior definition is appropriate given adoption of the PR II rate structure, development of that fuller explanation based on the record is unnecessary.

¹⁵⁸ The Judges also find no need to consider any inherent authority that may remain for consideration.

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downstream bundling and its price discriminatory effect *would not* be incentivized by a royalty structure that reflects the lower WTP of consumers who subscribe by paying for a Bundle.

To explain this difference, the Judges find it helpful to describe (as in the Determination and Dissent) how bundling facilitates price discrimination and how lower royalties for bundled streaming services incentivize such bundling.

Price discrimination occurs when a seller offers different units of output at different prices. *See, e.g.,* H. Varian, *Intermediate Economics* at 462 (8th ed. 2010). The benefit to the seller arises from attempting to “charge each customer the maximum price that the customer is willing to pay for each unit bought.” R. Pindyck & D. Rubinfeld, *Microeconomics* at 401 (8th ed. 2013). For all goods, and intellectual property goods such as copyrights in particular,¹⁵⁹ the social benefit is that price discrimination more closely matches the quantity sold with the competitive quantity as the seller or licensor better aligns the price with the WTP of different categories of buyers or licensees. *See* W. Fisher, *Reconstructing the Fair Use Doctrine*, 101 Harv. L. Rev. 1659, 1701 (1988).

A seller can engage in price discrimination in several ways. One form is known as “second-degree price discrimination,” by which buyers self-sort the packages and quantities they purchase.¹⁶⁰ *See* W. Adams & J. Yellen, *Commodity Bundling and the Burden of Monopoly*, 90 Q. J. Econ. 470, 476 (1976) (the profitability of bundling “stem[s] from its ability to sort customers into groups with different reservation price [WTP] characteristics.”). Bundling, *i.e.*, the “practice of selling two or more products as a package,” *Pindyck & Rubinfeld, supra* at 419, is thus a type of second-degree price discrimination. *See* A. Boik & H. Takahashi, *Fighting Bundles: The Effects of Competition on Second Degree Price Competition*, 12 Am. Econ. J. 156, 157 (2020).

The applicability of these basic economic principles was understood and explained by the parties’ experts at the hearing. *See, e.g.,* 3/15/17 Tr. 1224-25 (Leonard) (Google’s economic expert testifying that price discrimination through bundling is “very, very common ... even by pretty competitively positioned firms ... to sort out customers into willingness-to-pay groups.”); 3/30/17 Tr. 3983 (Gans) (Copyright Owners’ economic expert acknowledging that bundling is a form of price discrimination); *see also* Dissent at 69 (same).

How does this downstream (retail level) benefit of price discrimination impact the setting of upstream royalty rates? As the Majority explained (in summarizing the Services’ expert testimony) the linkage is explained by the economic concept of “derived demand”:

[M]ultiple pricing structures necessary to satisfy the WTP and the differentiated quality preferences of downstream listeners relate directly to the upstream rate structure to be established in this proceeding. Professor Marx opines that the appropriate *upstream* rate structure is derived from the characteristics of

¹⁵⁹ Streamed copies of intellectual property, such as musical works and sound recordings, have a marginal production cost of essentially zero, making price discrimination particularly beneficial, because charging any positive price, even to a buyer with the lowest WTP, still exceeds the zero marginal production costs. *See* Dissent at *passim*.

¹⁶⁰ “First-degree” price discrimination is a hypothetical construct by which a seller can identify the WTP of every buyer. “Third-degree” price discrimination occurs when the seller offers different prices to buyers based on their different characteristics (*e.g.*, a senior citizen discount). *See Pindyck & Rubinfeld, supra*, at 402, 404-05.

downstream demand. 3/20/17 Tr. 1967 (Marx) (rate structure upstream should be derived from need to exploit WTP of users downstream via a percentage of revenue). This upstream to downstream consonance in rate structures represents an application of the concept of “derived demand,” whereby the demand upstream for inputs is dependent upon the demand for the final product downstream. *Id.*; see P. Krugman & R. Wells, *Microeconomics* at 511 (2d ed. 2009) (“[D]emand in a factor market is ... *derived demand* ... [t]hat is, demand for the factor is derived from the [downstream] firm’s output choice”).

Determination at 19; *accord* Dissent at 32 (noting that “the upstream demand of the interactive streaming services for musical works (and the sound recordings in which they are embodied) – known as “factors” of production or “inputs” – is derived from the downstream demand of listeners to and users of the interactive streaming services ... This interdependency causes upstream demand to be characterized as “derived demand.”).

In the present proceeding, the PR II-based benchmark embodies the parties’ negotiated definition of Bundled Revenue for purposes of calculating royalties on bundled interactive offerings. This is definition in the Initial Determination. Copyright Owners’ preferred definition for Bundled Revenue – the Determination’s definition – would not only ignore this agreed-upon definition, but would also de-link the royalty rate from the WTP of purchasers of bundles.¹⁶¹ The Judges recognize that Copyright Owners have expressed concern the Services could use such bundling in order to diminish revenue otherwise payable on a higher royalty tier. However, the Majority noted that the evidence indicated such diminishment only occurred “in some cases.” Clarification Order at 17. Thus, the Judges find that eliminating the incentive for price discrimination via bundling would be a disproportionate response and inconsistent with the broad price discriminatory PR II-based benchmark they find useful in this proceeding.

Expert testimony in this regard is “substantial evidence” on which the Judges can rely. For example, the D.C. Circuit also relied in *Johnson* on the testimony of the same witness, Spotify’s economic expert witness, Professor Marx, who explained how a downstream “lower willingness (or ability) to pay” among some cohorts of consumers supports definitional terms, for student and family subscribers, that lower royalty rates in order to further “economic efficiency” in a manner that “still allows more monetization of that provision of that service.” *Johnson* at 392-93. Broadening her lens, Professor Marx also explained that this price discriminatory approach is appropriate “across all types of services and subscribers,” as in “[t]he current law [and in the PR II-based benchmark]” which “accommodates ... ad-supported

¹⁶¹ To see the incentivizing effect of the link between the royalty level and variable WTP, consider the following example. Assume a hypothetical bundle consists of a subscription to the “Acme” interactive music streaming service and the sports service NFL Sunday Ticket. Assume also that Acme and NFL Sunday Ticket have standalone monthly subscription prices of \$9.99/month and \$149.99/month respectively, so that purchasing both separately would cost \$159.98/month. But assume the bundle price is only \$140/month. Acme’s purpose in bundling its interactive music streaming service subscription offering with NFL Sunday Ticket would be to attract customers who had a WTP for the standalone Acme service below \$9.99/month, but a WTP at or above the \$140/month for the bundle.

Under the definition in the Determination, royalties would be paid on the standalone \$9.99/month Acme price. But the purpose of the bundling was to attract subscribers *who would not pay the standalone \$9.99/month price*, so no such would-be subscribers would sign-up, and *no royalties would be generated by them*.

By contrast, under the Initial Determination, the standalone price of NFL Sunday Ticket, \$159.98/month, would be subtracted from the \$140/month bundle price. Although that would preclude a payment of royalties on a *revenue* prong, *royalties still would be paid, under a different tier or on the mechanical floor*.

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services ... and ‘*bundled services*’ through different rate provisions.” Marx WRT ¶ 41 (emphasis added). *See also* 3/21/17 2182-83 (Hubbard) (Amazon’s expert witness testifying that “Prime Music, which is *bundled* with an Amazon Prime service ... sort[s] out customers’ willingness to pay, with an idea of trying to maximize the number of customers,” and agreeing that this approach constitutes “sorting by way of bundling.”) (emphasis added). Further, Professor Hubbard opined that, given the revenue attribution “measurement problem” associated with bundled products, the “Phonorecords II” approach “with the different categories and the minima” ... address this sort of problem [in] a very good way.” 3/15/17 Tr. 1221 (Hubbard).

As in the case of family and student price discrimination, the beneficial effect of such differential pricing was supported by industry witnesses as well as expert witnesses. *See, e.g.*, Mirchandani WDT ¶ 71 (Amazon executive citing the Phonorecords II-based benchmark provisions regarding bundling that “allowed Amazon to bundle Prime Music with Amazon Prime, enabling Amazon to bring a limited catalog of music [REDACTED]”). In sum, the same type of witness testimony that the D.C. Circuit found sufficient to support price discriminatory student and family plans also supports the use of the price discriminatory bundled definition contained in the Initial Determination.

Given the overall benefits from price discrimination, at first blush it is curious that Copyright Owners would risk “leaving money on the table” by removing the royalty-based incentive for price discrimination via bundling. The Judges have identified this problem earlier in this Initial Ruling, in connection with the broader issue of the overall beneficial price discriminatory structure of the PR II-based benchmark. As the Judges noted in that general price discrimination context, Copyright Owners’ own expert economic witnesses acknowledged that they would not irrationally “leave money on the table.” In fact, Copyright owners’ aim, according to that testimony, is to create an unregulated space—per the Bargaining Room theory—and to use their complementary oligopoly power to negotiate price discriminatory rates (in bundles or otherwise), which would free them from the section 801(b)(1) requirements of reasonableness and fairness.

The Judges further find that their prior ruling on this issue in *SDARS III* is distinguishable. There, a proffered bundled revenue definition eliminated the payment of any royalty at all. Copyright Owners quite correctly describe that result as “absurd,” but that is not the result here. Rather, in the present case, the parties’ negotiated an approach that the Judges adopted in the Initial Determination requiring royalties to be paid on interactive services bundled with other products or services.

Even more distinguishable is Copyright Owners’ assertion that *Web IV* provides support for their preferred definition of service revenue. The argument is immediately suspect, because *Web IV* involved per-play royalty rates – not percent-of-revenue rates, making the definition of revenue wholly inapposite. Further, the discussion of the price of an “ice cream cone” in *Web IV* – on which Copyright Owners rely – had nothing to do with bundling or isolating the WTP for different products or services. Rather, there the Judges criticized a bizarre argument made by a licensee (who had a quantity discount for plays steered in its direction), that was tantamount to arguing that if a vendor sells one ice cream cone for \$1.06 but a buyer could buy two for \$1.06, that the market price of an ice cream cone is thus only \$.06. This argument was indeed fallacious, because the price of an ice cream cone would be the average of the total cost for the two cones, *i.e.*, \$.53/cone. Here, the issue is how to address the WTP of different classes of

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buyers with heterogeneous WTP, not the pricing of a discount for all purchasers buying the same quantity. The parties utilized the Bundled Revenue definition from the PR II-based benchmark (and in the Initial Determination) to address the indeterminacy inherent in the variable WTP among purchasers of the bundles, by setting floors and minima, rather than attempt to sort out the WTP of individual (or individual blocs) of subscribers.¹⁶²

For the foregoing reasons, the Judges find that the definition in the Initial Determination (unlike the definition in the Determination) is consistent with the Judges' other substantive rulings herein. That is, just as the Majority abandoned its Bundled Revenue definition in its Initial Determination because it refused to credit the PR II-based benchmark (even as "guidance"), the Judges here do partially rely on the PR II-based benchmark, and thus find that it supports the Bundled Revenue definition contained in the Initial Determination.

4. Application of Four Itemized Statutory Factors

As the forgoing analysis explains, bundling is a form of price discrimination. Accordingly, the Judges' explanation of how price discriminatory rates in the PR II-based benchmark interrelate with the Factor (A) through (D) objectives in section 801(b)(1) are equally applicable here. Accordingly, the Judges incorporate by reference their discussion of those four factors set forth *supra* in connection with the PR II-based benchmark, and find that there is no basis pursuant to those four factors to adjust the PR II-based benchmark definition of Bundled Revenue.

V. Conclusion

On the basis of the foregoing analyses, and in consideration of the entirety of the record, the Judges make the following determination relating to the issues on remand from the D.C. Circuit.

As noted at the outset, the headline rate for all offerings throughout the *Phonorecords III* period shall be as follows:

¹⁶² Accordingly, Copyright Owners' assertion that the Services did not satisfy their burden of proof with regard to the Bundled Revenue definition misses the point. The Services' burden was to show the reasonableness of utilizing the Bundled Revenue definition in the PR II-based benchmark, not to show that their proffered approach measured the WTP of individual subscribers (or blocs of subscribers). Such an alternative approach might have had merit but no alternative approach was presented to the Judges.

To be clear, the Judges are not declaring that an alternative Bundled Revenue definition and/or alternative rates and structures for bundle, might not have been preferable. *See* 4/15/17 Tr. 5056-58 (Katz) ("[I]f someone had a proposal [with] a specific reason why we should adjust this minimum that's something I would have examined"); *see also* 3/15/17 Tr. 1227-28 (Leonard) (Google's economic expert testifying that "if somebody had ... suggest[ed] ... a different sort of bucket that should be created ... that's a good idea."). But Copyright Owners did not propose such alternatives at the hearing, and the alternative in their Motion for Clarification simply eviscerated the "derived demand"-based link between royalties and bundled offerings. As the Judges have noted *supra*, in the words of Judge Patricia Wald, all judges are cabined by the record evidence introduced by the parties. Therefore (in the absence of a way in which to synthesize the parties' proposals in a manner that does not "blindside" the parties) the Judges must choose between the proposals that are in the record, not potentially superior proposals that are not in the record. Here, the Judges favor the Bundled Revenue definition in the Initial Determination that was negotiated by the parties, incentivizes price discrimination and pays royalties on the bundled music, over the substituted definition in the Determination pursued by Copyright Owners that would eliminate price discrimination, except under the terms Copyright Owners could impose via their complementary oligopoly power, and without regard to the statutory requirements of a "reasonable rate" and a "fair income" for the Services.

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2018-2022 All-In Headline Royalty Rates

	2018	2019	2020	2021	2022
Percent of Revenue	11.4%	12.3%	13.3%	14.2%	15.1%

In all other respects, the rates and rate structure of the PR II-based benchmark shall be effective as the rates and structure throughout the *Phonorecords III* period.

The definition of Service Revenue for bundled offerings throughout the *Phonorecords III* period shall be the definition contained in the Initial Determination.

VI. Order

In light of the foregoing analyses and conclusions, the Judges hereby **ORDER** that the participants in this remand proceeding prepare and submit regulatory provisions consistent with this ruling.¹⁶³ The participants shall file agreed regulatory language within ten days of the date of this ruling.

The Judges **FURTHER ORDER** that if the participants cannot agree on a joint submission, the Judges will accept separate submissions respectively from (1) Copyright Owners and (2) Services, jointly. In absence of an agreed submission, the participants shall file separate submissions not later than 15 days after the date of this ruling.¹⁶⁴

The Judges **FURTHER ORDER** that parties shall not file, and the Judges shall not consider, briefing or legal argument beyond necessary explanatory notes to the proposed language, section by section, not to exceed 250 words per proposed section.¹⁶⁵ The Judges specifically admonish the parties that they shall not use these submissions as a basis to object to this Initial Ruling, either explicitly or implicitly by proposing regulatory provisions inconsistent with this Initial Ruling.

The Judges **FURTHER ORDER** that, within 30 days of the date of this Initial Ruling and the attendant dissenting documents, the parties shall file an agreed redacted version of this Initial Ruling, and the dissents, for PUBLIC viewing.

After the Judges have reviewed the parties' regulatory submissions, the Judges shall adopt and format the necessary regulatory language format terms relevant to this ruling and issue a RESTRICTED Initial Determination after Remand, which shall embody their determination of rates and terms. The parties will have an opportunity to suggest redactions from the Initial Determination after Remand before it is issued as a public version.

The parties shall not file any motions seeking rehearing or reconsideration of this Initial Ruling. Subsequent to the Judges' issuance of their Initial Determination after Remand as

¹⁶³ The Judges adopt this process in order to avoid a dispute regarding the regulatory provisions issued in connection with their ruling. Because this is a remanded proceeding, the Judges are not restricted to the procedures that would control in an original proceeding, and are exercising their authority to "make any necessary procedural ... rulings in any proceeding under this chapter." 17 U.S.C. § 801(c).

¹⁶⁴ In their agreed upon or separate submissions, the parties shall address the issue identified in note 135 *infra*, regarding Copyright Owners' assertion that the Services omitted from their proposed subpart C rates a portion of the *Phonorecords II* rates.

¹⁶⁵ A section of the regulations is designated by a number following the decimal after the part number, for example, § 385.5. The regulations relevant to this proceeding are found in part 385.

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identified in the immediately preceding paragraph, any party may file a Motion for Rehearing within 15 days of the issuance of said Initial Determination after Remand.

After ruling on any and all Motions for Rehearing as identified in the immediately preceding paragraph, the Judges shall issue a Final Determination after Remand.

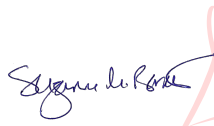
SO ORDERED.

**Steve
Ruwe** Digitally signed
by Steve Ruwe
Date: 2022.07.01
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Stephen S. Ruwe
Copyright Royalty Judge

**David
Strickler** Digitally signed
by David
Strickler
Date: 2022.07.01
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David R. Strickler
Copyright Royalty Judge

 Digitally signed by
Suzanne Barnett
Date: 2022.07.01
14:54:59 -04'00'

Suzanne M. Barnett
Chief Copyright Royalty Judge

Dated: July 1, 2022

APPENDIX A

Offering	% of Service Provider Revenue	TCC % or TCC Amount	“Mechanical-Only” Royalty Floor
<i>Standalone Non-Portable Subscription Offering—Streaming Only</i>	10.5%	The lesser of 22% of TCC for the Accounting Period or 50 cents per subscriber per month	15 cents per subscriber per month
<i>Standalone Non-Portable Subscription Offering—Mixed</i>	10.5%	The lesser of 21% of TCC for the Accounting Period or 50 cents per subscriber per month	30 cents per subscriber per month
<i>Standalone Portable Subscription Offering</i>	10.5%	The lesser of 21% of TCC for the Accounting Period or 80 cents per subscriber per month	50 cents per subscriber per month
<i>Bundled Subscription Offering</i>	10.5%	21% of TCC for the Accounting Period	25 cents per month for each Active Subscriber during that month
<i>Mixed Service Bundle</i>	11.35%	21% of TCC for the Accounting Period	n/a
<i>Limited Offering</i>	10.5%	21% of TCC for the Accounting Period	n/a
<i>Paid Locker Service</i>	12%	20.65% of TCC for the Accounting Period	n/a
<i>Purchased Content Locker Service</i>	12%	22% of TCC for the Accounting Period	n/a
<i>Free nonsubscription/ad-supported services free of any charge to the End User</i>	10.5%	22% of TCC for the Accounting Period	n/a

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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)

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ORDER 43 ON PHONORECORDS III REGULATORY PROVISIONS

Introduction

The present Order concerns a single issue in dispute among the parties¹ regarding regulatory language implementing the Judges’ Initial Ruling and Order after Remand (“Initial Ruling”) entered in this proceeding.² Subsequent to filing dueling submissions (*see* footnote 2 *infra*), the parties filed a Joint Submission, informing the Judges that they had “agree[d] on all of the regulatory language” except for certain rate percentages contained in Table 2 of the proposed Section 385.21. Joint Submission ... Regarding Regulatory Provisions Following Initial Ruling and Order (after Remand) at 1 (Nov. 30, 2022) (“Joint Submission”) (eCRB no. 27337).

¹ The parties who have joined on this dispute (through filings after the issuance of the Initial Ruling) are the National Music Publishers’ Association and Nashville Songwriters Association International (collectively, “Copyright Owners”) and Amazon.com Services LLC, Google LLC, Pandora Media, LLC, and Spotify USA Inc. (collectively, the “Services”). (Copyright Owners have informed the Judges that another party, George Johnson, joins in Copyright Owners’ position with respect to the issue considered in this Order.)

² The Judges instructed the parties to “prepare and submit regulatory provisions consistent with this ruling.” Initial Ruling and Order after Remand at 114 (July 1, 2022) (eCRB nos. 26938, 27063). The Judges further instructed that, “if the participants cannot agree on a joint submission, the Judges will accept separate submissions respectively from (1) Copyright Owners and (2) Services, jointly.” *Id.* The parties did not initially file an agreed-upon joint submission as to regulatory provisions, but rather filed the permitted separate submissions.

The Regulatory Language in Dispute

The dispute between the parties is whether the Judges should adopt in the Phonorecords III regulations: (1) the several “Total Content Cost” (“TCC”) rates³ set forth in the Phonorecords II-based benchmark; or (2) the single 26.2% TCC rate discussed in the Initial Ruling. This dispute relates to nine offerings made by interactive streaming services, as detailed below:

Offering	Copyright Owners’ Proposal	Services’ Proposal
<i>Standalone Non-Portable Subscription Offering—Streaming Only</i>	26.2%	The lesser of 22 % of TCC for the Accounting Period or 50 cents per subscriber per month
<i>Standalone Non-Portable Subscription Offering—Mixed</i>	26.2%	The lesser of 21% of TCC for the Accounting Period or 50 cents per subscriber per month
<i>Standalone Portable Subscription Offering</i>	26.2%	The lesser of 21 % of TCC for the Accounting Period or 80 cents per subscriber per month
<i>Bundled Subscription Offering</i>	26.2%	21 % of TCC for the Accounting Period
<i>Free nonsubscription/ad-supported services free of any charge to the End User</i>	26.2%	22% of TCC for the Accounting Period
<i>Mixed Service Bundle</i>	26.2%	21% of TCC for the Accounting Period
<i>Purchased Content Locker Service</i>	26.2%	22% of TCC for the Accounting Period
<i>Limited Offering</i>	26.2%	21% of TCC for the Accounting Period
<i>Paid Locker Service</i>	26.2%	20.65% of TCC for the Accounting Period

Sources: Offering column text from Exhibit A to Joint Submission ... Regarding Regulatory Provisions Following Initial Ruling and Order (after Remand) at 17 (Nov. 30, 2022) (eCRB no. 27338); Services’ Proposal column text from Services’ Joint Submission of Regulatory Provisions Ex. A at 11 (July 18, 2022) (eCRB no. 27005)

³ TCC is defined in the Initial Ruling as “a shorthand reference to the extant regulatory language describing generally the amount paid by a service to a record company for the section 114 right to perform digitally a sound recording.” Initial Ruling at 4 n.8 (citations omitted).

The Issue

At a high level, the remaining regulatory issue is the following:

Whether a 26.2% TCC rate identified in the hearing record, and discussed both on appeal and on remand by the D.C. Circuit, should substitute for TCC rates in the Phonorecords III period, or whether these uncapped TCC rates should be set at the specific levels ranging between 20.65% and 22% set forth in the Phonorecords II-based benchmark adopted by the Judges in the Initial Ruling.

To frame, address, and rule on this issue, in this Order the Judges place the parties' dispute in the context of the prior rulings by the D.C. Circuit and the Judges in connection with this proceeding.

Background

On January 5, 2016, the Judges initiated proceedings to determine the appropriate mechanical license royalty rates and terms for the January 1, 2018 to December 31, 2022 period. *See* Notice Announcing Commencement of Proceedings in Phonorecords III, 81 Fed. Reg. 255 (Jan. 5, 2016). After the parties filed their written and rebuttal testimonies and engaged in discovery, they participated in a five-week evidentiary hearing presided over by the Judges. *See* Determination of Royalty Rates and Terms for Making and Distributing Phonorecords, 84 Fed. Reg. 1918, 1920, 1923–1925 (Feb. 5, 2019).⁴

In the Majority Opinion, the Judges adopted a “greater-of” royalty rate structure for the mechanical license, which contained a TCC rate applicable to all categories of offerings⁵. *See* 84

⁴ The Determination was not unanimous. Judge David Strickler dissented from the Majority's setting of the TCC rate, and he proposed that the appropriate rates should essentially be those proposed in the Phonorecords II-based benchmark proposed by several of the Services. Thus, for clarity, this Order refers to the “Majority Opinion” and the “Dissenting Opinion,” rather than the “Final Determination,” when discussing the respective opinions.

⁵ The other prong in the “greater-of” rate structure is the percent-of-revenue generated by the interactive streaming service, *i.e.*, “service revenue.”

Fed. Reg. at 1963; *see also Johnson v. Copyright Royalty Board*, 969 F.3d 363, 372 (D.C. Cir. 2020) (summarizing the Majority Opinion). More particularly, the Majority adopted the following rates and rate structure:

2018-2022 All-In Royalty Rates: The Greater of:

	2018	2019	2020	2021	2022
Percent of Revenue	11.4%	12.3%	13.3%	14.2%	15.1%
Percent of TCC	22.0%	23.1%	24.1%	25.2%	26.2%

Majority Opinion at 1918, 1960.

The Services appealed.⁶ Among their arguments were the assertions – pertinent to this Order – that the Majority: (i) violated the Services’ procedural right to fair notice by choosing a structure that was not advanced by any party; (ii) acted arbitrarily and capriciously by simultaneously combining a TCC prong (phased-in to 26.2% of TCC) with an increase in the percentages on the revenue prong (phased-in to 15.1%); and (iii) failed to reasonably explain its rejection of the Phonorecords II settlement as a benchmark. *Johnson, supra*, at 376, 380-81.⁷

Copyright Owners argued in opposition that: (i) the Services’ procedural rights were not violated because “every component” of the Majority’s approach was contained in the hearing record; (ii) the Majority’s rate and rate structure rulings were well-reasoned, factually supported

⁶ The Copyright Owners and George Johnson also appealed; all three parties’ appeals were consolidated by the D.C. Circuit. *Johnson* at 375.

⁷ The annual phased-in rates are set forth in the Table *supra*.

and, therefore, not arbitrary and capricious; and (iii) sufficient reasons existed in the record to support the Majority’s rejection of the Phonorecords II-based benchmark. *Johnson, supra*, at 382-383; 387.

The D.C. Circuit vacated and remanded. More particularly, *Johnson* holds as follows:

1. The Majority Determination “failed to provide adequate notice of the drastically modified rate structure [they] ultimately adopted,” which was beyond “a reasonable range of contemplated outcomes” in “the parties’ pre-hearing proposals, the arguments made at the evidentiary hearing, and the preexisting rate structures.” *Johnson* at 381-82. Accordingly, as to this issue, “[i]f the [Judges] wish[] to pursue [their] novel rate structure, [they] will need to reopen the evidentiary record.” *Id.* at 383.
2. The appellate issue of whether the Majority’s adoption of the (phased-in) 26.2% TCC royalty rate was “arbitrary and capricious” could not be addressed – given the absence of “adequate notice” cited in point (1) above. *Id.*
3. The Majority’s derivation, calculation *and application* of the royalty rate of 15.1% on the revenue prong was proper.⁸ The D.C. Circuit explained that, as to *this* issue, the Majority had engaged in the “type of line-drawing and reasoned weighing of the evidence [that] falls squarely within the [Judges’] wheelhouse as an expert administrative agency.” *Johnson* at 386. More particularly, the D.C. Circuit approved of the Judges’ reliance on “substantial evidence” in the form of expert testimony to set the 15.1% service revenue rate. *Johnson*, at 384-85 (emphasis added). *See also id.* at 388 (finding “substantial evidence” for the Judges’ finding that an increase in the mechanical royalty rate was necessary to address a “marked decline in mechanical royalty income”).
4. The Majority’s rejection of the Phonorecords II-based benchmark is remanded because the D.C. Circuit “cannot discern the basis on which the [Judges] rejected the Phonorecords II rates as a benchmark in [their] analysis, that issue is remanded to the [Judges] for a reasoned analysis.” *Johnson* at 387.

On remand, the Judges adopted procedures that mainly followed the parties’ requests.

More particularly, the Judges followed the D.C. Circuit’s directive and reopened the evidentiary

⁸ The italicization of the word “application” serves to foreshadow a critical point discussed *infra*: The D.C. Circuit did not affirm any application of the 26.2% TCC rate, *except* for the use of that 26.2% rate as an *input* derived from a specific dataset, to set the 15.1% service revenue-based royalty rate. *Johnson, supra*, at 385-86; *see also* at 386 n.11.

record to receive evidence and testimony relating to the TCC issues. *See* Order Regarding Proceedings on Remand at 2 (Dec. 15, 2020). The post-remand supplementary record added: (1) rate evidence for the 33-months from January 2018 through September 2020, when the parties operated under the Majority’s new (but subsequently vacated) regulations including the TCC rates; and (2) new testimony from economic expert witnesses on behalf of Copyright Owners and the Services. *See* Initial Ruling, *passim*. However, none of the post-remand evidence submitted and relied upon by the parties *specifically* addressed as a separate issue the rates for the nine offerings that are the subject of the present Order.

On July 1, 2022, the Judges issued their Initial Ruling⁹ – applying *Johnson* and considering the entire record developed pre-remand and post-remand. In their Initial Ruling, the Judges made several findings that bear upon the issue at hand, *viz.*, whether to adopt in the Phonorecords III regulations the 26.2% TCC rate or the TCC rates (ranging from 20.65% to 22%) from the Phonorecords II-based benchmark. In particular, in the Initial Ruling, the Judges stated the following:

1. The Phonorecords II-based benchmark incorporates price discriminatory features for product differentiation as between: (a) subscription and ad-supported services; (b) portable and non-portable services; and (c) unbundled and bundled services. *See* Initial Ruling at 67-68 (noting the salutary price discriminatory nature of the Phonorecords II-based benchmark).
2. The Phonorecords II-based benchmark “reflect[s] a rate structure with an adequate degree of competition, because there was a balance of bargaining power [“countervailing power”] between the two negotiating industrywide trade

⁹ The findings and conclusions in the Initial Ruling were adopted by a majority of the Judges, but two Judges filed separate opinions. *See* Initial Ruling at 2 n.5. One Judge, former Chief Judge Suzanne Barnett, dissented from the Majority’s adoption in the Initial Ruling regarding the *Phonorecords II* rate structure (section II of the Initial Ruling), though not from the exception to that benchmark with regard to the headline rate of 15.1% and the imposition of a cap on the TCC rate prong. *See* Chief Judge Barnett’s “Dissent re Benchmark” (July 1, 2022) (eCRB no. 26943). The other opinion was issued by Judge Strickler, who dissented from the *reasoning* relating to the adoption of the definition of Service Revenue (section V), but concurred in the *adoption* of that definition. *See* Judge Strickler’s “Dissent in Part as to Section IV of the Initial Ruling and Order after Remand” (July 1, 2022) (eCRB no. 26965).

associations, offsetting the complementary oligopoly effects in place when a “Must Have” licensor bargains separately with each licensee.” Initial Ruling at 69.

3. Based upon the available record evidence, the Judges find ... the Services’ Phonorecords II-based benchmark ... “more than sufficient to satisfy the legal requisites for application, as well as a practical benchmark, when used in conjunction with the 15.1% headline revenue rate advocated by Copyright Owners.” Initial Ruling at 59.
4. “Substantial evidence demonstrates that the Phonorecords II-based benchmark rates, other than the headline rate, are not ‘too low.’” Initial Ruling at 73.
5. A Copyright Owner expert witness opined that “the evidence ... indicates that the relative valuation ratios implied by the current Section 115 compulsory license [*i.e.*, the Phonorecords II-based benchmark] implies a “*lower bound on the relative market valuations* of the reciprocal percentage of the value musical works rights relative to sound recording rights [*i.e.*, TCC rates] [of] 22% and 21 %.” Initial Ruling at 78 (emphasis therein).
6. The royalty rates and terms within Subpart C of the Phonorecords II-based benchmark – *which include the rates and term for the offerings at issue in this Order* – are expressly “covered by [the] foregoing analysis.” Initial Ruling at 93. In rejecting all of Copyright Owners’ arguments for different treatment of Phonorecords II-based benchmark rates in Subpart C therein, the Judges declined to adopt Copyright Owners’ “re-assert[ion] [of] the same arguments with respect to subpart C” that Copyright Owners advanced in opposing the Phonorecords II-based benchmark “for interactive streaming in subpart B.” *See* Initial Ruling at 93-94 (“The Judges find no reason on remand to treat the subpart C offerings differently than the manner in which they are treating the subpart B interactive streaming offerings That means, however, that the various “headline” rates for these subpart C offerings must also adjust to 15.1%,¹³¹ *whereas the alternative rates (identified in subpart C as “minima” and “subminima”) rates shall remain unchanged.*”) (emphasis added).
7. The D.C. Circuit had affirmed that: (a) the “headline” percentage royalty rate (not a TCC rate) of 10.5% was too low; and (b) that the Majority had not improperly exercised its authority when it increased that revenue royalty rate to 15.1% (as phased-in over the five-year rate term). Accordingly, on remand, the Judges maintained the 15.1% (phased-in) percentage royalty rate. *See, e.g.*, Initial Ruling at 4, 17.
8. The D.C. Circuit affirmed the Majority’s *derivation and calculation* of the 26.2% TCC rate for use as an input in calculating the 15.1% (phased-in) service revenue percentage royalty rate. However, *Johnson* vacated and remanded the Majority’s *application and inclusion* of the 26.2% TCC rate. Initial Ruling at 19-20.

For these reasons, the Judges decided in the Interim Ruling that: (1) the overall

Phonorecords II rates comprise a “useful benchmark,” when the 15.1% headline percentage rate

replaces the 10.5% headline percentage rate for the offerings in Subparts B and C of the Phonorecords II-based benchmark; and (2) “[t]he (phased-in) 26.2% rate [is] unreasonable.” Initial Ruling at 50 n.77; 88; and 93-94.

Procedures following the Post-Remand Initial Ruling

In the Initial Ruling, the Judges directed the parties to attempt to submit jointly agreed-upon regulatory provisions implementing the Initial Ruling, for the Judges to consider. The Judges further ruled that, if the parties could not agree on all the regulatory language, they should make separate submissions regarding regulatory provisions in dispute. *See* Initial Ruling at 114.

The parties agreed to many regulatory provisions but disagreed as to several such provisions. Accordingly, they filed separate submissions and respective replies, regarding the regulatory provisions. Services’ Joint Submission of Regulatory Provisions (July 18, 2022); Copyright Owners’ Submission of Regulatory Provisions to Implement the Initial Ruling (July 18, 2022); Services’ Joint Response to Copyright Owners’ Submission of Regulatory Provisions (Aug. 5, 2022); Copyright Owners’ Response to Judges’ July 27, 2022 Order Soliciting Responses Regarding Regulatory Provisions (Aug. 5, 2022).

The Judges considered those submissions and entered an order addressing the disputed regulatory provisions. *See* Corrected Order regarding Regulatory Provisions following Initial Ruling and Order (After Remand) (Nov. 10, 2022) (“November 10th Order”).¹⁰

In the November 10th Order, the Judges directed the parties once more to file a joint submission “of regulatory provisions that embody the rulings set forth in *Johnson*, the Initial Ruling and this [November 10th] Order, and any aspects of the [Majority] Determination (pre-

¹⁰ The November 10th Order corrected an otherwise substantively identical order issued two days earlier, on November 8, 2023, which had inadvertently included a small amount of text. *See* November 10th Order at 1.

remand) that the parties understand to remain effective after the foregoing rulings.” November 10th Order at 31.

On November 30, 2022, the parties made the Joint Submission (as also identified at the outset of the present Order), in which they provided joint regulatory language no longer in dispute that applied the binding rulings of the Judges and the D.C. Circuit. However, as also noted above, the parties identified the single issue in dispute that relates to the nine service offerings described *supra*.¹¹

The Parties’ Respective Arguments in their November 30th Joint Submission

Copyright Owners’ Arguments

According to Copyright Owners, the Initial Ruling “appears to plainly acknowledge that, in light of *Johnson*, the derivation and calculation of the (phased-in) 26.2% TCC rate percentage cannot be changed.” Joint Submission at 6. More particularly, Copyright Owners aver that, according to the Judges’ Initial Ruling, “the D.C. Circuit affirmed the Majority’s derivation and calculation of the 26.[2]% ... TCC rate” and further that “both rate prongs” – the service revenue rate and the TCC rate – were “derived from the same analyses.” Initial Ruling at 19; Joint Submission at 6-7 (quoting Initial Ruling at 19 (emphasis removed)). Further to this point, Copyright Owners rely on the Judges’ additional language in the Initial Ruling that the pre-remand Final Determination’s “*derivation and calculation* of the TCC rate [i.e., the 26.2%

¹¹ On January 10, 2023, Spotify USA Inc., Amazon.com Services LLC, Google LLC, Pandora Media, LLC, National Music Publishers’ Association, Inc. and the Nashville Songwriters Association International filed a joint Motion (eCRB no. 27418) requesting modification of the previously proposed language for 37 C.F.R. section 385.3, which governs fees owed for late payment. There was no opposition to the January 10, 2023 joint Motion. The Judges find good cause to adopt the modified language, which provides that “where payment is due to the mechanical licensing collective under 17 U.S.C. 115(d)(4)(A)(i), late fees shall accrue from the due date until the mechanical licensing collective receives payment.”

rate] ... is not subject to further consideration on remand by the Judges.” Joint Submission at 7 (quoting Initial Ruling at 20 (emphasis in Initial Ruling)).¹²

According to Copyright Owners, the foregoing points are consistent with the limited scope of the remand, which “was not opened for new evidence concerning TCC rate percentages.” Joint Submission at 7 (citations omitted). Accordingly, Copyright Owners emphasize that “there is no evidence in the record after remand to support changing the (phased-in) 26.2% TCC rate percentage. Joint Submission at 7. Copyright Owners – characterizing the former Phonorecords II TCC rates now at issue as newly derived and calculated – maintain that these “new” TCC rate percentages therefore are “foreclosed” by the Initial Ruling and post-remand orders cited above. Joint Submission at 7-8.

Copyright Owners also assert that the TCC rate at issue here – “was not appealed by the Services or challenged during the remand, nor called into question by the Circuit in *Johnson*.” Joint Submission at 8 (emphasis removed). The absence of an appeal as to this issue, according to Copyright Owners, means that the only TCC rate supported by *Johnson* is the 26.2% TCC rate. Joint Submission at 8.

The Services’ Arguments

According to the Services, the Judges should adopt in the regulations the TCC percentage rates – ranging from 20.65% to 22% – because those rates are contained in the Phonorecords II-based benchmark adopted by the Judges and thus essentially have been “expressly set out by the Judges” in two prior decisions. Joint Submission at 2 (citing Initial Ruling at 2; November 10th Order at 6 n.13). In light of these prior Orders, the Services characterize *Copyright Owners’ position as the new argument*, improperly seeking regulatory provisions that “reflect the 26.2%

¹² However, Copyright Owners disregard the Initial Ruling’s observation that *Johnson* vacated and remanded the Majority’s *application and inclusion* of the 26.2% TCC rate. Initial Ruling at 19.

rate previously imposed by the [M]ajority in the now-vacated pre-remand Final Determination.”
Id.

More pointedly, the Services argue that the Judges’ Initial Ruling already expressly considered and rejected application of the 26.2% TCC rate. *Id.* (citations omitted). Further, the Services maintain that it is because the Judges rejected the 26.2% TCC rate in the Initial Ruling that the Judges had no need to “substantively address the topic of TCC rates” in their November 10th Order. *Id.* at 4.

The Services further maintain that “*Johnson* does not compel the Judges to simply reinstate their original pre-remand TCC rates.” *Id.* To this point, the Services rely on the Judges’ post-remand finding that, although the error made by the Majority in adopting the 26.2% TCC rate in the pre-appeal Phonorecords III Determination was procedural, the “consequence ... was *substantive*.” *Id.* (emphasis herein).

For the above reasons, the Services maintain that the Judges could not possibly be required on remand to adopt an express 26.2% in any portion of the Phonorecords III regulations.

Turning from their argument that the 26.2% TCC rate was rejected by the Judges, the Services focus on the Judges’ finding in the post-remand Initial Ruling that the “*Phonorecords II* benchmark ... is the ‘better of the benchmarks proposed by the parties ... one that satisfies the requirements of 17 U.S.C. § 801(b)(1) in all respects.’” Joint Submission at 5 (quoting Initial Ruling at 2). Because the Phonorecords II benchmark includes the TCC rates now at issue – ranging from 20.65% to 22% – the Services maintain that those rates should properly be included in the Phonorecords III regulations. *Id.*¹³

¹³ The Services also argue that Copyright Owners’ assertion *at this time* that the 26.2% TCC rate should substitute for the Phonorecords II-based benchmark rates is *procedurally* untimely and improper. The Judges only partially agree with Services’ argument in this regard. If Copyright Owners had wanted to timely make this argument, they

The Judges' Analysis and Ruling

Having considered the parties' submissions, the Initial Ruling and all other pertinent material, the Judges rule that the 26.2% TCC rate cannot and shall not be applied in the regulatory provisions now at issue. Rather, the Judges rule that the TCC rates set forth in the Phonorecords II-based benchmark shall be applied in the nine regulatory provisions now at issue, because they are consistent with and give effect to the Judges' Initial Ruling. The more particular bases for this ruling are set forth below.

Most fundamentally, the Judges note at the outset that in the Initial Ruling they expressly *did not apply* the 26.2% TCC rate in any manner other than as an input – using that TCC rate only as the D.C. Circuit directed – to calculate the 15.1% of service-revenue royalty rate. *See, e.g.,* Initial Ruling at 41 (“[A] careful reading of the remand testimony by Copyright Owners’ economists, Professors Watt and Spulber, reveals that *neither of them actually testifies that there is sufficient theoretical and empirical evidence to support the ... 26.2% TCC rate* (emphasis in original). *See also id.* at 40-41 n.69 (contrasting the improper application of the 26.2% TCC

should have done so during the post-remand period *before* the Judges entered their Initial Ruling (or, of course, during the initial proceeding pre-appeal). In that sense, Copyright Owners failed to avail themselves procedurally of the right to make this substantive challenge. However, the Judges have afforded the parties the procedural right to propose regulatory language that they claim would implement the Initial Ruling; a procedural right exercised by both parties, as evidenced by, for example, their arguments in the Joint Submission. In that narrow sense, Copyright Owners’ present argument is not procedurally improper. As a matter of *substance* though, as explained in “The Judges Analysis and Ruling” *infra*, the Judges have considered herein Copyright Owners’ present arguments and found them inconsistent with the Initial Ruling.

Finally, with regard to subsequent substantive challenges to the Initial Ruling, the parties correctly understand that such challenges can be made after the Judges issue their post-remand “Initial Determination” (a statutorily-mandated ruling). *See* Joint Submission at 9 (Services agreeing with Copyright Owners’ understanding that they continue to properly “reserve all rights with respect to the Initial Ruling, any implementing regulations and any Initial and Final Determination, including the right to challenge any of the foregoing.”).

as a separate statutory rate from the use of the 26.2% TCC rate as input from a “bargaining model” solely to increase the service revenue rate to 15.1%).¹⁴

In this regard, the Initial Ruling has relied upon the clear distinction made in *Johnson* between the 15.1% service revenue rate and the 26.2% TCC rate. Compare *Johnson, supra*, at 385 (affirming the Majority’s *application* of the “revenue rate of 15.1%” as “the type of line-drawing and reasoned weighing of the evidence falls squarely within the[ir] wheelhouse as an expert administrative agency”) with *id.* at 382-83 (vacating the Majority’s decision for “significantly hiking the TCC rate to 26.2% from approximately 17% to 22%” without allowing the Services an opportunity to address the issue – an error that was even “worse” than the elimination of caps on certain other TCC offerings.).

Further, the offerings now at issue were contained in the Phonorecords II-based benchmark, and the Judges’ application of that benchmark in the Initial Ruling is unambiguous: Other than the new and increased headline rate of 15.1%, “the rates and rate structure of the *Phonorecords II*-based benchmark proposed by the Services ...) shall constitute the rates and rate structure for the *Phonorecords III* period.” Initial Ruling at 2. Accordingly, with regard to the single remaining issue, pertaining to the nine offerings listed *supra*, the regulatory provisions proposed by the Services in the Joint Submission are fully consistent with the Initial Ruling.

By contrast, Copyright Owners’ proposed language introduces a change in the Phonorecords II-based benchmark rates that was never the subject of an evidentiary proceeding

¹⁴ The Services claim that this distinction constitutes a semantic twisting of words. See Joint Submission at 7. The Judges reject that characterization. Rather, their ruling is substantive, not semantic, because they have relied upon the testimony of several economic expert witnesses, including one of Copyright Owners’ own economic experts, who identified five reasons that the Judges found to preclude adoption of the 26.2% TCC rate as a separate statutory rate. See, e.g., Initial Ruling at 41. Moreover, not a single economist who testified at the hearing proposed that the Judges adopt the 26.2% TCC rate as a statutory rate, see Initial Ruling at 38, further supporting the Judges’ adoption in the Initial Ruling of the consensual negotiated TCC rates contained in the Phonorecords II-based benchmark for the nine offerings at issue.

pre-or post-remand, whether through live or written testimony. But perhaps more importantly, as a matter of *substance*, Copyright Owners’ proposed regulatory provisions are inconsistent with the language and a key purpose of the Initial Ruling, which is to adopt the Phonorecords II-based benchmark rates, the basis of which were generated consensually by the parties, through negotiations between industrywide trade associations, which prevented unwarranted and disproportionate complementary oligopoly market power from affecting the royalty rates. See Initial Ruling at 69-70.¹⁵

The Judges also reject Copyright Owners’ argument that by maintaining the 20.65% through 22% TCC rates in the Phonorecords II-based benchmark they would be violating their prior rulings regarding the scope of the remand. Citing to the Judges’ Order Regarding Proceedings on Remand at 1 (eCRB no. 23390) (“Remand Order”), Copyright Owners state in their Joint Submission that that the remand “was not opened for new evidence concerning TCC rate percentages.” Joint Submission at 7. But the decision to re-open the existing, and robust, evidentiary record only as to rate *structure*, did not limit the *scope* of the remand itself, nor consideration of evidence from the underlying proceeding.

Moreover, the Judges find no language in either the Remand Order or the Remand Scheduling Order, and no other basis, that would support Copyright Owners’ characterization of

¹⁵ The Judges also note that their adoption of these 20.65% through 22% TCC rates in the Phonorecords II-based benchmark – because they are lower than the 26.2% rate proposed by Copyright Owners – is consistent with their rationale for adopting that benchmark. As the Judges explained *repeatedly and throughout the Initial Ruling*, their adoption of the Phonorecords II-based benchmark purposefully incorporates into the Phonorecords III regulations the beneficial price discriminatory features that are hallmarks of that benchmark. See, e.g., Initial Ruling at 65 n.98 (“[T]he granular discriminatory features that the parties had negotiated ... reflect an “appropriate form and extent of price discrimination” The Judges emphasized this point repeatedly. See *generally* Initial Ruling, *passim*.

Further, as the Services note, Copyright Owners themselves – even when advocating for an otherwise across-the-board 26.2% TCC prong -- had continued to propose the 20.65% to 22% TCC rates for the nine offerings at issue now. See Copyright Owners’ Submission of Regulatory Provisions to Implement the Initial Ruling at 15-16) (July 18, 2022); see also Joint Submission at 6.

the 20.65% through 22% TCC rates in the Phonorecords III-based benchmark as new evidence, given that they were expressly included in that benchmark which had been proffered at the hearing *prior to the remand*.

Further, the present issue of whether the regulatory provisions implementing the Initial Ruling should apply the Phonorecords II-based benchmark TCC rates or the 26.2% TCC rate is *not* a dispute regarding the derivation or calculation of a *new* TCC rate. The Phonorecords II-based benchmark rates are self-evidently *not new rates*, because they existed in that *prior* benchmark. Moreover, the present dispute relates to whether the language and reasoning in the Initial Ruling are consistent with maintaining the rates contained in the Phonorecords II-based benchmark for the nine offerings at issue, or whether the Initial Ruling calls for abandoning those benchmark rates and replacing them with the 26.2% TCC rate proffered by Copyright Owners. As explained *supra*, the 26.2% TCC rate was properly utilized by the Majority as an *input* (combined with other evidence) in order to calculate the 15.1% service revenue royalty rate. The record reflects no other context in which the 26.2% TCC rate can be utilized, let alone must be utilized. Indeed, as explained *supra*, the record reflects the Judges' rejection of the 26.2% TCC rate as a stand-alone statutory royalty rate.

The Judges also reject Copyright Owners' argument that the Services somehow waived their argument for maintaining the 20.65% through 22% TCC Phonorecords II-based benchmark rates. More particularly, Copyright Owners incorrectly assert that these rates were "not appealed by the Services" Joint Submission at 8. Rather, the D.C. Circuit stated unambiguously: "[T]he Streaming Services object to the [Judges'] ... rejection of the Phonorecords II ... settlement[] as [a] rate benchmark[]." *Johnson*, 969 F.3d at 384; *see also id.* at 386 ("The

Streaming Services argue ... that the [Judges] arbitrarily rejected ... [a] potential rate benchmark[] ... the Phonorecords II settlement—without adequate explanation.”).

Moreover, the D.C. Circuit repeatedly noted that it was vacating and remanding the Majority’s Determination with regard to, *inter alia*, the Majority’s improper decision to reject the Phonorecords II-based benchmark *writ large*, *i.e.*, without qualification by the appellate panel that some parts of that proffered benchmark might have been correctly rejected. *See Johnson*, 969 F.3d at 367, 376, 381, 387. Obviously, virtually all the elements of the Phonorecords II-based benchmark – including the offerings now at issue – were appealed, and not waived, foregone or forfeited by the Services.

Likewise, Copyright Owners are wrong in their claim that the Services had never “challenged” these rate issues “during the remand.” Joint Submission at 8. Rather, the Services argued on remand for the Phonorecords II-based benchmark to be applied *comprehensively*, without itemizing every element of that proffered benchmark. *See Services’ Joint Opening Brief* (post-remand) at 19-44 (Apr. 1, 2021) (detailing why “the Services’ proposal based on the *Phonorecords II* settlement is reasonable”); *see also Services’ ... Submission of Regulatory Provisions* at 2 (July 18, 2022) (“Services’ July 18th Submission”) (“[T]he Services have faithfully implemented the task at hand—to use the rates and rate structure of the “Phonorecords II-based benchmark” proposed by the Services during the remand proceeding”).¹⁶

Finally, the Judges find and conclude that their ruling in this Order sets forth reasonable rates satisfying the four objectives in the then-applicable (but now superseded) statutory rate

¹⁶ The decision in *Johnson* could be construed as rejecting *one* element of the Phonorecords II-based benchmark, viz., the 10.5% headline rate, because the appellate panel affirmed the higher Majority’s adoption of the (phased-in) 15.1% headline royalty revenue rate. The Initial Ruling is consistent with that ruling, and this rate is not now in dispute. *See Services’ July 18th Submission* at 2 (the Services acknowledge that in their proposed regulatory provisions they “replac[ed] the headline rate” of 10.5% with the headline royalty rate “set by the Judges [15.1%] in the Initial Ruling.”).

standard contained in 17 U.S.C. §801(b)(1).¹⁷ First, with regard to Factor (A),¹⁸ the Judges recognize and follow the D. C. Circuit’s ruling that the Majority’s decision to increase in the “headline” service revenue royalty rate by 44% from 10.5% to 15.1% was supported by substantial evidence. *Johnson* at 387-88.

Further with regard to Factor (A), the Judges understand their analysis and reasoning in the Initial Ruling – applying the Phonorecords II-based benchmark and thus rejecting the 26.2% TCC rate – to be applicable to the present dispute regarding the adoption of regulations to implement the Initial Ruling. Accordingly, the Judges adopt by reference herein their analysis and reasoning set forth at pages 90-91 of the Initial Ruling. For those reasons, the Judges decide, as they did in the Initial Ruling, that there is no basis for yet a *further* increase in the royalty rate based on Factor (A), finding “no evidence to suggest that the price discriminatory rates should be changed, in order to address the connection between price discrimination and the objective of Factor (A).” *Id.* at 91.

Next, in considering Factors (B) and (C),¹⁹ the Judges’ Initial Ruling adopts the Majority’s reasoning that the 15.1% service revenue royalty rate provided a “*fair* allocation of revenue between copyright owners and services” and it would be “substantively unwarranted to

¹⁷ The D.C. Circuit expressly declined to adopt most of the Majority’s application of the explicit statutory objectives. As to Factor (A), regarding the objective of “maximiz[ing] the availability of creative works to the public,” the D.C. Circuit held that the Majority’s finding that “an increase in the royalty rates for mechanical licenses was necessary to ensure the continued viability of songwriting as a profession” was “supported by substantial evidence.” *Johnson* at 387-388. However, with regard to the remaining statutory factors, *Johnson* instead vacated and remanded consideration of those matters to the Judges. *See Johnson* at 389. The Initial Ruling after remand considered these statutory objectives in detail. *See Initial Ruling* at 90-93. (The parties made no express argument regarding the application of these statutory objectives in their Joint Submission.).

¹⁸ Factor (A) provides that rates shall be calculated to achieve the objective of “maximize[ing] the availability of creative works to the public.” 17 U.S.C. § 801(b)(1)(A).

¹⁹ The Factor (B) objectives (providing a “fair return” and a “fair income” to the licensors and licensees respectively) and Factor (C) objectives reflecting their relative roles in making the streamed music available to the public) are typically considered jointly, because of their overlapping concerns. *See Initial Ruling* at 15 n.31 (citing *Johnson*, 969 at 388). In this Order, the Judges likewise jointly address Factors (B) and (C).

engage in any new consideration on remand of the impact, if any, of Factors (B) and (C) on the otherwise reasonable 15.1% revenue rate. *Id.* at 15-16.

In their Joint Submission, the parties have presented no arguments specifically addressing how Factors (B) or (C) might support their proposed TCC rates now at issue. Examining the record, the Judges find and conclude that maintaining the Phonorecords II-based rates ranging from 20.65% to 22% embodies the fairness associated with rates negotiated between industrywide trade associations wielding relatively comparable bargaining power, as discussed *supra* and in the Initial Ruling.²⁰ This notion of fairness is embodied in the determination of the reasonable rate and, as can be the case, when one of the four itemized statutory objectives of section 801(b)(1) is bound-up and appropriately addressed within the broader context of setting a reasonable rate, no further adjustment is necessary through an invocation of an itemized statutory factor. *See Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)* 84 Fed. Reg. 1918, 1955, 2015 (Feb. 5, 2019) (Majority and Dissenting Opinions agreeing that “to the extent market factors may implicitly address any (or all) of the four itemized factors, the reasonable, market-based rates may remain unadjusted.”).

Finally, the Judges see no reason to alter their adoption of the Phonorecords II-based benchmark rates for the nine offerings at issue in this Order based upon the final listed statutory objective, Factor (D).²¹ In the Joint Submission, Copyright Owners did not make an express argument relating to this factor (nor did the Services). Independently considering the potential

²⁰ In this regard, the Judges agree with the Services’ argument. *See* Initial Ruling at 61 (summarizing the Services’ position as to Factors (B) and (C)).

²¹ “Factor (D) ... instructs the Judges to consider the ‘competing priority’ of ‘minimiz[ing] any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.’” Initial Ruling at 16. More particularly, “disruption” potentially remediable under Factor (D) requires that the contemplated rate “directly produce[] an adverse impact that is substantial, immediate and in the short-run because there is insufficient time for either [party] to adequately adapt to the changed circumstance produced by the rate change” Initial Ruling at 53-54.

application of Factor (D), the Judges find no evidence that the continuation of the Phonorecords II-based benchmark rates for the offerings at issue in this Order would cause any disruption that Factor (D) is intended to address. Further, as noted *supra*, the Judges have phased-in an *increase* in the headline service revenue royalty rate from 10.5% to 15.1% – a 44% increase – rendering unreasonable any argument that the present decision to maintain the Phonorecords II-based TCC rates is “disruptive” to Copyright Owners under the statutory Factor (D) standard.

Moreover, the Judges reassert their point in the Initial Ruling that there is no need to independently consider any potential disruption under the Factor (D) standard because the Judges have already found an application of that rate to be unreasonable. *See* Initial Ruling at 50 n.77. Further, the D.C. Circuit was aware of the existence of the 20.65% to 22% TCC rates in the Phonorecords II-based benchmark for these nine offerings now at issue, and not only declined to affirm the Majority’s increase in those rates to 26.2% – a significant increase of 19% to 27%²² – but also condemned that increase. *See Johnson* at 383 (“Worse still ...the [Judges] also raised the total content cost [TCC] rate to 26.2%. ...That rate previously fell between approximately 17% and 22%”). Nothing in the record suggest that the Judges can or should utilize the narrow statutory “disruption” standard in Factor (D) of section 801(b)(1) as a basis to override the position of the D.C. Circuit or the Judges’ analysis in the Initial Ruling as to the inapplicability of the proffered 26.2% royalty rate.

²² An increase from 20.65% to 26.2% is a 5.55 percentage point increase, which is an increase of 27% (rounded). An increase from 22% to 26.2% is a 4.2 percentage point increase, which is an increase of 19% (rounded).

ORDER

For the foregoing reasons, the Judges shall adopt in the regulatory provisions²³ the several “Total Content Cost” (“TCC”) rates set forth in the Phonorecords II-based benchmark as proposed by the Services.²⁴

Within two days of the date of issuance of this Restricted Order, the parties shall file an agreed proposed redacted version for public viewing.

Dated: April 26, 2023

/s/
David P. Shaw
Chief Copyright Royalty Judge

²³ As addressed herein, the Judges find good cause to adopt the joint proposal for modified language regarding late fees, in 37 C.F.R. § 385.3.

²⁴ The Initial Determination shall issue forthwith.

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 AS TO SECTION IV OF THE INITIAL RULING AND ORDER
AFTER REMAND BY JUDGE DAVID R. STRICKLER¹

I. The Contours of this Partial Dissent

I respectfully Dissent from Section IV of the Initial Ruling and Order after Remand (Initial Ruling). As explained herein, I conclude that the D.C. Circuit’s rulings in *Johnson* preclude the Judges from engaging in “new ‘agency action.’”² See *Johnson v. Copyright Royalty Board*, 969 F.3d 363, 386 (D.C. Cir. 2020). Accordingly, I cannot join with the present Majority in its determination that this remand proceeding constitutes “new ‘agency action’” consistent with *Johnson*. That argument is circular and renders useless the D.C. Circuit’s careful analysis of the procedures that are and are not available to the Judges after they have issued their Initial Determination.

As further explained herein, the argument is *circular* because it begins with the D.C. Circuit’s ruling that the Determination³ was improper because it invented a new procedure to

¹ I am concurring in the Majority’s *substantive* re-adoption of the Bundled Service Revenue definition from the Initial Determination. As explained herein, I disagree with the Majority regarding the *procedural* manner in which the Judges may reach this result. Thus, it would be more accurate to describe this “Dissent” as a “Concurring Opinion”, or an “Opinion Concurring in Part and Dissenting in Part.” However, the Copyright Act does not expressly authorize Judges to issue a “concurring opinion,” but rather references the issuance of a “dissenting opinion.” See 17 U.S.C. § 803(a)(3). Accordingly, I identify this opinion as a “Dissent in Part as to Section IV of the Initial Ruling and Order after Remand.”

² I place the phrase *agency action* within quotation marks inside the broader phrase *new agency action* to avoid potential ambiguity and inconsistency with the directives in *Johnson*. There, the D.C. Circuit held that the Judges cannot assert “plenary authority to revise [their] determinations whenever [they] thought appropriate,” because such a power grab would render “a nullity ... the lines drawn by the authorizing statute ... to confine ... post hoc amendments” to statutorily identified circumstances.” *Johnson* at 392. So, “new” means the new application of an *existing* statutorily available “agency action” that had not previously been invoked—not “new” in the sense of a form of action conjured up to meet the moment. (When this phrase is used in a quotation I do not use the double quotation marks.) This distinction is important because the Majority and Copyright Owners advance new *forms* of (extra-statutory) agency action, not merely new applications of statutorily-authorized agency actions.

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) (citations to the Determination and to the Dissent in this Dissent in Part are found in this document). The Dissent is appended to and part of the same document as the Determination.

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change the Bundled Revenue definition that was in the Initial Determination⁴, only to circle back to where it started by creating—through the D.C. Circuit’s own remand no less—a further and extra-statutory “new ‘agency action’”.

The Majority also renders Johnson *useless*, by adopting a process by which—after the D.C. Circuit has remanded an issue because the Judges lacked procedural authority to rule—the procedural error is essentially honored in the breach, because the remand neuters the effect of the D.C. Circuit’s ruling.⁵

I join with the Majority though on its *substantive* decision to re-adopt the definition of Bundled Revenue set forth in the Initial Determination. As explained *infra*, I too find that it is clearly preferable to the definition that was swapped into the (Final) Determination. But as explained herein, I reconcile the procedural and substantive points differently. I apply what I believe to be the proper understanding of the D.C. Circuit’s ruling—finding, contrary to the Majority, no avenue for “new ‘agency action’” post-remand. Rather, the Judges must *revert* to the original – and substantively appropriate – definition of Bundled Revenue in the Initial Determination.

To explicate the bases of this Dissent, my opinion as to this issue is set forth below.

II. Introduction

The Majority and I analyze the definition of “Service Revenue” from “Bundled Offerings” (henceforth “Bundled Revenue” definition) in the context of our partial adoption of the PR II-based benchmark. As discussed *supra*, the Remand Majority found that the PR II-based benchmark is a useful benchmark, particularly because of its features that incentivize beneficial downstream price discrimination and generate more listeners, revenues, and royalties. As explained below, the Bundled Revenue definition—itsself an element within the PR II-based benchmark—also embodies such price discriminatory incentives. Thus, the Judges’ analysis of the PR II-based benchmark and the Bundled Revenue definition are connected.

In the Determination, the earlier Majority likewise found the issues relating to the PR II-based benchmark to be bound-up with the question of the appropriate Bundled Revenue definition. But because that earlier Majority *rejected* the PR II-based benchmark, it likewise rejected the Bundled Revenue definition contained in the Initial Determination. The definition in the Determination thus eliminated the royalty-based incentive to engage in price discrimination via bundling.

In the interregnum between the Initial Determination and the (Final) Determination, the Judges considered Copyright Owners’ post-hearing motion which sought, *inter alia*, to strike the Bundled Revenue definition in the Initial Determination. The Majority agreed with Copyright Owners that the definition in the Initial Determination should be replaced. An important rationale—highly relevant in the present context—was as follows: “The Judges have ... declined to rely on the 2012 ... benchmark ... as the basis for the rate structure, or, therefore, as

⁴ Initial Determination, 16-CRB-0003-PR (2018-2022) (Jan. 27, 2018).

⁵ The Initial Ruling suggests that the Judges *could* have utilized a “further explanation” for the switched Bundled Revenue definition, as opposed to using “new ‘agency action.’” I do not dissent from that general point. However, even though the Majority did not utilize this alternative approach on remand, I dissent to the extent that section could be read to allow a fuller explanation that would conflict with *Johnson*.

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regulatory guidance.” Amended Order Granting in Part and Denying in Part Motions for Rehearing at 17 (Jan. 4, 2019) (Clarification Order).⁶

Unlike in the Determination, in this Initial Remand Ruling the Judges *do* rely on the PR II-based benchmark in part because of its price discriminatory aspects. More particularly, because the bundling of interactive services also constitutes a form of price discrimination, the Judges find the PR II-based benchmark definition of Bundled Revenue set forth in the Initial Determination to be substantively reasonable and otherwise consistent with the four itemized factors in section 801(b)(1).

As a *procedural* matter though, I can neither: (1) offer any further or fuller explanation for why the Majority made this change in the Bundled Revenue definition nor (2) identify any “new ‘agency action’” that would permit this definitional switch. And contrary to present Majority on remand, I also cannot identify a “new ‘agency action’” that the Judges can now take to return to the definition in the Initial Determination. But, as explained *infra*, the Judges need not identify such action, because the absence of a justification for the definitional switch requires the Judges to *revert back* to the definition in the Initial Determination.

As a *substantive* matter though, the Judges unanimously agree to replace the post-hearing definition of Bundled Revenue in the Determination and reinstate the definition set forth in the Initial Determination.

III. Background

In this remand proceeding, the parties propose two starkly different definitions of Bundled Revenue. Each has a dramatically different impact on the use of the royalty structure and levels to incentivize price discrimination in the downstream market.

The Services argue in favor of the language contained in the Initial Determination, *i.e.*, in their PR II-based benchmark, which defines Bundled Revenue, in pertinent part, as

the revenue recognized from End Users [*i.e.*, consumers] for the Bundle less the standalone published price for End users for each of the other component(s) of the Bundle

Initial Determination, Attachment A at 7 (section 382.2 therein).

By contrast, Copyright Owners support the Majority’s substituted language contained in the Determination, which defines Bundled Revenue, in pertinent part, as

the lesser of the revenue recognized from End Users [*i.e.*, consumers] for the bundle and the aggregate standalone published prices for End Users for each of the component(s) of the bundle that are License Activities

⁶ This January 4, 2019 Order was issued in response to two motions; the Services’ “Joint Motion for Rehearing to Clarify the Regulations” and Copyright Owners’ “Motion for Clarification or Correction of Typographical Errors and Certain Regulatory Terms.” As explained *infra*, Copyright Owners did not style their motion as a “rehearing” motion and expressly declined to argue that their motion met the statutory and regulatory requisites for rehearing. This remand issue pertains only to the post-hearing switch in the Bundled Revenue definition sought and obtained by Copyright Owners via their motion. Accordingly, it is clearer to refer herein to the Judges’ January 4, 2019 Order as the “Clarification Order,” rather than as a “Rehearing Order,” because the semantic distinction carries substantive overtones. (I had dissented from the Initial Determination and the Determination, and thus did not join in the Clarification Order.)

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Determination, Attachment A at 8 (section 382.2 therein).

In *Johnson*, the D.C. Circuit succinctly summarized these conflicting definitions as follows:

In its Initial Determination, the [Judges] directed that the revenue from streaming services that are included in bundled offerings would generally be measured by the value remaining after subtracting the prices attributable to the other products in the bundle.

When the Copyright Owners objected to the substance of that definition in their motion for “clarification,” the Board adopted an entirely new definition of Service Revenue for bundled offerings. ... This new definition generally measured the value of the streaming component of a bundle as the standalone price of the streaming component.

Johnson at 389.⁷

In the Clarification Order, the Judges succinctly summarized the parties’ respective positions. *Id.* at 17. They noted that Copyright Owners had presented evidence that the PR II-based benchmark definition contained in the Initial Determination “led *in some cases* to an inappropriately low revenue base,” although the Judges “agree that there is *no support for any sweeping inference that cross-selling has diminished the revenue base.*” *Id.* at 17, 21 (emphasis added). The Judges further noted the Services’ assertion that the Bundled Revenue definition in the Initial Determination is consistent with the Judges’ “endorsement of the classic price discrimination enabled by bundling strategies.” *Id.*⁸

The Majority resolved this issue in the Clarification Order in favor of Copyright Owners. Specifically, the Majority found that, because of the “indeterminacy problem”⁹ inherent in bundling, “the Services—not the Copyright Owners – ... are in a position to provide evidence of how they price bundles and value the component parts thereof.” *Id.* at 17-18. However, according to the Majority, although the Services “bore the burden of providing evidence concerning the proper economic allocation of bundled revenue,” they “failed to do so,” and “[b]y default ... the Judges must adopt an approach to valuing bundled revenue that is in line with what the Copyright Owners have proposed.” *Id.* at 18.

IV. The Rulings in *Johnson* Regarding the Bundled Revenue Definition

⁷ As explained *infra* (including by way of an example), the Bundled Revenue definition in the Initial Determination aligns with and incentivizes price discrimination in the downstream market, but the definition in the Determination does not.

⁸ The parties’ substantive arguments are discussed in more detail *infra*.

⁹ The “economic indeterminacy arises when “the input supplier ... is paid as a percent of retail revenue, and the bundled revenue consists of some revenue attributable to the royalty base and other revenue excluded from the royalty base, the economic indeterminacy of the revenue attributable to each bucket creates a measurement problem, absent further information regarding the WTP [Willingness-to-Pay] of buyers/subscribers to the bundle.” *SDARS III*, 83 Fed. Reg. at 65264. As explained *infra*, the PR II-based benchmark addresses this informational uncertainty with the parties’ negotiated alternative rate prongs and floors that guarantee royalties are paid, whereas the definition in the Determination eliminated the alignment of royalties to price discriminatory bundles designed to increase downstream access to musical works.

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The Services appealed the Majority's abandonment of the Bundled Revenue definition in their Initial Determination. Their appeal "challenge[s] both the legal authority and the substantive soundness" of this switch.

First, the Services argued that the Majority failed to identify and explain the *procedural* basis for making the switch after the hearing had concluded. Second, the Services argued that, *substantively*, the replacement definition in the Determination "was arbitrary, capricious, or unsupported by substantial evidence." *Johnson* at 389, 392.

The D.C. Circuit agreed with the Services regarding the *procedural* issue and therefore vacated and remanded that aspect of the Bundled Revenue definitional switch. In light of its procedural ruling, the D.C. Circuit explicitly declined to rule on the Services' *substantive* argument relating to the definitional switch. *Id.* at 392. ("Because the Board failed to explain the legal authority for its late-breaking rewrite, we vacate and remand that aspect of the decision [and] we have no occasion to address the Streaming Services' separate argument that the definition was arbitrary, capricious, or unsupported by substantial evidence.").

The D.C. Circuit's rulings in *Johnson* pertaining to this Bundled Revenue Definition were clearly articulated. The D.C. Circuit found that the Majority "failed to explain under what authority" it made a material change to the definition "so late in the game." *Johnson* at 389, 392. The D.C. Circuit noted that the Judges expressly declined to treat the Clarification Motion as a motion for rehearing; consequently, the motion did not request and the Judges did not reconsider either evidence or legal argument. *Id.* at 390. Although appellate counsel offered rationales, the D.C. Circuit rejected counsel's *post hoc* reasoning. *Id.* and 391-92. Ultimately, the D.C. Circuit remanded the adopted regulation "either to provide 'a fuller explanation of the [Judges'] reasoning at the time of the agency action[,] or to take 'new agency action' accompanied by the appropriate procedures." *Id.* at 392, citing *Dep't of Homeland Sec. v. Regents of Univ. of Cal.* 140 S.Ct. 1891, 1908 (2020).

To be precise, I take note of the following specific rulings in *Johnson*:

1. "The problem is that the [Majority] has completely failed to explain under what authority it was able to materially rework that definition so late in the game." *Id.* at 389.
2. "The [Majority] did not treat Copyright Owners' motion to have the definition changed as a motion for rehearing ... [because] Copyright Owners' motion did not request a literal rehearing of evidence or legal argument." *Id.* at 390 (cleaned up).
3. "The [Majority] nowhere in its order or the [] Determination explains the source of its power to make "fundamental" changes under the authorizing statute" *Id.* at 392. [same as #1]
4. "[I]t should go without saying that we may not sustain the Board's action based on its attorney's theorizing at oral argument ... vacillating gestures to uninvoked authority will not do." *Id.* at 391-92 (the D.C. Circuit alluding to its rejection of arguments also

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made only by appellate counsel in support of the Majority’s rejection of the PR II-based benchmark earlier in the decision).¹⁰

“We must vacate the [] Determination’s bundled offering Service Revenue definition and remand for the [CRB Judges] either to provide ‘fuller explanation of the agency’s reasoning at the time of the agency action[,]’ or to take ‘new agency action’ accompanied by the appropriate procedures.” *Id.* at 392.

V. Remand Procedure Regarding Bundled Revenue Definition

Post-remand, the Judges stated their understanding, as well as the parties’ understanding, of the issue on remand with respect to the Bundled Revenue definition:

The Services and Copyright Owners agree that the proceedings on remand should be limited to three issues: * * * [3] the adoption of a revised definition of “service revenue” for bundled offerings between issuing their Initial Determination and [their] Determination.

Order Regarding Proceedings on Remand at 1 (Dec. 15, 2020) (Remand Order).

The parties proposed, and the Judges agreed, that the record would not be re-opened with regard to the Bundled Revenue definitional issue. Rather, the Remand Order permitted the parties only to provide further briefing on this matter. *Id.* Specifically, the Judges subsequently permitted each party to file simultaneous Initial Remand Submissions and simultaneous Reply Remand Submissions. *See* Order Adopting Schedule for Proceedings on Remand (Dec. 20, 2020). Thereafter, seeking further analysis on the question of “new agency action,” the Judges solicited, and received, further briefing on this issue. *See* Notice and *Sua Sponte* Order Directing the Parties to Provide Additional Materials (Dec. 9, 2021) (Feb. 9, 2021); *Sua Sponte* Order Regarding Additional Briefing (Feb. 9, 2021).

VI. The Parties’ Submissions Regarding Bundled Revenue Definition

In their respective briefing, Copyright Owners and the Services made arguments relating to: (1) the *procedural* issue, *i.e.*, the Judges’ authority, *vel non*, to switch to a new Bundled Revenue definition in the Determination; and (2) the *substantive* issue, *i.e.*, the relative merits of the two conflicting Bundled Revenue definitions. *See* Initial Remand Submission of Copyright Owners at 7-10 (Apr. 1, 2021) (CO Initial Submission); Services’ Joint Opening Brief (in Services’ Joint Written Direct Remand Submission at Tab D) at 64-76 (Apr. 1, 2021) (Services’ Initial Submission); Copyright Owners’ Reply Brief on Remand (in Reply Remand Submission of Copyright Owners, Vol. 1) at 64-88 (CO Reply); Services’ Joint Reply Brief at 52-63 (Services’ Reply).

A. The Procedural Issue

1. Copyright Owners’ Arguments

Copyright Owners assert first that the Judges can preserve their post-hearing switch of the Bundled Revenue definition by sidestepping the D.C. Circuit’s holding and rationale

¹⁰ Going beyond the Majority’s actual rulings, the CRB Judges’ appellate counsel argued that the Majority’s authority for this definitional switch fell under either or both of the “inherent” statutory powers of the Judges or their “rehearing power.” *Id.* at 392. (The D.C. Circuit rejecting appellate counsel’s argument that it was unnecessary “for this Court to address which one it is because ... it could properly be understood as both.”).

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in *Johnson*. That is, Copyright Owners maintain that this remand proceeding itself constitutes the necessary form of “new ‘agency action’” that *Johnson* invites, while also liberating the Judges from the consequences of the procedural infirmities identified by the D.C. Circuit. More particularly, Copyright Owners argue:

[T]he new agency action here is a determination after remand proceedings[.] [T]he [Judges are] largely free to chart [their] own procedural course, and [they] ha[ve] done so in [their] [Remand] Order. The [Judges are] not required to undertake any of the procedural steps set forth in 17 U.S.C. § 803(b) in order to take such “new agency action.” See 17 U.S.C. § 803(d)(3) (requiring only that on remand further proceedings be taken “in accordance with subsection (a)”); 37 C.F.R. § 351.15; *Intercollegiate Broad. Sys., Inc.*, 796 F.3d at 125 (“[N]either the Copyright Act nor the [Judge’s] regulations prescribe any particular procedures on remand.”) The Circuit’s instruction that the action be “accompanied by the appropriate procedures[.]” *Johnson*, 969 F.3d at 392, does not dictate what those “appropriate procedures” must be but instead plainly refers to these flexible rules. *See also Oceana, Inc.*, 321 F. Supp. 3d at 136 (explaining that when remanding to an agency, a court generally “may not dictate to the agency the methods, procedures, or time dimension, for its reconsideration”).

CO Initial Submission at 71 n.33.

Copyright Owners reject the Services’ position that the asserted procedural error is an “absence of authority” that can never be cured. *Id.* at 74 (citing Services’ Proposal for Remand Proceedings at 10). They note that the D.C. Circuit did not say the Judges lacked the authority to revisit the service revenue definition from bundles on remand. Nor, they observe, did it say the Judges have no authority to review the record evidence and the parties’ arguments and reach the same conclusion or a different conclusion on remand.

Copyright Owners further opine that if the only possible outcome were for the Judges to reinstate a definition that lacked any explanation or evidentiary support solely because it was present in the Initial Determination, then the D.C. Circuit would not have remanded the issue but would have simply reversed and reinstated the Initial Determination definition. But instead, they note, the D.C. Circuit remanded and said the Judges could take “new agency action” precisely to cure the asserted procedural defect. Copyright Owners assert that the remand allowed the parties to present the record evidence and their arguments so that the Judges can address the definition “afresh” in the remand determination. *Id.* at 74.

Further, Copyright Owners argue that 17 U.S.C. § 803(d)(3) states only that proceedings on remand must be in accordance with 17 U.S.C. § 803(a). They contend that remand proceedings need not be confined to procedures the Services claim are too late in the game for the Judges to follow, again relying on the holding in *Intercollegiate Broad. Sys.*, *supra*, that “neither the Copyright Act nor the Board’s regulations prescribe any particular procedures on remand.” *Id.* at 125. Accordingly, they argue, the Judges can reaffirm the adopted bundled service revenue definition following their review of the parties’ submissions without invoking section 803(c)(2) or 803(c)(4) that were ruled inapplicable in *Johnson*. CO Reply at 65-66.

Also, Copyright Owners argue that the Judges may properly justify the changed definition under section 803(c) as a fuller explanation of the agency’s reasoning at the time it was made. They urge that the Judges could explain that, especially in light of the evidence of

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how (in Copyright Owners' characterization) the Services misused the prior definition to make service revenue completely disappear, the Judges carry-over of the prior Bundled Revenue definition from *Phonorecords II* into the Initial Determination was unintended and inadvertent.¹¹ CO Reply at 69.

Copyright Owners also assert that, on remand, the Judges could explain that Copyright Owners had, in their Motion for Clarification, identified an "exceptional case" under section 803(c)(2) because the prior definition failed to comport with Judges' precedent and economic principles, and was unsupported by evidence. In addition, the Judges reheard the evidence and legal arguments as presented in the parties' briefs on the issue and, as a result, chose to adopt the revised definition. Copyright Owners maintain that for the Judges to do so would not be impermissible *post-hoc* reasoning. They note that the D.C. Circuit remanded precisely because the Judges did not provide any reason in the Determination for revising the Bundled Revenue definition. Copyright Owners note that it was the Services, not Copyright Owners, who appealed the Judges' modification of the bundled service revenue definition; thus, Copyright Owners cannot be penalized for not making every possible argument for affirmance. CO Reply at 70.

Further, and again notwithstanding the holding in *Johnson*, Copyright Owners argue that the Judges have the authority to engage in new agency action in this remand proceeding through a recasting of the Motion for Clarification as a motion for rehearing, pursuant to 17 U.S.C. § 803(c)(2)(A) and 37 C.F.R. § 353.1. In this regard, Copyright Owners dismiss the point, raised by the D.C. Circuit, that their Motion for Clarification could not be recast as a motion for rehearing because Copyright Owners had explicitly disavowed that their motion sought rehearing under the statute, and that the Judges agreed. Rather, Copyright Owners maintain that the foregoing is not the same as a finding that the standard could not have been met. In Copyright Owners' view, the Judges could revisit on remand the question of whether the rehearing standard has now been met, and find that Copyright Owners have satisfied the "exceptional case" standard for granting rehearing motions under section 803(c)(2).¹² Copyright Owners add that if the Judges do engage in new agency action that reconsiders the Motion for Clarification as a motion for rehearing, the Judges should fully explain their reasoning. *Id.* at 8-10.

However, Copyright Owners urge that proceeding in that fashion would add an entirely unnecessary and complicating step. They again suggest that there is no need to reconsider or

¹¹ Copyright Owners assert that the definition in the Initial Determination conflicted with the CRB Judges' finding in the Initial Determination that the adopted rates and terms would afford Copyright Owners a fair return for their creative works, thereby satisfying Factor B of the 801(b) standard. Thus, they maintain that the definitional switch was necessary so as to not "frustrate the proper implementation of" the Determination. CO Reply at 69 (*citing* 17 U.S.C. §§ 801(b) and 803(c)(4)).

¹² The Majority set forth the rehearing standard in the *Clarification Order*:

According to the Copyright Act, the Judges may grant a motion for rehearing in exceptional circumstances, provided the moving party shows that an aspect of the determination is "erroneous." See 17 U.S.C. 803(c)(2); 37 C.F.R. § 353.1. The moving participant must identify the aspects of the determination that it asserts are "without evidentiary support in the record or contrary to legal requirements." 37 C.F.R. § 353.2. In general, the Judges grant rehearing only "when (1) there has been an intervening change in controlling law; (2) new evidence is available; or (3) there is a need to correct a clear error or prevent manifest injustice." See, e.g., Order Denying Motion for Reh'g at 1, Docket No. 2006-1 CRB DSTRA (Jan. 8, 2008) (*SDARS I* Rehearing Order) (applying federal district court standard under Fed. R. Civ. P. 59(e)).

Clarification Order at 2, n.3.

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recharacterize the Motion for Clarification as a motion for rehearing because the remand itself affords the opportunity for the Judges to take new agency action, which, as in a rehearing, permits them to reconsider evidence and arguments, but, unlike a rehearing, is not limited by the constraints of section 803(c)(2). *See* Copyright Owners’ ... Additional Briefing on New Agency Action ... Question, etc., Tab B at 7-8 (Feb. 24, 2021).

2. The Services’ Arguments

The Services’ arguments are based on the reasoning of the D.C. Circuit in *Johnson*. Specifically, they assert that the D.C. Circuit found only “three ways in which the [Judges] can revise Initial Determinations” via “new agency action,” and the Judges failed to establish that the change to the service revenue definition fit any of those three categories. Services’ Initial Submission at 64-65 (citing *Johnson* at 390).¹³

According to the Services, the first statutory way the Judges may revise an Initial Determination is to “order rehearing ‘in exceptional cases’ in response to a party’s motion, 17 U.S.C. § 803(c)(2)(A).” Services’ Initial Submission at 65 (citing *Johnson* at 390). The Services argue that the D.C. Circuit held in *Johnson* that the Judges’ “material revision of the ‘[Bundled] Revenue’ definition ... does not fall within the [Judges’] rehearing authority under section 803(c)(2)(A)” because “the [Judges] [themselves] . . . w[ere] explicit that [they] ‘did not treat the [Copyright Owners’] motion[]’ ... ‘as [a] motion[] for rehearing under 17 U.S.C. § 803(c)(2).’” *Id.* The D.C. Circuit also noted that “as the [Judges] found, ... Copyright Owners’ motion did ‘not meet [the] exceptional standard for granting rehearing motions’ under section 803(c)(2).” *Id.* (citing *Johnson* at 390). The Services assert, quoting *Johnson* once more, that the Judges were not able to make “a volte-face” and justify on appeal their revision to the definition as an exercise of rehearing authority. As the D.C. Circuit held, agency action must be justified by “reasons invoked by the agency at the time it took the challenged action,” and post-hoc rationalizations are insufficient. *Id.* (citing *Johnson* at 390).

The Services add their view that the Judges cannot revisit the decision to deny rehearing without engaging in impermissible *post-hoc* reasoning. They note the Supreme Court has explained that, while an agency may “elaborate later” on its “initial explanation” of the reason (or reasons) for its action, it “may not provide new ones.” Services’ Initial Submission at 66, citing *e.g.*, *Regents at 1908*. The Services offer that the Judges, having stated that they did not consider the Copyright Owners’ motion to revise the definition to be a motion for rehearing, cannot now conclude that the motion qualified as one for rehearing and that the Judges in fact engaged in rehearing. *Id.*¹⁴

The Services next argue, relatedly, that the Judges cannot simply recast the Services Motion for Clarification as a rehearing motion in an attempt to satisfy the rehearing standard. In this regard, they maintain that Copyright Owners did not argue before the Judges or the D.C. Circuit that their Motion for Clarification satisfied the “exceptional cases” standard, and have therefore waived that argument. *Id.*

¹³ The Services acknowledge that the Judges could alternatively have attempted to provide on remand a fuller explanation of their prior reasoning (in lieu of engaging in “new ‘agency action’”). That issue is considered *infra*.

¹⁴ In fact, the issue of whether to characterize Copyright Owners’ Motion for Clarification as a motion for rehearing is not one raised by Copyright Owners, but rather by the Judges *sua sponte*.

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The Services assert that the second statutory way the Judges may revise an Initial Determination, *viz.* taking “new agency action” to correct a technical or clerical error under section 803(c)(4), cannot be used to justify the modification of the Bundled Revenue definition in the Initial Determination. The Services note that the D.C. Circuit held specifically that the Judges’ change in the Bundled Revenue definition could not be construed as correcting a technical or clerical error because it involved a substantive rewrite of the Service revenue definition. *Id.* at 67 (citing *Johnson* at 391).

The Services argue that the third and final statutory justification for the Judges to engage in “new agency action” is to revise the terms in an Initial Determination in response to “unforeseen circumstances” that would frustrate the proper implementation of the determination. *Id.* at 67. The Services note that the D.C. Circuit held in *Johnson* that this authority did not justify the Judges’ change to the Bundled Revenue definition because the Judges did not invoke this authority and “the need to ground the original definition in the record” could not credibly be described as “an unforeseen circumstance.” *Id.* (citing *Johnson* at 391).

The Services also note that the D.C. Circuit rejected the argument that the Judges have an “inherent authority” – unmentioned in the statute – to make changes to the Initial Determination. The D.C. Circuit explained that the specific restrictions Congress placed on the [Judges’] authority in section 803 “would be a nullity if [they] also had plenary authority to revise [their] determinations whenever [they] thought appropriate.” *Id.* (citing *Johnson* at 391-92). The Services add that even if the Judges offered a new source of authority capable of justifying substantive changes to the [Bundled] Revenue definition now, the Judges would be unable to rely on this “uninvoked authority” without engaging in impermissible *post-hoc* reasoning. *Id.*

The Services also reject Copyright Owners’ position that the Judges may sidestep the D.C. Circuit’s ruling by issuing a new determination on remand and simply arguing that *any* ruling after remand qualifies as new agency action pursuant to *Johnson*. The Services argue that failure to address the legal and factual issues on which the court remanded would violate the D.C. Circuit’s decision and would result in yet another remand. The Services emphasize that the issue of authority to make the changes to the Initial Determination are especially important in this context, because the D.C. Circuit recognized that the Copyright Act places limits on the Judges’ authority to alter an initial determination by defining conditions for rehearing and the types of changes that are permitted absent a rehearing. In this regard, the Services maintain that the Judges cannot do on remand what they lacked authority to do in the first instance. The Services assert that the Judges must resolve the legal question of whether authority exists to alter the revenue definition in the Initial Determination. Services’ Reply at 52-54.¹⁵

The Services also take note of the alternative path available to the Judges: to provide a “fuller explanation” of the prior conclusion that the Judges had legal authority to revise the Service Revenue definition. The Services maintain that if the Judges pursue the “fuller explanation” path, the Judges are limited to elaborating on what they said previously, and that they cannot add new reasons they did not initially provide. *Id.* at 54-55; *see also* Services’ Joint Rebuttal Brief Addressing the Judges’ Working Proposal at 38-42 (Feb. 24, 2022) (“Services’ Additional Submission”).

¹⁵ In The Services agree that this remand proceeding qualifies as a “new agency action” but do not maintain that a ruling on remand that is inconsistent with *Johnson* would be the type of “new ‘agency action’” that *Johnson* permits. *See* Services Additional Submission at 38-42.

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The Services address Copyright Owners’ position that if the only possible outcome were for the Judges to reinstate a definition that lacked any explanation or evidentiary support solely because it was present in the Initial Determination, then the D.C. Circuit would not have remanded the issue but would have simply reversed and reinstated the Initial Determination definition. The Services urge that the D.C. Circuit could not reverse because the CRB’s appellate counsel had raised—for the first time on appeal—new justifications for the Judges’ decision to change the Initial Determination. Instead, the Services maintain, the D.C. Circuit had to remand and give the Judges the opportunity to address appellate counsel’s new justifications in the first instance, as the D.C. Circuit could not rule them out given the posture of the appeal. Services’ Reply at 56.

VII. Analysis and Decision

A. The Procedural Issue: Is there “New Agency Action” Available to the Judges?

Having considered the parties’ arguments, I conclude that the rulings in *Johnson*, which clearly rejected all of the Majority’s procedural arguments seeking to justify their switch in the Bundled Revenue definition, foreclose any avenue for procedurally justifying this definitional switch. More particularly, I conclude that none of the procedural avenues proffered by Copyright Owners would constitute “new ‘agency action’” consonant with the holdings in *Johnson*. Further, I cannot identify any other procedural device (*i.e.*, an extra-statutory form of agency action) that would permit the switched definition in a manner consistent with *Johnson*.¹⁶ In addition, I cannot identify any further or fuller explanation that might support the Majority’s procedural reasoning for swapping out the Bundled Revenue definition in the Initial Determination and substituting the definition in the Determination.

In reaching this conclusion, I take note of the following specific language in *Johnson*:

Section 803 identifies three ways in which the Board can revise Initial Determinations. It can (i) order rehearing “in exceptional cases” in response to a party’s motion; (ii) correct “technical or clerical errors,”; and (iii) “modify the terms, but not the rates” of a royalty payment, “in response to unforeseen circumstances that would frustrate the proper implementation of [the] determination.”

Johnson at 390 (citations omitted). After identifying these three alternatives, the D.C. Circuit concluded that the CRB Judges “rollout of an entirely new manner for calculating the streaming service revenue from bundled offerings fit none of those categories.” *Id.*

First, I consider whether in the present case they can engage in “new ‘agency action’” pursuant to 17 U.S.C. § 803(c)(2)(A) by recasting Copyright Owners’ Motion for Clarification as a Motion for Rehearing. I conclude that this avenue has been unambiguously cut-off by *Johnson* and, indeed (as noted in *Johnson*), by the Judges’ own prior ruling:

¹⁶In this section, Copyright Owners’ arguments regarding recasting their Motion for Clarification as a request for rehearing, a correction for technical or clerical errors, or for unforeseen circumstances would constitute a new application of an *existing* “form of agency action” that the D.C. Circuit had rejected. But Copyright Owners’ argument in favor of the Judges’ supposed “inherent authority” to enlarge their post-hearing jurisdiction is an argument creating a *new form* of agency action, not an argument in favor of new application of an existing form of authority. Likewise, the next approach proffered by Copyright Owners, *i.e.* construing the remand itself as generating the requisite agency action, which is also the Majority’s approach, is an example of an agency action that is not statutorily specified and, as explained *infra*, is inconsistent with section 803(a).

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The [CRB Judges'] material revision of the Bundled Revenue definition ... does not fall within [their] rehearing authority under Section 803(c)(2)(A). We have that on no less an authority than the [CRB Judges themselves], [who were] explicit that [they] “did not treat the Copyright Owners’ motion” to have the definition changed “as a motion] for rehearing under 17 U.S.C. § 803(c)(2). That is because the Copyright Owners’ motion did not “request[] a literal rehearing of evidence or legal argument.”

Nor could they have because, as the [CRB Judges] found, the Copyright Owners’ motion did “not meet [the] exceptional standard for granting rehearing motions” under Section 803(c)(2). ... [The CRB Judges] explain[ed] that ... Copyright Owners “failed to make even a *prima facie* case for rehearing under the [rehearing] standard”.

Johnson, 369 F.3d at 390.

Further cutting off this “rehearing” approach, *Johnson* also expressly holds that it is a “forceful” principle that the D.C. Circuit “cannot sustain action on grounds that the agency itself specifically disavowed. *Id.* Moreover, in this Initial Remand Ruling I echo the Majority’s ruling in the Clarification Order that Copyright Owners had failed to present “even a *prima facie* case for rehearing under the applicable standard”. Clarification Order at 2.¹⁷

Next, I consider whether the Judges can engage in “new ‘agency action’” by recharacterizing their switch of the Bundled Revenue definition as an attempted correction of “technical or clerical errors,” pursuant to their “continuing jurisdiction” under section 803(c)(4). Once again, they cannot, and the D.C. Circuit has effectively explained why this is so:

The [Judges] do[] not even try to squeeze [their] substantive rewrite of the Service Revenue definition into that [§ 803(c)(4)] category. Quite the opposite, the [Judges] admit[] that the new definition “represent[s] a departure” from the definition in the Initial Determination, and was a substantive swap designed to “mitigate” the alleged “problem” of the original definition leaving the interactive streaming service providers free to “obscure royalty-based streaming revenue by offering product bundles that include music service offerings with other goods and services[.]” ... To that same point, the order itself labels the initial and new definitions “diametrically-opposed approaches to valuing bundled revenues.” Nothing technical or clerical about that.

Johnson at 391.

On remand, I am unable to ascertain any basis for describing or justifying the changed Bundled Revenue definition as a technical or clerical correction. Thus, I conclude that the Judges cannot engage in “new ‘agency action’” pursuant to this section.

¹⁷ The first two bases for rehearing under the statute, *viz.*, change in the controlling law and the availability of new evidence, clearly do not apply. The third basis, *i.e.*, to correct a clear error or prevent manifest injustice, also does not apply. As explained herein, the substantive difference between the conflicting Bundled Revenue definitions should be resolved consistent with the Judges’ adoption of the PR II-based benchmark and the parties’ negotiated compromise of the “price discrimination vs. revenue diminution” dilemma. This resolution does not constitute an “error,” let alone a “clear error,” and maintaining the parties’ rate architecture from the Initial Determination does not generate any “injustice,” “manifest” or otherwise.

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Next, I consider whether the Judges can engage in “new ‘agency action’” – by trying to squeeze the square peg of their definitional swap into the round hole that is the “unforeseen circumstances” clause in § 803(c)(4). That provision permits the Judges to exercise “continuing jurisdiction” if necessary to modify a regulatory term in a determination in response to “unforeseen circumstances,” if the absence of modification would frustrate the proper implementation of the determination. Once again, *Johnson* shuts the door:

Come oral argument, the [Judges] attempted to explain that the unforeseen circumstances would be that [they] initially adopted a definition that was not supported by the record, and that was in fact substantively unreasonable and would frustrate the proper implementation of their determination.” ... It is hard to see how the need to ground the original definition in the record was an unforeseen circumstance. That is Administrative Law 101. *See also* 17 U.S.C. § 803(c)(3) (“A determination of the [Judges] shall be supported by the written record.”).

Johnson at 391 (cleaned up). I agree. The present panel of Judges is bound by the D.C. Circuit’s ruling that the overlooking of the need to ground in the factual record the Bundled Revenue definition in the Initial Determination cannot constitute an “unforeseen circumstance.” Accordingly, I am unable to ascertain any basis for describing or justifying the changed Bundled Revenue definition as an “unforeseen circumstance” that would justify their invocation of “continuing jurisdiction.”

I further consider the argument (made by the Judges’ appellate counsel and by Copyright Owners) that the Judges have the “inherent authority *sua sponte* to make any ‘appropriate’ substantive ... or ‘fundamental changes after the Initial Determination ... that [they] believe[] serve ‘the interests of enhancing the clarity and administrability of the regulatory terms accompanying the [] Determination.’” *Johnson* at 391. The D.C. Circuit made short work of this argument as well, stating that, although the CRB Judges have “considerable freedom” with regard to determining their own procedures

that flexibility must be exercised within the lines drawn by the authorizing statute. Congress’s decision to limit rehearing to “exceptional cases,” and to confine other *post hoc* amendments to cases involving “technical or clerical errors,” would be a nullity if the [Judges] also had plenary authority to revise [their] determinations whenever [they] thought appropriate. The [Judges] nowhere in [their] order or the [] Determination explain[] the source of [their] power to make “fundamental” changes under the authorizing statute ... any time [they] deem such changes “appropriate” ... even after the Initial Determination.

Johnson at 392.¹⁸

As with regard to the proffered rationales discussed *supra*, I cannot identify any authority that would allow the Judges to declare for themselves in the present factual and legal context an “inherent” authority to override the Copyright Act and declare their right to engage in “new ‘agency action.’”

Finally, I consider Copyright Owners’ suggestion that the *remand itself* by the D.C. Circuit permits the Judges, pursuant to the Copyright Act, to engage in any procedure necessary

¹⁸ By the same reasoning, *Johnson* also rejected the Judges’ explanation in the *Determination* that they were permitted to treat Copyright Owners’ request as a general motion under § 350.4) of their regulations. *Id.*

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to support their switch in the Bundled Revenue definition. The present Majority essentially adopts this procedural approach. However, I reject that argument as meritless.

The argument begins with a correct premise but seriously veers off course. Copyright Owners correctly note (and the Services do not disagree) that this remand proceeding constitutes “new ‘agency action.’” Copyright Owners then maintain that, because the Copyright Act does not provide for procedures that govern remand proceedings, the Judges are statutorily unconstrained with regard to the procedures they may adopt. This premise, although perhaps correct in other contexts, is most definitely incorrect in this specific context, given the clear holding in *Johnson*.

Here, the D.C. Circuit has been unequivocal in identifying the statutory limitations that precluded the Judges from switching out the Bundled Revenue definition in their Initial Determination and replacing it with a different definition in the Determination that was, to use the Majority’s phrase, “diametrically opposed” to the prior definition, in that it would eliminate the royalty-based incentive to price discriminate via bundling.¹⁹ *But Copyright Owners assert that the remand itself clothes the Judges with the procedural authority to make the very switch that Johnson forbids!* I do not understand the D.C. Circuit to have admonished the Majority for its failure to respect the boundaries of its jurisdiction, only to provide them, via remand, with a back-door through which they may circle-back and exceed those very boundaries.

A reading of section 803(a), upon which Copyright Owners rely, provides a further demonstration of the error in this argument. This subsection lists the authorities whose pronouncements the Judges must “act in accordance with,” including, quite unsurprisingly, “the decisions of the court of appeals under this chapter.” 17 U.S.C. § 803(a). In the instant case, the D.C. Circuit has unambiguously held that the Judges lacked the statutory authority to make the definitional switch at issue. For the Judges to construe that clear ruling as an implicit invitation to create new extra-statutory remand procedures that contradict the D.C. Circuit’s rationale for the remand would be inexplicable and would render useless the procedural ruling in *Johnson*.²⁰

In sum, I cannot and do not understand that the D.C. Circuit intended in *Johnson* simply to write a meaningless procedural opinion that the Judges could not merely ignore, but use to cleanse the very procedural error the D.C. Circuit had condemned.²¹

¹⁹ This substantive impact of the definitional switch is discussed *infra*.

²⁰ In fact, this argument is dangerous. The CRB Judges or any administrative agency, could willfully engage in extra-statutory procedures to obtain a particular substantive result. If there is no appeal, the extra-statutory procedure would be successful. But if the extra-statutory procedure was the subject of a successful appeal resulting in a remand, the CRB Judges (or any agency) could declare the remand as license to engage once more in extra-statutory procedures in order to obtain the same substantive result. This is a “heads-I-win, tails-you-lose” strategy.

²¹ Copyright Owners also argue that if the D.C. Circuit had intended in *Johnson* to prohibit the Judges from engaging in “new ‘agency action’” on remand, they would have reversed and reinstated the Initial Determination, rather than vacated and remanded that aspect of the Determination. But that argument confuses prudence with uncertainty. The D.C. Circuit prudently allowed the Judges, who are presumed to have particular knowledge of their duties, to consider whether there exist further explanations of their reasoning or “new ‘agency actions’” they could invoke to support their definitional switch. That prudence hardly suggests that the D.C. Circuit was sanguine about the existence of further explanations or additional actions that might support the switch.

Also, 17 U.S.C. § 803(d)(3) explicitly allows the D.C. Circuit to “vacate [a] determination of the ... Judges and remand the case to the ... Judges for further proceedings,” but only expressly allows the court to “enter its own determination” in connection with “the amount or distribution of royalty fees and costs, and order the repayment of any excess fees, the payment of any underpaid fees and the payment of interest pertaining respectively thereto”

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Accordingly, the Bundled Revenue definition in the Initial Determination should be reinstated. As explained in the portion of the Initial Remand Ruling in which I join, this reinstatement is harmonious with the entirety of the Judges' findings and conclusions regarding the other remanded issues.

B. The Substantive Issue: The Dueling Definitions of Bundled Revenue

1. Introduction: The Issue as Framed in the Clarification Order

Regarding the definition of "Service Revenue" from bundled offerings, the Judges summarized the parties' competing arguments:

Copyright Owners presented evidence that the existing approach led, *in some cases*, to an inappropriately low revenue base—but did so in service to their argument that the Judges should reject revenue-based royalty structures. *They did not present evidence to support a different measure of bundled revenue* because their rate proposal was not revenue-based.

The Services rely on the fact that the approach to bundled revenue in the extant regulations is derived from the 2012 Settlement. The Judges have, however, *declined to rely on the 2012 Settlement as a benchmark*, as the basis for the rate structure, or, therefore, as regulatory guidance. The Services have observed *correctly* that the evidentiary records in *Web IV* and *SDARS III* differ from the record in this proceeding.²²

Clarification Order at 17 (emphasis added).

Despite these arguments, the Judges found that neither party presented evidence adequate to support the approach advocated in post-determination filings, because “the ‘economic indeterminacy’ problem inherent in bundling” remained unresolved.” *Id.* The Judges stated that the Services were the party in possession of the relevant information, and concluded that the Services bore the burden of providing evidence that might mitigate the “indeterminacy problem” inherent in bundling. Because the Judges concluded that the Services had not met that burden, they ruled that they must adopt an approach to valuing bundled revenue that is in line with what the Copyright Owners proposed. As a result, the Judges discarded the formula in the Initial Determination and ruled, instead, that streaming service providers will use their own standalone price (or comparable) for the music component (not to exceed the value of the entire bundle) when allocating bundled revenue. *Id.* at 16-18.

On remand, the parties have made the following arguments regarding the substance of the Bundled Revenue definition:

2. Copyright Owners

According to Copyright Owners, the prior Bundled Revenue definition in the Initial Determination failed to address the “‘economic indeterminacy’ problem inherent in bundling” appropriately and in a way consistent with Judges’ precedent. CO Initial Submission at 75 (citing Clarification Order at 16-18). Copyright Owners proceeded to cite several portions of testimony

Id. Thus, it is hardly clear that the D.C. Circuit understood it had any choice upon vacating, save to remand for further proceedings. .

²² In *Web IV* and *SDARS III*, unlike under the Phonorecords II-based benchmark, there were no minima or floors to provide licensors with royalties in the event bundled offerings would otherwise fail to generate royalties.

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from the Services' economic experts who acknowledged this problem. *Id.* They then point to hearing testimony in which Copyright Owners repeatedly raised the "economic indeterminacy" problem and demonstrated what they characterized as the absurd results to which the prior definition had led. *Id.* at 76. They pointed out that under the Initial Determination, the first step in computing Bundled Revenue was to identify revenues recognized from the entire bundle (*i.e.*, the price paid by the subscriber). The second step was to subtract "the standalone published price" for all non-music components of the bundle. According to Copyright Owners,

Id. at 76, 83.

Copyright Owners point out that the Judges already found with respect to other licenses that such an approach is not only fundamentally unfair, but "absurd." *Id.* (citing *Web IV*, 81 Fed. Reg. 26316, 26382 (May 2, 2016) (webcaster licenses); *see also SDARS III*, 83 Fed. Reg. 65210, 65264 (Dec. 19, 2018) (SDARS licenses) (rejecting proposed deductions by service from bundle revenues because of the "acknowledged 'economic indeterminacy' problem inherent in bundling"). Copyright Owners concur with the Judges' conclusion that the same reasoning applies to *Phonorecords III*. *Id.* at 76-77 (citing Clarification Order at 18 ("the 'economic indeterminacy' problem inherent in bundling is common to all three proceedings.")). Copyright Owners offer that Spotify conceded to this flaw in the definition in the Initial Determination, but offered an alternative that contained the same loophole. *Id.* at 77-78.

Copyright Owners also point out that the proponent of a term bears the burden of proof as to adoption. The Judges made clear that the licensee who wishes to offer bundles must bear the burden of providing evidence that might mitigate the acknowledged economic indeterminacy problem inherent in bundling, because any such evidence would be in its possession, not in the possession of the licensors. *Id.* at 79 (citing *SDARS III*, 83 Fed. Reg. at 65264 ("bundling [is] undertaken to increase [the Services'] revenues and it would be reasonable to assume that [the Services have] information relevant to the economic allocation of the bundled revenue.")). Copyright Owners contend they presented un rebutted evidence showing the unreasonableness of the Services' proposed definition while the Services offered no evidence to support their definition. *Id.* at 78, 79 (citing Clarification Order at 18). Copyright Owners maintain that no Service offered evidence concerning the separate values of the constituent parts of the bundles, or any other evidence concerning the economic allocation of bundled revenue, let alone the reasonableness of the definition in the Initial Determination. *Id.* at 80. Copyright Owners assert that in the absence of evidence to support the proposed definition, the Judges may adopt or fashion a definition of service revenue for bundled offerings that comports with the record evidence, which is precisely what the Judges did and, through new agency action, do again. *Id.* at 81.

They further argue that the hearing record and the Judges' precedent and reasoning further explain the unreasonableness of the prior definition and support the adopted bundle revenue definition. *Id.* at 82. Copyright Owners offer that in contrast to the Services' evidentiary failure, they have provided sufficient evidence showing the unreasonableness of the Services' proposed definition. They maintain that the definition adopted by the Judges in the Determination was consistent with the statutory factors and the evidence in the proceeding

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showing how the prior definition had been manipulated and “led, in some cases, to an inappropriately low revenue base.” *Id.* at 83 (citing Clarification Order at 17-18).

Copyright Owners dispute the Services’ assertion that there is support for the *Phonorecords II* approach to bundles in the record of this proceeding. Instead, Copyright Owners argue, the Services’ purported evidence at most supports the benefits of the practice or strategy of bundling. They maintain that the strategy of bundling covered music services with other products or services has nothing to do with [REDACTED]. They offer that the definition in the Initial Determination has nothing to do with such benefits, and that those benefits may be equally served by a definition that ensures value is apportioned to the music component in the bundle. CO Reply at 73-76.

3. The Services

The Services argue that the evidence in the existing written record addressing bundles shows both that this definition is supported by the *Phonorecords II* benchmark and that it has proven industry-wide benefits. Services’ Initial Submission at 68. They emphasize that Copyright Owners did not propose an alternative definition of service revenue until after the Judges issued the Initial Determination and that any definition they propose now would fail the basic requirement that the Judges must adopt rules “on the basis of a written record.” *Id.* (citing 17 U.S.C. §§ 803(a)(1) and § 803(c)(3)).

Addressing the merits of the definition contained in the Initial Determination, the Services argue that it best serves the goals of the Copyright Act; that as a bright-line, easily administered rule, it continues the broad industry agreement from *Phonorecords II*, which was negotiated voluntarily between the Services and ... Copyright Owners – strong evidence that its terms are mutually beneficial.” Services’ Initial Submission at 69.

The Services contend the prior negotiated definition increases output and incentivizes beneficial price discrimination to reach casual and passive listeners who would otherwise not pay for music and thus would not generate revenue from which royalties could be paid. With regard to [REDACTED]

[REDACTED] *Id.* at 71 (and record citations therein).

They further state that the definition of Bundled Revenue in *Phonorecords II* also enabled funneling of many of listeners into full-priced, full-catalog services. The Services allege that Copyright Owners also ignore the extensive royalties that were generated. They add that, for casual/passive listeners and those who may be funneled to subscription services, the per-subscriber minimum guarantees that the Copyright Owners will still be paid a fair royalty. The Services then cite several portions of testimony from various Services’ economic experts who point out the realization of an expanded royalty pool, which the Services offer as proving a functioning marketplace. *Id.* at 68-74.²³

²³ The Services’ Reply reiterates this point and offers that the testimony cited by the Copyright Owners also shows why the Initial Determination’s Service Revenue definition works for bundles and grows royalties. Services’ Reply at 57-58.

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The Services maintain that while neither the Services nor Copyright Owners submitted evidence specifically addressing the way that customers, Services, or Copyright Owners might value the component parts of bundles, such subjective valuations are unnecessary – given that the parties’ negotiated handling of the bundling issues provides the Judges with ample support for the PR II-based benchmark definition in the Initial Determination. See *id.* at 75-76.

The Services also argue that while the Judges’ decision in SDARS III did involve valuation of the music and non-music components of a bundle, the resolution in SDARS III is inapposite because, here, the rate structure has a way of ensuring that Copyright Owners are fairly compensated from bundles: the statutory minimum payment. Services’ Reply at 62.

C. Analysis and Decision

The fundamental difference between the impact of the two alternative definitions is simply stated:

Under the Initial Determination:

downstream bundling and its price discriminatory effect *would* be incentivized by a royalty structure that reflects the lower WTP of consumers who subscribe by paying for a Bundle;

Under the (Final) Determination:

downstream bundling and its price discriminatory effect *would not* be incentivized by a royalty structure that reflects the lower WTP of consumers who subscribe by paying for a Bundle.

To explain this difference, the Judges find it helpful to describe (as in the Determination and Dissent) how bundling facilitates price discrimination and how lower royalties for bundled streaming services incentivize such bundling.

Price discrimination occurs when a seller offers different units of output at different prices. See, e.g., H. Varian, *Intermediate Economics* at 462 (8th ed. 2010). The benefit to the seller arises from attempting to “charge each customer the maximum price that the customer is willing to pay for each unit bought.” R. Pindyck & D. Rubinfeld, *Microeconomics* at 401 (8th ed. 2013). For all goods, and intellectual property goods such as copyrights in particular,²⁴ the social benefit is that price discrimination more closely matches the quantity sold with the competitive quantity as the seller or licensor better aligns the price with the WTP of different categories of buyers or licensees. See W. Fisher, *Reconstructing the Fair Use Doctrine*, 101 Harv. L. Rev. 1659, 1701 (1988).

A seller can engage in price discrimination in several ways. One form is known as “second-degree price discrimination,” by which buyers self-sort the packages and quantities they purchase.²⁵ See W. Adams & J. Yellen, *Commodity Bundling and the Burden of Monopoly*, 90 Q. J. Econ. 470, 476 (1976) (the profitability of bundling “stem[s] from its ability to sort

²⁴ Streamed copies of intellectual property, such as musical works and sound recordings, have a marginal production cost of essentially zero, making price discrimination particularly beneficial, because charging any positive price, even to a buyer with the lowest WTP, still exceeds the zero marginal production costs. See Dissent, *passim*.

²⁵ “First-degree” price discrimination is a hypothetical construct by which a seller can identify the WTP of every buyer. “Third-degree” price discrimination occurs when the seller offers different prices to buyers based on their different characteristics (e.g., a senior citizen discount). See Pindyck & Rubinfeld, *supra*, at 402, 404-05.

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customers into groups with different reservation price [WTP] characteristics.”). Bundling, *i.e.*, the “practice of selling two or more products as a package,” *Pindyck & Rubinfeld, supra* at 419, is thus a type of second-degree price discrimination. *See* A. Boik & H. Takahashi, *Fighting Bundles: The Effects of Competition on Second Degree Price Competition*, 12 Am. Econ. J. 156, 157 (2020).

The applicability of these basic economic principles was understood and explained by the parties’ experts at the hearing. *See, e.g.*, 3/15/17 Tr. 1224-25 (Leonard) (Google’s economic expert testifying that price discrimination through bundling is “very, very common ... even by pretty competitively positioned firms ... to sort out customers into willingness-to-pay groups.”); 3/30/17 Tr. 3983 (Gans) (Copyright Owners’ economic expert acknowledging that bundling is a form of price discrimination); *see also* Dissent at 69 (same).

How does this downstream (retail level) benefit of price discrimination impact the setting of upstream royalty rates? As the Majority explained (in summarizing the Services’ expert testimony) the linkage is explained by the economic concept of “derived demand”:

[M]ultiple pricing structures necessary to satisfy the WTP and the differentiated quality preferences of downstream listeners relate directly to the upstream rate structure to be established in this proceeding. Professor Marx opines that the appropriate *upstream* rate structure is derived from the characteristics of downstream demand. 3/20/17 Tr. 1967 (Marx) (rate structure upstream should be derived from need to exploit WTP of users downstream via a percentage of revenue). This upstream to downstream consonance in rate structures represents an application of the concept of “derived demand,” whereby the demand upstream for inputs is dependent upon the demand for the final product downstream. *Id.*; *see* P. Krugman & R. Wells, *Microeconomics* at 511 (2d ed. 2009) (“[D]emand in a factor market is ... *derived demand* ... [t]hat is, demand for the factor is derived from the [downstream] firm’s output choice”).

Determination at 19; *accord* Dissent at 32 (noting that “the upstream demand of the interactive streaming services for musical works (and the sound recordings in which they are embodied) – known as “factors” of production or “inputs” – is derived from the downstream demand of listeners to and users of the interactive streaming services ... This interdependency causes upstream demand to be characterized as “derived demand.”).

In the present proceeding, the PR II-based benchmark embodies the parties’ negotiated definition of Bundled Revenue for purposes of calculating royalties on bundled interactive offerings. This is the definition in the Initial Determination. Copyright Owners’ preferred definition for Bundled Revenue – the Determination’s definition – would not only ignore this agreed-upon definition, but would also de-link the royalty rate from the WTP of purchasers of bundles.²⁶ The Judges recognize that Copyright Owners have expressed concern the Services

²⁶ To see the incentivizing effect of the link between the royalty level and variable WTP, consider the following example. Assume a hypothetical bundle consists of a subscription to the “Acme” interactive music streaming service and the sports service NFL Sunday Ticket. Assume also that Acme and NFL Sunday Ticket have standalone monthly subscription prices of \$9.99/month and \$149.99/month respectively, so that purchasing both separately would cost \$159.98/month. But assume the bundle price is only \$140/month. Acme’s purpose in bundling its interactive music streaming service subscription offering with NFL Sunday Ticket would be to attract customers

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could use such bundling in order to diminish revenue otherwise payable on a higher royalty tier. However, the Majority noted that the evidence indicated such diminishment only occurred “in some cases” and that such practices were not “sweeping.” Clarification Order at 17, 21. Thus, the Judges find that eliminating the incentive for price discrimination via bundling would be a disproportionate response and inconsistent with the broad price discriminatory PR II-based benchmark they find useful in this proceeding.

Expert testimony in this regard is “substantial evidence” on which the Judges can rely. For example, the D.C. Circuit also relied in *Johnson* on the testimony of the same witness, Spotify’s economic expert witness, Professor Marx, to affirm the inclusion of the price discriminatory structure for student and family plans. *Johnson*, 969 F.3d at 392-94. Professor Marx explained how a downstream “lower willingness (or ability) to pay” among some cohorts of consumers supports definitional terms, for student and family subscribers, that lower royalty rates in order to further “economic efficiency” in a manner that “still allows more monetization of that provision of that service.” *Johnson* at 392-93. Broadening her lens, Professor Marx also explained that this price discriminatory approach is appropriate “across all types of services and subscribers,” as in “[t]he current law [and in the PR II-based benchmark]” which “accommodates ... ad-supported services ... and ‘bundled services’ through different rate provisions.” Marx WRT ¶ 41 (emphasis added). See also 3/21/17 2182-83 (Hubbard) (Amazon’s expert witness testifying that “Prime Music, which is *bundled* with an Amazon Prime service ... sort[s] out customers’ willingness to pay, with an idea of trying to maximize the number of customers,” and agreeing that this approach constitutes “sorting by way of bundling.”) (emphasis added). Further, Professor Hubbard opined that, given the revenue attribution “measurement problem” associated with bundled products, the “Phonorecords II” approach “with the different categories and the minima” ... address this sort of problem [in] a very good way.” 3/15/17 Tr. 1221 (Hubbard).

As in the case of family and student price discrimination, the beneficial effect of such differential pricing was supported by industry witnesses as well as expert witnesses. See, e.g., Mirchandani WDT ¶ 71 (Amazon executive citing the Phonorecords II-based benchmark provisions regarding bundling that “allowed Amazon to bundle Prime Music with Amazon Prime, enabling Amazon to bring a limited catalog of music [REDACTED]”). In sum, the same type of witness testimony that the D.C. Circuit found sufficient to support price discriminatory student and family plans also supports the use of the price discriminatory bundled definition contained in the Initial Determination.

Given the overall benefits from price discrimination, at first blush it is curious that Copyright Owners would risk “leaving money on the table” by seeking to remove the royalty-based incentive for price discrimination via bundling. The Judges have identified this problem

who had a WTP for the standalone Acme service below \$9.99/month, but a WTP at or above the \$140/month for the bundle.

Under the definition in the Determination, royalties would be paid on the standalone \$9.99/month Acme price. But the purpose of the bundling was to attract subscribers *who would not pay the standalone \$9.99/month price*, so no such would-be subscribers would sign-up, and *no royalties would be generated by them*.

By contrast, under the Initial Determination, the standalone price of NFL Sunday Ticket, \$159.98/month, would be subtracted from the \$140/month bundle price. Although that would preclude a payment of royalties on a *revenue* prong, *royalties still would be paid, under a different tier or on the mechanical floor*.

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earlier in this Initial Remand Ruling, in connection with the broader issue of the overall beneficial price discriminatory structure of the PR-based benchmark. As the Judges noted in that general price discrimination context, Copyright Owners’ own expert economic witnesses acknowledged that they would not irrationally leave money on the table. In fact, Copyright owners’ aim, according to that testimony, is to create an unregulated space—per the Bargaining Room theory—and to use their complementary oligopoly power to negotiate price discriminatory rates (in bundles or otherwise), which would free them from the section 801(b)(1) requirements of reasonableness and fairness.

The Judges further find that their prior ruling on this issue in *SDARS III* is distinguishable. There, a proffered bundled revenue definition eliminated the payment of any royalty at all. Copyright Owners quite correctly describe that result as “absurd,” but that is not the result here. Rather, in the present case, the parties’ negotiated an approach that the Judges adopted in the Initial Determination requiring royalties to be paid on interactive services bundled with other products or services.

Even more distinguishable is Copyright Owners’ assertion that *Web IV* provides support for their preferred definition of service revenue. The argument is immediately suspect, because *Web IV* involved per-play royalty rates – not percent-of-revenue rates, making the definition of revenue wholly inapposite. Further, the discussion of the price of an “ice cream cone” in *Web IV*—on which Copyright Owners rely—had nothing to do with bundling or isolating the WTP for different products or services. Rather, there the Judges criticized a bizarre argument made by a licensee (who had a quantity discount for plays steered in its direction), that was tantamount to arguing that if a vendor sells one ice cream cone for \$1.06 but a buyer could buy two for \$1.06, that the market price of an ice cream cone is thus only \$.06. This argument was indeed fallacious, because the price of an ice cream cone would be reasonably identified as the average of the total cost for the two cones, *i.e.*, \$.53/cone, and never as \$.06 per cone.

Here, the issue, is how to address the WTP of different classes of buyers with heterogeneous WTP, not the pricing of a quantity discount. The parties addressed this issue by utilizing the Bundled Revenue definition contained in the PR II-based benchmark (and in the Initial Determination) to address the indeterminacy inherent in the variable WTP among purchasers of the bundles, by setting floors and minima, rather than attempt to sort out the WTP of individual (or individual blocs) of subscribers. The “ice cream cone” issue in *Web IV* is wholly unrelated, and the *SDARS III* situation, as explained *supra*, is also distinguishable.²⁷

²⁷ The foregoing analysis also explains why Copyright Owners’ assertion that the Services did not satisfy their burden of proof with regard to the Bundled Revenue definition misses the point. The Services’ burden was to show the reasonableness of utilizing the Bundled Revenue definition in the PR II-based benchmark, not to show that their proffered approach measured the WTP of individual subscribers (or blocs of subscribers). Such an alternative approach might have had merit but no alternative approach was presented to the Judges.

To be clear, the Judges are not declaring that an alternative Bundled Revenue definition and/or alternative rates and structures for bundle, might not have been preferable. *See* 4/15/17 Tr. 5056-58 (Katz) (“[I]f someone had a proposal [with] a specific reason why we should adjust this minimum that’s something I would have examined.”). *See also* 3/15/17 Tr. 1227-28 (Leonard) (Google’s economic expert testifying that “if somebody had ... suggest[ed] ... a different sort of bucket that should be created ... that’s a good idea.”). But Copyright Owners did not propose such alternatives at the hearing, and the alternative in their Motion for Clarification simply eviscerated the “derived demand”-based link between royalties and bundled offerings. As the Judges have noted *supra*, in the words of Judge Patricia Wald, all judges are cabined by the record evidence introduced by the parties. Therefore (in the absence of a way in which to synthesize the parties’ proposals in a manner that does not “blindsides” the parties) the Judges must choose between the proposals that are in the record, not potentially superior proposals that are not in the

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For the foregoing reasons, I find that – even if the Judges had a procedural mechanism by which to support the switch in the Bundled Revenue definition – I would decline to utilize it in this Initial Remand Ruling, because the definition in the Initial Determination (unlike the definition in the Determination) is consistent with the Judges’ other substantive rulings herein. That is, just as the Majority abandoned its Bundled Revenue definition in its Initial Determination because it refused to credit the PR II-based benchmark (even as “guidance”), the Judges here do partially rely on the PR II-based benchmark, and thus find that it supports the Bundled Revenue definition contained in the Initial Determination.

VIII. Application of the Four Itemized Statutory Factors

As the forgoing analysis explains, bundling is a form of price discrimination. Accordingly, the Judges’ explanation of how price discriminatory rates in the PR II-based benchmark interrelate with the Factor A through D objectives in section 801(b)(1) are equally applicable here. Accordingly, the Judges incorporate by reference here their discussion of those four factors set forth *supra* in connection with the PR II-based benchmark, and find that there is no basis pursuant to those four factors to adjust the PR II-based benchmark definition of Bundled Revenue.

IX. 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.

David
Strickler

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David R. Strickler,
Copyright Royalty Judge

Dated: July 2, 2022²⁸

record. Here, the Judges favor the Bundled Revenue definition in the Initial Determination that was negotiated by the parties, incentivizes price discrimination and pays royalties on the bundled music, over the substituted definition in the Determination pursued by Copyright Owners that would eliminate price discrimination, except under the terms Copyright Owners could impose via their complementary oligopoly power, and without regard to the statutory requirements of a “reasonable rate” and a “fair income” for the Services.

²⁸ Technical difficulties on July 1 caused the delay in filing of this Dissent until July 2.

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 dissents¹ 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).

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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

⁴The 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).

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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.

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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 prong⁸ 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.

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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).

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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.

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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* Eisenach 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.

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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.

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valuable benchmark. The Services' witnesses analyzed direct licenses and concluded that the rates closely matched the rates in the PR II regulations. [REDACTED]

[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.

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 AWDI Leonard ¶¶ 63-64
[REDACTED] See Leonard
AWDI ¶ 70-71

[REDACTED] See AWDI Leonard ¶ 54. (calculation is "effectively simplified").

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.

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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 [\$0.15 per subscriber]); [FORMER] 385.13(2) (Standalone portable subscription—mixed use [\$0.50 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.

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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.

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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]

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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.

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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.*

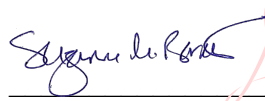
F. Rate Structure

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
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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.

These regulations will be published as historical regulations in an appendix to 37 C.F.R. part 385, Rates and Terms for Use of Nondramatic Musical Works in the Making and Distributing of Physical and Digital Phonorecords, indicating that they are effective for the period January 1, 2018, through December 31, 2022.

APPENDIX A to Part 385 -- Part 385 applicable to the period January 1, 2018, through December 31, 2022, as clarified on [date of publication in the Federal Register].

**PART 385 – RATES AND TERMS FOR USE OF MUSICAL WORKS UNDER
COMPULSORY LICENSE FOR MAKING AND DISTRIBUTING PHYSICAL AND
DIGITAL PHONORECORDS**

Subpart A – Regulations of General Application

385.1 General.

385.2 Definitions.

385.3 Late payments.

385.4 Recordkeeping for promotional or free trial non-royalty-bearing uses.

Subpart B – Physical Phonorecord Deliveries, Permanent Downloads, Ringtones, and Music Bundles

385.10 Scope.

385.11 Royalty rates.

Subpart C – Eligible Interactive Streaming, Eligible Limited Downloads, Limited Offerings, Mixed Service Bundles, Bundled Subscription Offerings, Locker Services, and Other Delivery Configurations

385.20 Scope

385.21 Royalty rates and calculations.

385.22 Royalty floors for specific types of offerings.

Subpart D – Promotional Offerings, Free Trial Offerings and Certain Purchased Content Locker Services

385.30 Scope.

385.31 Royalty rates.

Subpart A—Regulations of General Application

§385.1 General.

(a) *Scope.* This part establishes rates and terms of royalty payments for the use of nondramatic musical works in making and distributing of physical and digital phonorecords in accordance with the provisions of 17 U.S.C. 115. This subpart contains regulations of general application to the making and distributing of phonorecords subject to the section 115 license.

(b) *Legal compliance.* Licensees relying on the compulsory license detailed in 17 U.S.C. 115 shall comply with the requirements of that section, the rates and terms of this part, and any other applicable regulations. This part describes rates and terms for the compulsory license only.

(c) *Interpretation.* This part is intended only to set rates and terms for situations in which the exclusive rights of a Copyright Owner are implicated and a compulsory license pursuant to 17 U.S.C. 115 is obtained. Neither this part nor the act of obtaining a license under 17 U.S.C. 115 is intended to express or imply any conclusion as to the circumstances in which a user must obtain a compulsory license pursuant to 17 U.S.C. 115.

(d) *Relationship to voluntary agreements.* The rates and terms of any license agreements entered into by Copyright Owners and Licensees relating to use of musical works within the scope of those license agreements shall apply in lieu of the rates and terms of this part.

§385.2 Definitions.

For the purposes of this part, the following definitions apply:

Accounting Period means the monthly period specified in 17 U.S.C. 115(c)(2)(I) and in 17 U.S.C. 115(d)(4)(A)(i), and any related regulations, as applicable.

Active Subscriber means an End User of a Bundled Subscription Offering who has made at least one Play during the Accounting Period.

Affiliate means an entity controlling, controlled by, or under common control with another entity, except that an affiliate of a Sound Recording Company shall not include a Copyright Owner to the extent it is engaging in business as to musical works.

Bundled Subscription Offering means a Subscription Offering providing Licensed Activity consisting of Eligible Interactive Streams or Eligible Limited Downloads that is made available to End Users with one or more other products or services (including products or services subject to other subparts) as part of a single transaction without pricing for the

subscription service providing Licensed Activity separate from the product(s) or service(s) with which it is made available (e.g., a case in which a user can buy a portable device and one-year access to a subscription service providing Licensed Activity for a single price).

Copyright Owner(s) are nondramatic musical works copyright owners who are entitled to royalty payments made under this part pursuant to the compulsory license under 17 U.S.C. 115.

Digital Phonorecord Delivery has the same meaning as in 17 U.S.C. 115(e)(10).

Eligible Interactive Stream means a Stream in which the performance of the sound recording is not exempt from the sound recording performance royalty under 17 U.S.C. 114(d)(1) and does not in itself, or as a result of a program in which it is included, qualify for statutory licensing under 17 U.S.C. 114(d)(2).

Eligible Limited Download means a Limited Download as defined in 17 U.S.C. 115(e)(16) that is only accessible for listening for—

(1) An amount of time not to exceed one month from the time of the transmission (unless the Licensee, in lieu of retransmitting the same sound recording as another Eligible Limited Download, separately, and upon specific request of the End User made through a live network connection, reauthorizes use for another time period not to exceed one month), or in the case of a subscription plan, a period of time following the end of the applicable subscription no longer than a subscription renewal period or three months, whichever is shorter; or

(2) A number of times not to exceed 12 (unless the Licensee, in lieu of retransmitting the same sound recording as another Eligible Limited Download, separately, and upon specific request of the End User made through a live network connection, reauthorizes use of another series of 12 or fewer plays), or in the case of a subscription transmission, 12 times after the end of the applicable subscription.

End User means each unique person that:

- (1) Pays a subscription fee for an Offering during the relevant Accounting Period; or
- (2) Makes at least one Play during the relevant Accounting Period.

Family Plan means a discounted Subscription Offering to be shared by two or more family members for a single subscription price.

Free Trial Offering means a subscription to a Service Provider's transmissions of sound recordings embodying musical works when

- (1) Neither the Service Provider, the Sound Recording Company, the Copyright Owner, nor any person or entity acting on behalf of or in lieu of any of them receives any monetary consideration for the Offering;
- (2) The free usage does not exceed 30 consecutive days per subscriber per two-year period;
- (3) In connection with the Offering, the Service Provider is operating with appropriate musical license authority and complies with the recordkeeping requirements in § 385.4;
- (4) Upon receipt by the Service Provider of written notice from the Copyright Owner or its agent stating in good faith that the Service Provider is in a material manner operating without appropriate license authority from the Copyright Owner under 17 U.S.C. 115, the Service Provider shall within 5 business days cease transmission of the sound recording embodying that musical work and withdraw it from the repertoire available as part of a Free Trial Offering;
- (5) The Free Trial Offering is made available to the End User free of any charge; and
- (6) The Service Provider offers the End User periodically during the free usage an opportunity to subscribe to a non-Free Trial Offering of the Service Provider.

GAAP means U.S. Generally Accepted Accounting Principles in effect at the relevant time, except that if the U.S. Securities and Exchange Commission permits or requires entities with securities that are publicly traded in the U.S. to employ International Financial Reporting Standards in lieu of Generally Accepted Accounting Principles, then that entity may employ International Financial Reporting Standards as “GAAP” for purposes of this subpart.

Licensee means any entity availing itself of the compulsory license under 17 U.S.C. 115 to use copyrighted musical works in the making or distributing of physical or digital phonorecords.

Licensed Activity, as the term is used in subpart B of this part, means delivery of musical works, under voluntary or statutory license, via physical phonorecords and Digital Phonorecord Deliveries in connection with Permanent Downloads, Ringtones, and Music Bundles; and, as the term is used in subparts C and D of this part, means delivery of musical works, under voluntary or statutory license, via Digital Phonorecord Deliveries in connection with Eligible Interactive Streams, Eligible Limited Downloads, Limited Offerings, mixed Bundles, and Locker Services.

Limited Offering means a Subscription Offering providing Eligible Interactive Streams or Eligible Limited Downloads for which—

(1) An End User cannot choose to listen to a particular sound recording (i.e., the Service Provider does not provide Eligible Interactive Streams of individual recordings that are on-demand, and Eligible Limited Downloads are rendered only as part of programs rather than as individual recordings that are on-demand); or

(2) The particular sound recordings available to the End User over a period of time are substantially limited relative to Service Providers in the marketplace providing access to a comprehensive catalog of recordings (e.g., a product limited to a particular genre or permitting Eligible Interactive Streams only from a monthly playlist consisting of a limited set of recordings).

Locker Service means an Offering providing digital access to sound recordings of musical works in the form of Eligible Interactive Streams, Permanent Downloads, Restricted Downloads or Ringtones where the Service Provider has reasonably determined that the End User has purchased or is otherwise in possession of the subject phonorecords of the applicable sound recording prior to the End User's first request to use the sound recording via the Locker Service. The term Locker Service does not mean any part of a Service Provider's products otherwise meeting this definition, but as to which the Service Provider has not obtained a section 115 license.

Mixed Service Bundle means one or more of Permanent Downloads, Ringtones, Locker Services, or Limited Offerings a Service Provider delivers to End Users together with one or more non-music services (e.g., internet access service, mobile phone service) or non-music products (e.g., a telephone device) of more than token value and provided to users as part of one transaction without pricing for the music services or music products separate from the whole Offering.

Music Bundle means two or more of physical phonorecords, Permanent Downloads or Ringtones delivered as part of one transaction (e.g., download plus ringtone, CD plus downloads). In the case of Music Bundles containing one or more physical phonorecords, the Service Provider must sell the physical phonorecord component of the Music Bundle under a single catalog number, and the musical works embodied in the Digital Phonorecord Delivery configurations in the Music Bundle must be the same as, or a subset of, the musical works embodied in the physical phonorecords; provided that when the Music Bundle contains a set of Digital Phonorecord Deliveries sold by the same Sound Recording Company under substantially the same title as the physical phonorecord (e.g., a corresponding digital album), the Service Provider may include in the same bundle up to 5 sound recordings of musical works that are included in the stand-alone version of the set of digital phonorecord deliveries but not included on the physical phonorecord. In addition, the Service Provider must permanently part with possession of the physical phonorecord or phonorecords it sells as part of the Music Bundle. In the case of Music Bundles composed solely of digital phonorecord deliveries, the number of

digital phonorecord deliveries in either configuration cannot exceed 20, and the musical works embodied in each configuration in the Music Bundle must be the same as, or a subset of, the musical works embodied in the configuration containing the most musical works.

Offering means a Service Provider's engagement in Licensed Activity covered by subparts C and D of this part.

Paid Locker Service means a Locker Service for which the End User pays a fee to the Service Provider.

Performance Royalty means the license fee payable for the right to perform publicly musical works in any of the forms covered by subparts C and D this part.

Permanent Download has the same meaning as in 17 U.S.C. 115(e)(24).

Play means an Eligible Interactive Stream, or a play of an Eligible Limited Download, lasting 30 seconds or more and, if a track lasts in its entirety under 30 seconds, an Eligible Interactive Stream or a play of an Eligible Limited Download of the entire duration of the track. A Play excludes an Eligible Interactive Stream or a play of an Eligible Limited Download that has not been initiated or requested by a human user. If a single End User plays the same track more than 50 straight times, all plays after play 50 shall be deemed not to have been initiated or requested by a human user.

Promotional Offering means a digital transmission of a sound recording, in the form of an Eligible Interactive Stream or an Eligible Limited Download, embodying a musical work, the primary purpose of which is to promote the sale or other paid use of that sound recording or to promote the artist performing on that sound recording and not to promote or suggest promotion or endorsement of any other good or service and

(1) A Sound Recording Company is lawfully distributing the sound recording through established retail channels or, if the sound recording is not yet released, the Sound Recording Company has a good faith intention to lawfully distribute the sound recording or a different version of the sound recording embodying the same musical work;

(2) For Eligible Interactive Streams or Eligible Limited Downloads, the Sound Recording Company requires a writing signed by an authorized representative of the Service Provider representing that the Service Provider is operating with appropriate musical works license authority and that the Service Provider is in compliance with the recordkeeping requirements of § 385.4;

(3) For Eligible Interactive Streams of segments of sound recordings not exceeding 90 seconds, the Sound Recording Company delivers or authorizes delivery of the segments for

promotional purposes and neither the Service Provider nor the Sound Recording Company creates or uses a segment of a sound recording in violation of 17 U.S.C. 106(2) or 115(a)(2);

(4) The Promotional Offering is made available to an End User free of any charge; and

(5) The Service Provider provides to the End User at the same time as the Promotional Offering Stream an opportunity to purchase the sound recording or the Service Provider periodically offers End Users the opportunity to subscribe to a paid Offering of the Service Provider.

Purchased Content Locker Service means a Locker Service made available to End User purchasers of Permanent Downloads, Ringtones, or physical phonorecords at no incremental charge above the otherwise applicable purchase price of the Permanent Downloads, Ringtones, or physical phonorecords acquired from a qualifying seller. With a Purchased Content Locker Service, an End User may receive one or more additional phonorecords of the purchased sound recordings of musical works in the form of Permanent Downloads or Ringtones at the time of purchase, or subsequently have digital access to the purchased sound recordings of musical works in the form of Eligible Interactive Streams, additional Permanent Downloads, Restricted Downloads, or Ringtones.

(1) A qualifying seller for purposes of this definition is the entity operating the Service Provider, including Affiliates, predecessors, or successors in interest, or—

(i) In the case of Permanent Downloads or Ringtones, a seller having a legitimate connection to the locker service provider pursuant to one or more written agreements (including that the Purchased Content Locker Service and Permanent Downloads or Ringtones are offered through the same third party); or

(ii) In the case of physical phonorecords:

(A) The seller of the physical phonorecord has an agreement with the Purchased Content Locker Service provider establishing an integrated offer that creates a consumer experience commensurate with having the same Service Provider both sell the physical phonorecord and offer the integrated locker service; or

(B) The Service Provider has an agreement with the entity offering the Purchased Content Locker Service establishing an integrated offer that creates a consumer experience commensurate with having the same Service Provider both sell the physical phonorecord and offer the integrated locker service.

Relevant Page means an electronic display (for example, a web page or screen) from which a Service Provider's Offering consisting of Eligible Interactive Streams or Eligible

Limited Downloads is directly available to End Users, but only when the Offering and content directly relating to the Offering (e.g., an image of the artist, information about the artist or album, reviews, credits, and music player controls) comprises 75% or more of the space on that display, excluding any space occupied by advertising. An Offering is directly available to End Users from a page if End Users can receive sound recordings of musical works (in most cases this will be the page on which the Eligible Limited Download or Eligible Interactive Stream takes place).

Restricted Download means a Digital Phonorecord Delivery in a form that cannot be retained and replayed on a permanent basis. The term Restricted Download includes an Eligible Limited Download.

Ringtone means a phonorecord of a part of a musical work distributed as a Digital Phonorecord Delivery in a format to be made resident on a telecommunications device for use to announce the reception of an incoming telephone call or other communication or message or to alert the receiver to the fact that there is a communication or message.

Service Provider means that entity governed by subparts C and D of this part, which might or might not be the Licensee, that with respect to the section 115 license:

(1) Contracts with or has a direct relationship with End Users or otherwise controls the content made available to End Users;

(2) Is able to report fully on Service Provider Revenue from the provision of musical works embodied in phonorecords to the public, and to the extent applicable, verify Service Provider Revenue through an audit; and

(3) Is able to report fully on its usage of musical works, or procure such reporting and, to the extent applicable, verify usage through an audit.

Service Provider Revenue.

(1) Subject to paragraphs (2) through (5) of this definition and subject to GAAP, Service Provider Revenue shall mean:

(i) All revenue from End Users recognized by a Service Provider for the provision of any Offering;

(ii) All revenue recognized by a Service Provider by way of sponsorship and commissions as a result of the inclusion of third-party “in-stream” or “in-download” advertising as part of any Offering, i.e., advertising placed immediately at the start or end of, or during the actual delivery of, a musical work, by way of Eligible Interactive Streaming or Eligible Limited Downloads; and

(iii) All revenue recognized by the Service Provider, including by way of sponsorship and commissions, as a result of the placement of third-party advertising on a Relevant Page of the Service Provider or on any page that directly follows a Relevant Page leading up to and including the Eligible Limited Download or Eligible Interactive Stream of a musical work; provided that, in case more than one Offering is available to End Users from a Relevant Page, any advertising revenue shall be allocated between or among the Service Providers on the basis of the relative amounts of the page they occupy.

(2) Service Provider Revenue shall:

(i) Include revenue recognized by the Service Provider, or by any associate, Affiliate, agent, or representative of the Service Provider in lieu of its being recognized by the Service Provider; and

(ii) Include the value of any barter or other nonmonetary consideration; and

(iii) Except as expressly detailed in this part, not be subject to any other deduction or set-off other than refunds to End Users for Offerings that the End Users were unable to use because of technical faults in the Offering or other bona fide refunds or credits issued to End Users in the ordinary course of business.

(3) Service Provider Revenue shall exclude revenue derived by the Service Provider solely in connection with activities other than Offering(s), whereas advertising or sponsorship revenue derived in connection with any Offering(s) shall be treated as provided in paragraphs (2) and (4) of this definition.

(4) For purposes of paragraph (1) of this definition, advertising or sponsorship revenue shall be reduced by the actual cost of obtaining that revenue, not to exceed 15%.

(5) In instances in which a Service Provider provides an Offering to End Users as part of the same transaction with one or more other products or services that are not Licensed Activities, then the revenue from End Users deemed to be recognized by the Service Provider for the Offering for the purpose of paragraph (1) of this definition shall be the revenue recognized from End Users for the bundle less the standalone published price for End Users for each of the other component(s) of the bundle; provided that, if there is no standalone published price for a component of the bundle, then the Service Provider shall use the average standalone published price for End Users for the most closely comparable product or service in the U.S. or, if more than one comparable exists, the average of standalone prices for comparables.

(6) In the case of a Mixed Service Bundle, the revenue deemed to be recognized from End Users for the Offering for the purpose of paragraph (1) of this definition shall be the greater of—

(i) The revenue deemed to be recognized pursuant to paragraph (5) of this definition;
and

(ii) Either—

(A) In the case of a Mixed Service Bundle that either has 750,000 subscribers or other registered users, or is reasonably expected to have 750,000 subscribers or other registered users within 1 year after commencement of the Mixed Service Bundle, 40% of the standalone published price of the licensed music component of the bundle (i.e., the Permanent Downloads, Ringtones, Locker Service, or Limited Offering); provided that, if there is no such standalone published price for the licensed music component of the bundle, then the average standalone published price for End Users for the most closely comparable licensed music component in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used; and further provided that in any case in which royalties were paid based on this paragraph due to a reasonable expectation of reaching 750,000 subscribers or other registered users within 1 year after commencement of the Mixed Service Bundle and that does not actually happen, applicable payments shall, in the accounting period next following the end of such 1-year period, retroactively be adjusted as if paragraph (6)(ii)(B) of this definition applied; or

(B) Otherwise, 50% of the standalone published price of the licensed music component of the bundle (i.e., the Permanent Downloads, Ringtones, Locker Service, or Limited Offering); provided that, if there is no such standalone published price for the licensed music component of the bundle, then the average standalone published price for End Users for the most closely comparable licensed music component in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used.

Sound Recording Company means a person or entity that:

(1) Is a copyright owner of a sound recording embodying a musical work;

(2) In the case of a sound recording of a musical work fixed before February 15, 1972, has rights to the sound recording, under chapter 14 of title 17, United States Code, that are equivalent to the rights of a copyright owner of a sound recording of a musical work under title 17, United States Code;

(3) Is an exclusive Licensee of the rights to reproduce and distribute a sound recording of a musical work; or

(4) Performs the functions of marketing and authorizing the distribution of a sound recording of a musical work under its own label, under the authority of the Copyright Owner of the sound recording.

Standalone Non-Portable Subscription Offering—Streaming Only means a Subscription Offering through which an End User can listen to sound recordings only in the form of Eligible Interactive Streams and only from a non-portable device to which those Eligible Interactive Streams are originally transmitted while the device has a live network connection.

Standalone Non-Portable Subscription Offering—Mixed means a Subscription Offering through which an End User can listen to sound recordings either in the form of Eligible Interactive Streams or Eligible Limited Downloads but only from a non-portable device to which those Eligible Interactive Streams or Eligible Limited Downloads are originally transmitted.

Standalone Portable Subscription Offering means a Subscription Offering through which an End User can listen to sound recordings in the form of Eligible Interactive Streams or Eligible Limited Downloads from a portable device.

Stream means the digital transmission of a sound recording of a musical work to an End User—

(1) To allow the End User to listen to the sound recording, while maintaining a live network connection to the transmitting service, substantially at the time of transmission, except to the extent that the sound recording remains accessible for future listening from a Streaming Cache Reproduction;

(2) Using technology that is designed such that the sound recording does not remain accessible for future listening, except to the extent that the sound recording remains accessible for future listening from a Streaming Cache Reproduction; and

(3) That is subject to licensing as a public performance of the musical work.

Streaming Cache Reproduction means a reproduction of a sound recording embodying a musical work made on a computer or other receiving device by a Service Provider solely for the purpose of permitting an End User who has previously received a Stream of that sound recording to play the sound recording again from local storage on the computer or other device rather than by means of a transmission; provided that the End User is only able to do so while maintaining a live network connection to the Service Provider, and the reproduction is encrypted or otherwise protected consistent with prevailing industry standards to prevent it from being played in any other manner or on any device other than the computer or other device on which it was originally made.

Student Plan means a discounted Subscription Offering available on a limited basis to students.

Subscription Offering means an Offering for which End Users are required to pay a fee to have access to the Offering for defined subscription periods of 3 years or less (in contrast to, for

example, a service where the basic charge to users is a payment per download or per play), whether the End User makes payment for access to the Offering on a standalone basis or as part of a bundle with one or more other products or services.

Total Cost of Content or *TCC* means the total amount expended by a Service Provider or any of its Affiliates in accordance with GAAP for rights to make Eligible Interactive Streams or Eligible Limited Downloads of a musical work embodied in a sound recording through the Service Provider for the Accounting Period, which amount shall equal the Applicable Consideration for those rights at the time the Applicable Consideration is properly recognized as an expense under GAAP. As used in this definition, “Applicable Consideration” means anything of value given for the identified rights to undertake the Licensed Activity, including, without limitation, ownership equity, monetary advances, barter or any other monetary and/or nonmonetary consideration, whether that consideration is conveyed via a single agreement, multiple agreements and/or agreements that do not themselves authorize the Licensed Activity but nevertheless provide consideration for the identified rights to undertake the Licensed Activity, and including any value given to an Affiliate of a Sound Recording Company for the rights to undertake the Licensed Activity. Value given to a Copyright Owner of musical works that is controlling, controlled by, or under common control with a Sound Recording Company for rights to undertake the Licensed Activity shall not be considered value given to the Sound Recording Company. Notwithstanding the foregoing, Applicable Consideration shall not include in-kind promotional consideration given to a Sound Recording Company (or Affiliate thereof) that is used to promote the sale or paid use of sound recordings embodying musical works or the paid use of music services through which sound recordings embodying musical works are available where the in-kind promotional consideration is given in connection with a use that qualifies for licensing under 17 U.S.C. 115.

§385.3 Late payments.

A Licensee shall pay a late fee of 1.5% per month, or the highest lawful rate, whichever is lower, for any payment owed to a Copyright Owner and remaining unpaid after the due date established in 17 U.S.C. 115(c)(2)(I) or 17 U.S.C. 115(d)(4)(A)(i), as applicable and detailed in part 210 of this title. Late fees shall accrue from the due date until the Copyright Owner receives payment, except that where payment is due to the mechanical licensing collective under 17 U.S.C. 115(d)(4)(A)(i), late fees shall accrue from the due date until the mechanical licensing collective receives payment.

§385.4 Recordkeeping for promotional or free trial non-royalty-bearing uses.

(a) *General.* A Licensee transmitting a sound recording embodying a musical work subject to section 115 and subparts C and D of this part and claiming a Promotional Offering or Free Trial Offering zero royalty rate shall keep complete and accurate contemporaneous written records of making or authorizing Eligible Interactive Streams or Eligible Limited Downloads,

including the sound recordings and musical works involved, the artists, the release dates of the sound recordings, a brief statement of the promotional activities authorized, the identity of the Offering or Offerings for which the zero-rate is authorized (including the internet address if applicable), and the beginning and end date of each zero rate Offering.

(b) *Retention of records.* A Service Provider claiming zero rates shall maintain the records required by this section for no less time than the Service Provider maintains records of royalty-bearing uses involving the same types of Offerings in the ordinary course of business, but in no event for fewer than five years from the conclusion of the zero rate Offerings to which they pertain.

(c) *Availability of records.* If a Copyright Owner or agent requests information concerning zero rate Offerings, the Licensee shall respond to the request within an agreed, reasonable time.

Subpart B – Physical Phonorecord Deliveries, Permanent Downloads, Ringtones, and Music Bundles

§385.10 Scope.

This subpart establishes rates and terms of royalty payments for making and distributing phonorecords, including by means of Digital Phonorecord Deliveries, in accordance with the provisions of 17 U.S.C. 115.

§385.11 Royalty rates.

- (a) *Physical phonorecord deliveries and Permanent Downloads.* For every physical phonorecord and Permanent Download the Licensee makes and distributes or authorizes to be made and distributed, the royalty rate payable for each work embodied in the phonorecord or Permanent Download shall be either 9.1 cents or 1.75 cents per minute of playing time or fraction thereof, whichever amount is larger.
- (b) *Ringtones.* For every Ringtone the Licensee makes and distributes or authorizes to be made and distributed, the royalty rate payable for each work embodied therein shall be 24 cents.
- (c) *Music Bundles.* For a Music Bundle, the royalty rate for each element of the Music Bundle shall be the rate required under paragraph (a) or (b) of this section, as appropriate.

Subpart C—Eligible Interactive Streaming, Eligible Limited Downloads, Limited Offerings, Mixed Service Bundles, Bundled Subscription Offerings, Locker Services, and Other Delivery Configurations

§385.20 Scope.

This subpart establishes rates and terms of royalty payments for Eligible Interactive Streams and Eligible Limited Downloads of musical works, and other reproductions or distributions of musical works through Limited Offerings, Mixed Service Bundles, Bundled Subscription Offerings, Paid Locker Services, and Purchased Content Locker Services provided through subscription and nonsubscription digital music Service Providers in accordance with the provisions of 17 U.S.C. 115, exclusive of Offerings subject to subpart D of this part.

§385.21 Royalty rates and calculations¹

(a) *Applicable royalty.* Licensees that engage in Licensed Activity covered by this subpart pursuant to 17 U.S.C. 115 shall pay royalties therefor that are calculated as provided in this section, subject to the royalty floors for specific types of services described in § 385.22, provided, however, that Promotional Offerings, Free Trial Offerings, and certain Purchased Content Locker Services shall instead be subject to the royalty rates provided in subpart D of this part.

(b) *Rate calculation.* Royalty payments for Licensed Activity in this subpart shall be calculated as provided in this paragraph (b). If a Service Provider includes different Offerings, royalties must be calculated separately with respect to each Offering taking into consideration Service Provider Revenue and expenses associated with each Offering.

(1) *Step 1:* Calculate the All-In Royalty for the Offering. For each Accounting Period, the all-in royalty for each Offering under this subpart shall be the greater of the applicable percent of Service Provider Revenue, as set forth in Table 1 below, and the result of the TCC Prong Calculation for the respective type of Offering, as set forth in Table 2 below:

Table 1					
Royalty Year	2018	2019	2020	2021	2022
Percent of Service Provider Revenue	11.4	12.3	13.3	14.2	15.1

¹ Although these Phonorecords III regulations adopt the *substance* of the Phonorecords II-based benchmark where the Judges so require, in sections 385.21 and 385.22, these Phonorecords III regulations are *structured*, consistent with the parties' Joint Submission, in the same consolidated manner as set forth in the pre-remand Phonorecords III regulations (a structure as to which no party appealed). See Exhibit A to the Joint Submission at 16, n. 47; see also Exhibit B to the Joint Submission at n.17 (red-lined version of Exhibit A, *supra*).

Table 2	
Type of Offering	TCC Prong Calculation
<i>Standalone Non-Portable Subscription Offering—Streaming Only</i>	The lesser of 22 % of TCC for the Accounting Period and 50 cents per subscriber per month
<i>Standalone Non-Portable Subscription Offering—Mixed</i>	The lesser of 21% of TCC for the Accounting Period and 50 cents per subscriber per month
<i>Standalone Portable Subscription Offering</i>	The lesser of 21 % of TCC for the Accounting Period and 80 cents per subscriber per month
<i>Bundled Subscription Offering</i>	21 % of TCC for the Accounting Period
<i>Free nonsubscription/ad-supported services free of any charge to the End User</i>	22% of TCC for the Accounting Period
<i>Mixed Service Bundle</i>	21% of TCC for the Accounting Period
<i>Purchased Content Locker Service</i>	22% of TCC for the Accounting Period
<i>Limited Offering</i>	21% of TCC for the Accounting Period
<i>Paid Locker Service</i>	20.65% of TCC for the Accounting Period

(2) *Step 2: Subtract Applicable Performance Royalties.* From the amount determined in step 1 in paragraph (b)(1) of this section, for each Offering of the Service Provider, subtract the total amount of Performance Royalty that the Service Provider has expensed or will expense pursuant to public performance licenses in connection with uses of musical works through that Offering during the Accounting Period that constitute Licensed Activity. Although this amount may be the total of the Service Provider’s payments for that Offering for the Accounting Period, it will be less than the total of the Performance Royalties if the Service Provider is also engaging in public performance of musical works that does not constitute Licensed Activity. In the case in which the Service Provider is also engaging in the public performance of musical works that does not constitute Licensed Activity, the amount to be subtracted for Performance Royalties

shall be the amount allocable to Licensed Activity uses through the relevant Offering as determined in relation to all uses of musical works for which the Service Provider pays Performance Royalties for the Accounting Period. The Service Provider shall make this allocation on the basis of Plays of musical works or, where per-play information is unavailable because of bona fide technical limitations as described in step 4 in paragraph (b)(4) of this section, using the same alternative methodology as provided in step 4.

(3) *Step 3: Determine the Payable Royalty Pool.* The payable royalty pool is the amount payable for the reproduction and distribution of all musical works used by the Service Provider by virtue of its Licensed Activity for a particular Offering during the Accounting Period. This amount is the greater of:

- (i) The result determined in step 2 in paragraph (b)(2) of this section, and
- (ii) The royalty floor (if any) resulting from the calculations described in § 385.22.

(4) *Step 4: Calculate the Per-Work Royalty Allocation.* This is the amount payable for the reproduction and distribution of each musical work used by the Service Provider by virtue of its Licensed Activity through a particular Offering during the Accounting Period. To determine this amount, the result determined in step 3 in paragraph (b)(3) of this section must be allocated to each musical work used through the Offering. The allocation shall be accomplished by dividing the payable royalty pool determined in step 3 for the Offering by the total number of Plays of all musical works through the Offering during the Accounting Period (other than Plays subject to subpart D of this part) to yield a per-Play allocation, and multiplying that result by the number of Plays of each musical work (other than Plays subject to subpart D of this part) through the Offering during the Accounting Period. For purposes of determining the per-work royalty allocation in all calculations under this step 4 only (i.e., after the payable royalty pool has been determined), for sound recordings of musical works with a playing time of over 5 minutes, each Play shall be counted as provided in paragraph (c) of this section.

Notwithstanding the foregoing, if the Service Provider is not capable of tracking Play information because of bona fide limitations of the available technology for Offerings of that nature or of devices useable with the Offering, the per-work royalty allocation may instead be accomplished in a manner consistent with the methodology used for making royalty payment allocations for the use of individual sound recordings.

(c) *Overtime adjustment.* For purposes of the calculations in step 4 in paragraph (b)(4) of this section only, for sound recordings of musical works with a playing time of over 5 minutes, adjust the number of Plays as follows.

- (1) 5:01 to 6:00 minutes—Each Play = 1.2 Plays
- (2) 6:01 to 7:00 minutes—Each Play = 1.4 Plays

- (3) 7:01 to 8:00 minutes—Each Play = 1.6 Plays
- (4) 8:01 to 9:00 minutes—Each Play = 1.8 Plays
- (5) 9:01 to 10:00 minutes—Each Play = 2.0 Plays
- (6) For playing times of greater than 10 minutes, continue to add 0.2 Plays for each additional minute or fraction thereof.

(d) *Accounting.* The calculations required by paragraph (b) of this section shall be made in good faith and on the basis of the best knowledge, information, and belief at the time payment is due, and subject to the additional accounting and certification requirements of 17 U.S.C. 115(c)(2)(I), 17 U.S.C. 115(d)(4)(A)(i), and part 210 of this title. Without limitation, statements of account (where applicable) shall set forth each step of the calculations with sufficient information to allow the assessment of the accuracy and manner in which the payable royalty pool and per-play allocations (including information sufficient to demonstrate whether and how a royalty floor pursuant to § 385.22 does or does not apply) were determined and, for each Offering reported, also indicate the type of Licensed Activity involved and the number of Plays of each musical work (including an indication of any overtime adjustment applied) that is the basis of the per-work royalty allocation being paid.

(e) *Computation of subscriber months in TCC Prong Calculation.* In connection with the TCC Prong Calculation in step 1 of this section for an Accounting Period, to the extent applicable, the total number of subscriber-months for the Accounting Period shall be calculated, taking all End Users who were subscribers for complete calendar months, prorating in the case of End Users who were subscribers for only part of a calendar month, and deducting on a prorated basis for End Users covered by an Offering subject to subpart D of this part. The product of the total number of subscriber-months for the Accounting Period and the specified number of cents per subscriber shall be used as the subscriber-based component (if any) in step 1 for the Accounting Period.

§ 385.22 Royalty floors for specific types of offerings.

(a) *In general.* The following royalty floors for use in step 3 of § 385.21(b)(3)(ii) shall apply to the respective types of Offerings.

(1) *Standalone non-portable Subscription Offering—streaming only.* Except as provided in paragraph (a)(4) of this section, in the case of a Subscription Offering through which an End User can listen to sound recordings only in the form of Eligible Interactive Streams and only from a non-portable device to which those Streams are originally transmitted while the device has a live network connection, the royalty floor is the aggregate amount of 15 cents per subscriber per month.

(2) *Standalone non-portable Subscription Offering—mixed.* Except as provided in paragraph (a)(4) of this section, in the case of a Subscription Offering through which an End User can listen to sound recordings either in the form of Eligible Interactive Streams or Eligible Limited Downloads but only from a non-portable device to which those Streams or Eligible Limited Downloads are originally transmitted, the royalty floor is the aggregate amount of 30 cents per subscriber per month.

(3) *Standalone portable Subscription Offering.* Except as provided in paragraph (a)(4) of this section, in the case of a Subscription Offering through which an End User can listen to sound recordings in the form of Eligible Interactive Streams or Eligible Limited Downloads from a portable device, the royalty floor is the aggregate amount of 50 cents per subscriber per month.

(4) *Bundled Subscription Offering.* In the case of a Bundled Subscription Offering, the royalty floor is the aggregate amount of 25 cents per month for each Active Subscriber.

(b) *Computation of royalty floors.* For purposes of paragraph (a) of this section, to determine the royalty floor, as applicable to any particular Offering, the total number of subscriber-months for the Accounting Period shall be calculated by taking all End Users who were subscribers for complete calendar months, prorating in the case of End Users who were subscribers for only part of a calendar month, and deducting on a prorated basis for End Users covered by an Offering subject to subpart D of this part, except in the case of a Bundled Subscription Offering, subscriber-months shall be determined with respect to Active Subscribers. The product of the total number of subscriber-months for the Accounting Period and the specified number of cents per subscriber (or Active Subscriber, as the case may be) shall be used as the subscriber-based component of the royalty floor for the Accounting Period. A Family Plan shall be treated as 1.5 subscribers per month, prorated in the case of a Family Plan subscription in effect for only part of a calendar month. A Student Plan shall be treated as 0.50 subscribers per month, prorated in the case of a Student Plan End User who subscribed for only part of a calendar month.

Subpart D – Promotional Offerings, Free Trial Offerings and Certain Purchased Content Locker Services

§385.30 Scope.

This subpart establishes rates and terms of royalty payments for Promotional Offerings, Free Trial Offerings, and certain Purchased Content Locker Services provided by subscription and nonsubscription digital music Service Providers in accordance with the provisions of 17 U.S.C. 115.

§385.31 Royalty rates.

(a) *Promotional Offerings.* For Promotional Offerings of audio-only Eligible Interactive Streams and Eligible Limited Downloads of sound recordings embodying musical works that the Sound Recording Company authorizes royalty-free to the Service Provider, the royalty rate is zero.

(b) *Free Trial Offerings.* For Free Trial Offerings for which the Service Provider receives no monetary consideration, the royalty rate is zero.

(c) *Certain Purchased Content Locker Services.* For every Purchased Content Locker Service for which the Service Provider receives no monetary consideration, the royalty rate is zero.

(d) *Unauthorized use.* If a Copyright Owner or agent of the Copyright Owner sends written notice to a Licensee stating in good faith that a particular Offering subject to this subpart differs in a material manner from the terms governing that Offering, the Licensee must within 5 business days cease Streaming or otherwise making available that Copyright Owner's musical works and shall withdraw from the identified Offering any End User's access to the subject musical work.