Before the

UNITED STATES COPYRIGHT ROYALTY BOARD

Library of Congress

Washington, D.C.

ORIGINAL

In Re:	Docket No. 15-CRB-0001-WR (2016-2020) Volume 1-PUBLIC Pages 1-239
Determination of Royalty Rates and Terms for Ephemeral Recording and Digital Performance of Sound Recordings (Web IV)	

PUBLIC SESSION

Washington, D.C.

Monday, April 27, 2015

The hearing in the above-entitled matter was convened at 9:30 a.m.

BEFORE COPYRIGHT ROYALTY JUDGES:

SUZANNE M. BARNETT, CHIEF JUDGE

DAVID R. STRICKLER, JUDGE

JESSE FEDER, JUDGE

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1 (THIS BEGINS PUBLIC SESSION)
2 P R O C E E D I N G S
3 CHIEF JUDGE BARNETT: Good morning.
4 Please be seated.
5 I was telling my friends I'm not a
6 real judge. I just play one at work, but with
7 all of the suits and the boxes and the binders,
8 suddenly I feel like a real judge again.
9 Well, good morning, all.
10 Is anyone having any trouble hearing
11 me?
12 Please let me know -- you are?
13 Okay. I will see if I can -- is
14 that any better?
15 Oh, okay. At any time during these
16 proceedings if anyone has trouble hearing,
17 please let us know. We -- otherwise, we will
18 not be aware and you could miss out on
19 something really exciting.
20 Today marks the commencement of the
21 copyright royalty judge's hearing to Determine
22 Terms and Royalty Rates for the Ephemeral
23 Reproduction and Digital Performance of Sound
24 Recordings during the period January 1st, 2016
25 to December 31st, 2020.

1 For those of you I have yet to meet,
2 I am Judge Suzanne Barnett. Seated to my right
3 is Judge Jessie Feder. Seated to my left,
4 Judge David Strickler.
5 Our attorney advisor, Mrs. Kim
6 Whittle has been drafted for the duration to
7 act as clerk of the court. She is seated over
8 in the spotlight. She will manage all exhibits
9 and keep the official record of admitted and
10 refused exhibits. At the end of the hearing,
11 she will also work with your staff to return or
12 destroy exhibits that you did not offer or that
13 the judges refused.
14 Seated at the back of the room at
15 the last row of tables is our senior counsel,
16 Mr. Rich Strausser. Richard Strausser. He
17 might and might not attend all days, but he is
18 here certainly for the beginning and what we
19 hope will be a very interesting session today.
20 You -- I'm sure you've all met our
21 court reporters today. On duty is Ms. Bonnie
22 Russo and she will be trading off with Ms.
23 Michele Eddy. They will be rotating. We have
24 two reporters, so we can all have daily
25 transcripts without having to take time off to

1 resuscitate the court reporter.
2 Please respect the skill and
3 patience of the reporters by speaking one at a
4 time clearly and at a conversational rate.
5 We have 13 participants in this
6 hearing, this proceeding, excuse me. Some are
7 jointly represented by Counsel. We anticipate
8 some ebb and flow of counsel witnesses and
9 guests during the course of the hearing. We
10 ask that anyone entering or leaving the hearing
11 room do so without disturbing the ongoing
12 proceedings to the extent possible. We have
13 crowded the room and rearranged tables and
14 welcomed shelving and technology and so forth
15 to accommodate this hearing. As a result, in
16 the counsel table rows, some power and data
17 monuments on the floor could present a tripping
18 hazard. Be alert. You have been warned. We
19 know they are there. Now you know they are
20 there.
21 All of the parties have brought in
22 voluminous materials all over the room and so
23 we ask that you exercise care and courtesy when
24 you are gaining access to those materials or
25 moving about the hearing room. As on the side,

1 it is public knowledge, indeed, it is
2 statutorily mandated that the judges employe
3 three full-time staff members total. While our
4 program specialist, administrative specialist
5 was in the process of wrangling dozens of
6 banker's boxes of binders and documents for
7 this proceeding, one of our folding tables
8 collapsed, dumping table boxes and all on our
9 program specialist. For the past week, she has
10 been on leave nursing an injured back. She
11 expects and we hope for a full recovery, but
12 that means our total person power for the past
13 week has been five strong.
14 Now, in the interest of full
15 disclosure, I want to state that many of the
16 participants in this proceeding who work with
17 larger teams have pitched in generously. We
18 welcomed, thankfully, that assistance with
19 logistics, technology, document preparation and
20 moral support. The staffs of the participants
21 work with our attorney advisor. The judges do
22 not know, and therefore cannot be influenced by
23 which participants in particular provided the
24 necessary assistance, but we do want you all to
25 know that we appreciate it greatly.

1 There are some loose ends. Motions
2 and amendments and supplements continue to flow
3 into our office until late in the day last
4 Friday. We, as a panel, have not discussed the
5 contents of the papers filed within the last
6 week. A partial list includes Pandora's
7 objections to Mr. Johnson's exhibits; service
8 participants objections to Mr. Johnson's
9 exhibits; SoundExchange motions in limine;
10 SoundExchange motion to strike portions of
11 testimony; service participants objections to
12 SoundExchange exhibits; SoundExchange response
13 to iHeart response to SoundExchange evidentiary
14 objections; service participants objections to
15 SoundExchange proposed supplemental exhibits;
16 iHeart second supplemental exhibit list;
17 National Religious Broadcasters supplemental
18 exhibits and amended exhibit list; NAB
19 supplemental exhibit and amended exhibit list;
20 iHeart emergency motion challenging
21 SoundExchange's assertion of privilege and
22 attempt to clawback documents. And some of
23 those arrived in our second mail delivery on
24 Friday. Really.
25 To the extent you need guidance on

1 any of those pending motions for the purposes
2 of your opening statements today, you may
3 assume that all requests were not filed or are
4 denied. If, after they are able to consult, or
5 we are able to consult the judge's change that
6 position, you may adjust your presentation of
7 evidence accordingly. Opening statements are
8 meant as a guide to assist the judges. The
9 statements and comments of Counsel are not
10 evidence. The evidence will be the evidence.
11 The judges will focus on the evidence and will
12 not impose demerits on Counsel for -- or
13 parties for evidence that is inconsistent in
14 any particular with the opening statements.
15 This proceeding shall follow a
16 pattern. All parties will have an opportunity
17 to make an opening statement describing what
18 they expect their evidence to show. Licensors
19 and record companies will then present the
20 direct case detailing their proposed rates and
21 terms and the support therefor. After the
22 licensors complete presentation of direct case,
23 the licensee services, that's users of the
24 copyright and sound recordings, will present a
25 rebuttal to the licensors' direct case. The

1 licensee services will then have an opportunity
2 to present the direct case detailing their
3 proposed rates and terms and the support
4 therefor. Following the licensee services
5 presentation, the licensors will have an
6 opportunity to rebut. Counsel will examine
7 their witnesses and all other parties may
8 cross-examine each witness.
9 At the end of the presentation of
10 all the evidence, direct and rebuttal, the
11 parties will have an opportunity to make
12 closing arguments, sometimes called a
13 summation, in which they state the applicable
14 law and the way they wish the judges to apply
15 that law to the evidence. Closing arguments
16 are currently scheduled for June 3rd.
17 If you are in this hearing room
18 today, you are undoubtedly aware that the
19 issues the judges must consider require review
20 of sophisticated economic analyses,
21 confidential business strategies, and sensitive
22 financial information.
23 Early in the proceeding, the judges
24 issued a protective order requiring every
25 participant to follow a protocol to maintain

1 and protect the confidential nature of
2 information the parties rely upon to advocate
3 for a desired royalty rate. The fact that this
4 is an open hearing does not override the
5 parties' need to protect their confidential
6 business information. Throughout all the early
7 phases of this proceeding, all parties have
8 diligently marked and edited confidential
9 documents and have filed copies of all
10 documents redacted for public viewing along
11 with restricted documents for the judges'
12 review.
13 Whenever a party needs to question a
14 witness regarding restricted documents, the
15 judges will direct that any person in the
16 hearing room, who has not signed an appropriate
17 nondisclosure certificate, to leave the room
18 and wait outside until we reopen the room. The
19 first time we will need to close the hearing
20 room is today for the parties to describe
21 adequately the range and the import of their
22 evidence they need to discuss and display
23 confidential information. The parties will
24 begin with the public opening statement. Then
25 we will close the room and hear the

1 confidential portions of the parties' opening
2 statements.
3 Counsel, we understand that some of
4 you have the realtime transcript streaming to
5 your offices. Be advised that the protective
6 order applies to your office and assure that no
7 individual is privy to the realtime stream
8 unless that individual is permitted by the
9 protective order. We appreciate your
10 cooperation in this process.
11 At this time, I ask that lead
12 counsel for each party -- we'll just go down
13 this side and come back up this side -- lead
14 counsel, please stand, identify yourself for
15 the record, introduce your client,
16 representatives, your co-counsel, and staff who
17 are here.
18 MR. POMERANTZ: Good morning, Your
19 Honor.
20 I'm Glenn Pomerantz, and I'll be
21 representing SoundExchange in this proceeding.
22 CHIEF JUDGE BARNETT: Pleased to
23 meet you, Mr. Pomerantz.
24 MR. POMERANTZ: Thank you.
25 CHIEF JUDGE BARNETT: I think this

1 is our first meeting.
2 MR. POMERANTZ: Yeah, and it's nice
3 to meet all of you.
4 Let me introduce my colleagues who
5 are sitting here at counsel table. This is Mr.
6 Kelly Klaus, Melinda LeMoine, Martha
7 Larraondo-Klipper, Jennifer Bryant, Jonathan
8 Blavin, Anjan Choudhury of our office. I
9 skipped Mr. Collin Rushing, who is the general
10 counsel of SoundExchange.
11 There's other people in the room in
12 the back who are also either with our firm or
13 with SoundExchange, and I'm sure you will get a
14 chance to meet them during the course of the
15 proceeding, but this is probably sufficient for
16 right now.
17 CHIEF JUDGE BARNETT: Thank you.
18 Mr. Pomerantz, I understood that
19 SoundExchange was going to be sharing table
20 space with Mr. Johnson.
21 Is Mr. Johnson here?
22 MR. POMERANTZ: I understood that,
23 too, and I thought I was sharing some time
24 today with him. So we'll have to wait and see,
25 but I -- I don't know what his schedule is.

1 CHIEF JUDGE BARNETT: Nor do we.
2 Thank you.
3 Mr. Fakler, good morning.
4 MR. FAKLER: Good morning.
5 And, Your Honor, my name is Paul
6 Fakler. I'm with the firm of Arent Fox. I am
7 here today on behalf of SiriusXM Radio. I'm
8 working with my colleagues Martin Cunniff,
9 Jackson Toof, as well as Patrick Donnelly, who
10 is the executive vice president and general
11 counsel of SiriusXM Radio, as well as Cynthia
12 Greer, vice president and associate counsel.
13 CHIEF JUDGE BARNETT: Thank you.
14 Last but not least row.
15 MR. STEINTHAL: Kenneth Steinthal
16 from King & Spalding for NPR. We were not
17 expecting to be here at some point today. I'll
18 address why we're here today. We're working
19 that out with the participants. I just need a
20 little bit of time.
21 CHIEF JUDGE BARNETT: I expected
22 that -- well, I wasn't sure how NPR and CBI
23 were going to cope with the fact that your
24 agreements are still pending, so...
25 MR. STEINTHAL: Correct.

1 And that's -- we can do that now or
2 do it later.
3 CHIEF JUDGE BARNETT: Let's do it
4 later.
5 Okay. Someone here representing
6 CBI?
7 MR. GOLDEN: Your Honor, David
8 Golden from College Broadcasters. A short
9 statement.
10 CBI is a settled party. They have
11 jointly moved with SoundExchange -- CBI is a
12 settled party. They have jointly moved with
13 SoundExchange to have their settlement adopted
14 as a statutory rates in terms for noncommercial
15 educational broadcasters. The settlement was
16 submitted pursuant to 17 U.S.C. 801(b)(7)(A).
17 That was published for comment and received.
18 Thank you.
19 CHIEF JUDGE BARNETT: Thank you.
20 Now, beginning at this back.
21 Malone.
22 MR. MALONE: Good morning, Your
23 Honor. I'm William Malone. I represent two
24 parties here. The first is the Intercollegiate
25 Broadcasting System, and the second is the

1 Harvard Radio Broadcasting Company,
2 Incorporated, the licensee of station WHRB in
3 Cambridge, Massachusetts. I am unaccompanied.
4 CHIEF JUDGE BARNETT: Thank you.
5 Good morning.
6 MR. JOSEPH: Good morning, Your
7 Honor.
8 Bruce Joseph of Wiley Rein
9 representing the National Association of
10 Broadcasters. I am here with a number of
11 colleagues. My partner, Karyn Ablin and
12 Michael Sturm, who will also be involved. I
13 have a number of people in the back, maybe we
14 can introduce them later or I can introduce
15 them now if you would prefer.
16 CHIEF JUDGE BARNETT: Let's do it --
17 well, go ahead. Let's meet them all.
18 MR. JOSEPH: Okay. Colleagues
19 Christopher Mills, Leslie Weeks. Along in the
20 back, Jennifer Elgin.
21 CHIEF JUDGE BARNETT: Good morning.
22 MR. JOSEPH: And we have here the
23 associate general counsel of NAB, Ms. Suzanne
24 Head and another lawyer who is working with us
25 on behalf of NAB, David Oxenford.

1 CHIEF JUDGE BARNETT: Thank you.
2 Mr. Joseph, I think we've met only
3 once and it was across the street. We
4 haven't -- you haven't been in here in room
5 with us, with this particular panel.
6 MR. JOSEPH: I have not had that
7 honor, Your Honor. We did meet at another
8 hearing, as I recall.
9 CHIEF JUDGE BARNETT: That's right.
10 MR. HANSEN: Good morning, Your
11 Honor.
12 Mark Hansen. With me is John Thorne
13 of Kellogg Huber, representing iHeartRadio. At
14 the table is Tres Williams, Mr. Rob Walls, Ms.
15 Donna Schneider, counsel at iHeartRadio. Mr.
16 Rob over there on the technology table. We
17 will be seeing his wizardry and we have other
18 colleagues in the courtroom, which I'm sure you
19 will come to know during the course of the
20 hearing.
21 Thank you, Your Honor.
22 CHIEF JUDGE BARNETT: Thank you.
23 Mr. Rich, we meet again.
24 MR. RICH: Good morning, Your Honor.
25 Nice to meet Judges Feder and Strickler.

1 I'm Bruce Rich representing Pandora
2 Media. With me at the front table are my
3 partners Todd Larson and Ben Marks. Sandwiched
4 in between is Chris Harrison and legal counsel
5 to Pandora Media. In the far corner as
6 co-counsel is Jacob Ebin, a former colleague of
7 mine who is now with Akin Gump. And in the
8 back of the courtroom we have several other
9 lawyers, several of whom I think will stand up
10 and actually take and cross-examine witnesses,
11 which is wonderful. Reid Collins, David
12 Yolkut, Jennifer Ramos, our trustee paralegal,
13 and we are pleased to be here.
14 CHIEF JUDGE BARNETT: Thank you.
15 MR. RICH: Oh, let me -- I did
16 neglect another co-counsel, Gary Greenstein,
17 who is also, I think, in the courtroom. There
18 he is. Gary.
19 MR. JOSEPH: Your Honor. I'm sorry
20 to get back up, but I should mention that my
21 colleague Karyn Ablin will be taking the lead
22 for National Religious Broadcasting licensing.
23 CHIEF JUDGE BARNETT: You
24 anticipated my question.
25 Thank you, Mr. Joseph.

1 Mr. Pomerantz, you may begin your
2 public opening statement.
3 MR. POMERANTZ: Thank you, Your
4 Honor.
5 Most of the materials that I'll be
6 using I'll put up on the screens for Your
7 Honor, but there are a few materials that I'll
8 direct your attention to that are confidential,
9 and I will just look at them in the binder. If
10 I may hand the binder to Your Honor and spread
11 them around to other counsel?
12 CHIEF JUDGE BARNETT: Certainly.
13 MR. POMERANTZ: Thank you.
14 CHIEF JUDGE BARNETT: And you will
15 forgive us if we turn our back to look at the
16 wall.
17 MR. POMERANTZ: I understand that,
18 Your Honor.
19 I have -- how many -- can I
20 approach, Your Honor?
21 CHIEF JUDGE BARNETT: Yes, please.
22 You may. Whether you can is a different
23 matter.
24 Good morning.
25 MR. POMERANTZ: I had thought I was

1 splitting my time with Mr. Johnson and so what
2 I had anticipated, since you had assigned us
3 two hours of time, and as one of my colleagues
4 had discussed with Mr. Johnson was that he
5 asked for 15 minutes. So I understood that I
6 would have an hour and 45 minutes. I will
7 divide that up between this morning's public
8 opening and probably this afternoon's
9 confidential.
10 CHIEF JUDGE BARNETT: We don't know
11 his schedule, but just keep an eye on the
12 floor. He might come in. I don't know him. I
13 haven't met him, so...
14 MR. POMERANTZ: We are both in the
15 same boat. I have not met him either and
16 wouldn't recognize him; but, hopefully, he'll
17 acknowledge who he is when he enters the room.
18 CHIEF JUDGE BARNETT: Okay. Great.
19 Thank you.
20 MR. POMERANTZ: At the outset of
21 this proceeding, this board issued a notice
22 with some important questions. You asked about
23 the possibility of establishing a rate that is
24 based on a percentage of revenue, at least in
25 part. And you asked whether the differences

1 among the buyers and sellers in this market
2 might affect the rates. And you asked several
3 other important questions. And you also issued
4 an early order in this proceeding in which you
5 asked us to provide you with a thick market of
6 agreements so that you can better understand
7 the market.
8 Over the next five weeks, we will do
9 our best to answer your questions and we will
10 provide you with that thick market of
11 agreements. And, at the end of the day, we
12 think the evidence will prove four things. And
13 I'm going to start using the slides now.
14 First, we will prove that the
15 interactive service agreements are the most
16 reasonable benchmarks, and we say that for
17 several reasons. Perhaps, most importantly,
18 though, it's because consumer behavior has made
19 interactive services and non-interactive
20 services closer than ever.
21 I'm holding my phone. This is how
22 most people today listen to music. Most people
23 listen to music through their phones. And what
24 they are looking for is a series of songs that
25 fits their own personal tastes, and that's what

1 you get when you listen to your personalized
2 radio stations from Pandora or iHeart. And
3 that's also what you get when you listen to the
4 playlist that you create on Spotify and other
5 interactive services.
6 So, today, Pandora and iHeart,
7 statutory Webcasters, are competing head to
8 head with Spotify and other interactive
9 services for the very same listeners; the ones
10 who want to listen to music on their mobile
11 devices.
12 Consumers do not care whether a
13 service is called noninteractive or
14 interactive. All they care about is accessing
15 music that they like, that fits their own
16 personal desires and interests. And if the
17 experience that consumers have with interactive
18 and non-interactive services are getting
19 closer. And if the competition between
20 noninteractive and interactive services are
21 getting closer, then economics is going to tell
22 us that the terms of their agreements would get
23 closer if there wasn't a statutory license.
24 Now, there still would need to be
25 some adjustment for interactivity. One has it,

1 the other doesn't. But the interactive service
2 agreements are an even better benchmark today
3 than five years ago when this panel had the Web
4 III proceeding.
5 The second thing that we will prove
6 in this hearing is that the Apple agreements
7 with Sony and Warner for the iTunes radio
8 service also support our rate proposal. When
9 we look at the rates and terms in those
10 agreements, we'll see that they're much closer
11 to the rate proposal offered by SoundExchange
12 than the rate proposal offered by the services.
13 And that's regardless of whether you look at
14 the rates derived from the projections of the
15 parties when they entered into the contract or
16 the rates derived from the actual usage and
17 payments under the contracts as they have been
18 performing.
19 Third, we will show that virtually
20 all of the benchmark agreements offered by all
21 of the participants use a greater-of rate
22 structure. These agreements generally require
23 a service to pay the greater of two or three
24 things. There's usually a minimum floor. The
25 minimum floor is either on a per stream basis

1 or it's on a per subscriber basis or both. And
2 then it's a greater of that or a specified
3 share of the revenue.
4 And the uniform usage of the
5 greater-of formulas and all the market
6 agreements you're going to see tells us
7 something very important. It tells us that if
8 there wasn't a statutory license, the record
9 companies and the Webcasters would agree to a
10 greater-of formula because that's what's
11 happening in the marketplace. And that's why
12 our proposal has a greater-of formula.
13 And, fourth, what you will see is
14 that the services rate proposals are
15 unreasonable. Rate proposals have been
16 submitted not just by us, but by Sirius,
17 Pandora and iHeart and NAB. And here is our
18 rate proposal right here. We will see what's
19 the current Web III rates are, and this is our
20 proposal. We continue on from 2016 to 2020,
21 and then we have a greater-of formula where you
22 have either the per-play rate or a sharing of
23 55 percent of the revenue amongst the copyright
24 owners. That's our proposal.
25 Here is the proposal that's offered

1 by the services compared to ours. And I'm
2 focusing right now on the per-play rates.
3 There is ours. Sirius has -- I'm going to say
4 $0.16 because it's just easier than all the
5 zeros. I think others might use the same
6 terminology. Hopefully, we can all agree on
7 that.
8 Pandora is at 11, and then slightly
9 increasing over time. IHeart is $0.05 and so
10 is NAB.
11 I would note there's a footnote to
12 Pandora. Pandora joins us in a greater-of
13 formula. They have a lower percentage of
14 revenue that's shared, but they also have a
15 greater-of formula in their proposal.
16 Now, let me try to put these
17 proposals into context. This is what the
18 parties are proposing. I'm just comparing the
19 current rates, 2015 CRB rates, to what the
20 per-play rates are that each party proposes in
21 2016. And you can see that we're proposing a
22 slight uptick. Sirius is proposing a 30
23 percent decrease. Pandora, more than 50
24 percent. And iHeart and NAB, almost 80
25 percent.

1 What these services proposals are
2 telling us is they believe something is
3 terribly wrong in the market and that drastic
4 measures need to be taken to fix it. Well, we
5 strongly disagree with that, and we think the
6 evidence will show that there is nothing
7 drastically wrong with the Webcasting market.
8 We think the evidence is going to show that
9 that market is already shown significant
10 growth, as well as significant innovation. And
11 we think that the evidence will show that our
12 proposed benchmark agreements and our rate
13 proposal is exactly what a willing buyer and a
14 willing seller would agree to in a world in
15 which there wasn't a statutory license.
16 Now, I have already introduced to
17 you the members of our team. We're really
18 pleased to be her. It's our first time in
19 front of this panel, and it's been an
20 interesting trip so far. Looking forward to
21 the next five weeks.
22 I failed to mention our technology
23 colleague, Phil Nichols. And you'll -- Mr.
24 Nichols can bring up any documents that you
25 need during the course of the proceedings, if

1 that proves necessary.
2 And our firm has been privileged to
3 work with SoundExchange, our first time also
4 working with SoundExchange. And while it is
5 our firm's first time in these proceedings,
6 it's certainly not SoundExchange's first time.
7 As in prior proceedings,
8 SoundExchange is here representing artists and
9 record companies, established artists, and
10 artists who are still trying to break through,
11 the three major record companies, as well as
12 thousands of independent labels. SoundExchange
13 has been proud to serve as the entity that
14 collects the royalties and distributes them to
15 the artists and represent -- and the record
16 companies, and they certainly hope to continue
17 in that role in the future.
18 In the course of our case, you're
19 going to hear from every constituency of
20 SoundExchange. Here's a list of our witnesses,
21 and I have organized them by constituents.
22 There will be witnesses from SoundExchange,
23 itself. We'll have representatives from each
24 of the major record companies. We will have
25 representatives from four independent record

1 companies. I see three and one record company
2 -- I'm sorry. Independent record company
3 agent, Merlin, and you will have artists and
4 artist representatives. You'll hear from all
5 facets of SoundExchange.
6 And then you will also hear from a
7 series of experts. This is, obviously, an
8 economically driven exercise and there's a
9 number of economists. These are the economists
10 that you will here from, as well as a survey
11 expert, Ms. Butler. And we hope that through
12 the -- our presentation of all of this
13 testimony, we will provide you with a broad and
14 a detailed look into the music streaming
15 market.
16 The services, of course, are going
17 to have a lot of witnesses of their own. And
18 I'm guessing that we're going to have some
19 disagreements between the witnesses as to
20 certain facts. But I actually think there's
21 two facts that every witness is going to agree
22 on, and so let me start with the facts -- and I
23 think every witness is going to agree.
24 Here is the first fact: More and
25 more consumers are using streaming services to

1 access music. For decades, people in the
2 industry and probably a lot of us outside the
3 industry kind of referred to music products by
4 their format; vinyl, cassettes, CDs, downloads.
5 CHIEF JUDGE BARNETT: Eight track.
6 MR. POMERANTZ: Eight track.
7 Today, people in the industry don't
8 tend to refer to music products by format.
9 They tend to refer to it by business model.
10 And the two business models you're going to
11 hear about are what's called the ownership
12 model and the access model.
13 The ownership model refers to sales
14 of music products that people who own -- you
15 own a CD or you own the download. What you
16 will see is that consumers are moving away from
17 owning music products. This slide shows you
18 what's happening with CDs. It's declining year
19 after year after year. This shows 2005 to
20 2013.
21 JUDGE STRICKLER: Mr. Pomerantz, I
22 have a question for you. Which, if any, of
23 your economic experts will use an access model
24 to describe the value of the proposed rates as
25 opposed to any other model?

1 MR. POMERANTZ: I think that
2 Professor Rubinfeld's course look at the
3 agreements that were reached between record
4 companies and streaming services. And so to
5 that extent, it's focused on the access model
6 because streaming services, as I'll get to,
7 that is the access model. And then Professor
8 Talley will also be focused on that. I think,
9 actually, all of our experts, because they're
10 focused on what's happening in the streaming
11 business much more so than what's happening
12 with compact discs or downloads, will be
13 focused on what I would call the -- what they
14 call the access mode.
15 And then downloads has taken a turn.
16 Here is what's happening with downloads. It
17 was going up until 2012. And now sales of
18 downloads through the iTunes store, which is
19 the -- by far, the largest retailer of
20 downloads, and other download retailers,
21 they're declining. It went down in 2013,
22 further down in 2014, and initial numbers show
23 going down again in 2015.
24 Now, the access model, as we just
25 discussed, that refers to streaming services;

1 both interactive and noninteractive. They're
2 access models. Because what they do is they
3 allow ready access to a large catalog of music.
4 You don't own it, but you have access to it.
5 And consumers are moving to the access model in
6 numbers that are absolutely staggering and
7 absolutely fast.
8 Here is what see in the numbers.
9 This is the number of people in America who are
10 using a streaming service each week. And you
11 can see how it's grown dramatically. The last
12 time we were here on a Webcasting proceeding in
13 2010, 43 million Americans were listening to a
14 streaming service each week. Now it's in the
15 94 million. That's -- greater than one in four
16 Americans access music every single week
17 through a streaming service.
18 And the listening hours have gone
19 through the roof. This is how many hours each
20 of those listeners is listening to a streaming
21 service each week. So back in 2010, it was
22 eight hours a week, and now it's over 13 hours
23 a week, on average, that a streaming listener
24 is listening to music through a streaming
25 service.

1 It's not just the usage of these
2 services that has changed. What's also changed
3 is the platform they're using to access it.
4 What this chart shows is what the movement from
5 using -- listening to a streaming service with
6 your desktop computer to listening to music
7 with a mobile device. This is Pandora's
8 numbers. And you see just five years ago, in
9 the first quarter of 2010, only 14 percent of
10 Pandora's users were listening to Pandora
11 through a mobile phone. And now in the middle
12 of 2014, it's 80 percent.
13 The mobile device is becoming the
14 primary platform for listening to music through
15 these streaming services. Given this dramatic
16 change, it's not surprising that a lot of
17 companies have entered the streaming business,
18 because when consumers go there companies
19 follow. Some of the biggest and most powerful
20 companies in America have entered the streaming
21 business since 2010, since Web III; Google,
22 Apple, Amazon, and so have a lot of others
23 entered the business, startups, innovators,
24 both statutory Webcasters and interactive
25 services.

1 There's been a lot of entry since
2 2010 because that's where consumers are going.
3 So, of course, that's where businesses go. And
4 Pandora stands out. We've got to mention
5 Pandora. It's by far and away the most popular
6 noninteractive in this country.
7 Let's look at Pandora's group. Just
8 Pandora. In 2011, Pandora had 29 million
9 active listeners. By the beginning of last
10 year, they had 75 million active listeners.
11 And I think Pandora is now recording over 80
12 million active listeners. That's a lot of
13 people in America using Pandora to listen to
14 music.
15 This shows the listening hours.
16 This is listening hours on Pandora. And those
17 numbers, those are billions of hours.
18 So, in 2011, Pandora listeners
19 listened to 7.8 billion hours of music. And,
20 in 2014, it's over 20 billion hours.
21 And, of course, Pandora dominates
22 the Webcasting space. This is Pandora data. I
23 think it may be before the iTunes radio service
24 entered the market. But this shows Pandora's
25 share, according to Pandora, at the time this

1 chart was created in the last few years, couple
2 of years. And, at that time, they had 77.6
3 percent of the Webcasting market. IHeart was
4 second at 10 percent. And everybody else had
5 smaller amounts.
6 And I should also highlight Spotify.
7 Spotify is not a statutory service. It has
8 on-demand features. It was not even in the
9 market in the United States in 2010, the last
10 time that it was a Webcasting proceeding. It
11 entered in 2011.
12 Today, Spotify is by far the largest
13 subscription music streaming service in
14 America. It dominates the subscription music
15 streaming space.
16 Now, this shift in consumer behavior
17 has, of course, shifted the revenue of the
18 record companies. What you see in the red on
19 the bottom is streaming. And in just the last
20 three years, it's grown from a billion dollars
21 to $1.9 billion. Very dramatic growth. And
22 you can see that in 2014 it now exceeds CD
23 revenue. And you can see that the download
24 revenue is declining.
25 The projections are that streaming

1 revenue is going to quickly overtake the
2 download revenue, and certainly during the next
3 term, the 2016 to 2020 term, streaming will
4 overtake downloads.
5 Now, let me go to the second fact
6 that I think where all the witnesses will agree
7 to, and that's as consumers' listening habits
8 evolve, so do the streaming services. That's
9 just basic economics. Supply and demand. What
10 consumers want, businesses try to provide.
11 At the time of the Web III hearing
12 in 2010, the difference between what a
13 noninteractive service was and what an
14 interactive service was seemed pretty clear at
15 the time. An interactive service was
16 on-demand. You can pick what music you want to
17 listen to and it plays it. And noninteractive
18 meant that the service basically picked the
19 music for you, although you could, as a user,
20 influence what they delivered to you. And that
21 was the basic sense.
22 Today, it's not quite so simple,
23 because as consumer behavior has changed, both
24 noninteractive and interactive services have
25 responded to it. I think what would be helpful

1 just to make sure we're all starting at the
2 same place is to see exactly how Pandora works
3 and how iHeart works, the two leading statutory
4 Webcasters; and how Spotify works, the largest
5 non-statutory streaming service. And you will
6 see how they're trying to meet what consumers
7 want.
8 So here is Pandora. And what
9 happens is when you start a Pandora, this is
10 the very first thing that you see. And I went
11 to my colleague, Mr. Choudhury back there, and
12 I said Mr. Choudhury, Anjan Choudhury, I said,
13 who is your favorite artist. And whether he
14 actually said this or not, what I wrote down
15 was Katy Perry. And so I said, okay, we're
16 going to use Katy Perry. And when you enter
17 Katy Perry, this is what happens on Pandora.
18 Up in the upper left, you get a Katy Perry
19 radio station. And the very first track that
20 Pandora plays for you, at least played when we
21 were doing this experiment, was "Last Friday
22 Night." See that there by Katy Perry.
23 And I asked Mr. Choudhury: Do you
24 like "Last Friday Night"?
25 He said, yeah, I really do. So we

1 clicked the thumbs-up button at the top and
2 that's a message to the Pandora algorithm that
3 Anjan likes "Last Friday Night" by Katy Perry,
4 and the algorithm remembers that so that the
5 next time Mr. Choudhury comes back and he
6 clicks on his Katy Perry radio station, it will
7 remember that he likes "Last Friday Night" and
8 it will make sure that's in the mix of music
9 that he hears. When that song is over, Pandora
10 plays the next one and it's a song below by
11 Kesha. And it's an artist that Pandora's
12 algorithm thinks is like Katy Perry and that
13 Mr. Choudhury will like it, Kesha -- "Blow" by
14 Kesha.
15 But the algorithm wasn't quite right
16 this time, and Mr. Choudhury said, you know, I
17 don't really like "Blow" by Kesha. I like
18 Kesha, but not "Blow." So it gives him a
19 thumbs down, and that tells the Pandora
20 algorithm don't include this song on my Katy
21 Perry radio station. And so it goes on.
22 And the third track he got was
23 "Teenage Dream" by Katy Perry, and this is
24 actually what happened when we did this. So
25 you can see that in the two of the first three

1 songs when we entered Katy Perry, Pandora
2 delivered to Mr. Choudhury two Katy Perry
3 tracks. He likes this sounds, so he gives it a
4 thumbs up, and then the next song plays, and
5 it's "Shake It Off" by Taylor Swift. And Mr.
6 Choudhury likes Taylor Swift, but he just
7 doesn't want to listen to it right now. So he
8 clicks the skip button up at the top, and he
9 says skip this song.
10 Pandora's algorithm understands that
11 he wants to skip it, but not keep it off of his
12 particular radio station, and it goes to the
13 next track. And it's "Tick Tock" by Kesha.
14 This track, he actually likes. He doesn't
15 dislike Kesha. He just didn't like "Blow."
16 And so he gives it a thumbs up and says,
17 Remember to include this in my Katy Perry radio
18 station, and so it goes to the next track.
19 And that's the way that Pandora
20 works when you pick an artist. And you don't
21 just pick one radio station -- I'm sorry --
22 one -- you don't get only one radio station.
23 You can have many radio stations. So I asked
24 Mr. Choudhury, who are your other favorite
25 artists? And he gave me a list of others. He

1 said The Lumineers and Bleachers, and Vampire
2 Weekend, and Fun, all groups.
3 And what Pandora does is it creates
4 a separate radio station for each of those
5 artists, and Mr. Choudhury can influence what
6 is played for him by the thumbs up and thumbs
7 down. So that even if Mr. Choudhury and Mr.
8 Klaus both pick the Lumineers through their
9 thumbs up and thumbs down, they actually have
10 somewhat different radio stations. They would
11 both have the Lumineers, but they'd hear
12 different things based on what they liked and
13 what they didn't like.
14 And Pandora allows you not only to
15 keep -- to create a radio station by the name
16 of an artist, but you can also create a radio
17 station by the things you like to do, the music
18 you like to listen to when you're engaged in a
19 certain activity, because we all have certain
20 music we like in one setting and then maybe
21 different music that you like in a different
22 setting.
23 And so this is what Pandora allowed
24 Mr. Choudhury to do. He created a radio
25 station for his barbecues and for his working.

1 And when he's just relaxing or running or
2 driving, those are all different radio stations
3 that he can influence through the thumbs up and
4 thumbs down.
5 And so the way this works is when
6 you decide you want to listen to music, you
7 pick up your mobile device, you click on
8 Pandora, and there is your list of radio
9 stations you have created, and you have
10 influenced through your thumbs up and thumbs
11 down. And you decide what do I feel like
12 listening to right now, and you can pick a
13 radio station that you created that you
14 specially tailored to your personal taste with
15 thumbs up and thumbs down and you can create
16 many different stations depending on what you
17 want to listen to. That's basically how
18 Pandora works.
19 Now, I should say, Pandora worked
20 that way, largely, back in 2010. But what
21 changed was this. Now, Pandora goes
22 everywhere. Back in 2010, people weren't using
23 their mobile devices much to access Pandora.
24 You could, but people weren't doing it. But
25 now 80 percent are using their phone to access

1 music, and what that means is that you can get
2 Pandora virtually everywhere.
3 Here is a slide. This is a slide
4 that actually was created by Pandora for -- I
5 think for an investor presentation. And you
6 see Pandora everywhere in quotes because that's
7 a campaign that Pandora has established, and
8 they're telling the consumer you can get
9 Pandora everywhere. When you wake up in the
10 morning, you can listen to whatever station you
11 want to listen to in the morning, and while
12 you're drive to work, and at work, and when
13 you're driving home and when you get home in
14 the evening. Pandora is everywhere. You can
15 use it day and night. And this strategy that
16 they have, that people should use Pandora
17 everywhere, is working.
18 As you see, more and more users are
19 spending more and more time with Pandora.
20 That's what's happening. And, of course, that
21 means that they're spending less and less time
22 and less and less money on CDs and downloads.
23 And you see that happening, too.
24 Now, let me go to iHeart. Let's
25 talk about iHeart. IHeart, which used to be

1 called Clear Channel, and you'll see in the
2 documents that it's mostly referred to as Clear
3 Channel because they only changed their name, I
4 think, last year. They are the largest owner
5 of terrestrial radio stations in America; AM
6 and FM radio stations. They own a lot of them
7 all over the country.
8 And they then take those radio
9 stations and they simulcast them. They make
10 them available on the Internet for people to
11 listen to it. There are Terrestrial radio
12 stations on the Internet.
13 So when you go to iHeart, it looks
14 something like this. You can say, I want to
15 listen to country music, which -- what are your
16 country music radio stations?
17 And there are your country music
18 radio stations, and you can pick which one you
19 want to listen to. And so even though you may
20 be in Washington, D.C., you can listen to
21 Dallas or you can listen to Minnesota or New
22 York. You can listen to whatever radio station
23 you want. But iHeart realized this isn't where
24 consumers are going. Consumers want something
25 more personalized than just whatever an AM or

1 FM radio station is playing.
2 And so iHeart did something to their
3 simulcast service. What they did is this.
4 This is the iHeart simulcast service. And you
5 will see at the very top there's a search bar
6 there, and you see that I typed in Madonna.
7 And what iHeart does is when you type in
8 Madonna, they immediately take you to radio
9 stations that are now playing Madonna. So I
10 can't see -- but I think it's La Isla Bonita is
11 in -- playing in Los Angeles and Vogue is
12 playing in Savannah, Georgia. And so you can
13 sit there and immediately click on one of those
14 two stations and you will hear that track by
15 Madonna.
16 JUDGE STRICKLER: Can I interrupt
17 you a second, Mr. Pomerantz?
18 Will your witnesses testify that
19 when you click on the now playing button that
20 you join the song in progress?
21 MR. POMERANTZ: Yes, I believe
22 that's how it works. I believe that's how it
23 works.
24 And so what this allows the users to
25 do is to find an artist that they're interested

1 in, enter the name, and immediately be sent to
2 where that track is playing. So it's almost
3 on-demand. Almost on-demand.
4 Now, iHeart also has a customized
5 radio service, and this is an example of its
6 customized radio service. So you could
7 create -- Mr. Choudhury could go to iHeart's
8 customized service and do exactly what I just
9 showed you he did on Pandora where you can
10 start with Katy Perry and through your thumbs
11 up and thumbs down create a Katy Perry radio
12 station and all of the other radio stations.
13 Now, iHeart also offers customized service.
14 Now, let me talk about Spotify.
15 Spotify is not statutory. It has a premium
16 on-demand service. It has a free on-demand
17 service, something it calls mobile shuffle, and
18 it's custom radio service. Let me start with
19 its on-demand service. The on-demand service,
20 -- if we can go to the next slide -- this is
21 what happens: You can create a Katy Perry --
22 in Spotify, you wouldn't call it a radio
23 station. You'd call it a playlist. And what
24 you can is create a Katy Perry playlist. And,
25 basically, what you can do is pick your

1 favorite Katy Perry tracks and you can list
2 them in whatever order you want, and if you
3 want to put some other artists that you like
4 along with Katy Perry, you can add them to the
5 list, as well. And that's your Katy Perry
6 playlist.
7 And then you can do the same thing
8 for those other artists, Lumineers, and
9 Bleachers, and Fun, and you can create a
10 barbecue mix and you can create a driving mix,
11 and you can create all of those.
12 Now, it's a little different because
13 you're creating -- you're picking the
14 particular tracks. But the way consumers use
15 it is very similar. They pick up their phone
16 and they say, I want to listen to Katy Perry.
17 I'm going to go to my Katy Perry playlist. For
18 Pandora, you would go to your Katy Perry radio
19 station. Not exactly the same, but very close
20 from the consumer experience.
21 Same thing with barbecue music or
22 driving music. Again, not exactly the same,
23 but the consumers are creating playlists,
24 they're creating radio stations, and that's how
25 they're getting to their music so that they

1 have a group of songs that's tailored to what
2 they love. That's what Spotify is doing with
3 its on-demand service.
4 Now, the on-demand service has a
5 paid component where you pay a subscription and
6 a free subscription. If you pay the
7 subscription which is 9.99 a month right now,
8 it's come down. It was 15.99, 12.99. Right
9 now, Spotify's price is 9.99. What you get is
10 no advertisements and you can listen to it on
11 your desktop or on your mobile device.
12 You can also use Spotify's on-demand
13 service for free. There's two significant
14 differences. One is you have to listen to ads,
15 and the other is you can't take it on your
16 mobile device. It's only available on your
17 desktop. So that's Spotify's on-demand
18 services.
19 Now, Spotify also has other services
20 and they have a custom radio service. This is
21 basically exactly the same as iHeart and
22 Pandora. You can see the same playlist. It's
23 radio, so it's not on-demand. You basically
24 say what -- who you want, Spotify will deliver
25 the -- that artist or music from artists who

1 they think are similar to that artist, and you
2 can thumbs up and thumbs down and create radio
3 station exactly the same way you do on Pandora
4 and iHeart. So Spotify also offers a custom
5 radio service to its customers.
6 And then, last, Spotify has what it
7 calls its mobile shuffle service. And this is
8 a new service. It came out in December of
9 2013. And what it does is it allows you to, on
10 your phone, use something that is sort of in
11 between fully on-demand and customized radio.
12 What you can do is you can pick certain songs
13 or certain albums and you have to have a long
14 enough list. So I don't remember an exact
15 list, but something like an hour or more of
16 songs. And then Spotify will shuffle those
17 songs. So you don't know which one you're
18 going to get in which order, but you've picked
19 what songs you listen to. And if you don't
20 pick enough songs, then Spotify fills in the
21 gaps with songs that they think you will like
22 based on the songs that you selected. And
23 that's a shuffle service. It's also free, and
24 it's available on your mobile device.
25 So those are examples -- I've only

1 given you three examples. There's, obviously,
2 a lot more statutory services out there and a
3 lot more interactive services out there, but I
4 have given you examples of the three largest
5 players out there in the market.
6 So I would now like to turn to the
7 benchmarks that you're going to hear about in
8 this proceeding. Here are the benchmarks, at
9 least the primary benchmarks that are proposed
10 by each of the participants. We point to the
11 interactive agreement, the agreement between
12 record companies and interactive services as
13 our primary benchmarks. We believe also that
14 the agreement between Apple and Sony and Apple
15 and Warner fully corroborate our benchmark.
16 IHeart primarily points to its
17 agreement with Warner. It also points to
18 agreements it has with some indies. Pandora
19 focuses on its agreement with Merlin and that's
20 its primary benchmark. NAB does not offer any
21 agreement as a benchmark of other ways of
22 trying to get to a rate proposal. And SiriusXM
23 also does not propose any agreement as a
24 benchmark.
25 So I would like to start with our

1 benchmark, the interactive agreements. You
2 will hear witnesses from major and independent
3 record companies, and they are going to
4 describe for you those agreements and the rates
5 and terms in those agreements. They're going
6 to explain to you the basic economics of the
7 interactive service agreements. They're going
8 to explain to you why they agreed to those
9 terms and they're going to explain to you their
10 expectations, what they thought when they were
11 going into the deal.
12 They're also going to explain to you
13 how the deals turned out. Did it meet their
14 expectations or not?
15 And they'll explain to you why those
16 interactive agreements explained how they would
17 look at a deal between that record company and
18 a Webcaster if there wasn't a statutory
19 license. It tells you something about the way
20 the parties look at an agreement that is
21 reached in the marketplace.
22 Professor Rubinfeld will then take
23 those facts, what the witnesses say and the
24 agreements, and he will do two things: He will
25 explain why the interactive service agreements

1 provide a reasonable benchmark in this
2 proceeding, and he will also calculate rates
3 for the statutory license based on those
4 agreements.
5 I'm going to put the calculations to
6 one side and we'll deal with that this
7 afternoon, because you'll have to get into some
8 confidential information.
9 But Professor Rubinfeld will say
10 that there's three reasons why he thinks that
11 the interactive service agreements are good
12 benchmarks for Your Honor -- Your Honor to
13 consider in this proceeding. The first reason
14 is that there's a wide range of interactive
15 service agreements, and that ensures that the
16 benchmark is representative.
17 Up on the screen is a list of all of
18 the agreements that Professor Rubinfeld
19 considered in establishing his interactive
20 service benchmark. And what you will see from
21 this list is that it involves big record
22 companies and independent record companies.
23 You will see there is agreements with Universal
24 Music, the largest record company. And there's
25 also agreements that Professor Rubinfeld

1 considered with Beggars, and with Secretly
2 Canadian, independent record companies.
3 And you will also see that he
4 considered a broad range of streaming services.
5 You have Spotify, a very now large established
6 service. You have services offered by big
7 corporations like Google and Amazon. You have
8 niche players like Classical Archives, and you
9 have small startups like Yonder.
10 And this depth and this breadth of
11 agreements provides you with the confidence
12 that the rates and terms are truly reflective
13 of what happens in a marketplace. It's not
14 just a one-off aberration. You have confidence
15 that no one agreement is aberrational when you
16 can look at such a broad range of agreements
17 that are reached in the back and forth of the
18 marketplace.
19 Now, the second reason that
20 Professor Rubinfeld thinks that the interactive
21 service agreements are the most reasonable
22 benchmark is because they're less affected by
23 the statutory license. These services want to
24 offer some on-demand features, as well as
25 others; and, therefore, you can't just rely on

1 the statutory license. And I don't think it's
2 going to be disputed in this hearing that this
3 gives a big advantage to the interactive
4 service agreements because they are not nearly
5 as affected by the statutory license. They
6 aren't affected by the shadow of the statutory
7 license in the way that the benchmarks are that
8 are offered by the participants.
9 Here is some testimony from their
10 experts in this matter about this issue.
11 Professor Shapiro is on the top and he is the
12 economist for Pandora. And he says: "I agree
13 with Professor Rubinfeld that agreements signed
14 by statutory Webcasters are influenced more by
15 the availability of the statutory license than
16 are agreements signed by interactive services.
17 Professors Fischel and Lichtman are the experts
18 for iHeart. They said: "Admittedly, there is
19 a drawback associated with relying on evidence
20 from noninteractive licensing agreements.
21 These agreements were negotiated in the shadow
22 of the statutory rate."
23 The third reason Professor Rubinfeld
24 thinks that the interactive services provide
25 the best benchmark is because the differences

1 between an interactive service agreement and a
2 noninteractive -- an agreement that a
3 noninteractive service have reached can be
4 quantified and accounted for. And you will
5 see there will be a lot of discussion about the
6 interactivity interests. And I know Your
7 Honors are familiar with that. It can be
8 quantified and it can be accounted for, and
9 Professor Rubinfeld does so. And we'll discuss
10 that a little bit more this afternoon in the
11 confidential portion.
12 Now, I do want to respond directly
13 to some of the issues that Your Honors raised
14 in your Web III remand decision about the
15 interactive service benchmark that was used in
16 that case -- in that proceeding. There you
17 raised four concerns about the interactive
18 service benchmark, and we think we have
19 addressed each of those concerns. It's up on
20 the screen behind you.
21 We analyzed the ad-supported side of
22 the streaming market. We incorporated the
23 indie deals into our benchmark analysis. We
24 based our proposal on the most recent year of
25 data to account for the downward trends in the

1 rates. And we supported our interactivity
2 adjustment with a conjoint survey, not a
3 hedonic regression.
4 Let me explain the moment on the
5 conjoint survey. It was designed by Professor
6 Daniel McFadden, and you will meet Professor
7 McFadden in this proceeding. Professor
8 McFadden won the Nobel Prize in economics for
9 his work related to consumer choice. And it's
10 that expertise that we're drawing upon in the
11 conjoint survey. His conjoint survey analyzes
12 how consumers value interactivity and other
13 features of a streaming service. We'll present
14 that evidence in our direct case. You will
15 hear from Professor McFadden later this week.
16 Now, the services have raised
17 challenges to our reliance on the interactive
18 service agreements. Quite a lot of challenges.
19 I don't have time to address all of them this
20 morning, but I do want to go through one of
21 them. We'll get to the rest of them during the
22 course of the next five weeks.
23 The servicers' economists argue that
24 the interactive service agreements were not
25 negotiated in an effectively or workably

1 competitive market. One expert says
2 effectively competitive, the other one says
3 workably competitive. I think they both agree
4 that they are referring to the same thing. And
5 they tell you that because the market was not
6 workably competitive or effectively
7 competitive, you should just disregard those
8 agreements.
9 Now, the board has mentioned
10 effective competition in some of its earlier
11 decisions. I don't think the board has
12 provided what they would consider to be a hard
13 and fast definition what effective competition
14 is. But you certainly have given us some
15 indication of some factors that should be
16 considered. Whether the buyer or the seller
17 there is a pricing. Whether negotiations
18 between the parties are merely superfluous or
19 whether they're really meaningful. Whether the
20 negotiated rates approximate a monopoly.
21 Whether there are sufficient competitive
22 factors in the marketplace. Those are examples
23 of some of the factors.
24 We will show you that no matter what
25 definition you apply of effective competition

1 or workable competition or competition, we will
2 show you that the market for licensing
3 recordings through interactive services is
4 competitive.
5 Here is the basic premise of the
6 servicers' argument. They say streaming
7 services must have the catalogs of the three
8 major record companies to be successful. You
9 need to have all three catalogs, the three
10 major ones. And they say a market can't
11 possibly be competitive if there are must-have
12 subscribers. That's their argument.
13 Well, we don't dispute, at least,
14 the first part. That is to say we think the
15 major record companies may be must-have
16 suppliers for at least some streaming services.
17 But we very strongly disagree with the second
18 part of it. Just because there are must-have
19 suppliers does not mean that the market is
20 automatically not competitive. You have to
21 look at the market. You have to look at the
22 factors in the market and see how the market is
23 operating. You can't just jump to that
24 conclusion.
25 Now, when Universal acquired EMI,

1 which was then the fourth major record company,
2 when Universal acquired EMI back in 2012, the
3 transaction was reviewed by the FTC. And
4 Universal told the FTC that the major record
5 companies are must-haves for some streaming
6 services. I was counsel for Universal in that
7 transaction, in that merger, and Professor
8 Rubinfeld was Universal's economist in that
9 transaction.
10 What Professor Rubinfeld believed
11 back in 2012 was that the majors were
12 must-haves for most streaming services, and he
13 also believed that the market facts showed that
14 the licensing for streaming services was
15 competitive. Was very competitive. And he
16 still believes both of those things today. The
17 majors are must-haves and the market is
18 competitive. And he believes those things for
19 several reasons. And I'll just briefly mention
20 a few of them now and then we'll hear testimony
21 over the course of the next week or two.
22 First, the record companies' ability
23 to set rates for interactive services is
24 significantly affected by the free alternatives
25 that are available to consumers. Consumers

1 have a lot of free alternatives available to
2 them. One of those free alternatives is
3 Internet piracy, and we've all heard about the
4 ability to get music for free from pirate
5 services that don't pay for the music. And
6 this has, obviously, greatly affected consumer
7 demand for legitimate music when so much
8 illegitimate music is available.
9 This is what has happened to the
10 revenue of the record industry in the last 20
11 years. And what you see is that it hit its
12 peak in 1999 and has been declining ever since.
13 And in 1999 is when NAPSTER entered the market.
14 And what has happened to the record industry is
15 that sales of legitimate music has gone down
16 because so many people are turning to the
17 illegitimate music that are available through
18 pirate sources.
19 And so for a music distributor like
20 Wal-Mart or like the iTunes downloads or like
21 Spotify subscription services, they've all had
22 to lower their retail price to compete with an
23 illegitimate competitor, someone who's offering
24 exactly the same product, the same music, but
25 for free, and they don't have to pay for it.

1 And Spotify is an example. Started
2 out with a 15.99 subscription price. Consumers
3 weren't going there because they can get the
4 music for free. So they lowered it to 12.99
5 and then 9.99. That's what it is today. And,
6 of course, as the retail price has gone down,
7 the record companies have to lower their price
8 in order to -- in order to -- for the
9 distributors to lower their prices to the
10 consumer. And that's what's happened. Record
11 companies have lowered their prices to
12 distributors, including to interactive
13 streaming services because of what's going on
14 at the consumer level. Consumer demands.
15 And Professor Shapiro, Pandora's
16 expert economist, he agrees with that. Here's
17 what he said in his testimony. He said: "The
18 rates paid by interactive services have been
19 falling as a result of competition from
20 piracy." That greatly affects what record
21 companies can do as the wholesale level, at the
22 price that they're charging to interactive
23 services. They are not a price maker.
24 There's another free alternative out
25 there and that's extremely popular, and that's

1 YouTube. YouTube is being used as a music
2 streaming service by millions and millions and
3 millions of Americans. You can go onto
4 YouTube, find a video of Journey's greatest
5 hits and listen to all of journey's greater
6 hits for free, and there's very little that the
7 record companies can do about it because that
8 music has been uploaded by a user. And under
9 the DMCA Safe Harbors, it's very little the
10 record companies can do about it.
11 So that's another free alternative
12 that consumers can access, and that affects
13 what the record companies can charge its
14 streaming services.
15 Now, second, what you're going to
16 see is documents that show the negotiations
17 between a record company and an interactive
18 service, Spotify. And what -- or other
19 interactive services. And you're going to see
20 those documents do not show where a must-have
21 supplier is dictating the price to the
22 streaming services. That is not what happens
23 in the real world, and that tells you that
24 there is competition going on even though a
25 catalog of a major is a must have for a

1 streaming service.
2 The services do push back. The
3 services do get concessions. And I will review
4 a few examples of that this afternoon because
5 they're confidential documents.
6 Third, what Professor Rubinfeld will
7 point out is that subscriptions -- streaming
8 services are absolutely critical to the
9 long-term health of the record companies.
10 Record companies make more money when a user
11 subscribes to Spotify than if they stream from
12 Pandora or if they take it for free from a
13 pirate service or from YouTube. It's in their
14 interest to have subscribers go to Spotify.
15 And so yes, of course, Spotify needs the
16 catalogs of the majors, but the majors also
17 need Spotify. It's the largest subscription
18 streaming service out there and it's vital to
19 the survival of the record industry. We want
20 consumers to subscribe so they're paying for
21 music instead of taking it for free. And, of
22 course, Spotify -- that gives Spotify
23 bargaining power. There is bargaining power on
24 both sides of that negotiation.
25 And, finally, even if the majors do

1 have some bargaining power, whatever that is,
2 because of their must-have status with a
3 streaming service, they would have the same
4 bargaining power with respect to a
5 noninteractive service in the hypothetical
6 world where there isn't a statutory license.
7 Because the major catalogs -- the catalogs of
8 the majors are also -- are also going to be
9 must-haves for the noninteractive services. If
10 Pandora were missing all of Universal's record
11 company, that would affect Pandora. They're
12 going to want Universal, and, therefore, it's
13 going to affect the negotiation that Universal
14 has with Pandora.
15 Let me briefly turn, if I may, to
16 some of the other benchmarks that you're going
17 to see, and that was the interactive service
18 benchmarks. I want to talk briefly about
19 Apple. Apple's agreements with Sony and
20 Warner, that Your Honors know about because
21 there has been some litigation of those in the
22 motion practice, they are another benchmark.
23 ITunes is ad support, iTunes radio,
24 just like Pandora, just like iHeart. And it's
25 not on-demand, just like Pandora and just like

1 iHeart. So they can't distinguish it on that
2 basis like they try to do with the interactive
3 services.
4 But even though the iTunes radio
5 service is ad supported and not on-demand, its
6 rates and terms in the agreements are much
7 closer to what SoundExchange is proposing than
8 what the servicers are proposing. And that
9 shows you what's happening in the market. And
10 if that's going to be true no matter when you
11 look at what Apple and Sony and Warner thought
12 going into the deal, that is what their
13 expectations were or whether you look at it in
14 terms of what actually occurred. Either way,
15 the rates that are derived are much closer to
16 what SoundExchange is proposing than what
17 servicers are proposing.
18 And I don't think the servicers are
19 challenging the Apple agreement as being
20 reached in an environment where there wasn't
21 effective competition. The record companies
22 are sitting across the table from Apple. No
23 one has a lot of bargaining power when you sit
24 across the table from Apple, and particularly
25 the record companies, because Apple is their

1 largest customer.
2 So there is no -- I don't believe
3 there's going to be any other argument that
4 those agreements lacked effective competition.
5 We'll look at the economics of those deals
6 later this afternoon.
7 IHeart is going to turn to the
8 agreement that they have with Warner. And,
9 again, I'll save some of my comments about that
10 deal for this afternoon because we should put
11 that with the deal terms. But what you're
12 going to see in the iHeart deal -- I just want
13 to get a few points right now. You're going to
14 see that iHeart provided Warner with a certain
15 piece of consideration that it couldn't
16 possibly provide to all of the other record
17 companies. It couldn't. It's the way that the
18 consideration works. It can only be provided
19 to less than all the record companies. And,
20 yet, the rates that were agreed upon were
21 specifically derived from that unique or
22 unusual consideration.
23 Since iHeart can't provide that same
24 consideration to all other record companies,
25 you really can't look at that deal as something

1 that is a basis for an industry-wide license
2 for a license that would apply to all record
3 companies equally because all record companies
4 have to license their music pursuant to the
5 statutory license.
6 Second, there is no question that
7 the shadow of the statutory license greatly
8 affected the negotiations between iHeart and
9 Warner. IHeart and Warner both knew that if
10 they didn't reach a deal, iHeart could just
11 keep using Warner's music pursuant to the terms
12 of the statutory license. And that policy
13 makes a fundamental difference in the dynamic
14 of the negotiation.
15 Third, you will see that iHeart's
16 experts made a very serious error in the way
17 that they calculated and analyzed the deal.
18 They only looked at a portion of the streams --
19 of Warner streams that are used under the deal,
20 what they call the incremental streams. And
21 we'll show that that's not the right way to
22 look at it, and you really have to look at all
23 the streams and all of the consideration
24 provided in this agreement.
25 And then there's Pandora's deal with

1 Merlin. That's their primary benchmark.
2 Merlin is an agent for a group of independent
3 labels. They negotiate on their behalf with
4 digital services, and they -- the agreement
5 between Merlin and Pandora was signed on June
6 16th, 2014, four or five months after this
7 proceeding started and just a few months before
8 the direct testimony was submitted. And before
9 this deal was reached, Pandora was using the
10 music of the labels of Merlin pursuant to
11 what's called the Pure Play. And the Pure Play
12 agreement is an agreement that was reached
13 under Webcasters Settlement Act. I understand
14 this is not the time to engage in any legal
15 arguments, so I will put that aside, and what
16 we have proposed is simply to provisionally
17 admit evidence relating to the Pandora-Merlin
18 deal and the Pure Play deal so that Your Honors
19 can later consider whether the Pandora-Merlin
20 deal can even be considered as a benchmark in
21 this proceeding under the Webcaster's
22 settlement.
23 But what you will see is that, on
24 the facts, is that Pandora's relying just on
25 one agreement. They're not relying on any

1 agreement between a service and a major record
2 company. They're not relying on any agreement
3 between a record company and any service other
4 than Pandora. Just Pandora and Merlin. And
5 what we're going to show you is that is not a
6 representative agreement and you will not have
7 the same confidence that what you're really
8 seeing is something that would reflect market
9 rates.
10 Third, if the Pandora-Merlin
11 agreement is admissible, you'll see how greatly
12 affected the terms are by the Pure Play
13 agreement. You will see that the Pure Play
14 agreement has dictated many of the terms,
15 including the core economics of the deal.
16 And, finally, you'll hear Pandora's
17 witnesses talk a lot about something called
18 steer up. And what they will say is that they
19 can manipulate that Pandora algorithm so that
20 it will deliver to Mr. Choudhury only music
21 that's cheaper than other music, so that they
22 can save money. So he will get music that
23 costs them less. And they think that because
24 they can steer to cheaper music, that the
25 record companies, in turn, will therefore

1 negotiate lower rates in order to avoid such
2 steering. And that's not what's going to
3 happen if there wasn't a statutory license.
4 First, the record companies would
5 negotiate provisionals so that they aren't
6 discriminated against by some steering within
7 the algorithm. But, also, Pandora is going to
8 get slammed in the marketplace.
9 What do you think iHeart and iTunes
10 radio is going to do if the world starts
11 knowing that Pandora is steering towards music
12 that costs them less?
13 Think of the advertising campaign.
14 Pandora gives you the cheapest music. We give
15 you what you want to hear. What's that going
16 to do?
17 If the consumer knows that Pandora
18 is delivering music based on price and not
19 based on taste, what's going to happen in the
20 marketplace?
21 And you know these are competitors.
22 They're going to go after each other. So I
23 think you will find that steering is not a
24 super bullet for many reasons.
25 Let me briefly talk about NAB. We

1 didn't offer any benchmark agreement. Instead,
2 what NAB does is they point to two different
3 things out there in the market -- not in the
4 market, out there in the world, that they think
5 create a zone of reasonableness; low end and a
6 high end. And the first thing they point to is
7 terrestrial rating. And what they say, and
8 through their economist, Professor Katz, is
9 that terrestrial radio is a lower bound for the
10 zone of reasonableness, and that lower bound is
11 zero. And the reason why it's zero is because
12 over-the-air broadcasters pay zero for use of
13 sound recordings. But we all know why they pay
14 zero. It's because the U.S. copyright laws do
15 not provide a public performance right for
16 sound recordings used over the air. So radio
17 stations are paying zero because that's the
18 law, not because some market has driven it to
19 zero. So the terrestrial radio doesn't tell us
20 anything about what a willing buyer and willing
21 seller would agree to if there wasn't a
22 statutory license.
23 And then they look to the SDARS II
24 decision to create, I think, the upper bound of
25 their zone of reasonableness. But the SDARS II

1 decision, the decision of this board, it's not
2 a market agreement between a willing buyer and
3 a willing seller. And it's not only a decision
4 of this board, but it's a decision of this
5 board under an entirely different standard than
6 what applies in this proceeding. And it's not
7 only a decision of this board under a different
8 standard, but it's a decision about an entirely
9 different type of service that involves very
10 different economic considerations of satellite
11 radio.
12 Now, I have not yet directly
13 addressed issues of promotion and substitution;
14 but, of course, the statute asks you to
15 consider those things. It's hard wired right
16 into the statute. But the market has already
17 given us the answer to promote substitution
18 because economists on both sides will say, and
19 this board has previously said, that benchmark
20 agreements reached within the marketplace
21 already factor the promotional and
22 substitutional effects into the terms of those
23 agreements. The record companies and the
24 services think about those things when they set
25 the economic terms.

1 So the promotional and
2 substitutional effects are already in the terms
3 of the interactive service agreements that we
4 rely on, and they're already in the agreements
5 between Apple and Warner and Sony. And they're
6 already in the Pandora-Merlin deal and the
7 iHeart/Warner deal. But the servicers are
8 raising one other argument that I think will
9 cause some additional evidence to come in
10 beyond just the agreements themselves. What
11 they say is that statutory Webcasters are more
12 promotional than interactive services like
13 Spotify; and, therefore, you need to make
14 another adjustment from the interactive
15 services to adjust for the fact that the
16 Webcasters are more promotional.
17 Well, we will show that they are
18 just wrong. Remember what their game plan is.
19 Remember Pandora's game plan. Remember,
20 they're going to put Pandora everywhere.
21 They're going to make sure that consumers are
22 listening to Pandora morning, noon and night.
23 This is not a game plan for
24 promotion. It's not a game plan to say to
25 users of Pandora go buy a CD or go by a

1 download. It's not saying go subscribe to
2 Spotify. What this is saying is substitute for
3 all those things because we're going to give
4 you the music you want morning, noon and night.
5 Now, of course, we all know that it's working.
6 Pandora is really, really popular. And so
7 you're getting 20 billion hours of music
8 streamed through Pandora just last year.
9 There's a particular aspect of
10 promotion that the evidence from the servicers
11 almost entirely miss and that's -- and
12 promotion and substitution, and that is the
13 effect of a Webcaster on the revenue stream to
14 Spotify and to other interactive services.
15 Does Pandora and iHeart substitute
16 for Spotify and other interactive services?
17 They want you to focus on CDs and
18 downloads, and that's relevant, but so is the
19 substitution of the revenue stream that would
20 otherwise go to Spotify and to other
21 interactive services.
22 We asked our survey expert, Sarah
23 Butler, to look at that question, to look at
24 whether Pandora is substituting for Spotify,
25 for interactive services, for FM radio. What

1 is it substituting for?
2 And Ms. Butler has done a lot of
3 market studies, and you will meet her in our
4 case. And she designed a survey that asked
5 these questions about -- to Pandora users.
6 And, by the way, she did the same thing to
7 iHeart.
8 The first question: Imagine you can
9 no longer listen to music on Pandora. Which of
10 the following statements represents what you
11 would be most likely to do?
12 And if they picked the substitution,
13 the substitute number one, she asked Question
14 3. You said you would find a substitute for
15 the music you listen to on Pandora. Which of
16 the following, if any, would be your most
17 preferred substitute for Pandora? And she then
18 gives them 24 different alternatives.
19 What would you do if Pandora didn't
20 exist? What would you do to satisfy your music
21 interest and needs?
22 And this -- these are the results.
23 The number one answer was Spotify. Almost 20
24 percent of one in five said they would go to
25 Spotify, and you can see where the rest of this

1 comes out. And what this tells you is that
2 Pandora is substituting for Spotify and for a
3 bunch of other alternatives that are more
4 valuable to the record industry than Pandora.
5 JUDGE STRICKLER: Do you know, Mr.
6 Pomerantz, whether she will testify with regard
7 to the first line with regard to Spotify,
8 breaking down that 19.7 percent between free
9 Spotify and paid Spotify?
10 MR. POMERANTZ: No, she will not.
11 But what you will have is the conversion from
12 free to paid by Spotify. Spotify is what's --
13 what is referred to in the industry as a free
14 service. And like in other industries, what
15 the concept is, is get people into the free,
16 and then upsell them to the paid service. And
17 there is a percentage. I believe it's 20
18 percent, in that range, where Spotify is
19 converting users from free to paid. So the
20 concept here of Spotify and of the premium
21 model that's not just Spotify, but many
22 streaming services, get them into free, get
23 them to really like the service, don't love the
24 ads, want to take it mobile, and so you upsell
25 them to the paid service.

1 JUDGE STRICKLER: Will Ms. Butler
2 testify that all that information about that
3 conversion from free to paid was given to the
4 individuals in the survey, or no?
5 MR. POMERANTZ: I don't believe it
6 was. I can't be certain. I believe it was not
7 provided to them. So this is based upon what
8 the consumer -- I should -- I think it was
9 based on what the consumer would have
10 understood about Spotify. So you know what
11 you've heard about Spotify. If you haven't
12 heard about it, you may not know about it.
13 Okay. So you have to identify what
14 you've heard about it. So this would not be
15 asked of someone who has not heard about
16 Spotify. It would only be asked of someone who
17 has, and you're going to get a list here of the
18 ones you actually heard, and that's the way she
19 organized her study.
20 But -- and what's important about
21 that conversion, methodology of -- or model of
22 Spotify is that when a record company enters
23 into a contract with premium service like
24 Spotify, it builds into the contract conversion
25 incentives. So if Spotify -- unless -- this is

1 not the actual terms, so I shouldn't disclose
2 it anyway. But if Spotify only converts, let's
3 say, 5 percent or less of its free users to
4 pay, your per-play rate, let's say, is $0.30.
5 But if you convert five or 10 percent, it goes
6 down to $0.28. If you convert 10 to 20
7 percent, it goes down to $0.26.
8 And so what the record companies are
9 trying to do is to incentivize Spotify to move
10 users from free to paid. It's also in
11 Spotify's self interest to do so. But the
12 record companies are building an additional
13 economic incentive into their contracts for
14 premium services.
15 JUDGE STRICKLER: Thank you.
16 MR. POMERANTZ: We will also offer
17 testimony from Dr. Blackburn that is relevant
18 to the issue of substitution of programming and
19 promotion. He analyzed data that was provided
20 by iHeart. IHeart examined the same data and
21 they had -- and they offered direct testimony
22 on it from Professor Danifer. Professor
23 Danifer then realized that he actually had not
24 analyzed the data correctly, and that -- and so
25 he went back and he corrected his testimony.

1 And when he corrected his testimony, he
2 specifically said that the data, now that he
3 realizes it, doesn't show any meaningful
4 difference between the promotional effects of
5 noninteractive services and the promotional
6 effects of interactive services. And so he
7 submitted his corrected testimony to correct
8 that. Very important correction.
9 Thereafter, iHeart decided his
10 testimony doesn't really help us, so they
11 withdrew Professor Danifer's testimony.
12 So we asked Dr. Blackburn to go
13 analyze the same data, and he did. He did a
14 regression analysis of the same data; and, of
15 course, he came to the same conclusion. The
16 data does not show a meaningful difference
17 between the promotional effects of a
18 noninteractive service and the promotional
19 effect of an interactive service.
20 CHIEF JUDGE BARNETT: Mr. Pomerantz,
21 you might want to know you've been going for an
22 hour and ten minutes.
23 MR. POMERANTZ: Okay. I will try to
24 wrap it up.
25 The participants' own behavior also

1 shows the -- something about the promotional
2 and substitutional effects of these services.
3 What the servicers are going to say is that
4 record companies try to get their music played
5 on terrestrial radio, and that shows that
6 terrestrial radio is promotional. They spent a
7 lot of money to try to convince terrestrial
8 radio to play new releases. They put a lot of
9 effort behind it, but that -- and that's true.
10 Other companies do try to get terrestrial radio
11 stations to play their music. And many people
12 at record companies believe that that helps to
13 sell CDs and downloads. We're not here to
14 claim otherwise.
15 But that evidence actually proves
16 exactly the opposite of what the servicers are
17 using it for. Because what you will see is the
18 record companies do not spend a lot of money or
19 put a lot of resources to try to get Pandora or
20 iHeart to play the music. So if the
21 expenditure of money and resources shows what
22 the record companies think, then their own
23 behavior would show that they don't think it's
24 very promotional to have Pandora play their
25 music.

1 Now, I handed you a binder with some
2 documents in it. I just want to point you
3 quickly to the first two documents. And these
4 are documents that both come from Sony decks,
5 internal decks here. And just take a quick
6 moment to scan Tab 1 and Tab 2.
7 And I'll tell you that the way I
8 read Tab 1 and Tab 2 is that they're
9 fundamentally inconsistent. They say two
10 different things. In fact, I think they say
11 the opposite. And what that tells you is that
12 people inside the record companies don't always
13 see it the same way. And you would probably
14 expect that in a market that is rapidly
15 evolving as the music industry.
16 And so we will give you a chance to
17 meet Sony's witnesses. Tomorrow, Dennis Kooker
18 will be the first witness we call from Sony.
19 You will also meet a lot of other witnesses,
20 and you will be able to assess their
21 credibility. You will be able to see whether
22 they really believe that Pandora is or is not
23 promotional, and you will be able to make that
24 judgment yourself.
25 And what you'll also see is that the

1 actual behavior of the Webcasters also tells
2 you something about promotion and substitution
3 because what it shows you, if you look at Tabs
4 3 through 6, is that Pandora and iHeart are
5 viewing Spotify as a significant competitor.
6 They're competing for the same listeners.
7 They're trying to get listeners to go back and
8 forth with each other. That's what good
9 competitors do, they try to take customers away
10 from each other. And that's what these
11 documents show. These are Pandora's and
12 iHeart's internal documents. They view each
13 other as competitors.
14 So when you're sitting there
15 thinking about the statutory factor of whether
16 Webcasters are interfering with other revenue
17 streams, these documents tell you that Pandora
18 and others are interfering with the revenue
19 streams that would otherwise come from
20 interactive services.
21 Briefly, a note about price
22 discrimination. I'm sorry. I actually skipped
23 the simulcasters -- well, skipped Slide 69 and
24 70, and 71. Price discrimination. We are not
25 proposing any price discrimination. You raised

1 the issue in your initial reports. Pandora is
2 proposing a form of price discrimination. NAB
3 maybe is.
4 What Pandora is proposing is that
5 you should establish rates where ad-supported
6 services pay less than subscription services.
7 But we think there's a problem with that. We
8 think there are several problems.
9 First, creating the wrong
10 incentives. Lower rates for ad-supported
11 services would financially motivate a service
12 to go to ad support. You would be favoring one
13 business model over another. You would be
14 disfavoring another. And if you look at Tab --
15 the last tab in your binder, it's an
16 internal -- it's an e-mail between Pandora and
17 Merlin in the negotiations. And you will see
18 that the Merlin -- the Pandora representative
19 is saying exactly this point. So you're
20 creating incentives that are going to distort
21 the marketplace. You have a financial
22 incentive to be ad-supported and not
23 subscription.
24 Second, that's not what would happen
25 in the but-for world where there was no

1 statute. The record companies would not give a
2 lower rate for ad support unless there was a
3 conversion incentive, an incentive to upsell to
4 the subscription services. But that's not what
5 Pandora is proposing. They're just proposing a
6 lower rate for an ad-supported service, and
7 that's not what would happen in the market.
8 And you can look at the benchmark agreements to
9 see that.
10 And, finally, the statutory license
11 grants each licensee the same rights. It's up
12 to the licensee to decide what they want to do
13 with those rights. Are they going to use all
14 of them? Some of them? None of them? It's up
15 to the licensee to decide how they want the use
16 them and what model they want to offer. But
17 the license should be agnostic. The license
18 should let the licensee decide how much of
19 those rights they want to use and how they want
20 to use them.
21 NAB offers their very, very low rate
22 of .0005 for simulcasters, like what I should
23 you on the screen. They don't say what they're
24 offering for non-simulcasters. They say we
25 don't take a position on that. But some of

1 their arguments will suggest that they think
2 Pandora and other customized radio services
3 should pay more because the user gets to
4 influence the music much more so than in a
5 simulcast. And so that's what they're
6 proposing.
7 Again, we think there's problems
8 with that. First of all, simulcasts are
9 subject to user influence, and I showed you the
10 Madonna example. And, second, you have the
11 same problems again. You're creating
12 incentives for a simulcaster not to get it, and
13 not to get it too personal because if you do
14 you cross the line and have to pay a higher
15 rate, and you'll have to define what is a
16 simulcast.
17 Is Madonna a simul -- is that
18 Madonna example a simulcast?
19 And here's another problem you will
20 have. If you look at iHeart's definition of a
21 simulcaster in their rate proposal, they say a
22 simulcaster, and the call it a broadcast
23 transition. But they're saying a simulcast is
24 anything that involves a majority of the music
25 in the same thing as on terrestrial radio. The

1 majority of the music.
2 So what they're saying is that you
3 can take the terrestrial broadcast, switch out,
4 flip out 49.9 percent of that music and it
5 would still be a simulcast for rate purposes,
6 and they want a very low rate for simulcast.
7 The revenue share that we propose,
8 we propose the revenue share of 55 percent, and
9 I think when you see the benchmark agreement
10 you'll see where we get it from and that it's
11 conservative. I would also note that out there
12 in the marketplace, companies like Netflix and
13 Amazon and Apple's download store, they all pay
14 70 percent, probably 70 percent of the revenue
15 to the content owners that supply them with the
16 content that they own. And we think we have
17 offered a definition of revenue that will work
18 for the license.
19 Non-commercial Webcasters. We
20 believe that the non-commercial Webcasters,
21 first, is that most of them pay the minimum
22 fee, and we're not proposing any change in the
23 minimum fee. Same $500 that it's been for
24 years. There's only one non-commercial
25 Webcaster, the NRB-NMLC that's provided you

1 with a rate proposal. And they sought to
2 change it so that there's three tiers of rates,
3 three levels. 500 up to 1,500 is the highest.
4 We don't see a reason for the change.
5 If you have less than 159,000
6 aggregate tuning hours, you pay the minimum
7 fee. If you're above that you, you pay the
8 same per-play rate as commercial Webcasters.
9 That's what the board ordered back in 2010 and
10 we think that should continue.
11 I will reserve my -- any further
12 comments having gone out, and quite long right
13 now, for this afternoon. And I thank you for
14 your attention.
15 CHIEF JUDGE BARNETT: Thank you, Mr.
16 Pomerantz.
17 We're going to take our morning
18 recess, which will be 15 minutes and try to --
19 two 15 minutes, which means by the time
20 everybody gets out of the room, it will be time
21 to come back in.
22 Before we do, may I assume you are
23 Mr. Johnson?
24 MR. JOHNSON: Yes, Your Honor. I
25 apologize for being late.

1 CHIEF JUDGE BARNETT: That's all
2 right.
3 Please stand and identify yourself
4 for the court reporter.
5 MR. JOHNSON: George Johnson from
6 GEO Music in Nashville, Tennessee.
7 CHIEF JUDGE BARNETT: Welcome.
8 MR. JOHNSON: Thank you.
9 CHIEF JUDGE BARNETT: And you can
10 coordinate with Mr. Pomerantz regarding opening
11 statement if you would like to give one.
12 MR. JOHNSON: Yes.
13 CHIEF JUDGE BARNETT: Okay. We will
14 be at recess, then, for 15 minutes.
15 (A short recess was taken.)
16 CHIEF JUDGE BARNETT: Mr. Johnson,
17 would you like to make an opening statement?
18 MR. JOHNSON: Yes, I would, Your
19 Honor.
20 Good morning, Your Honor, and thank
21 you for this opportunity to be here with you
22 today, and my name is George Johnson.
23 For the past 30 years, I have been
24 an independent singer-songwriter in Nashville,
25 Tennessee and Los Angeles, California, who

1 writes and composes his own music. It's a real
2 privilege to be able to share my story with you
3 in this great proceeding, it's the story of all
4 American creators, and unfortunately, the story
5 is tragic.
6 For the past 15 years, whether you
7 are young or old, just starting out,
8 well-seasoned, independent or with a major
9 label, streams have taken over the entire
10 industry. Everything is set at .00 cents.
11 There is no way for us to survive.
12 Most importantly, I think we need
13 your intervention and without your help, Your
14 Honor, the story does not have a happy ending
15 for 99 percent of the current and future
16 American copyright creators, especially
17 independent digital sound creators, who create
18 both 114 and 115 copyrights, sometimes at the
19 same time. So many incredible American
20 singer-songwriters, producers and independent
21 record labels throughout the decades made their
22 own records, hit records, without the help or
23 benefit of major recording labels.
24 CHIEF JUDGE BARNETT: Excuse me.
25 Can you pull that mic just a little bit closer?

1 MR. JOHNSON: Sure. Sorry, Judge.
2 These independents have a talent,
3 business savvy and just enough money to help
4 create the great American songbook, despite the
5 royalty system the federal government has
6 designed for them. In a way we independents
7 are the foreign team, the minor league, the
8 life blood of the music industry. We are being
9 put out of business by streamers and, yes,
10 three major labels, now all four known, in the
11 most anticompetitive way possible and on
12 purpose.
13 Sadly, we have become -- come to the
14 proverbial crossroads in the industry. Garth
15 Brooks is correct, we're dealing with the
16 devil, as he called it, YouTube streamers
17 several months ago. Being the number one
18 recording artist of all times who pointed out
19 the heart of the matter, as he said on video, I
20 think the thing is you have to put music first.
21 The government has passed a lot of laws really
22 quickly and allowed technology kind of just to
23 use music as a tool without paying for it.
24 And I would like to see the
25 government revisit that, because music could

1 come back to the front and center if we could
2 just get some help, he's exactly right, and we
3 do need some help from the copyright office and
4 Your Honor.
5 And we'd also hope this proceeding
6 is the beginning of raising rates for all music
7 copyright creators that actually covers the
8 costs of copyright creation, like it used to.
9 And that's kind of the heart of the matter is
10 the cost of copyright creation.
11 The independent music copyright
12 creator is the one person in the copyright
13 clause and the copyright action designed to
14 protect. Unfortunately, right now and for the
15 past ten to 20 years, the alleged digital
16 revolution, these independent music creators
17 and their livelihood have been systematically
18 destroyed by greed and premeditation of a
19 handful of streaming companies, like Pandora,
20 Google, YouTube, Spotify, and now Apple. It is
21 the most anticompetitive marketplace I have
22 ever seen in my lifetime and we are allowing it
23 to happen.
24 What they all have in common is they
25 use government interventions in the music

1 royalty system to make their money, using
2 loopholes and laws designed to help music
3 copyright creators to take control and extract
4 all the profits from our personal private
5 company, our copyrights.
6 One example is 37 CFR 385, it
7 enshrines the mechanical rate at 9.1 cents for
8 115 underlying works and spends the rest of 385
9 destroying Section 385.3 with 30-day limited
10 downloads of your entire playlist without
11 paying for the minimum statutory rate. This
12 also applies to digital sound recording and
13 there's no money for that either. They are
14 allowed to take it for 30 days, download
15 without the 70 percent you should get from
16 Apple.
17 And I realize that some people
18 consider streaming different from downloads,
19 but to me, it is still performance. It is
20 still a -- there's still a mechanical side to
21 the -- to a stream, but it's a copyright. It's
22 a sound recording copyright basic before you
23 ever get to interactive, noninteractive, all
24 those different definitions, which I don't
25 think really matter anymore and I think as

1 SoundExchange said interactive and
2 noninteractive are boring in their conversions.
3 I think downloads and streaming are conversions
4 as well.
5 So another prime loophole is the
6 safe harbor in DCMA. It potentially lets
7 streamers bootleg your digital sound recorder
8 and I think that is wrong.
9 Section 114(f)(2)(B), I think (i),
10 the Copyright Act states: "In determining such
11 rates and terms, the judges must base their
12 decisions on economic, competitive and
13 programming information presented by the
14 parties. Specifically, they must consider
15 whether the service may substitute for or may
16 promote the sales of phonorecords or otherwise
17 affect the copyright owner's other streams of
18 revenue," and nothing could be more true than
19 that to streamers.
20 Now I was asked to prove in the
21 first response and I -- in my admitted written
22 statement, you know, do -- does streaming
23 cannibalize the sale of phonorecords, and I
24 think Mr. Pomerantz did a wonderful job proving
25 that, and I think they will prove that and it's

1 partly my case, too. I believe the streamings
2 cannibalize phonorecords, streamings and
3 downloads. Streaming is the future, and if it
4 is the future, we must make sure we get paid at
5 this point.
6 As his own office said in the
7 current copyright music marketplace setting
8 conducted by the copyright office who issued
9 February of 2015, there is no policy
10 justification for a standard that requires
11 music creators to subsidize those who seek to
12 profit from their works, and that is absolutely
13 true, and that recent statement clearly
14 summarizes GEO's case in this hearing.
15 The copyright interests and needs of
16 millions of American recording artists and
17 independent label, songwriters being published,
18 performers come first before the wants and
19 demands of starts up like Pandora, Google and
20 Spotify, who seek to profit from other people's
21 creation and private property.
22 Additionally, Pandora's so-called
23 business model is not a matter of public
24 policy. As legendary singer-songwriter Rosanne
25 Cash said, streaming is just dressed up piracy,

1 and she could not be more correct. She also
2 strongly argues there is no law form, moral
3 justification for music creators to subsidize
4 those who seek to profit from our work.
5 Back in 1971, RIAA president Stanley
6 Gortikov was called to testify in front of the
7 policy judiciary committee. His great quote
8 was: "The pirates skim the cream of what
9 artists and record companies offer, except for
10 one particular ingredient which he avoids like
11 the plague, our risks."
12 That is the exact predicament all
13 independent and individual digital sound
14 recording copywriter, creators are in with all
15 streaming, internet radio, Webcasting, and
16 video streaming corporations.
17 Recent register of copyrights from
18 Maria Pallante also notes that music creators
19 are forced to do business in legal quicksand,
20 and she is exactly right. Another classic
21 statement that summarizes GEO's case is that if
22 music did not pay, it would be given up,
23 whether it pays or not, the purpose of
24 employment is profit, and that is enough. And
25 that was written by a Supreme Court Justice

1 Oliver Wendell Holmes in Herbert versus
2 Stanley.
3 GEO would also like to stress
4 Justice Holmes like Register Pallante, they
5 strictly used the word profit, not income,
6 payment or make money. He also used the word
7 music. Not a mechanical, a performance, or a
8 noninteractive stream are exempt from copyright
9 law.
10 Here is a Supreme Court opinion from
11 one of the most legendary respected justices,
12 emphatically stating that the entire purpose of
13 licensing music copyrights is to profit. That
14 means we profit. The individual copyright
15 owners, not Pandora, Pandora executives who
16 have taken out almost a half billion dollars
17 for themselves the past four years, which I
18 find incredible.
19 Justice Holmes also rightly points
20 if music did not pay, it would be given up.
21 That is where we are, Your Honor. I hope that
22 carries weight in this proceeding.
23 Since the digital revolution 15
24 years ago, I am seeing, as a songwriter and
25 someone who creates sound recordings together,

1 they are all bundled up for me. They are not
2 separate, but I am watching my friends go back
3 to Texas, work selling magazines, driving
4 around, working at Walmart, and if you listen
5 to Bart Herbison who says 90 percent is from
6 NSAI, 90 percent of songwriters and music
7 publishers in Nashville have been -- have gone
8 away the past 15 years.
9 And that goes for artists and sound
10 recording industry and independent labels too
11 and why we are here today.
12 So let me see. If you could please
13 put up my one exhibit here. What I am
14 proposing, the copyright office also -- I
15 participated in the last year's roundtables and
16 music licensing institute with the copyright
17 office, and they talked about bundling
18 copyrights. Now there is a carveout for RA and
19 SoundExchange, which I think should be included
20 in the bundled copyright, but what I am trying
21 to propose to Your Honor is, we are here to set
22 the rates and the terms, so let's change the
23 terms because there is no way that we can
24 survive without paying for the cost of
25 copyright creation.

1 So what I am proposing, of course,
2 we are not dealing with songwriters and music
3 publishers in this hearing, but let's pay
4 recording artists and independent record
5 labels, and this includes the major labels, 25
6 cents up front, a one time fee in a streaming
7 account, it was bundled like the copyright
8 office wants to, and I think it's a great idea.
9 Let's start doing that and change the terms so
10 that we are not all put out of business.
11 And that is my basic case right
12 there. Is to have a copyright bundle streaming
13 account up front one time. If it is not 25
14 cents, it's 10 cents. I am trying to offer at
15 least a dollar. But when you look at --
16 actually Mr. Nichols switch to G2 and then G3.
17 Recently, the RIAA came out with
18 these figures of what sound recordings have
19 been over through the course of history. Now,
20 to me, these are actual real benchmarks for
21 sound reporting copyrights. Now Pandora and
22 others will argue that, oh, no, that doesn't
23 apply but it is a copyright. It's a
24 performance. So this is what we should be
25 charging for streaming account for different

1 things.
2 Let's switch to the other one, Mr.
3 Nichols. That is just a general one, but, you
4 know, I look back and I have the Beatles
5 proposal which is Proposal 3 which is basically
6 $5 a song, and when you look back at the
7 Beatles album in 1964, it is $5 a song. An
8 album should be about $40. But we are at .00
9 nothing now.
10 So what I am trying to say is that
11 we should apply these sound recording
12 benchmarks that are real benchmarks to
13 streaming in a streaming account and that the
14 customer pays up front one time and pays for
15 the cost of copyright creation, which they are
16 not paying for right now and it is kind of a
17 scam.
18 So that is my case, and I would also
19 like to say something about benchmarks, and Mr.
20 Harrison is trying to say they offer open
21 market, fair market, effectively a competitive
22 market in their latest filing, they say true
23 competitive forces at arm's length, and to me,
24 these are not benchmarks because you are not in
25 a free market. The music business hasn't seen

1 a free market grow over a hundred years and
2 this is statutory license, compulsory license,
3 statutory rate, consent decree, even this rate
4 court here. We are setting rates and we're not
5 letting millions of price points operate in a
6 free market to where that sets the benchmark
7 and I believe it would be much higher, and if
8 we're going to set a free market rate, then
9 let's set an actual free market rate.
10 And if we did set one, then we
11 wouldn't even be here, because the market will
12 take care of it for us. But while we're here,
13 if we are to going price fix, let's give us
14 something that we can create and have a
15 livelihood instead of just being robbed and
16 having costs, $55 to register your work and
17 take over million streams just to pay for my
18 registration and my copyrighting work.
19 So in closing, I think that we
20 should -- Mr. Nichols go back to the other one.
21 The customer who pays for copyright creation
22 and it has to be part of a distribution model
23 and the dollar up front, maybe even more, one
24 time per song, then stream all you want if
25 streamers were still making profits and sell it

1 advertising.
2 I think the bundle copyright idea is
3 the way to go and include SoundExchange, and
4 the other thing is my fifth amendment property
5 right, which I believe is absolutely being
6 violated. My right to property without due
7 process, without just compensation and
8 certainly these songs seem like they are for
9 public use.
10 And I also have a first amendment
11 right for my copyright, and that is it. So I
12 ask the Judge to please consider the copyright
13 bundling, and if not, Proposal 1 that I have
14 offers ten cents per stream, which is
15 reasonable. And I think -- what I am trying to
16 do with this is pass the cost of copyright
17 creation and not give it to Pandora, not say,
18 you need to have your advertisers get the money
19 or even the investors need to get more money.
20 Let's pass it on to the customers. Sure, it
21 will change your business model, but to me, I
22 think you guys had a legal business model the
23 whole time.
24 So if we're going to do ten cents
25 and not up front, I would like to see it maybe

1 like an electric meter, which I said in my
2 amended written statement, and that the
3 customer gradually pays for these songs and,
4 you know, at least, it would, you know, if it's
5 a stream as a mechanical and a performance at
6 the same time, ten cents would cover the cost
7 of a mechanical, which I think is still there,
8 even though we are in a DSR hearing.
9 So I hope you will consider this,
10 Proposals 2 and 3 for up front copyright
11 streaming account. Thank you, Your Honor. I
12 appreciate it.
13 CHIEF JUDGE BARNETT: Thank you,
14 Mr. Johnson.
15 Mr. Rich, do you want to begin?
16 MR. RICH: Thank you. Thank you and
17 good morning, Your Honor. The order of
18 presentation on the service side, at least
19 insofar as the public rounds of openings is
20 concerned, will begin with my remarks on behalf
21 of Pandora. I expect to take about an hour. I
22 will be followed by Mr. Joseph on behalf of the
23 NAB. He will be followed by Mr. Hansen,
24 respecting iHeartMedia. Following that, Ms.
25 Ablin will make opening remarks on behalf of

1 the National Religious Broadcasters Music
2 License Committee. And Mr. Malone will then
3 speak on behalf of IBS and Harvard Radio. For
4 myself, my intention is to only pop up once
5 today.
6 CHIEF JUDGE BARNETT: Is Sirius
7 going to have a --
8 MR. RICH: I beg your pardon. I
9 left Mr. Fakler out. Unintentional,
10 unintended. He will follow iHeartRadio's
11 presentation. Thank you very much. I
12 appreciate Ms. Ablin's presentation.
13 I intend only to be here once and
14 with that in mind, have created a binder of
15 materials which, with Your Honor's permission,
16 I would like to hand out, which I'm not going
17 to project, because the majority of it contains
18 protective order type material, and so I will
19 allude to them, but ask you to read them
20 privately when we get to the appropriate place.
21 CHIEF JUDGE BARNETT: Thank you.
22 MR. RICH: I have divided my opening
23 statement into three parts. First, I want to
24 talk a little bit about Pandora, its business,
25 what is unique as a music licensing platform,

1 the nature of the competition it faces, and of
2 course, the importance of the royalties to be
3 set here to Pandora's ongoing business.
4 You will hear more detail on each of
5 these topics principally from Mr. Westergren,
6 who is the founder of Pandora, Mr.
7 Fleming-Wood, who is its chief marketing
8 officer and from Michael Herring who is its
9 chief financial officer.
10 Second part of my remarks will
11 describe the starkly different approaches to
12 rate making, which have been adopted by the
13 respective sides in construing the standard
14 that governs this proceeding and applying it to
15 proposed benchmark agreements. In connection
16 with that portion of my opening, I'll discuss
17 how Professor Shapiro, our lead economist and
18 other witnesses will describe how Pandora's
19 rate proposal fits closely the aspirational
20 goal of determining rates that willing buyers
21 will pay willing sellers a competitive margin,
22 to license digital transmissions of sound
23 recordings meeting the statute's requirements.
24 I will discuss how in contrast, our evidence
25 will demonstrate that the SoundExchange's rate

1 proposal fails in fundamental respects to do
2 so.
3 In the third component of my
4 opening, I will discuss the principal ways we
5 anticipate from the evidentiary filings to
6 date, that SoundExchange will attempt to
7 denigrate the services benchmarking drawn from
8 the service's direct license very
9 intentionally, as well as SoundExchange's
10 efforts to prop up the probative value of the
11 record companies own interactive services
12 benchmark.
13 So Pandora. Pandora is the
14 country's most popular Internet radio service
15 serving now over 80 million active users. It
16 was launched in 2005 under the direction of its
17 founder, Ken Westergren, and has grown steadily
18 ever since. In many cities across the country,
19 it's the most listened to radio service,
20 period, including traditional terrestrial
21 radio. Pandora has a very simple and intuitive
22 interface. That interface as Mr. Pomerantz
23 conceded, is largely unchanged from the way it
24 operated when it was first launched. Like
25 other radio services, Pandora offers expertly

1 tiered genre stations, ranging from top 40 to
2 highly specialized Blueglass, Big Band,
3 Bollywood and so forth.
4 But the real heart of Pandora is
5 personalized radio. On their computer or
6 mobile phone, the user simply enters the name
7 of an artist or genre, and then that is it.
8 Pandora then creates a station based on that
9 starting point, they call it a seed, with songs
10 that share similar musicalogical
11 characteristics to the seed. What is the
12 sauce. How does it get done.
13 What makes Pandora different and
14 more popular than other all Internet radio
15 services combined is something they call the
16 Music Genome Project. The team of Pandora
17 music analysts, many with Ph.D.s in musicology,
18 have spent the better part of 15 years mapping
19 the detailed traits of over a million sound
20 recordings. Those characteristics include
21 tempo, instrumentation, melody, harmonic
22 structure, lyrical content and vocal quality.
23 Hundreds of traits in all that make up the
24 musicalogical DNA, as it were, of a given
25 recording.

1 Based on these traits or what are
2 called genes, Pandora creates playlists with
3 songs that share the same musical DNA as the
4 seed and that spans sounds from indies and
5 majors, songs that have had very little
6 currency or popularity including songs that the
7 listener has probably and most certainly have
8 never heard before.
9 Now Pandora then allows users also
10 to give feedback preferences, by so-called
11 thumbs up and thumbs down icons while the song
12 is playing. Then the algorithms that underlie
13 this big engine can then use that feedback
14 along with the thumbs up and thumbs down of
15 other users who have indicated similar musical
16 tastes to further refine the listening
17 experience.
18 The result of this process is summed
19 up by Mr. Westergren who has written direct
20 testimony in Paragraph 3, quote, Pandora is a
21 personalized Internet radio platform that
22 exposes listeners to music they will love and
23 gives artists the opportunity to have their
24 music discovered by fans who might not
25 otherwise have learned about them.

1 Now, to be sure, Pandora provides
2 benefits to artists and labels well beyond
3 royalty payments. Pandora plays songs from
4 more than 120,000 different artists a month.
5 As I indicated, many of these artists lesser
6 known, and many of them don't have any
7 realistic prospect of being played on radio
8 stations, traditional radio stations or even
9 other major Webcasters.
10 Pandora, in addition, receives
11 thousands of artist submissions a month, both
12 artist and record labels I should say, asking
13 to be played on Pandora to gain wider audience
14 reach for their music. Artists routinely
15 report to Pandora that their recordings are
16 thanks to Pandora, receiving exposure they
17 would never have attained otherwise, and
18 correspondingly, generating sales they never
19 otherwise would have realized.
20 Now the evidence that plays on
21 Pandora's need to increase sales are not just
22 anecdotal. You will hear from Dr. McBride, who
23 is an inside the company scientist, about a
24 project conducted with other scientific team
25 colleagues. What they did was run a series of

1 experiments designed to empirically and
2 rigorously test Pandora's impact, if any, on
3 sales or sales recordings. So what they did
4 was, they turned off thousands of songs. They
5 basically stopped playing them in half the
6 country. Half the country kept hearing the
7 songs, the other half, they shut them down.
8 And then they compared and tracked sales
9 experience in those demographic markets with
10 the turned-off songs versus the non-turned-off
11 songs.
12 And as Dr. McBride's testimony will
13 explain and validate, the experiments
14 definitively demonstrate that performances on
15 Pandora actually caused sales of songs to
16 increase. I want to emphasize that this is
17 empirical evidence of a type never before
18 presented in a CRB proceeding. It is not just
19 anecdotal. It is not supposition. It's a
20 rigorously conducted scientific experiment and
21 Dr. McBride will appear and defend its
22 integrity.
23 Finally, by way of extra benefits to
24 the recorded music industry, it's worth noting
25 that Pandora also affords artists and their

1 managers data at a level that has never been
2 before assembled, and it's highly useful,
3 through something they call an artist marketing
4 program.
5 Pandora is making the uniquely rich
6 trove of such data available to these artists
7 and managers. This includes songs of the
8 artist that are playing on Pandora, how often
9 each play, how many listeners hear those songs
10 and aggregated demographic information about
11 those listeners, such as age, gender and
12 geography.
13 This has been proved to be highly
14 useful in connection with figuring out other
15 ancillary activities including where to
16 schedule concerts and where the opportunity to
17 boost sales is most available to these
18 particular artists.
19 Now although sometimes referred to
20 as a customized or personalized service,
21 Pandora is above all radio. Other than
22 selecting this seed we discussed and thumbing
23 up and thumbing down, the user just leans back
24 and let's Pandora do the work of selecting a
25 great playlist. This makes Pandora

1 meaningfully different than the so-called lean
2 forward, on demand services like Rhapsody on
3 Radio or Spotify, where the listener chooses
4 the particular songs he wants to hear, the
5 order in which he wants to hear them and can
6 listen to them when and as often as he likes.
7 Well, Mr. Pomerantz suggested that
8 this is a slight difference in access to music,
9 all evidence is really to the contrary, that it
10 is actually a quite profound difference, not
11 only in listening experience but in the nature
12 of both the downstream, as we will talk about,
13 and upstream markets or consumer user
14 respectively on interactive services and
15 noninteractive services.
16 The point is that if a subscriber to
17 an interactive service wants to gorge on a
18 given song, album or artist, to rewind, skip
19 without limitation, all of that can be done,
20 all of that can be done unlike the limitations
21 presented by Pandora being subject to the
22 statutory license limitations.
23 Now despite SoundExchange's efforts
24 which you will hear much about, using the
25 witness testimony, it's a poor trade, Pandora

1 has an intense head-to-head competition with
2 interactive services or as being in the vortex
3 of this so-called convergence between
4 interactive and noninteractive services, none
5 of that can explain away this basic
6 distinction. Very basic distinction between on
7 demand listening where the user selects the
8 songs he or she will listen to, an Internet
9 radio where the service itself programs the
10 songs.
11 We will submit that the weight of
12 the evidence shows there is no slight
13 difference either in actual performance and
14 more importantly in its implications for rate
15 setting here. Indeed, if one looked at the --
16 and thought about the very legislation giving
17 rise to these statutory proceedings, Your
18 Honor, as yourself as recently as 2013
19 recognized how fundamental this very
20 distinction in listening concept and in
21 accessibility to music, it's in your Web III
22 remand determination, may I remind you, you
23 indicated that the rationale for permitting the
24 on demand side of the market to be unregulated
25 be subject to the free market forces as it

1 were, was Congress's recognition that
2 interactive services are the most likely to
3 pose the greatest risk of substitution.
4 That is, of course, displacement of
5 record sales. The reason being that the user
6 of an interactive service, in Your Honor's
7 words, quote, essentially decides which sound
8 recordings he will receive, unquote, open
9 quote, and analogous to the decision to
10 purchase music digitally or otherwise.
11 Conversely, Your Honor has
12 recognized Webcasters pose a, quote, major
13 difference, unquote, in the risk of
14 displacement and that's so because Webcasting
15 services, in your words, quote, play a more
16 passive role in the music selection process
17 with the Webcaster itself anticipating what
18 music the listener might enjoy, in your words,
19 quote, much like radio, unquote.
20 Nothing since 2013 has changed with
21 respect to those basic observations.
22 JUDGE STRICKLER: Web III remand
23 decision asks for those evidence -- preceded in
24 2013, will you please present a witness who
25 discusses how the convergence has changed if at

1 all from the evidence that we had in the record
2 from the 2013?
3 MR. RICH: Fair question and
4 answering, we definitely will -- both our fact
5 and economic witnesses will do exactly that, as
6 will the survey results presented by Edison
7 Research, Mr. Rosin which is a current snapshot
8 of user behavior, interchangeability, so the
9 response -- not response, but a counter to the
10 Butler evidence, and that in combination will
11 directly address why, as I have indicated,
12 nothing has changed in the respect that were
13 relevant to your last determination.
14 JUDGE STRICKLER: Which specific
15 witness would you say was contrary to Ms.
16 Butler?
17 MR. RICH: Mr. Rosin of Edison.
18 Now, the core premise of
19 SoundExchange's case is that listening to
20 Pandora is a substitute for subscribing on
21 demand services such as Spotify, for a
22 proposition. And that Pandora in fact is not,
23 quote, much like radio, but instead satiates
24 the user's interest in deciding which sound
25 recordings he will receive to the same or

1 similar degree.

2 I respectfully submit that the

3 evidence we will submit will expose this as a

4 fundamental misconception. Nearly 70 percent

5 of the time spent listening to music is through

6 so-called lean back services, terrestrial radio

7 and Webcasting.

8 If you look at your first slide in

9 the demonstrative package, you will see that

10 through the shaded sectors, and you will see

11 another interesting statistic there. This is

12 an exhibit presented by Professor Shapiro at

13 Page 9 of his rebuttal testimony. I just put

14 it forward here.

15 You will see on that same chart that

16 only seven percent, only seven percent of total

17 music listeners is to interactive services. So

18 what does that tell us? Tells us that that

19 marketplace is populated by a small, but avid,

20 group of music listeners. The very survey I

21 just mentioned, Your Honor, conducted by Edison

22 Research, which was referenced in one or more

23 slides put up during his opening by Mr.

24 Pomerantz which has been retained by the music

25 industry on all sides for generations as the

1 gold standard of survey research in this field,
2 conducted a survey here about which Mr. Rosin,
3 who is its president, will testify,
4 demonstrating among other fundamental
5 propositions, the following, which is as to the
6 small universe of avid music listeners, fewer
7 than four percent, four percent of the
8 respondents to the Edison Research's survey
9 reported paying for subscription to the by far
10 dominant platform premium on-demand service,
11 pardon me, Spotify.
12 Fully 91 percent of respondents who
13 are not current subscribers to an on-demand
14 service indicated that they were not at all
15 likely or not very likely to spend $9.95 a
16 month to subscribe to such a service, and a
17 highly significant majority responded to the
18 same effect even when punitive price points
19 were dropped down to as low as 3 or $4 a month.
20 For its part, that survey will indicate and the
21 testimony will reveal that Pandora with its
22 more than 80 million active users is
23 predominantly shifting listeners from
24 terrestrial radio, which pays nothing to the
25 record labels, or second largest category of

1 diversion for listeners is people who were not
2 listening to music at all. So if you step back
3 and think about that, the significant majority
4 of listeners who are attracted to Pandora
5 historically either never through terrestrial
6 radio paid the record industry anything at all
7 with respect to sound recordings or are new
8 music listeners and therefore every play of
9 these converted listeners, whether from
10 terrestrial radio time or from other
11 entertainment options is money in the record
12 industry's pocket. Key statistic, key
13 statistic.
14 Again, from the Edison survey, only
15 one percent of Pandora's monthly users said
16 that the time spent listening to Pandora is
17 replacing time spent listening to an on-demand
18 service like Rhapsody or Spotify. One percent.
19 This is not evidence of substitution
20 or of convergence between services like Pandora
21 and on demand services. I will come back to
22 that a little bit later.
23 Pandora, which has been growing its
24 revenue just as fast as it can, has experienced
25 pretty astonishing growth since its inception.

1 Over the first decade of its existence, its
2 revenues have grown from something less than $3
3 million a year to over $900 million in 2014,
4 but the astonishing revenue growth really tells
5 only half the story. Pandora has plowed back
6 into the business and incurred costs of nearly
7 $2.7 billion to grow to scale and to ultimately
8 hope to attain its first profitable year.
9 Over one billion dollars of that
10 $2.7 billion has been paid in the form of
11 royalties to recording artists and record
12 labels. And in 2014 alone, Pandora will have
13 paid more than $400 million in statutory
14 royalties.
15 To place those in some perspective,
16 I just offer you two slices of information.
17 $400 million represents more than half of
18 SoundExchange's total receipts across all
19 categories of digital service. Not simply
20 limited to Webcasting. More than half of
21 SoundExchange's total receipts, statutory
22 users, licensees, are paid by Pandora itself.
23 That 2014 sum exceeds the total music
24 performing rights royalties paid by the entire
25 terrestrial Webcasting industry ASCAP, BMI and

1 SESAC for the very musical works embodied in
2 these sound recordings. Let me say that again.
3 The $400 million paid by one entity, Pandora,
4 outstrips the cumulative payments by all
5 terrestrial radio broadcasters to use all of
6 the musical works embodied in all of these
7 sound recordings. This is a remarkable sum of
8 money by any measure.
9 Now as is known to the judges,
10 Pandora has been paying royalties to the record
11 industry based on the so-called peer-play
12 rates. Those negotiated rates, it's important
13 to point out, are different and lower than the
14 statutory rates which Mr. Pomerantz put up on
15 the screen that were established by the CRB in
16 Webs II and III.
17 An important point is that when Mr.
18 Pomerantz says that the rate Pandora seeks
19 here, which I think the number was 52 percent
20 lower than statutory rate, that loads the deck
21 a bit, because Pandora has never paid the Web
22 II or III statutory rate. It has paid
23 significantly less. And its rate proposal is
24 far more in line with the rates it has paid for
25 reasons independently justifiable.

1 You don't rely on the peer-play
2 rates to set a fee here like Tweeter, but in
3 point of fact, Pandora is not looking to reduce
4 its royalty obligations by a level of anything
5 like 52 percent from any asserted prior fee
6 obligation. It never paid under the Web II or
7 Web III rates. In fact, had it paid under
8 those rates, it would have incurred beyond the
9 billion dollars it has paid another $800
10 million in royalty obligations over the span of
11 Web II and Web III and it would have translated
12 into fees exceeding 80 percent of Pandora's
13 revenues over that entire time.
14 As Mr. Herring will testify, to
15 avert going out of business under a scenario
16 where Pandora would have paid out those higher
17 rates, Pandora would have had to pull back on
18 necessary investments to grow the business and
19 to continue to develop the Internet radio
20 advertising market, and in his professional
21 estimation, the result of such cutbacks would
22 have been at best a business vastly reduced in
23 scale and accompanying that vast reduction in
24 scale, a company that would have actually paid
25 significantly reduced royalties to artists and

1 labels, given the fact that it would not have
2 been able to continue to allow unlimited growth
3 in numbers of compensatory pricing.
4 Now going forward under Pandora's
5 rate proposal, it is estimated that artists and
6 labels will receive more than $2 billion in
7 royalty payments over the 2016 to 2020 license
8 term. Conversely, if the rates were set by
9 Your Honors in a range of SoundExchange's
10 proposal, again it is Pandora's professional
11 judgment and you will hear it, and seeing those
12 defendant's reasoning on cross-examination I'm
13 sure, that they would likely need to engage in,
14 again, serious cost curtailment measures such
15 as capping listening, which they had to do
16 twice before, as recently as 2013, with respect
17 to their mobile platform, with resulting
18 SoundExchange payments actually coming in below
19 what we estimate the $2 billion payments that
20 would be yielded by adoption of a rate proposal
21 asked for in the range.
22 JUDGE STRICKLER: Will one of your
23 witnesses testify how much less?
24 MR. RICH: I think Mike Herring
25 would be the best person to ask. By nature,

1 it's not a scientific process because it
2 requires making a number assumption, but I
3 think he will certainly be the best person and
4 I think he will make his best run at it.
5 JUDGE STRICKLER: Okay.
6 MR. RICH: Now, it is not an option,
7 not an option for Pandora to simply pass along
8 higher royalties by raising subscription
9 prices. As Your Honors are aware, a very small
10 percentage of Pandora's business is
11 subscription-based. It's advertising, too.
12 Contrary to what you're going to
13 hear Dr. Blackburn from the other side
14 speculate, it is not an option for Pandora
15 simply to, quote, sell more ads. And again,
16 Mr. Herring, the CFO is going to explain, this
17 quarterback, this armchair quarterbacking as I
18 will call it, he doesn't describe it. I'll
19 call it that, ignores the fundamental realities
20 of a growing business like Pandora. What Dr.
21 Blackburn fails to account for is that
22 decisions that might increase short-term
23 profitability can have severely adverse
24 consequences over the longer term.
25 Pandora is constantly running models

1 and making evaluative decisions as to
2 optimizing its advertising mix, so as to
3 continue to grow its listener base and at the
4 same time, achieve profitability for its
5 shareholders. We will talk about that at
6 length to a wealth of questions for us, Your
7 Honors.
8 These assessments -- I am told I
9 better move along. These assessments are not
10 offered to suggest that Pandora's entitled to
11 any special treatment either to ensure its
12 survival or prosperity. To the contrary, it is
13 solely intended to be made that Pandora would
14 not be a willing buyer at rate levels which
15 would create potentially insurmountable hurdles
16 in its path of growing into a profit.
17 Let me get to heart of the matter.
18 The parties' competing approaches to rate
19 setting.
20 As Your Honors are aware, I'm going
21 to read a little bit just to move along, and I
22 apologize, I normally wouldn't but I want to
23 stay on track.
24 As Your Honors are aware, the rates
25 and terms determined in this proceeding are

1 those that, quote, most clearly represent those
2 that would have been negotiated in the
3 marketplace between a willing buyer and a
4 willing seller. That is the statutory task.
5 It has never seriously been contested and it is
6 by now firmly established that this task calls
7 for rates and terms that would have emerged
8 from negotiations in a competitive marketplace.
9 It's also clear that competitive, as
10 Mr. Pomerantz also would agree, does not mean
11 perfectly competitive but effectively
12 competitive, and certain economists, including
13 ours, I think tend to prefer to it as workably,
14 but they are interchangable for this purpose.
15 It is also clear, however, that
16 competitive does not mean monopolize. Pandora
17 will present a straightforward and we believe
18 compelling case supporting its proposed rate
19 and rate structure. The case features the
20 first meaningful evidence of the Webcast
21 proceeding of direct licenses entered into
22 between parties to this very proceeding
23 covering the very same statutory rates as are
24 involved here.
25 In other words, the agreements

1 forming the nucleus of Pandora's rate proposal
2 have been entered into by the same buyers and
3 the same sellers valuing the same copyright
4 rights as are involved in this proceeding.
5 Unlike in previous Webcasting proceedings,
6 there is no need to reach into other markets
7 that require necessarily imprecise adjustments
8 to account at an minimum for different buyers
9 acquiring different rates under potentially
10 different market conditions.
11 In contrast, SoundExchange again
12 relies on benchmarks on rates major record
13 labels have obtained in license agreements with
14 on demand services like Spotify. At the
15 outset, as a comparative here, this benchmark
16 has two strikes against it. It involves some
17 of the same sellers as are involved in rate
18 setting here, it involves different buyers
19 whose services make fundamentally different
20 uses of sound recordings that implicate grants
21 of different and broader copyright rates.
22 If you look at Demo Slide 2, please,
23 we simply depicted the basic attributes that
24 one looks for in a benchmark comparison, and in
25 Column 1, you see four checks in terms of the

1 alignment of Pandora's direct license benchmark
2 and the fact that SoundExchange's benchmark
3 aligns in only one of the four categories.
4 There are other fundamental
5 differences between these competing benchmarks
6 however as well. There is for the first time,
7 a developed record as to the starkly different
8 competitive conditions in two distinct
9 so-called upstream markets for licensing sound
10 recording performing rates. One of those
11 markets is involving statutory Webcasters and
12 the other interactive services.
13 So just to talk about, to get
14 terminology straight at least as I tend to use
15 it, and as explicated by Professor Shapiro's
16 written rebuttal testimony at Pages 7 to 13:
17 In order to properly understand the competitive
18 dynamics of the recorded music market, one
19 needs to distinguish between the so-called
20 downstream market to provide music to listeners
21 which, if you will flip the page, it's depicted
22 graphically in Slide 3, that is showing all of
23 the different music inputs for listeners and
24 the separate upstream market, which you will
25 see at Slide 4. These are drawn again from

1 Professor Shapiro's testimony. A separate
2 upstream market for the inputs used to make the
3 final products that consumers use. In this
4 case, the relevant markets in which servicers
5 acquire the necessary licenses to perform
6 recorded music.
7 Professor Shapiro's comprehensive
8 examination of the competitive conditions in
9 the distinct upstream markets for licensing
10 interactive and noninteractive services
11 demonstrate the fundamental difference in the
12 ability of these servicers to control the mix
13 of music they performed. In only one of those
14 two upstream markets involving noninteractives,
15 Webcasters, does one find the characteristics
16 necessary to enable meaningful competition to
17 occur between and among record labels for plays
18 of their sound recordings.
19 I quote Mr. Pomerantz from his
20 opening, something I could not contest at all.
21 Good competitors try to take customers away
22 from each other. That is what they do, end
23 quote. To observe complete absence of record
24 companies competing with one another to take
25 plays from each other in the interactive space

1 means virtually by definition, that one doesn't
2 observe the necessary features of a competitive
3 market in the licensing of sound recording
4 performing rights to interactive services.
5 That interactive services benchmark
6 built on, we will submit and our evidence will
7 prove, it fundamentally fails to meet the
8 criterion that the rates to be set in this
9 proceeding must reflect those that would be
10 negotiated in a competitive market.
11 And what's the basis for this key
12 difference? Why is one market capable of this
13 form of fundamental price competition and the
14 other provably is not. The key is a concept
15 called steering. Steering as our economists
16 use the term is the ability of a service to
17 play relatively more or relatively fewer sound
18 recordings from a given label based on the
19 prices charged. Fairly basic. Somebody says,
20 I'm going to reduce my per-play rate by 10
21 percent if you will play me more, then there is
22 an incentive, all things equal, for that
23 service to say that sounds good, assuming I can
24 do it commercially viably and not harm my
25 business and at the same time by definition,

1 competitors of that price cutting label who
2 refuse to do so risk having less of their
3 product sold, fewer performances of their music
4 played, that is simply how competitive markets
5 operate.
6 The record demonstrates that Pandora
7 has an unequivocal ability to steer at a robust
8 level. It also shows the unequivocal lack of a
9 similar ability by on demand services certainly
10 at minimum with respect to the basic raise on
11 debt of those services which is allowing their
12 user to dictate what is getting played, their
13 unequivocal inability to do the same level of
14 steering.
15 Now you will hear from both
16 Professor Shapiro and from Pandora's senior
17 scientist, Dr. McBride, about a really
18 important Point 14 steering experiment in which
19 the company engaged. What they did was to test
20 the proposition of how sensitive listenership
21 on Pandora would be to meaningful alterations
22 of the intensity of use of various majors,
23 repertories. They tested it at a 15 percent
24 level higher or lower for Universal or Warner,
25 Sony and they tested it at a 30 percent level

1 higher and lower and the results of the
2 experiment are telling.
3 Pandora can, with no discernible
4 impact on its listening experience, increase or
5 decrease its reliance on the repertory of any
6 major by 15 percent, and it can do that up to
7 30 percent with only minimal effects on
8 listenership.
9 There is an exhibit appended to Mr.
10 Shapiro's written direct testimony in which he
11 indicates how imputing lower royalty rates that
12 can be negotiated and returned for that
13 steering ability, it can be a win-win for both
14 Pandora in reducing its overall royalty burden
15 and for a record label which has, relatively
16 speaking, earned more from increased plays of
17 its sound recordings than it otherwise would
18 have earned, for example, had it solely
19 received revenues from a statutory license.
20 Now, the bottom line is this, Your
21 Honors. This steering ability enables Pandora
22 to inject competition into the licensing of
23 sound recording rights by affording record
24 companies that want to increase their market
25 share the opportunity to do so, in return for

1 offering Pandora the lower price per play. By
2 definition, not every record label can receive
3 such benefits. The other side wants to try to
4 make something meaningful of that proposition.
5 But rather than undermine the force of such
6 steering ability in inducing competition, that
7 fact makes the very point. Competition is all
8 about trying to gain market share at the
9 expense of one's competitors and doing so by
10 charging the lower price. In such a
11 competitive market, labels that charge more
12 than their competitors will be played less.
13 That is how markets operate.
14 Now the primary benchmark that
15 Pandora relies on for fee setting here are its
16 direct licensing arrangements with Merlin and
17 with the access labels as they reflect
18 precisely such competition of work.
19 Let me briefly tell you about the
20 principle of Merlin's agreement. Merlin is a
21 global rights agency that represents numerous
22 independent labels in license negotiations of
23 the type that it concluded with Pandora.
24 Through its ability to aggregate the licensing
25 of work from numerous labels, Pandora has been

1 dubbed, including by the record industry,
2 quote, a virtual fifth major, unquote.
3 JUDGE STRICKER: Are you referring
4 to Merlin?
5 MR. RICH: Yes. And of course, that
6 was -- I should say that was at the time when
7 there weren't four actual majors, and now I
8 guess, to use the analogy, would be it is a
9 virtual fourth major, if I may take the liberty
10 to convert that.
11 By all accounts, including those of
12 SoundExchange's witnesses from whom you will
13 hear, Messrs. Wheeler and Van Armen, Merlin is
14 a sophisticated organization which is savvy in
15 the digital licensing arena and one that is
16 able to negotiate rates that are comparable to
17 those in the majors. One of the interesting
18 features of this case is that SoundExchange's
19 own principal economic expert, Professor
20 Rubinfeld, himself has studied and proffered
21 analyses as to what gap one would experience
22 and one has observed in the licensing of sound
23 recording performing rights in agreements
24 entered into by the majors on one hand and the
25 independent labels on the other.

1 So any suggestion that the Merlin
2 agreement is somehow tainted or
3 unrepresentative because it only involves
4 indies is responded to virtually completely by
5 Professor Rubinfeld of SoundExchange's own
6 analysis. He found barely a two percent price
7 differential in the marketplace. Two percent.
8 Between the royalty fees one would expect the
9 majors to elicit in marketplace transactions
10 for sound recording performing rights and what
11 independent labels would be expected to yield.
12 It is really a non-factor. It's a rounding
13 error.
14 Now Merlin saw the benefit of
15 entering into a direct license arrangement with
16 Pandora because of its very recognition of
17 Pandora's ability to steer. In the words of
18 one of its deposition witnesses, Mr. Lexton,
19 whom you will hear from, more air play is
20 better than less air play. That sort of sums
21 it all up. They recognized it and they went
22 for it.
23 The resulting agreement captures
24 precisely this competitive dynamics. Merlin
25 members receive more air time in exchange for

1 incrementally lower per-play payments with
2 Pandora.
3 If we turn to Slide 5, please, you
4 will see the Pandora fee proposal which is
5 drawn from the Merlin agreement. It is a
6 little bit of a complicated slide to unpack. I
7 admit it. I apologize. The person here to
8 walk you through the translation of the Merlin
9 terms to what it appears on Slide 5 is
10 Professor Shapiro, and with much more time than
11 I have available to me this morning, will
12 explain what that translation amounts to.
13 Now, it's important to contrast this
14 market dynamic that I have described that
15 enabled Pandora to enter into the transaction
16 with Merlin, and after that, with a very
17 prominent classical label, Naxos, says exactly
18 the same thing. So what one observes in the
19 record industry has chosen benchmark -- has
20 chosen benchmark marketing, the interactive
21 services.
22 As Professor Shapiro again will
23 elucidate, this is a market characterized by a
24 complete lack of price competition between
25 record labels to have their work performed on

1 interactive services. It is the essential
2 nature -- because of the essential nature of
3 these on demand services together with their
4 limited inability to steer that brings about
5 this circumstance.
6 Now you need not rely on this
7 recognition. You need not rely solely on
8 Professor Shapiro's testimony, or that of
9 iHeartMedia or any of these supporting
10 economists. The basic tutorial on this subject
11 was provided by none other than Universal Music
12 Group, the largest distributee of statutory
13 rights by Glenn Pomerantz, its counsel and by
14 Professor Rubinfeld himself, all in government
15 submissions, supporting Universal's proposed
16 merger of its sound recording business with
17 that of another major music company, EMI, in
18 front of the Federal Trade Commission.
19 Now because we couldn't clear with
20 my friends on the other side actually leading
21 you with significant quotes, I have instead
22 presentative excerpts from key submissions from
23 each of these individuals appearing at Pages 6,
24 7, 8 and 9, and some excerpts from very telling
25 documents of the demonstratives.

1 The bottom line is that UMG and its
2 advisors explained to the FTC that interactive
3 services by their nature must offer consumers
4 access to virtually all music to be viable. We
5 understand that. That is a fact. That's true.
6 As a consequence, catalogs of each of these
7 majors are must-haves for an interactive
8 service making the catalogs of the majors
9 compliments rather than substitutes.
10 Those are again the sort of terms of
11 economics which will I think be explicated as
12 we go, but bottom line meaning that in a -- you
13 don't see in that marketplace efforts, you
14 don't see price rivalry between competitors to
15 achieve more plays than its competition. That
16 will be substitution. Rather, every major's
17 entire repertory is needed in unlimited amounts
18 by on demand services making them compliments.
19 Now, in plain English terms, as
20 opposed to economies, the stark admissions
21 attest to a complete lack of price competition
22 between and among recording music companies in
23 what is now an even more concentrated industry
24 in their dealings with interactive streaming
25 services. Not a lack of perfect competition or

1 even of effective competition, no competition
2 at all.
3 Now while these admissions might
4 have helped secure the merger, for reasons I
5 won't go into, they are devastating. We will
6 submit in this record here, and hence, I might
7 add, it is no surprise the lengths to which
8 SoundExchange went to avoid producing these
9 privileged documents, but now we have them.
10 Now notably, in Mr. Rubinfeld's --
11 Dr. Rubinfeld's written direct testimony in
12 this case, while he extensively discussed why
13 the major licenses with on demand services
14 purportedly render them optimal benchmarks
15 here, he failed to address at all, not a word,
16 the necessary showing that the rates emerging
17 from these licenses must reflect those that are
18 emerging in a competitive marketplace. He went
19 through lots and lots and lots of factors,
20 indicating willing buyer, willing seller and
21 the like, but never mentioned the word
22 competition once, and therefore, devotes not a
23 word to the critical evidentiary showing of
24 what the transactions could be said to have
25 occurred in an effectively priced competitive

1 market. Recent deposition when asked whether
2 that was simply an accidental omission, Dr.
3 Rubinfeld said no, he had been aware of it from
4 the beginning, and while he tries mightily in
5 his rebuttal of testimony to make up for lost
6 ground, finally, at Page 26 of his rebuttal
7 testimony, the word competition first appears,
8 the kind of attributes that he indicates
9 resuscitates the interactive service market
10 that, in fact, allegedly infuse it with
11 sufficient indicia of competition to provide
12 the benchmark simply is unavailing.
13 Can I get a time check from someone?
14 Let me just say, I am moving through
15 some material I would have preferred to cover,
16 but let me just say this, that while we believe
17 and our testimony will suggest, that this
18 crippling limitation of SoundExchange's case,
19 wholly aside from the fact that it requires
20 lots of other adjustments to make it comparable
21 to this market setting, should render it an
22 inactive benchmark for this proceeding. At a
23 bare minimum, it would have been incumbent on
24 SoundExchange and its experts to attempt to
25 make some adjustment beyond merely its

1 interactivity adjustment to account for this
2 lack of basic competition in the benchmark
3 market, simply to ignore it, simply to hope it
4 won't see the light of day, simply to dance
5 around it by saying there are lots of other
6 externalities in the marketplace that limit the
7 ultimate pricing ability of a major is no
8 substitute for that test of competition, which
9 is head to head competition.
10 JUDGE STRICKLER: I apologize. Mr.
11 Rich, will any of your witnesses be testifying
12 as to the effect of the rates that Pandora
13 proposes on the capacity of record companies,
14 both majors and the independents to recover the
15 cost of creating the copyrights?
16 MR. RICH: I'm not aware that we
17 have taken on that issue, Your Honor.
18 Let me quickly turn to some of
19 SoundExchange's retorts to some of this because
20 nothing I am saying is new to the other side,
21 and we have had a chance to exchange rounds as
22 you know.
23 So how does SoundExchange attack the
24 Merlin agreement? Principal argument is the
25 supposed shadow of the statutory license

1 argument.
2 As we interpret Professor Rubinfeld,
3 its sponsor, we would have the judges disregard
4 any, any marketplace agreement reached by a
5 noninteractive, I will say, other than Apple,
6 which helps them but we believe will not. At a
7 level below the statutory rate, so that you
8 should disregard any private agreement reached
9 by any service subject to a statutory license
10 that is reached at a level below the statutory
11 rate as necessarily tainted by this so-called
12 shadow of the statutory license.
13 As we understand Professor
14 Rubinfeld's logic, every such agreement is
15 suspect insofar, A, as the service always had a
16 statutory license available to fall back on,
17 and B, that the record label involved couldn't
18 decline to issue a license, let alone at a
19 price higher than the statutory license.
20 Now, one can accept each of those
21 propositions standing on their own. But the
22 question left completely unanswered by
23 Professor Rubinfeld is what would motivate a
24 record label to license a statutory service at
25 below the prevailing statutory rate, which is

1 what we have observed in the Merlin and Naxos
2 transactions.
3 Well, the answer -- it's actually
4 supplied unwittingly by Professor Rubinfeld
5 himself, because when he filed his written
6 direct testimony not yet aware of these direct
7 license arrangements, he correctly observed
8 that, quote, if the statutory rate is too high,
9 unquote, i.e., if it exceeds the market rates
10 that will be voluntarily negotiated between
11 willing partners in the absence of a statutory
12 license, then licensees and licensors would
13 have a joint incentive to renegotiate. That is
14 Professor Rubinfeld's own statement of basic
15 economic principle.
16 What he stated is precisely what the
17 Pandora Merlin and Pandora Naxos transactions
18 revealed. Sellers determining it to be in
19 their economic interest, the license plays
20 Pandora at rates below the statutory rate at
21 which Pandora has been paying to have their
22 music played more. Discounting below the
23 statutory rates, in Professor Rubinfeld's own
24 words, provides clear evidence that the
25 statutory rate, quote, exceeds the market rate.

1 Now to be sure, there is a quote up
2 on one of Mr. Pomerantz's demonstratives, an
3 alleged admission by our guy, Professor
4 Shapiro, that statutory rates do have an impact
5 on how one observed transactions involving
6 statutory licenses, we agree with that and
7 Professor Shapiro agrees with that. But it's
8 not the affect, it's not the affect that
9 Professor Rubinfeld postulates.
10 Instead, as Professor Shapiro will
11 explain, the impact of the statutory license
12 when one observes a Merlin-type transaction is
13 to artificially elevate the prices that were
14 agreed to above fair market levels because in
15 that situation, the statutory rate acts as a
16 magnet pulling the negotiated rates up towards
17 it, so if there is a distortion in the
18 marketplace, in a situation where Professor
19 Rubinfeld has conceded one would expect to find
20 transactions bidding below the statutory rate,
21 it would be if anything, that the observed
22 transactions overstate the actual fair market
23 price for the reasons that Professor Shapiro
24 explained.
25 What about the asserted

1 representativeness of the Merlin transaction,
2 another refrain from the other side. A couple
3 quick points.
4 The fact that Merlin and Naxos deals
5 reflect the direct license were solely a small
6 percentage of record labels and don't
7 themselves at least yet represent a large
8 percentage overall of spins on Pandora, doesn't
9 suggest they should get only limited weight.
10 As I've already noted, Merlin is a
11 heavyweight, a virtual fourth major and
12 SoundExchange and its witnesses repeatedly site
13 as being a significant competitive force in the
14 industry. I've mentioned already that the
15 argument that it can't be representative
16 because no major signed it, is responded to by
17 none other than Professor Rubinfeld himself,
18 who in defending his own interactive services
19 benchmark featuring only licenses by the major,
20 it's the flip side, says don't worry about the
21 non-including of indies because what the
22 marketplace tells us is there is no real
23 difference between them. Sauce for the goose,
24 sauce for the gander.
25 Same argument would apply to any

1 attack on the Merlin agreement on the basis
2 that the majors would certainly have gotten
3 much higher fees when SoundExchange in the
4 comments says this is not how this market has
5 organized itself is operated.
6 I will skip present purposes, Dr.
7 McBride's impact on sales experiment which
8 provides further support for the validity and
9 representative nature of the Merlin agreement,
10 and I just want to indicate finally though, and
11 this is a fact of life, that the record is
12 replete and you will see evidence of record
13 company testimony, that even though
14 transactions below the statutory rate may make
15 economic sense, years of creating adverse, CRB
16 president, counseled many companies and to this
17 day, counseled many companies against entering
18 into such agreements.
19 One shouldn't underestimate the
20 limiting affect on direct license transactions
21 one would otherwise expect to see on the basis
22 of this broad based record industry.
23 How much more to an hour?
24 MR. LARSON: Five minutes.
25 MR. RICH: All right. Other

1 defenses of interactive services benchmark.
2 Two arguments. The suggestion that the market
3 is competitive. I think I have really covered
4 that and I'm not going to spend very much time
5 on it at all. It is belied by the evidence.
6 It is belied by the admissions you will see of
7 the record industry and of its own
8 representatives in another setting here. There
9 is just a complete lack of ability to steer on
10 the part of the on demand services that freezes
11 price competition in that market.
12 And again, Professor Rubinfeld's,
13 late in the day, rebuttal effort to demonstrate
14 that the market -- that benchmark market
15 evinces sufficient indicia of competition to
16 qualify as effective competition. We feel when
17 the record is complete, will be shown not to
18 hold water.
19 Strange argument, strange argument,
20 averted to by Mr. Pomerantz in his opening.
21 Mr. Rubinfeld speculates that while major
22 labels may be must-haves that were referred and
23 both used for interactive services, so too are
24 they must-haves for Webcasters. The
25 implications of this argumentation are pretty

1 remarkable.

2 The argument appears to suggest that

3 Your Honors need not be concerned about the

4 competitiveness of the interactive services

5 market in assessing a proper benchmark here,

6 insofar as the same noncompetitive condition

7 afflict the Webcasting market. So rather than

8 frontally address and attempt economically to

9 adjust for the monopoly pricing conditions that

10 afflict the interactive services market,

11 Professor Rubinfeld would sooner have Your

12 Honors act upon -- what I'll call a perverse

13 principal, which is that you needn't worry

14 about the severe shortcomings of the

15 interactive services benchmark, insofar as in

16 the absence of a statutory license, there

17 wouldn't be any competition anyway among record

18 labels in licensing Webcasters.

19 The argument is not only remarkable,

20 I'll submit, it misses its mark. First of all,

21 there is no -- there is certainly an incomplete

22 record and a debated record as to the degree of

23 which any major is a, quote, must-have, in the

24 sense that for a Webcaster -- in the sense

25 that, for example, Pandora could do entirely

1 without, let's say, Universal. There is
2 differences of opinion. Pandora has never
3 reached that point of determination, it hasn't
4 tested for that, we all know the answer.
5 But even assuming that were the
6 case, let's stipulate that the majors are
7 must-haves, that begs the relevant question.
8 The relevant issue here is whether Webcasters
9 can influence the extent to which they will
10 perform work from a catalog of a major. That
11 is the essence of steering. By the nature of
12 an on-demand service, an interactive service
13 lacks that ability, everyone, Professor
14 Rubinfeld included, recognizes that Webcasters
15 like Pandora do have that ability.
16 I will stop here. I wanted to cover
17 convergence, but out of respect for my
18 colleagues and the Apple agreement which I
19 suspect a number of others will cover, I will
20 pause here and defer to my colleague, and you
21 will hear more on those topics certainly during
22 the proceedings on this case. Thank you very
23 much.
24 CHIEF JUDGE BARNETT: Thank you. We
25 will take our noonish recess at this time. We

1 will reconvene at 1:40 and I ask during this
2 recess, that you not monopolize the clerk's
3 time. This is her lunchtime as well. If you
4 need to confer with her, we will do that at the
5 end of the day.
6 (A short recess was taken.)
7 CHIEF JUDGE BARNETT: Good
8 afternoon. Please be seated.
9 Before we started we asked
10 facilities to lower the temperature in this
11 room as much as possible. I think there's a
12 congressional edict that says, you know,
13 temperature can only be between this point and
14 that point. Consequently, with all these hot
15 bodies in the room, we're all very, very warm,
16 as I'm sure you are too.
17 Please, please feel free to remove
18 your jackets. It is really -- we try to
19 maintain a bit of formality, but I don't want
20 to see anybody like dropping out during the
21 middle of the proceeding. So please feel free
22 to remove your jackets and make yourselves as
23 comfortable as possible.
24 We did call at noon to ask them to
25 lower the temperature again. So we'll see if

1 it happens.
2 Mr. Joseph, are you next up?
3 MR. JOSEPH: I am, Your Honor.
4 Thank you.
5 CHIEF JUDGE BARNETT: Oh, and before
6 you get started, Mr. Joseph.
7 From facilities again. There is a
8 door that is directly at the back of the room.
9 That is an exit. And no chairs can block that
10 door. There's a door over there that says "Not
11 an Exit." It's okay to sit in front of that
12 one, just not in front of the one that's
13 directly in the center at the back. Thank you.
14 MR. JOSEPH: Thank you, Your Honors.
15 And good afternoon.
16 My name is Bruce Joseph. I am here
17 today representing the National Association of
18 Broadcasters, which is appearing in this case
19 on behalf of its members who are simulcasting
20 their radio stations over the Internet and
21 those who would consider simulcasting their
22 radio stations over the Internet if the
23 economics permitted it.
24 Today it's just me. I don't have
25 any handouts. No dogs. No ponies. You'll

1 just have to take whatever it is that I say, I
2 guess.
3 CHIEF JUDGE BARNETT: At your peril.
4 MR. JOSEPH: I understand, and I'm
5 willing to assume the risk.
6 This afternoon I am going give you a
7 preview of the evidence that NAB expects to
8 present in this case to show why that evidence
9 will support a rate for simulcasting of no more
10 than .05 cents per performance with no
11 percentage of revenue component.
12 First I will discuss what
13 simulcasting is and why even SoundExchange's
14 witnesses admit that simulcasting is
15 significantly different from the other services
16 that are participating in this proceeding.
17 I will introduce you to NAB's
18 broadcaster witnesses and summarize the
19 highlights of what they will tell you about
20 their businesses.
21 Second, I will dive into the
22 economics, introducing Professor Michael Katz,
23 NAB's lead economic expert and will describe
24 his testimony in which he elaborates on the
25 economic significance of competition and

1 explains why sound recordings' primary
2 benchmark in this case does not reflect
3 competitive rates.
4 Professor Katz will also testify
5 that even correcting for just some of the flaws
6 in SoundExchange's benchmark analysis would
7 result in rates at a level of those proposed by
8 NAB.
9 Third, I will discuss the evidence
10 that will show that SoundExchange's proposal
11 for a greater-of fee is neither economically
12 supportable nor administratively viable for
13 simulcasting.
14 Finally, I will discuss the evidence
15 demonstrating why SoundExchange's late-found
16 Apple benchmark should be rejected and why
17 neither the existing Web III rates nor the
18 NAB/SoundExchange Webcaster Settlement Act
19 agreement are valid indicia of effectively
20 competitive license fees.
21 So what is simulcasting? It's
22 radio. The only significant difference is that
23 you'll hear it over the Internet rather than
24 over the air. And thus it has everything that
25 radio has.

1 Now, every other service in this
2 proceeding is claiming to be radio.
3 Simulcasting really is. It has the same on-air
4 hosts and personalities that keep you company.
5 It has the same connection to the local
6 community, providing local news, traffic,
7 weather, discussions of community events and
8 emergency information in a crisis. And yes, it
9 does have the same music introduced and
10 promoted by the same trusted DJs whose
11 endorsements the major record companies go to
12 enormous lengths to obtain, as even Mr.
13 Pomerantz concedes.
14 So music is a part of radio and of
15 simulcasting. But unlike most of the services
16 in the benchmark and target markets that will
17 be discussed here in this proceeding,
18 simulcasting is not just a music service.
19 You won't hear much about
20 simulcasting in SoundExchange's presentation.
21 It doesn't fit into SoundExchange's theory of
22 the case. The foundation of SoundExchange's
23 case is that customized Webcasting substitutes
24 for other record company revenue streams, is
25 not promotional of sound recording sales, is

1 not like radio, and has functions that are
2 converging with interactive on-demand services.
3 Whatever the validity of that thesis
4 for custom Webcasting -- and I'm confident that
5 the other services will have something to say
6 about that -- the evidence will show that
7 SoundExchange's premises are simply false for
8 simulcasting.
9 As NAB's witnesses will explain,
10 simulcasting is not customized. It is not
11 influenced by the user. It is the same program
12 for everyone chosen by the broadcaster. It is
13 not converging with on-demand streaming. It is
14 just like radio.
15 It does not substitute for CD sales
16 or downloads. It promotes them. And there is
17 no evidence that it substitutes for
18 subscription on-demand streaming.
19 And the music that a station decides
20 to play is only part of the reason that
21 listeners choose simulcasts of their favorite
22 radio stations.
23 If you really wanted to listen to
24 just music, there are lots of other places to
25 find it. Moreover, the use of music varies

1 widely among simulcasters. And the right to
2 play music is not what differentiates radio
3 stations.
4 SoundExchange's own witnesses
5 recognize the difference between simulcasting
6 and other forms of Webcasting.
7 For example, SoundExchange's first
8 witness tomorrow will be Dennis Kooker of
9 Sonny. His written direct testimony draws what
10 he calls a fundamental distinction -- those are
11 his words -- between streaming services
12 mirroring terrestrial radio and services
13 enabling customized music access.
14 Of course simulcasting mirrors
15 terrestrial radio. And it is still
16 fundamentally distinct from on-demand services.
17 There is more that I'll be able to
18 discuss in closed session regarding what
19 SoundExchange's witnesses have said, but they
20 were mostly said in depositions, which the
21 parties are still treating as restricted. So
22 I'll reserve that.
23 But the key point is that even the
24 evidence from SoundExchange --
25 CHIEF JUDGE BARNETT: To be sure the

1 folks in the back can hear, can you move that
2 microphone, just to get closer. Is that okay?
3 MR. JOSEPH: Sure.
4 CHIEF JUDGE BARNETT: Great.
5 Thanks.
6 MR. JOSEPH: Or I can even, perhaps
7 easier, move myself a bit closer to the
8 microphone.
9 The key point is that the evidence
10 from SoundExchange will be that simulcasting is
11 different and different in ways that matter for
12 setting rates.
13 Now, NAB's fact witnesses will not
14 be a parade of lawyers, like three of the four
15 major label witnesses. Rather, you will hear
16 from real broadcasters who will tell you about
17 the industry to which they have devoted their
18 professional lives, broadcasters such as John
19 Dimick, senior vice president of programming
20 and operations of Lincoln Financial Media, has
21 35 years in the radio industry; Robert Kocak,
22 the vice president of program development at
23 Greater Media, who was known professionally as
24 Buzz Knight, and is another 35-plus-year
25 veteran of the industry; Steve Newberry, the

1 chief executive officer of Commonwealth
2 Broadcasting of Kentucky, who began his career
3 in radio at the age of 14, worked on the air in
4 high school and college, and later founded
5 Commonwealth almost 20 years ago; Julie Koehn,
6 the president and general manager of Hemingway
7 Broadcasting in Adrian, Minnesota, who has held
8 her current position for 25 years; Ben Downs,
9 the vice president and general manager of Bryan
10 Broadcasting of College Station, Texas, who has
11 over 45 years' experience in radio; and Johnny
12 Chiang, who heads up Cox Radio's country
13 stations in the Houston, Texas market.
14 On the buyer side of the willing
15 buyer/willing seller standard, Mr. Dimick and
16 Mr. Downs will testify that simulcast streaming
17 is not profitable for their companies and never
18 has been, primarily due to the cost of sound
19 recording royalties; and the fact that, despite
20 their efforts, advertisers simply are not
21 willing to pay significant amounts for ads on
22 their streams. That, of course, dramatically
23 affects what a buyer would be willing to pay.
24 NAB witnesses will also describe how
25 the success of a radio station, even a

1 music-formatted radio station, does not depend
2 primarily on music. All stations have access
3 to the same music.
4 Rather, success depends primarily on
5 how the station differentiates itself from
6 other radio stations by developing a
7 relationship with its listeners through on-air
8 personalities, community programming and
9 community outreach, among other things.
10 That testimony will be supported by
11 ordinary course of business documents and
12 studies showing that programming elements other
13 than music, including the ones I've just
14 mentioned, contribute much of the value of
15 radio programming. That should be contrasted
16 with services offering only music programming.
17 In addition, NAB will present the
18 results of a commission survey by Professor
19 Dominique Hanssens, distinguished professor of
20 marketing at UCLA. That survey, his survey,
21 confirms that the importance of nonmusic
22 programming on radio also applies to
23 simulcasting.
24 The evidence will thus show that
25 simulcasting should be contrasted with services

1 that offer only music programming. And
2 contrary to Mr. Huffy's assertion that you'll
3 see in his written direct testimony, that, with
4 simulcasting, as with radio, it's not, quote
5 all about the music, close quote.
6 Now, Ms. Koehn and Mr. Newberry will
7 also highlight the importance of their
8 station's community programming and community
9 service.
10 Ms. Koehn will explain how she would
11 like to better serve her station's community by
12 providing access to its programming online but
13 has decided not to do so primarily due to sound
14 recording royalties. Because her station is
15 not streamed, her community loses, and the
16 public loses.
17 Mr. Dimick and Mr. Knight will --
18 and others will provide -- will also describe
19 the enormous promotional benefit and the
20 promotional value that radio broadcasts provide
21 to artists and record labels and how labels and
22 artists undertake extensive efforts to cause
23 broadcasters to play their recording.
24 And as Mr. Dimick will explain, the
25 context of the simulcast stream is the same as

1 the content of the broadcast; thus, ear for
2 ear, it provides the same promotional benefits
3 to record companies and artists.
4 The value of the record company --
5 the value to the record companies of radio
6 airplay is confirmed in industry studies and by
7 the record companies' own behavior and as
8 reflected in the labels' own testimony and
9 documents.
10 Mr. Pomerantz concedes this is true.
11 He could scarcely do otherwise.
12 Numerous industry studies show the
13 importance of radio for music discovery. Radio
14 is the primary source of music discovery. And
15 if you don't discover it, you don't buy it.
16 Declarations submitted in this case
17 by high-level executives of all three major
18 labels, in their efforts to avoid discovery
19 from their radio promotion departments, stated
20 that their companies had multiple promotion
21 departments employing hundred of people in the
22 aggregate whose job it was to try to get their
23 recordings on the radio.
24 NAB will also present evidence of
25 the large sums of money that the record

1 companies spend to promote their recordings to
2 radio. And there's a simple economic fact. If
3 it weren't worth it to them, they wouldn't
4 spend that money.
5 Now, there's a bit more that I'll
6 discuss in closed session, but we'll come back
7 to that.
8 And as I will discuss shortly, this
9 promotional benefit would be reflected in an
10 effectively competitive market by lower royalty
11 rates.
12 Now, as we've all been waiting for,
13 to the economics.
14 In addition to its broadcaster
15 witnesses, NAB will present the expert
16 testimony of Professor Michael Katz from the
17 University of California at Berkeley. You'll
18 notice there seems to be a surfeit of Berkeley
19 economists in this case, and we have ours.
20 He's a leading expert in the
21 economics of industrial organization, which
22 includes the study of competition and pricing
23 as well as antitrust and regulatory policy.
24 Professor Katz has served as the
25 chief economist of the Federal Communications

1 Commission and more recently as the top
2 economist at the Justice Department, a position
3 responsible for merger and nonmerger
4 competition analysis and enforcement.
5 Your Honors have recognized that the
6 goal of this exercise that we're embarked upon
7 is to set prices that would exist in a
8 hypothetical, effectively competitive market
9 for sound recording devices. That standard is
10 central to this entire case.
11 The evidence will show that the
12 services embrace it. SoundExchange does not.
13 You will be able to contrast the
14 presentations of Professor Katz, who elaborates
15 on the economic significance of effectively
16 competitive markets and why they are the
17 paradigm that rate setting should strive to
18 achieve.
19 We'll be able to contrast that with
20 the testimony of SoundExchange's lead
21 economist, Professor Daniel Rubinfeld, who in
22 his direct testimony, the testimony in which he
23 develops SoundExchange's rate proposal, never
24 even once mentions the need for rates to
25 reflect an effectively competitive market. He

1 ignores it.
2 Professor Katz will testify that
3 economists have long recognized the value of
4 competition. Under competitive conditions,
5 consumers benefit, and the net welfare of
6 society's resources are maximized. Competition
7 among sellers gives consumers, both businesses
8 and individuals, the benefits of lower prices,
9 higher quality products and services, more
10 choices and greater innovation.
11 Professor Katz will describe how, in
12 an effectively competitive market, prices are
13 driven down towards -- not to but towards
14 sellers' marginal costs. And those costs
15 include what economists call opportunity costs,
16 the affect of a sale or a license on the other
17 revenue streams of a seller.
18 For example, where a buyer's
19 activity substitutes for other sales and thus
20 reduces the seller's other revenues, a seller
21 in a competitive market will charge that buyer
22 more.
23 Professor Katz will testify that
24 opportunity cost can also be negative. Think
25 of it as opportunity benefits. And when that

1 happens, that will reduce the amount that a
2 seller in an effectively competitive market
3 will charge, for example, where a buyer's
4 activity, such as simulcast streaming, promotes
5 other revenue streams of the seller.
6 Professor Katz will explain that, if
7 you are comparing license fees for two
8 different types of services, you must account
9 for these differences in opportunity costs and
10 benefits. It is not enough to suggest, as Mr.
11 Pomerantz, did that the interactive agreements
12 internalize the promotional and substitutional
13 effects of interactive services without
14 considering any differences between interactive
15 and noninteractive services in that regard.
16 Now, Professor Katz will explain the
17 hallmark of competition is that buyers have the
18 ability to substitute the offerings of one
19 seller for another. That's what competition is
20 all about. It is this possibility of
21 substitution that drives sellers to offer
22 higher quality and lower prices in order to
23 attract buyers to themselves rather than their
24 rivals.
25 I was struck by how well Mr.

1 Pomerantz himself put it. That's what
2 competitors do. They try to take customers
3 away from each other.
4 But a market where that kind of
5 rivalry, that kind of substitution does not
6 exist is not a competitive market. Simplest
7 case should go without saying that a
8 monopolized market is not competitive. There
9 are no sellers to compete with a monopoly.
10 Moreover, as Professor Katz will
11 show, a monopolized market does not become
12 effectively competitive even if, contrary to
13 the facts here, a buyer has its own market
14 power facing a monopoly. That's just not
15 competition.
16 And as Your Honors recognized in Web
17 III, and as Professor Katz will testify,
18 suppliers of what economists call complementary
19 products do not compete with each other.
20 Indeed, economics tells us that the sellers of
21 complementary products will actually set price
22 that, in the aggregate, exceed even those of a
23 monopolist.
24 Now, the primary benchmark on which
25 Professor Rubinfeld and SoundExchange seem to

1 rely in this case is the same one on which
2 SoundExchange primarily relied in Web II and
3 again relied upon in Web III, licenses in which
4 the major record companies licensed interactive
5 on-demand streaming services.
6 Professor Katz will demonstrate
7 these agreements are decidedly not the result
8 of competitive forces, and as a result, that
9 SoundExchange's benchmark is not a sound basis
10 for rate setting.
11 He will then demonstrate the serious
12 methodological flaws in Dr. Rubinfeld's
13 analysis, even taking it at its own word on its
14 face, resulted in a severe overstatement of the
15 rates that are implied even by that
16 noncompetitive benchmark.
17 Indeed, correcting for just the
18 easily quantifiable errors committed by
19 Professor Rubinfeld, Professor Katz shows that
20 the interactive benchmark would result in a
21 rate of .06 cents per performance, not the
22 .$0.26 per performance that Professor Rubinfeld
23 claims is what it shows.
24 And that rate doesn't even reflect
25 adjustments for the numerous other flaws in

1 Dr. Rubinfeld's analysis that are not so easily
2 quantified. But I'll come back to that.
3 Let's start with the overarching
4 issue of competition.
5 In Web III, Your Honors observed
6 that the parties had not presented evidence to
7 enable you to decide whether the catalogs of
8 the major record companies were complements or
9 substitutes. Well, you now have that evidence.
10 And you have it specifically for the very
11 interactive service licenses on which
12 SoundExchange is purporting -- attempting to
13 relay in this case. The major record labels'
14 catalogs are complements they do not compete.
15 In Mr. Pomerantz's words, they do not try to
16 take customers away from each other.
17 You'll hear the testimony of
18 Professor Rubinfeld in this case that the
19 repertoires of the majors are complements. And
20 then, as Mr. Rich alluded to in his opening --
21 in fact, he showed me some of the language, and
22 I'll show you more in our closed session -- we
23 have extensive evidence from the mouths of
24 Universal Music Group and Professor Rubinfeld
25 himself when they successfully advocated to the

1 Federal Trade Commission that it should approve
2 the proposed merger between -- that it was
3 investigating between UMG and EMI, two of the
4 then four major labels.
5 We also have the evidence presented
6 to the FTC by Mr. Pomerantz as counsel to
7 Universal. And the evidence presented to the
8 FTC is clear: that the catalogs of the major
9 record companies are complements for the
10 interactive services. To be viable, the
11 services must have licenses from all of the
12 majors and, the evidence suggests, the larger
13 independents. And I don't use that word "must
14 have" lightly. It is all over the evidence
15 that you will see in this case.
16 Now, the interactive services must
17 have each of the majors. The majors don't
18 compete. And the license fees they charge are
19 not effectively competitive.
20 And indeed, as you have recognized,
21 economics tells us that complements will, in
22 the -- sellers of complementary product will,
23 in the aggregate, charge more than even a
24 monopoly seller of all of the rights. And
25 there is no way you can construe that as an

1 effectively competitive price.
2 What was the FTC doing when it
3 looked at the Universal/EMI merger? It was
4 reviewing the merger to determine whether it
5 would lessen the competition in any market,
6 including the market in which the record
7 companies license interactive services.
8 The FTC approved the merger,
9 concluding that it would not lessen competition
10 because -- and this is worth reading -- in the
11 words of the FTC, commission staff found
12 considerable evidence that each leading
13 interactive streaming service must carry the
14 music of each major to be competitive. Because
15 each major currently controls recorded music
16 necessary for these streaming services. The
17 music is more complementary than substitutable
18 in this context, leaded to limited competition
19 between UMG and EMI.
20 In other words -- and frankly,
21 really ironically -- the merger -- FTC found
22 that the merger wouldn't lessen competition in
23 licensing interactive services because there
24 simply was no competition to lessen.
25 Now, the FTC didn't reach that

1 conclusion sua sponte. Universal, Professor
2 Rubinfeld and Mr. Pomerantz proved it to them.
3 And indeed, the documents submitted by those
4 folks to the FTC are compelling. And I will
5 discuss them in greater detail in a closed
6 session.
7 But now that we have this evidence,
8 it demonstrates that there is no economic
9 validity to SoundExchange's primary benchmark
10 in this case because the licenses are not the
11 result of an effectively competitive market.
12 Now, Mr. Pomerantz suggested that
13 there will be evidence that counters the
14 showings that they made to the FTC. That
15 piracy imposes some constraints on the price
16 that downstream services can charge.
17 But the evidence will show,
18 Professor Katz will testify, that the fact that
19 there may be some downstream constraint doesn't
20 mean that the upstream market is competitive.
21 Mr. Pomerantz says the evidence will
22 show that there are negotiations between major
23 record companies and services. But as even
24 Dr. Rubinfeld admits, even monopolists engaged
25 in negotiations with their customers. The

1 existence of some give and take doesn't mean
2 that a market is competitive.
3 And Mr. Pomerantz also argues that
4 its relevant that the major record companies
5 would have the same market power, would also be
6 must-haves, in licensing statutory services.
7 Now, we'll have a legal dispute
8 about the significance of that that I don't
9 want to get into in my opening. But the
10 economic evidence will show that a hypothetical
11 market in which the record companies don't
12 compete cannot be construed as a hypothetical
13 effectively competitive market, which is the
14 task that you all are settling.
15 Now, Professor Katz will also
16 demonstrate that the lack of effective
17 competition is not the only problem with
18 Dr. Rubinfeld's analysis of the interactive
19 services benchmark on which SoundExchange
20 relies.
21 Dr. Rubinfeld committed serious
22 methodological errors that inflated his
23 recommended rate by a factor of over four and a
24 half. Adjusting for only the easily
25 quantifiable errors, Professor Katz will

1 demonstrate that the interactive benchmark,
2 even only partially corrected, points to a rate
3 of .06 cents per performance, not the .$0.26
4 claimed by Dr. Rubinfeld.
5 Professor Katz will show that
6 Dr. Rubinfeld's assumption that interactive and
7 statutory services were paid the same
8 percentage of their revenue, an assumption that
9 was essential to Dr. Rubinfeld's analysis, was
10 wholly unsupported by Dr. Rubinfeld and lacks
11 any economic validity.
12 Simply changing that assumption to a
13 more economically supportable assumption that
14 the two services -- two types of services will
15 pay the same percentage of their profits
16 results -- rather than revenues results in the
17 dramatic reduction of the license fees implied
18 by Dr. Rubinfeld's interactive benchmark.
19 Professor Katz will also demonstrate
20 that Dr. Rubinfeld failed properly to account
21 for the fact that interactive service benchmark
22 license fees are largely driven by subscription
23 revenues and that statutory services are
24 overwhelmingly nonsubscription.
25 Professor Katz will demonstrate

1 that, if you account for the different revenues
2 earned by subscription an nonsubscription
3 services in a way that properly reflects the
4 mix between the two types of services,
5 interactive and noninteractive, you
6 dramatically reduce the license fee implied for
7 nonsubscription services by Dr. Rubinfeld's
8 interactive benchmark.
9 Professor Katz will also show that
10 Dr. Rubinfeld inflated his benchmark rate by
11 artificially overweighting the higher royalty
12 bearing rate and unweighting the lower royalty
13 performances. And if you just correct for
14 those three, as Professor Katz shows, using
15 Dr. Rubinfeld's own data, you wind up with a
16 recommended rate of .06 cents per performance.
17 You actually will have the tools to do that if
18 you want to.
19 And that still doesn't correct for
20 the numerous other flaws in Dr. Rubinfeld's
21 analysis that inflate his proposed rate but
22 that are more difficult to quantify. Professor
23 Katz discusses these additional flaws in
24 detail. I've already talked about the lack of
25 effective competition in the benchmark market.

1 Also, Professor Katz testifies to
2 the fact that interactive services are more
3 substitutional and less promotional of other
4 record companies' revenues streams than
5 statutory services in general and simulcasting
6 in particular.
7 Those differences, those differences
8 in opportunity costs, would be reflected in
9 pricing in an effectively competitive market.
10 And finally, Dr. Rubinfeld fails to
11 account for the differences in the relative
12 contribution of music to all music-on-demand
13 services and part-music simulcasting. We've
14 already talked about that a little bit. In
15 other words, even the .06 cents per-performance
16 rate is conservative.
17 In his direct testimony, Professor
18 Katz reaches a similar conclusion -- it'll be a
19 while before you hear that -- estimating limits
20 on the bounds of reasonable rates. He actually
21 doesn't, as Mr. Pomerantz said, actually give
22 you the bounds of reasonable rates. He gives
23 you numbers that he believes are beyond the
24 bounds of reasonable rates so that you're
25 inside of that.

1 But first what does he do? First he
2 highlights the economic value of the
3 promotional benefits conferred by simulcasting
4 on record companies and artist and concludes
5 that they would drive competitive license rates
6 for simulcasting down to very low levels.
7 Now, Mr. Pomerantz, for a reason I
8 don't understand, mischaracterized what Dr.
9 Katz said. He did not say that, "I'm going to
10 rely on the fact that there's a statutory zero
11 rate for terrestrial ratio." He specifically
12 looked at the market behavior of the
13 participants related to radio to conclude that
14 the evidence suggested that, if there were such
15 a market, the rates would be very close to
16 zero.
17 He also considers the possible use
18 of the rates that Your Honors set in the most
19 recent satellite radio case as a benchmark and
20 concludes that the 13 percent of revenue rate
21 used in that case, which was based in large
22 measure on the flawed interactive service
23 benchmark, exceeds the upper bounds of the
24 reasonable rate. Those were the bounds he set
25 in his direct testimony.

1 Now, NAB will also present expert
2 testimony that Dr. Rubinfeld's reliance on a
3 survey performed by Professor McFadden, as
4 mentioned by Mr. Pomerantz, to corroborate his
5 interactivity adjustment, is misplaced.
6 Professor John Hauser, the Kirin
7 professor of marketing at MIT's Sloan School of
8 Management, will testify that Dr. McFadden's
9 survey data are not reliable.
10 Among other flaws, Professor Hauser
11 will testify that the survey relied on
12 complicated feature descriptions that were
13 long, overlapping, jargon heavy, and prone to
14 confusion, requiring careful evaluation of the
15 Respondent's understanding, and evaluation of
16 Professor McFadden failed to implement.
17 Professor Hauser will testify that
18 his qualitative study of those featured
19 descriptions indicated that the vast majority
20 of respondents likely were confused by one or
21 more of Professor McFadden's feature
22 definitions.
23 NAB will also present, along with
24 Pandora -- and by the way, NAB is presenting
25 Professor Hauser along with iHeart.

1 We're also presenting, along with
2 Pandora, Dr. Steven Peterson, an expert
3 economist who also specializes in industrial
4 organization. And he will testify that
5 Professor Rubinfeld misuses the results of
6 Professor McFadden's survey.
7 Dr. Peterson will demonstrate that
8 Professor McFadden estimates of the average
9 consumer willingness to pay for the features
10 that he tested mask great individual divergence
11 and cannot be used to provide insight into
12 market price or how consumers would respond to
13 market prices.
14 Dr. Peterson will also respond to
15 SoundExchange's witness Dr. David Blackburn and
16 demonstrate that Dr. Blackburn's claims that
17 the Webcasting industry is healthy and that
18 existing rates are not choking off growth based
19 on -- I'm sorry -- are not choking off growth
20 are based on unsound economics and lack
21 evidentiary support.
22 He will testify that even a
23 monopolist would not choke off growth. So Dr.
24 Blackburn's standard is meaningless to the --
25 in this case.

1 The evidence will also show that
2 SoundExchange receipts are overwhelmingly from
3 two services. And one of them, SiriusXM
4 satellite radio, for their satellite
5 operations, isn't even Webcasting. So the
6 claims of the health of the market are grossly
7 overstated.
8 Professor Katz's rebuttal testimony
9 also describes how the flaws in Professor
10 Rubinfeld's per-performance rate proposal also
11 infect the percentage of revenue problem of his
12 fee proposal.
13 But more fundamentally, Professor
14 Katz -- more fundamentally, Dr. Katz will
15 testify that Dr. Rubinfeld's proposed
16 greater-of fee structure that includes the
17 percentage of revenue is economically unsound,
18 inconsistent as a matter of economics with the
19 statutory standard, and would be difficult to
20 administer, particularly for simulcasters.
21 SoundExchange's proposed percentage
22 of revenue fees distort the incentives to
23 innovate and improve elements of the service
24 other than sound recording rights. Allowing
25 the recording industry to impose a significance

1 tax on revenue attributed to or enhanced by
2 nonmusic elements of a service would diminished
3 the incentive to improve those nonmusic
4 elements.
5 Second, SoundExchange's proposed
6 percentage of revenue fee runs counter to the
7 statutory mandate that license fees reflect the
8 relative value of each party's contribution to
9 the overall value of the service.
10 Enhancements of the service that
11 increase revenue but do not arise from the
12 right to perform sound recordings are
13 contributed by the service and shouldn't be
14 subject to a percentage of revenue fee paid to
15 the recording industry.
16 Third, allocation of revenue among
17 programming elements for different simulcasters
18 whose use of music varies widely would present
19 serious practical obstacles. Dr. Rubinfeld
20 even acknowledged the need to make such
21 allocations but didn't offer any means of doing
22 so.
23 And SoundExchange's rate proposal,
24 while it proposes certain other allocations, is
25 wholly silent about any allocation with respect

1 to the use of music and the value of nonmusic
2 programming.
3 NAB will also present Professor
4 Roman Weil, professor emeritus of accounting at
5 the University of Chicago's, Booth School of
6 Business, who will testify that, from an
7 accounting standpoint, the percentage of
8 revenue fee as proposed by SoundExchange is not
9 appropriate and that it is particularly
10 inappropriate for simulcasting.
11 He will describe the intractable
12 difficulties for revenue allocation the
13 percentage-of-revenue fee would impose on
14 simulcasters that sell advertising in bundles
15 that include elements that are subject to --
16 those bundles include elements that are subject
17 to the statutory license and elements that
18 aren't subject to the statutory license.
19 He will also testify, based on years
20 of experience, that there is no clearly correct
21 way to allocate revenue and that revenue-based
22 fees in this context will inevitably result in
23 disputes, costs, and controverts, including the
24 cost of performing the allocation, the cost of
25 audits and the cost of potential litigation.

1 He offers his opinion that the best
2 way to avoid these intractable problems is, in
3 his words, simply sticking with the current
4 per-play royalty structure for simulcasters.
5 Now, following the disclosure of the
6 merger documents evidencing the lack of
7 competition for licenses in interactive
8 services, SoundExchange belatedly attempts,
9 through Dr. Rubinfeld and only through
10 Dr. Rubinfeld, introducing new benchmark,
11 certain agreements between Apple and two of the
12 major labels for its iTunes Radio services.
13 Professor Katz will show that the
14 reliance on the Apple agreements is not
15 reasonable, most obviously because Professor
16 Rubinfeld relies entirely on retrospect of
17 analysis and claims that the licenses reflect a
18 rate that is substantially higher than the
19 statutory rate, a rate that he and other
20 SoundExchange witnesses correctly argue, at
21 least when they're not talking about Apple,
22 that no service that qualified for the
23 statutory license would ever willingly pay. In
24 other words, Professor Rubinfeld's analysis
25 shows that the proposal is absurd on its face.

1 Professor Katz will identify
2 numerous flaws in Dr. Rubinfeld's analysis in
3 the Apple agreement, including Dr. Rubinfeld's
4 inappropriate ex post reliance on unexpected
5 results rather than the parties' expectations
6 at the time they entered into the agreements;
7 Dr. Rubinfeld's inclusion of significant
8 payments in the numerator of his calculation of
9 a per-play rate that should not have been
10 included; his exclusion of significant numbers
11 of performances in the denominator of his
12 calculation of the per-play rate that should
13 actually have been included.
14 As Professor Katz will testify, a
15 partially corrected analysis reveals that, far
16 from confirming the reasonableness of the
17 interactive services benchmark, the iTunes
18 Radio agreement show that that benchmark is
19 unreasonably high by a very significant amount.
20 Moreover, Professor Katz will
21 explain that there are important additional
22 factors that bias Dr. Rubinfeld's analysis
23 upward to a significance degree, rendering the
24 Apple benchmarks an invalid benchmark.
25 Professor Katz also discusses

1 whether the existing statutory rates provide a
2 reasonable basis for fee setting. And he
3 concludes that they do not.
4 He will testify that the existing
5 rates as set in Web III, as Your Honor knows
6 are the direct result of what we believe will
7 be the discredited interactive service
8 benchmark, and certain Webcaster Settlement Act
9 agreements that were themselves the products of
10 the rates set in Web II -- but the rates set in
11 Web II were, in turn, the result of again what
12 we believe will be the discredited interactive
13 service benchmark.
14 In other words, Dr. Katz will
15 testify that today's rates are a direct result
16 of Web II and the invalid interactive services
17 benchmark on which SoundExchange has
18 consistently relied.
19 Moreover, Professor Katz will
20 identify methodological errors and other flaws
21 with SoundExchange's interactive service
22 benchmark analysis in Web II. The invitation
23 is not to relitigate Web II but to show, with
24 evidence that we now have, that the rate that
25 sprung forth from Web II, which have brought us

1 where we are today, are not a reasonable basis
2 to look forward.
3 Among other things, for example,
4 Professor Katz will show how, with the benefit
5 of hindsight, it is now clear that
6 SoundExchange's Web II expert, Dr. Michael
7 Pelcovitz, improperly based his analysis on
8 data for a nascent industry that was not in
9 equilibrium. Indeed, of the seven interactive
10 services of which Dr. Pelcovitz relied for his
11 analysis, only one is still in business.
12 Now, the evidence will also show
13 that the NAB/SoundExchange Webcaster Settlement
14 Act Agreement is not a valid benchmark.
15 As broadcaster witness Steven
16 Newberry, who was part of the negotiating team
17 for that agreement, will testify, the agreement
18 was the direct result of the outcome of Web II,
19 which was viewed as a major setback for
20 streaming by broadcasters.
21 He will describe how the NAB
22 negotiators believed that they entered the
23 negotiations with no leverage and that
24 broadcasters did not contribute -- consider
25 another trip to the CRB, at that time, Your

1 Honor, to be a viable alternative.
2 Professor Katz will examine the same
3 agreement from the standpoint of economics.
4 And he will conclude that it did not reflect
5 the outcome of an effectively competitive
6 market. He concludes that SoundExchange
7 possessed monopoly power, that NAB's decision
8 not to litigate was consistent with sound
9 economic reasoning, that the precedential
10 effect of the agreement further biased the
11 rates upward, and more generally that the
12 exclusion of other Webcaster Settlement Act
13 agreements from consideration creates a
14 selection bias that renders the available
15 agreements inappropriate to serve as
16 benchmarks.
17 Professor Katz will also explain why
18 the fact that numerous broadcasters signed up
19 for the agreement does not speak to whether the
20 agreement reflects an effectively competitive
21 market. Rather it reflects only that the
22 broadcasters perceived that they lacked a
23 better alternative.
24 As a general matter, the fact that a
25 monopolist makes sales to buyers at a monopoly

1 price doesn't mean that the monopoly price is
2 competitive. It's as simple as that.
3 Now, Dr. Rubinfeld chose not to rely
4 on the NAB Webcaster Settlement Act in his
5 direct testimony. In his rebuttal he admits
6 that the Webcaster Settlement Act Agreements
7 were negotiated in a unique context, his words,
8 that differs from the hypothetical market at
9 issue here. But he does say they are
10 nonetheless, in his words, instructive.
11 Well, the evidence will show that
12 they are instructive only about what a party
13 will agree to pay when it perceives that it has
14 no realistic alternative. That is not what a
15 willing buyer would pay a willing seller in an
16 effectively competitive market.
17 To summarize, Your Honors, the
18 evidence will show that simulcasting has always
19 been and is still radio. It is different in
20 key respects from other forms of Webcasting.
21 It is not customized, and it is not converging
22 with interactive service.
23 Simulcasting, like radio, is highly
24 promotional of record company revenue streams.
25 Moreover, a percentage of revenue-based fee as

1 proposed by SoundExchange, or SoundExchange's
2 proposed greater-of fee, including a percentage
3 of revenue, would create intractable
4 difficulties, controversy and unwarranted
5 costs.
6 As a result, license fees for
7 simulcasters should be set on a per-performance
8 basis and should be at or near the low end of
9 any range of reasonable rates.
10 NAB submits that the evidence will
11 support a rate of .05 cents per performance;
12 and that, to the extent there is any percentage
13 of revenue-based fee adopted for other
14 services, it should not be applied to
15 simulcasters.
16 Thank you, Your Honor. I'll
17 continue with, sometime in the closed session,
18 probably about ten more minutes.
19 CHIEF JUDGE BARNETT: Thank you.
20 I belive iHeart is up next.
21 MR. HANSEN: Very briefly, Your
22 Honors.
23 As I said in our telephone
24 conference, iHeart is very eager to make a
25 presentation to the Court. But to do so we

1 need to show the Court what the evidence will
2 be. And largely that evidence has been marked
3 restricted by the record labels.
4 So in this public part of our
5 proceeding, I'm only going to say the
6 following:
7 We are here to propose a very
8 different rate. I think Mr. Pomerantz's
9 conventional rate of 5, not 25. But we're
10 basing it on a record of thick deals in this
11 market for the first time before a panel of the
12 CRB. Never had that evidence before.
13 That evidence, which we'd like to
14 show you here, but the record labels won't let
15 us show you here, proves our point about these
16 deals, that willing buyers and willing sellers
17 agree to an incremental price to spend. Why do
18 they do that? We're going to prove that to you
19 too.
20 The word is "promotion." Radio
21 promotes. Digital radio industry. And that's
22 going to be proved too.
23 Again, how are we going to prove it?
24 Through the record labels' own documents and
25 witnesses. Because they know it as much as we

1 know it. And we can show you their documents,
2 which we can't do in this public setting. They
3 won't let them be shown here. You're going to
4 see they recognize that as well.
5 We also know, and we're going to
6 show you through their documents, that they
7 know these rates that we're paying now are too
8 high. They're strangling an industry. They
9 need to restructure -- restructure broadcaster
10 Webcaster economics in order to have a viable
11 Webcaster industry, which benefits them through
12 promotion.
13 The promotion you're going to hear
14 about in detail in my presentation, which I
15 hope to give today, if we have time, is going
16 to be strongly focused on empirical evidence
17 and their documents showing that we are the key
18 to music discovery.
19 We, the digital broadcasting, the
20 broadcasting, radio industry is absolutely
21 fundamental to the sales of the record
22 industry. And they know it. They just don't
23 want to admit it here.
24 We also know that everything -- or
25 virtually everything the record labels do in

1 this arena is done with a eye toward how it
2 will play here in this proceeding. They don't
3 do anything without thinking about how it's
4 going to play.
5 And what we're going prove to you --
6 and I'm going to be done here in a minute --
7 but I think you're going to see something
8 dramatic and remarkable.
9 There are effectively two camps
10 within the record labels. There's the camp
11 you're going to hear in this courtroom. Those
12 are the digital rights folks, the lawyers. And
13 they're going to tell the story, "Oh, this is
14 basically a world of -- everybody is converging
15 on everybody, and there's only going to be
16 music subscribers, and we just got to scrub
17 every last nickel we can from the subscribers."
18 Then there's the business people on
19 the record labels. They're not coming. But
20 we're going to show you their documents. What
21 the rec -- what the business people are going
22 to tell you is, "We see the benefits of
23 promotion. We wish to expand music sales. We
24 wish to promote new artists."
25 And those business people, when they

1 can get out from under the digital rights
2 people, who are going to choke this off, make
3 these 29 deals that prove to the market price
4 because they want the benefits of promoting;
5 they want the incremental promotional
6 opportunities provided by these market deals.
7 And you're going to see that they
8 are very different in their view of the world
9 from the people whose only perspective is, "How
10 I do keep these rates high, these unjustifiable
11 leveraged rates?" And you'll see that word
12 used.
13 They use rates as leverage because
14 they have the upper hand. They see the rates
15 as essentially effectively set to benefit the
16 record industry. And we're going to show you
17 documents where they say that.
18 So we would like to be able to
19 review all this powerful evidence right here
20 and now, but we can't. We have to follow the
21 rules. I'm very eager to bring that
22 information to you.
23 I'm going to stop now. I'm going to
24 reserve the rest of my time for our restricted
25 session.

1 And I thank you very much for your
2 attention and look forward to presenting my
3 full opening statement at that time.
4 CHIEF JUDGE BARNETT: Thank you.
5 Mr. Fakler on behalf of SiriusXM.
6 MR. FAKLER: Good afternoon, Your
7 Honors.
8 SiriusXM will present one witness in
9 that proceeding -- in this proceeding, and that
10 witness will be David Frear. Mr. Frear is the
11 chief financial officer of SiriusXM Radio.
12 And Mr. Frear will testify on three
13 primary points. The first point is that the
14 SiriusXM Webcaster Settlement Act, or WSA
15 settlement agreement, does not accurately
16 reflect the fair market value of the license at
17 issue in this proceeding.
18 And that's because the set of --
19 that's due to a set of circumstances that
20 SiriusXM found itself in at the time of those
21 negotiations that had nothing to do with the
22 value of the license but dictated the outcome
23 of those negotiations.
24 The second primary point, which
25 flows from the first, is that, in the absence

1 of any other benchmark, and to the extent that
2 the judges do look to the WSA settlement rates
3 for the purposes of setting the rates in this
4 proceeding, the entry point of those rates, the
5 first year rate, .16 cents per performance,
6 should set the upper bound of any range --
7 reasonable range of fair market value.
8 And the third primary point to which
9 Mr. Frear will testify is that the use of
10 percent of revenue to calculate the royalties
11 across all types of commercial Webcasters would
12 be both unworkable and unfair.
13 Turning to the first point relating
14 to the SiriusXM WSA settlement agreement.
15 SiriusXM's circumstance at the time of that
16 negotiation put in a position where its only
17 rational option was to accept whatever rates
18 were offered by SoundExchange.
19 Those rates did represent a
20 decrease, after all, to the Web II rates that
21 were in effect. And any decrease, however
22 slight, was preferable to no decrease or, even
23 worse, the cost of another rate proceeding.
24 When Sirius -- Sirius and XM,
25 because they were separate companies at the

1 time, when they first introduced their Internet
2 radio services, they were essentially
3 simulcasting their satellite channels over the
4 Internet for free at a lower sound quality.
5 And they were doing this largely for promotion.
6 The idea was that the free access to the
7 reduced quality service would drive
8 subscriptions to the satellite service.
9 But then in 2007, the copyright
10 royalty judges released their determinations in
11 the Webcasting II proceeding. That rate
12 determination almost tripled the rates during
13 the term of that rate period that would be
14 applicable to Webcasters.
15 In the wake of that massive rate
16 increase, SiriusXM phased out the free access
17 to their Internet radio service and made it
18 available only to subscribers.
19 That change led to a drastic
20 decrease in usage of the Internet radio
21 services. It also led to a drastic decrease in
22 the royalties paid to SoundExchange.
23 In -- and of course the
24 Webcasting II -- drastic increase in the
25 Webcasting II rate determination was going to

1 cause tremendous problems for the entire
2 Webcasting market. And for that reason,
3 congress got involved with Webcasters
4 Settlement Agreement.
5 That legislation allowed Webcasters
6 and SoundExchange to negotiate reduction to the
7 Web II rates and also to come up with rates
8 that would roll forward into the Web III rate
9 period. So naturally SiriusXM took advantage
10 of that legislation and began negotiations with
11 SoundExchange.
12 But in those negotiations, SiriusXM
13 found itself in a perfect storm of
14 circumstances having nothing to do with the
15 value of the license but which led it to
16 inevitably take any rate decrease offered by
17 SoundExchange.
18 On the one hand, the company was
19 suffering extreme financial distress. And on
20 the other hand, the low usage of the Internet
21 radio service and the low revenues coming from
22 the Internet radio service made it such that it
23 simply was not worth fighting over.
24 Turning first to the financial
25 distress element.

1 At the time of the Web II rate
2 determination, both Sirius and XM had endured
3 years, year of sustained losses flowing from
4 the company's investment of billions of dollars
5 into the technology and infrastructure
6 necessary to invent, create and grow the
7 satellite radio business.
8 In 2007, in order to save both
9 companies, they announced their intent to
10 merge. But that merger wound up taking much
11 longer and costing far more money than anyone
12 could have anticipated. By the time the merger
13 was consummated, the companies have spent
14 upwards of $150 million just on the merger
15 costs.
16 At the same time, both Sirius and XM
17 were participating in the -- spending millions
18 of dollar participating in the SDARS I rate
19 proceeding.
20 Now, this severe financial stress
21 didn't just disappear the day after the merger.
22 In fact, by late 2008, company found itself
23 with insufficient cash to pay hundreds of
24 millions of dollars in debt that was going to
25 come due in February 2009.

1 Unfortunately, this also coincided
2 with the credit crisis of the country. So
3 Sirius was unable to find any financing to help
4 restructure that debt.
5 As the February 2009 deadline
6 approaches, the company found itself on the
7 drink of bankruptcy and, in fact, was preparing
8 filings.
9 That bankruptcy was only averted in
10 the 11th hour when Liberty Media agreed to
11 provide some financing, though at a very high
12 cost and on very an onerous terms.
13 During that time period, SiriusXM's
14 stock price had plummeted. It went from $4 a
15 share in January of 2007 to only $0.05 a share
16 in February 2009, which of course was right
17 before the WSA negotiations occurred.
18 And even shortly after the
19 negotiations were finished, in September 2009,
20 the company received a delisting notice from
21 NASDAQ because its stock had been trading at
22 such a low rate for so long.
23 So the bottom line is that, in the
24 period leading up to the negotiations, during
25 the negotiations, and even directly after the

1 negotiations, SiriusXM was experiencing
2 profound financial distress. But at the same
3 time, the Internet radio service, which the
4 negotiations were about, was experiencing very,
5 very low usage, very low revenue.
6 The Internet radio service for
7 SiriusXM has always been an ancillary extension
8 of its satellite radio service. Only a tiny
9 fraction of SiriusXM's subscribers ever listen
10 to the Internet radio service, and that was
11 certainly true back then.
12 In fact, at the time of these
13 negotiations, even as the rates had been
14 dropped to zero, the cost savings would not
15 have justified a rate proceeding before the
16 copyright royalty judges.
17 Also, before SiriusXM began
18 negotiations with SoundExchange, the NAB had
19 already concluded its WSA. And that agreement
20 was designated as presidential.
21 So SoundExchange was unwilling to
22 materially move off of the rates it had
23 established in the NAB agreement. At the end
24 of the day though, the terms that were offered
25 to SiriusXM did provide some rate relief at a

1 time when the company was undergoing tremendous
2 financial stress.
3 Because of all of these
4 circumstances, the only rational business
5 decision that SiriusXM could make was to take
6 whatever rate decrease it could get, however
7 slight. The only real alternatives were
8 staying with the higher Web II rates that were
9 already in effect or enduring an expensive rate
10 proceeding.
11 And that flows to the second part of
12 my point of Mr. Frear's testimony, which is
13 that, given that the WSA rates were necessarily
14 higher than what fair market value would have
15 been back then, to the extent those rates are
16 considered in this proceeding, at best they
17 should establish the upper bounds of a
18 reasonable range of fair market value.
19 And we note that, while the judges
20 did use these rates in the Web III remand as
21 one benchmark for setting the current rates for
22 commercial Webcasters, of course in that
23 proceeding the judges didn't have the benefit
24 of any testimony or evidence from either NAB or
25 SiriusXM on the context, valuation and

1 negotiation of those agreements.
2 Turning finally to the third, which
3 is a percentage of revenue. The use of
4 percentage of revenue to calculate the rate for
5 all commercial Webcasters would be both
6 unworkable and unfair.
7 The commercial Webcasting market is
8 a diverse market. There are many commercial
9 Webcasters out there. Not all of them are
10 Pandora. There are different types. And as
11 you heard about the broadcasters when they
12 simulcast, and as SiriusXM, which is
13 predominantly a simulcasting service as well,
14 its satellite service. And then there are all
15 sorts of models in between.
16 Each of these services have
17 different programming philosophies; they have
18 different cost structures; they have different
19 features and functionality; they have different
20 business models.
21 There's just no one-size-fits-all
22 way to calculate a percentage of revenue metric
23 that could be fairly applied across that broad
24 spectrum of services.
25 For example, with respect to

1 SiriusXM, it bundles its Internet radio service
2 along with the satellite radio service. Very
3 few of SiriusXM's subscribers subscribe solely
4 to Internet radio services.
5 In addition to that, SiriusXM
6 obtains revenue from various other sources
7 completely unrelated to the public performance
8 of sound recordings through the Web. For
9 example, the sale of radios and other
10 equipment.
11 But perhaps most importantly,
12 SiriusXM broadcasts a large amount of nonmusic
13 content. And much of that nonmusic content is
14 exclusive content that people can only hear on
15 SiriusXM.
16 That's important because the
17 exclusive content of SiriusXM's broadcasts and
18 the wide variety of content it broadcasts, that
19 includes substantial music content, are two key
20 drivers of consumers' willingness to pay
21 subscription fees to SiriusXM, subscriptions
22 fees that they've shown unwillingness to pay
23 for other services.
24 It would be manifestly unfair for
25 SiriusXM to have to pay sound recording and

1 Webcasting and performance royalties based on
2 all of these other types of revenue that would
3 get swept up somehow in this calculation.
4 And there's really no good accurate
5 way to try to apportion that revenue so that
6 you only get out a base that's truly and
7 directly related to just the Webcasting of
8 sound recordings.
9 Certainly any attempt at coming up
10 with a formula like that would be subject to
11 tremendous dispute and litigation. And even if
12 you could come up with an apportionment that
13 was accurate and that you were comfortable with
14 for SiriusXM, that same apportionment certainly
15 wouldn't apply to any of the other Webcasters
16 in the marketplace.
17 And, in fact, you heard
18 Mr. Pomerantz say in his opening that
19 SoundExchange doesn't believe that there should
20 be price discrimination amongst the servicers;
21 and that the judges, when they implement a
22 rate, should not be favoring one business model
23 over another. But the percentage of revenue
24 formula, no matter how you try to craft, will
25 inherently do just that.

1 Instead the judges should stay with
2 the per-performance rate which has the benefit
3 of being directly tied to the usage of the
4 music, is very easy to administer and very easy
5 to account for.
6 Thank you.
7 CHIEF JUDGE BARNETT: Thank you, Mr.
8 Fakler.
9 Ms. Ablin.
10 MS. ABLIN: Good afternoon, Your
11 Honors.
12 My name is Karyn Ablin. And as
13 Bruce Joseph mentioned this morning, I
14 represent, in addition to the National
15 Association of Broadcasters, the National
16 Religions Broadcasters Noncommercial Music
17 license Committee. They're participating in
18 this proceeding on behalf of Noncommercial
19 Religious Broadcasters that primarily simulcast
20 online their broadcast programs.
21 Now, you've heard a lot today so far
22 about the commercial licensing participants,
23 including the special class of licensees that
24 are commercial broadcast simulcasters.
25 So for what I hope will be a welcome

1 change of pace, at least for a few moments
2 before we head into restricted session, I'd
3 like to give you a preview of what the evidence
4 will show regarding noncommercial broadcast
5 simulcasters. And specifically I'd like to
6 touch on three points.
7 First, I'll talk about some
8 similarities that noncommercial broadcasters
9 and commercial broadcasters share as radio
10 broadcasters that distinguish them from other
11 licensee participants whose only transmissions
12 to listeners occur over the Internet.
13 All of the features that Mr. Joseph
14 mentioned in his opening statement regarding
15 commercial broadcast of simulcasters also point
16 to a lower rate for noncommercial simulcasters.
17 Second, I'll talk about some
18 fundamental differences between noncommercial
19 broadcasters and commercial services, both in
20 how they conduct their operations and in the
21 license rates that they pay.
22 And, in fact, noncommercial
23 broadcasters and Webcasters always have paid
24 very different and much lower rates than
25 commercial Webcasters in every Webcasting

1 license period to date since the right was
2 first expanded to cover Webcasting about 17
3 years ago.
4 And then third and finally, I'll
5 talk about some fundamental differences in
6 SoundExchange's and the NRB-NMLC's rate
7 proposals and what the evidence will show
8 regarding those proposals.
9 You'll hear testimony from the
10 NRB-NMLC's witnesses regarding how important it
11 is for noncommercial broadcasters to be subject
12 to predictable and affordable fees as well as
13 evidence regarding other noncommercial rates
14 that are structured as flat fees.
15 This evidence is most consistent
16 with the tiered and capped flat-fee structure
17 proposed by the NRB-NMLC and most consistent
18 with the rates that willing buyers will seek
19 and willing sellers will adopt.
20 So the NRB-NMLC will present two
21 witnesses who will address these points.
22 The first is Mr. Joe Emert. He's
23 been involved in Christian broadcasting for
24 over 45 years. He is the founder and president
25 of Life Radio Ministries, which is celebrating

1 its 20 anniversary this year and operates two
2 stations as New Life FM in the Atlanta, Georgia
3 area.
4 Second witness is Mr. Gene Henes.
5 He's been involved in Christian broadcasting
6 for over 20 years. He is the president of the
7 board of directors of the Prayz Network based
8 in Northern Nebraska. The Prayz Network has
9 been operating for over 25 years, and over that
10 time it has grown to nine radio stations and FM
11 translators that cover low population areas in
12 four states throughout the Midwest.
13 Now, Mr. Emert and Mr. Henes will
14 testify that the format on the stations that
15 they operate consist of a mix of both Christian
16 talk and teaching programs as well as
17 inspirational praise and worship and Christian
18 contemporary music. And both have used
19 broadcasting simulcasting for several years.
20 So my first point: Similarities
21 between noncommercial and commercial
22 broadcasters.
23 Mr. Joseph provided a list of trades
24 that distinguish radio simulcasters and other
25 types of services participating in this

1 proceeding. And as I said, those trades apply
2 equally to noncommercial broadcasters as well.
3 First, like commercial broadcasters,
4 the primary online transmissions of
5 noncommercial religious broadcasters are
6 simulcasts of their religious terrestrial radio
7 programming. The only significant difference
8 is how you hear that programming. It's over
9 the Internet instead of over the air.
10 Second, like commercial
11 broadcasters, noncommercial broadcasters
12 simulcast programming by the same hosts and DJs
13 who keep the listeners company on their
14 terrestrial broadcast.
15 Mr. Emert and Mr. Henes will both
16 testify how they personally host portions of
17 programming on their respective stations and
18 how many of their other staff members do as
19 well.
20 Third, like commercial broadcasters,
21 noncommercial broadcasters actively foster
22 strong connections with the local communities
23 that they serve. You'll hear from Mr. Emert
24 how four of New Life FM's six member staff have
25 lived and worked in New Life FM's broadcast

1 community for at least 18 years of New Life's
2 20-year existence.
3 And Mr. Henes will similarly testify
4 how he has been with the Prayz Network in that
5 community in the Midwest for over 20 years.
6 Fourth, similarity: Like commercial
7 broadcasters, noncommercial broadcasters
8 transmit substantial amounts of nonmusic
9 programming that contribute significantly to
10 the popularity and unique flavor of those
11 broadcasts an simulcasts.
12 As the New Life FM and Prayz Network
13 witnesses will testify, this programming
14 includes several nationally renowned talk and
15 teaching programs such as "Uncommon Moments"
16 with former Super Bowl winning Coach Tony Dungy
17 as well as Chuck Swindoll's "Insight For
18 Living."
19 You'll also hear from Mr. Emert how
20 its online listenership peak during hours when
21 New Life FM is transmitting teaching program
22 rather than music.
23 While Mr. Emert and Mr. Henes agree
24 that the music that their organization transmit
25 is also important, there are plenty of other

1 places to listen to wall-to-wall Christian
2 music online rather than a noncommercial
3 religious simulcast of a locally flavored mix
4 of Christian talk and support.
5 Instead, like commercial
6 broadcasters, noncommercial broadcasters are
7 frequently and aggressively solicited by
8 artists and record companies to obtain air play
9 which necessarily results in air play not only
10 over the air but also in their simulcasts.
11 And Mr. Emert and Mr. Henes will
12 testify to that effect and how artists thank
13 them when they do receive the air play that
14 they've requested.
15 Mr. Henes also will testify how one
16 of his stations has received so many
17 solicitations for air play that it adopted a
18 local artist policy, which provides guidance
19 for artists seeking air play of their songs and
20 warns artists that not every song that's
21 committed to the station will actually make it
22 on the air.
23 And a sixth similarity is that, like
24 commercial broadcasters, noncommercial
25 broadcasters stream in large part as a way to

1 connect with their local over-the-air
2 listeners. And their simulcast audiences
3 typically are far smaller than those broadcast
4 audiences.
5 Both Mr. Emert and Mr. Henes will
6 describe how streaming is not a standalone
7 product for them, the way it is for many other
8 services in this proceeding, but it's a tool to
9 serve their broadcast listeners. And they'll
10 also tell you about how the vast majority of
11 their listenership comes from within the
12 broadcast reach of their stations.
13 Each of these traits I've just gone
14 through are shared by both commercial and
15 noncommercial broadcast simulcasters and
16 support entry of a lower rate for such services
17 than for other types of services.
18 And then second, having discussed
19 the similarities, I'll now discuss some of the
20 differences that distinguish noncommercial
21 entities from commercial ones.
22 And first, why are these differences
23 important? Well, that's a simple answer.
24 Under governing statue, congress has
25 commanded that the rates and terms applicable

1 to nonsubscription Webcasting shall distinguish
2 among the different types of services in
3 operation.
4 And as the evidence will show,
5 differences between noncommercial and
6 commercial entities affect both the rates the
7 willing noncommercial buyers would agree to pay
8 and the rates that willing sellers would agree
9 to accept.
10 So one difference is in the mission
11 and nonprofit purpose that noncommercial
12 entities have.
13 Noncommercial religious broadcasters
14 are organized and operated exclusively to
15 advance religious, charitable, educational or
16 other nonprofit goals.
17 As Mr. Emert and Mr. Henes will
18 describe, the success of their ministries is
19 not defined by profits. Instead it's defined
20 by the listeners who are enriched and uplifted
21 by experiencing their programming, whether that
22 programming is a teaching programming providing
23 parenting advice, the message from an
24 encouraging song that infuses their listeners
25 with new purpose for living, or even a hosted

1 call-in show that allows listeners to interact
2 with the host and share prayer with them.
3 In other words, noncommercial
4 religious broadcasters are engaged in a labor
5 of love to serve their listeners by offering
6 encouragement and teachings that nourishes the
7 human spirit.
8 A second way in which noncommercial
9 broadcasters differ from commercial entities is
10 in how they fund their operations.
11 Unlike commercial broadcasters,
12 noncommercial broadcasters cannot sell ads.
13 And listeners will not hear such ads when they
14 tune in to that lower end of the dial on a
15 noncommercial broadcast or simulcast.
16 Instead the evidence will show that
17 noncommercial broadcasters must depend
18 primarily on support from individual listener's
19 donations.
20 Mr. Emert and Mr. Henes will testify
21 also that, unlike NPR, noncommercial religious
22 broadcasters do not receive government funding
23 to supported their operations. And so the
24 generosity of their listeners becomes that much
25 more critical to maintaining their ministries.

1 A third difference lies in how
2 noncommercial broadcasters use the funds that
3 they receive.
4 Mr. Emert and Mr. Henes will discuss
5 that, because of their organizations' nonprofit
6 status, they used the funds that they receive
7 to serve their listeners, not to pay out
8 profits to their owners. If their operations
9 and funning were to grow, they would not pocket
10 that money; but rather, that additional money
11 would enable them to expand their outreach and
12 serve more people than this.
13 Now, these differences do not exist
14 in a void, but they have consistently
15 translated into very different and lower
16 license fees for noncommercial broadcasters
17 than those that have been set for commercial
18 entities.
19 You'll hear testimony from
20 SoundExchange witness Thomas Lys that
21 noncommercial and commercial broadcasters
22 really aren't that different and that one class
23 of Webcasters should not be treated differently
24 than another.
25 But the evidence presented to Your

1 Honors will show the opposite and will not only
2 confirm why every Webcasting rate setting
3 proceeding to date has set different and lower
4 rates for noncommercial Webcasters, including
5 rates proposed by the copyright owners in the
6 very first Webcasting proceeding that reflected
7 a two-thirds discount from commercial rates,
8 but also it will confirm the conclusion of the
9 arbitrators in Web I that applying the same
10 commercial broadcaster rates to noncommercial
11 entities, quote, front common sense.
12 To begin with, you'll hear
13 SoundExchange's own witness, Daniel Rubinfeld,
14 propose noncommercial rates that are different
15 and lower than those he proposes for commercial
16 Webcasters. Thus, despite what Professor Lys
17 has said, there's really no dispute between the
18 willing buyers and sellers in this proceeding
19 that noncommercial Webcasters should pay
20 different rates, at least in some extent.
21 There's also other evidence that has
22 been or will be presented to Your Honors that
23 shows that willing buyers and willing sellers
24 have agreed to different lower noncommercial
25 rates than those that apply to noncommercial

1 entities.
2 First is the agreement between the
3 college broadcasters, a participant in this
4 proceeding, and SoundExchange that was filed
5 with Your Honors in this case last October.
6 That agreement included a flat $500
7 fee for and allotment of aggregate tuning
8 hours, which I will refer to as ATH, that,
9 based on SoundExchange licensee data appears
10 large enough to ensure that all eligible
11 educational Webcasters would fall below that
12 threshold and not -- pay no more than that flat
13 $500 cap annually.
14 Second is and agreement between
15 national public radio and SoundExchange that
16 was filed with Your Honors last February. That
17 agreement sets a single flat fee for a large
18 annual loment of music ATH that covers hundreds
19 of originating stations and translators across
20 NPR's entire network.
21 And if NPR exceeds the number of
22 covered stations provided for in that
23 agreement, it's able to add additional stations
24 under the agreement for a flat $500 apiece. No
25 usage fees apply.

1 While NPR is somewhat different from
2 noncommercial religious broadcasters in that it
3 can rely on government funding, the flat-fee
4 structure of this agreement is nonetheless
5 instructive of what willing buyers and willing
6 sellers would agree to.
7 Third, Mr. Emert will also testify
8 about the flat fees that apply to noncommercial
9 broadcaster rates for performing musical works,
10 which are set under the Section 118 statutory
11 license in the Copyright Act.
12 These flat fees were negotiated
13 between noncommercial broadcasters on the one
14 hand and ASCAP BMI and SESAC on the other. And
15 they're tiered based on market size, but they
16 do have an absolute cap for even the biggest
17 stations in the largest markets.
18 And fourth, Mr. Emert will discuss a
19 provision that SoundExchange publicly supported
20 in proposed legislation to create a full sound
21 recording performance right that would apply to
22 terrestrial radio.
23 That bill was introduced in 2009,
24 and it includes a special provision for
25 noncommercial broadcasters that would enable

1 them to pay either a flat annual fee of $500 if
2 their gross receipts are less than $100,000 or
3 no more than $1,000 annually if their receipts
4 exceed that amount.
5 And while Mr. Emert and the
6 NRB-NMLC, to be clear, strongly oppose the
7 enactment of any such legislation, and while
8 not too much can be read from and unenacted
9 bill, Mr. Emert will nonetheless testify that
10 the bill does reveal something about the
11 willingness of SoundExchange as a willing
12 seller to accept modest flat fees from
13 noncommercial broadcasters that are different
14 and much lower than the fees that it would seek
15 to apply to commercial broadcasters if this
16 bill were enacted.
17 And my third and final point, I'll
18 touch briefly on some aspects of
19 SoundExchange's and the NRB-NMLC's rate
20 proposals that have been presented to Your
21 Honors.
22 And I'll start by mentioning one
23 similarity between the two sides' proposals.
24 Both SoundExchange and the NRB-NMLC have
25 proposed a flat $500 annual fee to cover

1 transmissions up to a certain number of average
2 listeners, although they do differ in the
3 number of average listeners that would be
4 covered by that fee.
5 So in this respect, SoundExchange's
6 proposal differs from what they've proposed for
7 commercial entities. And the NRB-NMLC
8 appreciates SoundExchange's recognition that
9 noncommercial broadcasters should be subject to
10 different rates.
11 The biggest difference between the
12 two proposals, however, is what happens above
13 that $500 listener account.
14 So Your Honors will hear testimony
15 from SoundExchange witness Daniel Rubinfeld
16 asserting that there is no marketplace evidence
17 from which to set noncommercial rates and that
18 the judges therefore should just default to the
19 rates that currently are published in the
20 regulations, which apply commercial usage rates
21 to noncommercial broadcasters that exceed that
22 specified ATH.
23 But the there's a problem with that
24 proposal. Evidence from SoundExchange's own
25 licensing payment data will show that

1 noncommercial Webcasters have actually not been
2 paying those usage fees under the public CRB
3 rates that are specified in the regulations.
4 And that's not because there aren't any
5 noncommercial Webcasters who exceed that cap.
6 There are.
7 But those Webcasters have been
8 paying those additional fees that would accrue
9 not under the published rates but instead under
10 an alternative Webcaster Settlement Act
11 Agreement that include much lower rates than
12 those that appear in regulations.
13 In addition, both Mr. Emert and Mr.
14 Henes will testify that even the largest
15 noncommercial broadcasters that simulcast the
16 most do not suddenly lose their nonprofit
17 status and start pocketing profits if they
18 reach a certain size. But rather they're
19 simply able to reach or more listeners with
20 their ministry without additional size and
21 funding.
22 This evidence demonstrates that
23 there is no basis to apply commercial usage
24 rates to noncommercial broadcasters at any
25 size; and that to do so, in the words of the

1 Web I arbitrators, affronts common sense.
2 In contrast, the SoundExchange
3 proposal for what should happen above the cap,
4 the NRB-NMLC proposed flat-fee tiers of $200
5 for each additional 100 listeners capped at
6 $1,500 per station per year.
7 You'll hear testimony from Mr. Emert
8 and Mr. Henes about the importance of
9 predictable and affordable fees to them as
10 willing noncommercial buyers because they do
11 not know in advance how generous their
12 listeners will be in any given year; and
13 therefore, they need to plan how much time
14 every year they'll be forced to divert from
15 their core mission of reaching and serving
16 their listeners to instead attempting to
17 persuade those same listeners to donate to them
18 so that they continue to do what they do. And
19 the more that fees go up, the more time that
20 noncommercial broadcasters will have to divert
21 to fund-raising.
22 Mr. Emert will testify that he's
23 encountered many noncommercial broadcasters
24 that don't stream at all under the current
25 rates because they're so concerned with

1 incurring large royalty obligations. And he'll
2 also testify that he's personally aware of
3 other broadcasters that impose caps on their
4 programming specifically to avoid incurring
5 usage fees above those caps and how this runs
6 counter to noncommercial religious
7 broadcasters' core mission of listener
8 outreach.
9 Mr. Emert and Mr. Henes will also
10 testify that the NRB-NMLC's proposed flat fee
11 tiers will provide more predictable and
12 affordable fees for noncommercial broadcasters,
13 and that that will provide an incentive for
14 noncommercial broadcast simulcasters actually
15 to increase their streaming and therefore the
16 royalties that SoundExchange will receive from
17 them as long as those fees are predictable and
18 affordable.
19 Mr. Emert also will testify about
20 the fixed fee cap, including testimony
21 regarding other rate structures -- and I've
22 gone through some of those -- where
23 SoundExchange or willing selling copyright
24 owners have agreed to fixed caps even for the
25 largest stations.

1 And I'll touch just briefly on two
2 other features of the NRB-NMLC's proposal.
3 First, the NRB-NMLC proposes to
4 convert the ATH allotment committed under the
5 $500 annual fee to an annual rather than a
6 monthly quota.
7 Mr. Emert will testify that it would
8 be easier at administratively to calculate fees
9 due for exceeding the listener allotment
10 committed under that $500 fee one time annually
11 instead of having to reset the quota and figure
12 out additional fees that would apply every
13 month.
14 Second, the NRB-NMLC proposes to
15 clarify the ATH definition to make clear that
16 only aggregate tuning hours that actually
17 include sound recordings subject to the
18 statutory licensing should count toward
19 determining when that ATH threshold is hit.
20 Mr. Emert and Mr. Henes will both
21 testify that this is a particularly important
22 clarification for noncommercial religious
23 broadcasters, such as themselves, as they play
24 significance amounts of Christian talk and
25 teaching programs that don't include any music

1 at all in addition to the music that they do
2 play and that they do not believe that
3 programming that does not include sound
4 recordings should make their sound recording
5 fees increase.
6 And so to recap, noncommercial
7 broadcast simulcasters share many traits with
8 commercial broadcasters that support giving
9 noncommercial broadcasters any benefits in
10 lower rates that Your Honors determine to be
11 warranted for commercial broadcast
12 simulcasters.
13 But in addition, there are strong
14 reasons to give noncommercial broadcasters much
15 lower rates even than commercial broadcasters
16 because, one, noncommercial broadcasters don't
17 do what they do to make money or simply to
18 entertain but rather to offer spiritual
19 encouragement to their listeners through
20 teaching, practical advice and, yes, inspiring
21 music to help them navigate life's challenges.
22 Two, noncommercial religious
23 broadcasters primarily rely on the generosity
24 of their listeners to support their outreach.
25 And they pour those dollars right back into

1 this those listeners to enhance their outreach
2 effectiveness.
3 And three, the evidence in past
4 Webcasting rate setting history before Your
5 Honors shows that noncommercial broadcasters
6 consistently have paid much lower rates than
7 commercial entities.
8 So the NRB-NMLC respectfully request
9 that Your Honors take into account all of these
10 differences and the consistent history that's
11 always distinguished noncommercial broadcasters
12 from commercial entities in determining rates
13 that would apply to noncommercial broadcast
14 simulcasters.
15 Thank you.
16 CHIEF JUDGE BARNETT: Thank you.
17 Mr. Malone, would you like to just
18 hold that microphone there and make your
19 statement from where you sit?
20 MR. MALONE: I'm prepared to come
21 up, Your Honor.
22 CHIEF JUDGE BARNETT: Okay.
23 MR. MALONE: Good afternoon, Your
24 Honor.
25 I represent the Intercollegiate

1 Broadcasting System, which is not going to have
2 any ATH itself from its members.
3 CHIEF JUDGE BARNETT: Could I ask
4 you to pull the microphone down a little bit.
5 There you go. Thank you.
6 MR. MALONE: And it represents the
7 largest group of so-called college stations in
8 the United States and also a few overseas.
9 These stations vary among themselves.
10 They are also joined by high school
11 stations and high school streamers. And their
12 hours of operation are obviously much
13 different. And they don't -- very few of the
14 college -- the quote, unquote, college stations
15 operate year round. So we're talking about a
16 much smaller number of hours per year than your
17 average commercial station.
18 In addition, of course many of these
19 stations are operated by state educational
20 institutions, local institutions. And as such,
21 of course, they have certain restrictions on
22 them under state law. And also the
23 SoundExchange rates appear as a tax on state
24 operations, which is certainly questionable.
25 But I think I am fairly on sound

1 ground in saying that college broadcasters,
2 quote, unquote, are noncommercial educationally
3 affiliated streamers. They, in many cases,
4 have instructional responsibilities, such as
5 the music one final exam preparation.
6 They also -- and their programming
7 is -- in terms of the listenership is
8 relatively small. That is they don't use music
9 -- they don't sell music. They use music as an
10 instructional tool for students to learn about
11 the real life in the commercial area -- in the
12 industry area.
13 I think that the two written direct
14 statements from Captain Kass and Mr. Papish
15 describe two mutually consistent but somewhat
16 different methods of operation and purposes of
17 operation and indicate though both that varsity
18 sports broadcasts are much, much more popular
19 with their listeners than the programs that are
20 devoted to training.
21 And the -- well, I think that that's
22 basically -- unless you have any questions,
23 that's what college radio, campus radio is all
24 about.
25 Now, IBS has filed a comments on the

1 motion published in the Federal Register as to
2 SoundExchange, NPR, CPB petition for an
3 approval of their agreed rate.
4 And while this is labelled an
5 objection, the objection is not to the
6 substantive aspect of that proposal but rather
7 to the timing.
8 And our feeling is that, in prior
9 proceedings, we've been prejudiced by the
10 board's making up its mind that it wanted to
11 accept that and then took care of the small
12 stations, which, you know, typically have
13 listeners other than varsity sports of about
14 five -- five listeners. So you're looking at
15 five ATH.
16 And the -- we certainly agree with
17 the petition that distinguishes noncommercial
18 and commercial streamers. And we take the
19 position basically that that is -- we'd like to
20 use the SoundExchange NPR, CPB petition rates
21 as a basis for determining what a proportional
22 value of the music hours would be.
23 And if you look at the five
24 listeners per hour, it's certainly far, far
25 less than $500. And the $500, to the extent

1 it's paid, is a deterrent to the education of
2 the students in the new digital world.
3 And we think that there is a -- not
4 only a public interest there, but it's also and
5 interest of the industry to encourage students
6 to participate in the digital music world.
7 Now -- and so I think that, if I
8 clarified that point, I don't mean to hold up
9 the SoundExchange NPR CP agreement -- CPB
10 agreement. But I do think that it needs to be
11 -- proceed on the basis that the -- that it
12 won't prejudice the really small operators.
13 Now, the earlier SoundExchange-CBI
14 agreement, also published in the Federal
15 Register, we do oppose substantively. We don't
16 feel that that represents the bulk of the
17 campus radio operations.
18 CDI's membership by and large has
19 been derived from the CMA or the Campus
20 Marketing Association, which is a group that
21 deals with full-time paid media people on
22 campus.
23 And the campus stations by and large
24 do not have -- well, they don't pay salaries to
25 begin with. And they by and large don't have

1 paid faculty. They may have faculty advisers
2 with and additional duty who will sign, you
3 know, their initials once a year to the deed.
4 But these are student-run
5 operations. And that's the real virtue in
6 them, is that the students learn by doing; they
7 learn by having responsibility.
8 And it may be that occasionally
9 you'll get a balance sheet that doesn't
10 balance. And that's the instructional
11 opportunity. And some of the stations have, as
12 Mr. Papish indicates, retreats in the spring
13 off campus in which they have accountants,
14 salesmen and other expert people teach the
15 student management something they're not get in
16 any of the other courses in their college
17 career.
18 And the -- so then I think that that
19 is not a fact that some CBI members, which are
20 bigger paid, that was with a minimum of five
21 paid -- or I'm sorry -- with paid employees --
22 the fact that they're paying more is fine for
23 them, but it's not something that's
24 particularly appropriate for the smaller campus
25 stations.

1 And so our position here is simply
2 that this is a group that is large enough, much
3 larger than the CBI group -- I don't know, 800
4 at least, maybe more -- they -- you shouldn't
5 buy a rate set based on a different population.
6 And so we would ask for a
7 proportional rate based on ATH keyed off of the
8 SoundExchange-NPR-CPB rate they explain legally
9 why a noncommercial stations are appropriately
10 titled to the appropriate rate.
11 CHIEF JUDGE BARNETT: Thank you, Mr.
12 Malone.
13 We will take our afternoon recess
14 for 15 minutes.
15 And the courtroom will -- or excuse
16 me.
17 The hearing room will be closed
18 after the recess. So anyone who's here now who
19 has not signed a nondisclosure certificate and
20 is not privy to the information that was marked
21 as restricted during the course of discovery in
22 this proceeding will have to wait outside for
23 the balance of the day.
24 Or you may go home. I don't think
25 we're going to do anything that's not

1 restricted for the rest of the day so.
2 So we'll be at recess for 15
3 minutes.
4 (A short recess was taken.)
5 CHIEF JUDGE BARNETT: Good
6 afternoon.
7 Please be seated.
8 MR. STEINTHAL: This is not an
9 opening statement, but in talking to the
10 participants, we thought this was the opportune
11 time after the other non-commercial entities
12 made their presentations, for me to just share
13 a couple of thoughts with you about the NPR
14 settlement exchange process.
15 As you know, on February 24th, we
16 filed a joint motion to adopt settlement
17 between SoundExchange and NPR, and it covers
18 what is defined as covered entities under the
19 settlement agreement, which are National Public
20 Radio, American Public Media, Public Radio
21 International, Public Radio Exchange, and the
22 NPR CPB affiliated stations up to 530 such
23 originating public radio stations, and it
24 covers the Section 114 transmissions and the
25 licensing, of course, made by these covered

1 entities.

2 We are a single licensee, which

3 undertakes to handle the myriad selection,

4 administration and consolidated reporting

5 functions across the whole group of covered

6 entities which SoundExchange otherwise would

7 need to undertake. Importantly, the settlement

8 covered and binds only covered entities, as I

9 have defined that term and as set forth in the

10 agreement. It's a closed group of licensees.

11 There are no other non- commercial service

12 participants that are covered by that

13 agreement, and we are submitting it with

14 SoundExchange to the CRB for adoption to ensure

15 that the settlement is binding, not just on

16 SoundExchange, but all the other copyright

17 owners and performers who are not SoundExchange

18 members.

19 On March 26th, Your Honor published

20 a notice and request for comments about that

21 subject. Under Section 807(b)(7)(A), it is

22 provided that the Copyright Royalty Board has

23 the authority to adopt, as statutory terms and

24 rates, an agreement between some or all

25 participants. And 807(b)(7)(A) provides that

1 only if both of two things, a participant who
2 would be bound by the agreement, by the
3 settlement agreement, and if Your Honors
4 conclude that the rates and terms in the
5 settlement agreement do not provide a
6 reasonable basis for setting statutory terms
7 and rates, only if both of those elements are
8 present is there a basis for adoption to be
9 rejected.
10 Now, pursuant to our settlement
11 agreement, the parties, SoundExchange and we,
12 NPR, agreed not to file rebuttal statements as
13 to the case between us and we agreed to pursue
14 adoption of the settlement under 801(b)(7).
15 That's why we didn't submit rebuttal statements
16 and that's why we didn't sign up for an
17 allocation of time, but evidence during the
18 hearings.
19 Now, just briefly, there is no
20 statutory basis here for conceivably rejecting
21 the settlement. As I said, only if both of
22 those two elements are present. It has to be
23 somebody who would be bound by the settlement
24 that objects. Here, the only comment received
25 at all was from IBS. As for IBS, neither IBS

1 nor any of its constituent stations are covered
2 entities under our settlement. No one that
3 would be bound, quote/unquote, under 801(b)(7)
4 has objected or commented on our settlement.
5 So, in our view, there is no statutory basis at
6 all not to adopt the settlement. And, of
7 course, as you've heard from Mr. Malone, IBS
8 doesn't really object to the rates and terms in
9 our settlement. It's simply a matter of timing
10 from their perspective.
11 So I come to you -- I submit that
12 there's no basis or reason to delay the
13 adoption of our settlement. There is no
14 prejudice to Mr. Malone's clients as long as he
15 is not prejudiced in making whatever arguments
16 about proportionate rate he wants to make; but,
17 certainly, that shouldn't delay adoption of our
18 settlement. And, in these circumstances, I
19 come to you asking for guidance as to how you
20 would like us to proceed.
21 Is there anything you want from us,
22 more than what we've done, which I think is
23 absolutely all that's needed to approve
24 adoption of our settlement?
25 CHIEF JUDGE BARNETT: Unless my

1 colleagues disagree and want to confer on this,
2 the deadline has passed for comments, that is
3 correct, and there is only the one comment from
4 IBS regarding your settlement. And, at this
5 point, it's a matter of logistics. We have to
6 forward the settlement as final rules to the
7 librarian for him to sign off, and that needs
8 clearance through several people internally and
9 also approval by the Federal Register. We have
10 to do what they tell the us as far as
11 formatting and all that sort of thing. And
12 they're different -- picky. We've been working
13 with them for a while, so we sort of know what
14 they expect.
15 But given the fact that we have no
16 reason not to recommend acceptance or to seek
17 the librarian's signature, it seems to me that
18 there would be no reason for you to have to
19 remain and participate in this proceeding.
20 MR. STEINTHAL: Well, thank you very
21 much. And that's really what NPR wanted to
22 know. Didn't want this to go without comment
23 one way or the other, so I thank you for the
24 time and interrupting everybody's openings. So
25 thank you.

1 CHIEF JUDGE BARNETT: Certainly.
2 Now, with regard to -- with regard
3 to CBI, has the deadline come on that one yet?
4 MR. STEINTHAL: Your Honor, I
5 believe the representative of CBI has left for
6 the day.
7 CHIEF JUDGE BARNETT: He threw in
8 the towel.
9 Yeah, I printed out the wrong one
10 and I believe we published CBI before NPR;
11 isn't that correct?
12 MR. STEINTHAL: Yes.
13 CHIEF JUDGE BARNETT: Thank you.
14 Okay. But since they're not here
15 and he's not asking, I'm not saying.
16 Mr. Pomerantz, did you have more as
17 closed hearing presentation?
18 MR. POMERANTZ: If you will tolerate
19 it, yes, I have a few more minutes.
20 CHIEF JUDGE BARNETT: I think you
21 have a very few.
22 MR. POMERANTZ: I think we have 25,
23 as we counted.
24 CHIEF JUDGE BARNETT: I trust your
25 count.

1 (THIS ENDS PUBLIC SESSION)

2 (RESTRICTED SESSION BOUND SEPARATELY)

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1 CERTIFICATE OF COURT REPORTER

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3 I, Bonnie L. Russo, do hereby certify that
4 the foregoing transcript is a true record of
5 the proceedings to the best of my ability, that
6 I am not related to or employed by any of the
7 parties involved in these proceedings, and,
8 further, that I am not a relative or employee
9 of any attorney or counsel employed by the
10 parties hereto, or financially interested in
11 the proceedings.

12

13 Bonnie L. Russo

14 Notary Public

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16 My Commission Expires:
17 May 31, 2015

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