Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress
Washington, D.C.

In re **Determination of Royalty Rates and Terms for Transmission of Sound Recordings by Satellite Radio and "Preexisting" Subscription Services (SDARS III)**	**Docket No. 16-CRB-0001 SR/PSSR (2018-2022) (Remand)**

PUBLIC
INITIAL DETERMINATION AFTER REMAND

I. Introduction

The Copyright Royalty Judges (Judges or CRB Judges[1]) issued a Final Determination in this proceeding on December 19, 2018. 83 FR 62510 (Final Determination).[2] The Final Determination set the royalty rates and terms for transmission of sound recordings by Satellite Digital Radio Services (SDARS) and Preexisting Subscription Services (PSS). Music Choice, the only remaining PSS that participated in the proceeding, appealed three rulings embodied in the determination. *See Music Choice v. Copyright Royalty Board*, *et al.*, 970 F.3d 418 (D.C. Cir. 2020). As discussed below, the Court remanded the Final Determination with respect to two of those rulings.[3]

More particularly, the two broad issues that the D.C. Circuit directed the Judges to address on remand are (1) whether Music Choice's internet transmissions qualify for the PSS royalty rate and (2) whether the Judges' regulation regarding audits of PSS's royalty payments should be changed to permit SoundExchange to engage in audit procedures that are outside the scope of so-called "defensive audits"[4] conducted by independent auditors selected by the PSS. *Music Choice*, 970 F.3d at 421-22.

II. Proceedings On Remand

Upon remand by the D.C. Circuit, the Judges issued an Order Regarding Proceedings on Remand (Remand Order) (eCRB no. 23252). Adopting the parties' agreement as to the remand issues, the Remand Order poses the issues as: (1) "the extent to which Music Choice's Internet

[1] To avoid any confusion, when this Initial Determination After Remand discusses the D.C. Circuit and the Copyright Royalty Board (CRB) in the same context, it refers to the "CRB Judges" rather than simply the "Judges."

[2] Final rule and order, *Determination of Royalty Rates and Terms for Transmission of Sound Recordings by Satellite Radio and ''Preexisting'' Subscription Services (SDARS III)*, Docket No. 16-CRB-0001-SR/PSSR (2018-2022), 83 FR 62510 (Dec. 19, 2018) (Final Determination).

[3] The ruling that was not remanded by the D.C. Circuit was the correctness of the Judges' procedural decision to refer the legal issue of the categorization of Music Choice's internet streaming to the Register of Copyrights (Register) for a legal opinion, pursuant to 17 U.S.C. 802(f)(1)(B)(i). The D.C. Circuit affirmed that ruling. Final Determination at 65214, *aff'd Music Choice, supra,* at 423-24.

[4] The term "defensive audit" refers to the challenged audit provision, allowing the PSS to self-audit, but the regulation in dispute does not use the phrase "defensive audit." *See* 37 CFR 382.6(e) (*Acceptable verification procedure*) (citation is to the regulation in effect during the SDARS III proceeding).

transmissions are covered by the PSS license" and (2) the effect of so-called "defensive audits" in precluding independent audits conducted at SoundExchange's request. Remand Order at 1.

After reviewing the parties' proposals, the Judges determined that the proceedings on remand would entail the following steps:[5]

- Exchange of document requests and a limited number of interrogatories;
- Delivery of responses and objections to document requests;
- Production of documents, delivery of interrogatory responses, and identification of individuals from whom parties intend to submit declarations;
- Conduct of a limited number of depositions;
- Filing of [initial] written brief[s] … and supporting material[s] such as deposition transcripts, documents, and declarations; and
- Filing of reply briefs.

Id. at 2.[6]

Subsequently, the Judges solicited and then adopted the parties' joint schedule to govern proceedings on remand. Order Approving Joint Proposed Schedule for Proceedings on Remand (Dec 28, 2020) (eCRB no. 23380).[7]

III. The "Grandfathering" of PSS Rates and Terms for Music Choice's Internet Transmissions

A. Introduction

As indicated in note 3, *supra*, during the pre-remand proceeding, the Judges referred several legal questions to the Register. These questions concerned whether Music Choice's internet transmissions should be governed by PSS rates and terms. Order Referring Novel Material Question of Substantive Law and Setting Briefing Schedule (Oct. 5, 2017) (eCRB no. 13833) (Referral Order).[8] In addressing these referred questions, the Register explained that "the ultimate question is whether a particular program offering by a PSS entity qualifies as a PSS offering within the meaning of section 114(j)(11), and is therefore subject to the grandfathered rate standard under section 114(f)(1)." Final order, *Scope of Preexisting Subscription Services*, Docket No. 2017-20, 82 FR 59652, 59657 (Dec. 15, 2017) (Register's Ruling).

[5] These steps applied as well to the remanded audit issue, considered *infra*.

[6] Specific evidence and testimony on which the parties relied is described *infra* in connection with each issue.

[7] The Judges reserved the right to request subsequent additional briefing and/or testimony. *Id.* The Judges find it unnecessary to seek further briefing or testimony.

[8] The precise questions referred were: (1) Are a preexisting subscription service's transmissions of multiple, unique channels of music that are accessible through that entity's website and through a mobile application "subscription transmissions by preexisting subscription services" for which the Judges are required to determine rates and terms of royalty payments under Section 114(f)(1)(A) of the Copyright Act? and (2) If yes, what conditions, if any, must the PSS meet with regard to streaming channels to qualify for a license under Section 114(f)(1)(A)? For example, must the streamed stations be identical to counterpart stations made available through cable television? Is there a limitation on the number of channels that the PSS may stream? Is there a limitation on the number or type of customers that may access the website or the mobile application? Referral Order at 3-4.

The Register's Ruling stated first that, as a matter of law, Music Choice's internet transmissions could not be "grandfathered" under the statutory provision for grandfathering a PSS that transmitted its programming using the "same transmission medium." *See* 17 U.S.C. 114(d)(2)(B). Explaining this decision, the Register concluded that, even if Music Choice had made internet transmissions "to some limited degree" on and prior to July 31, 1998, that was legally irrelevant because the legislative history of the Digital Millennium Copyright Act (DMCA) demonstrated that the statutory phrase "same transmission medium" was limited to the "cable" and "satellite" media. Register's Ruling at 59658.

Second, the Register's Ruling concluded that a limited grandfathering could potentially be effected under a different statutory subsection, 17 U.S.C. 114(d)(2)(C), applicable to program offerings that were made available to subscribers via a "different transmission medium." *Id.* at 59657.[9] To determine if a PSS could avail itself of the benefits of limited grandfathering for program offerings made available via a "different transmission medium," the Register set forth a six-factor test for the Judges to apply. *Id.* at 59658-59.[10]

The Judges adopted the Register's Ruling, as required by law. *See* 17 U.S.C. 802(f)(B)(1)(i) ("[T]he Judges shall apply the legal determinations embodied in the decision of the Register … in resolving material questions of substantive law."). Specifically, they rejected the "unconditional" grandfathering sought by Music Choice, applying the Register's legal conclusion that internet transmissions were categorically not subject to grandfathering under the DMCA. Final Determination at 65226. The Judges then applied the Register's six-factor test for "conditional" PSS grandfathering (discussed *infra*) and determined that Music Choice failed to meet this standard as well. Final Determination at 65226-27.

The D.C. Circuit vacated and remanded the Determination as to these issues. *Music Choice*, 970 F.3d at 421. Briefly stated (and discussed in greater detail *infra*), the D.C. Circuit held that "Music Choice had been providing some digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998," and that, contrary to the Register's Ruling and the Final Determination, these "transmissions … fall within the scope of the DMCA's preexisting service definition." *Id.* at 425. However, the D.C. Circuit also ruled that, based on precedent, *SoundExchange, Inc. v. Muzak LLC,* 854 F.3d 713 (D.C. Cir. 2017) (henceforth *Muzak*), the CRB Judges must further determine whether "Music Choice's *program offerings* transmitted via the internet," qualify for statutory grandfathering, by focusing not only on Music Choice's status as a PSS entity, but also on its "*program offerings*." *Music Choice*, 970 F.3d at 425 & n.6 (emphasis added) (citing *Muzak*).[11]

After remand proceedings, for the reasons stated *infra*, the Judges hereby determine that (1) Music Choice's "program offerings" on internet-exclusive channels are not grandfathered and thus are not subject to the PSS rates and terms, (2) Music Choice's "program offerings" over the internet that are identical to transmissions of sound recordings on its cable television

[9] The D.C. Circuit, in its review, coined the terms "unconditional" and "conditional" to describe the two (unlimited and limited, respectively) statutory forms of PSS grandfathering that the Register had referenced. *See Music Choice*, 970 F.3d at 421.

[10] The Register's six-factor test is set forth *infra*.

[11] The Judges emphasize the phrase "program offerings" because, as discussed *infra*, the parties at times use a different phrase, "service offerings," to cover a wide aspect of Music Choice's business, including, but not limited to, its "program offerings." Because *Muzak*, on which the D.C. Circuit relied in this case, only used the phrase "program offerings," the Judges use that precise phrase instead of the less precise phrase "service offering."

channels are grandfathered and thus are subject to the PSS rates and terms, and (3) Music Choice's mobile service (including transmissions available "outside the home" whether through "smartphone applications" or otherwise) delivering "program offerings" of such identical "program offerings" are grandfathered and thus are subject to the PSS rates and terms.[12]

B. Background

1. Music Choice and Its Internet Transmissions

The pertinent facts, law, and procedural history, as laid out by the D.C. Circuit, are as follows:

> Started in the late 1980s, Music Choice is a digital broadcast music service that consists of several cable television channels. These channels are often included with digital cable television packages and now are also available to cable subscribers over the internet….
>
> Congress enacted the Digital Performance Right in Sound Recordings Act of 1995 to grant copyright protections to the digital transmissions of music … subject to a compulsory licensing regime … in which existing subscription music services, including Music Choice, would be entitled to continue transmitting copyrighted works in exchange for a royalty payment. …. The amount and terms of such royalty payments were … based on a reasonable rate standard.
>
> . . .
>
> [In 1998], Congress modified this regime in the Digital Millennium Copyright Act [DMCA], which requires certain digital music services to pay royalty rates at a market-based standard… *The market-based standard generally results in higher royalty rates for copyright holders.*
>
> . . .
>
> The DMCA, however, includes *a grandfathering provision*[] that makes [a PSS], such as Music Choice, *eligible to pay only "reasonable rates," which generally allow the service providers to pay lower royalty rates*.
>
> To be eligible for the grandfathered rate, a service must qualify as a [PSS], which is defined as
>
> > "a service that performs sound recordings by means of *noninteractive audio-only subscription digital audio transmissions,* which was *in existence* and was *making such transmissions* to the public for a fee on or before July 31, 1998.…"

[12] As noted *supra*, the D.C. Circuit found that Music Choice's provision of its service over the internet could qualify for the statutory "unconditional" grandfathering under 17 U.S.C. 114 (d)(2)(B) as transmissions of sound recordings in the "same transmission medium used by such service on July 31, 1998". Thus, Music Choice's internet transactions do not (and cannot) qualify for "conditional" grandfathering as transmissions by a PSS "other than in the same transmission medium used by such service on July 31, 1998." Therefore, the Register's six-factor test for application of the "conditional" grandfathering provision is not applicable as a matter of law.

> If a preexisting service's "subscription transmission" is made *"in the same transmission medium used by such service on July 31, 1998," it is entitled to the grandfathered royalty rate.* 17 U.S.C. § 114(d)(2)(B) (hereinafter the "unconditional grandfathered rate").
>
> A transmission made by a preexisting service *in a different transmission medium*, … may also be eligible for the grandfathered rate if it meets several additional conditions and requirements. 17 U.S.C. § 114(d)(2)(C) (hereinafter the "conditional grandfathered rate").

Music Choice, 970 F.3d at 421 (emphasis added).

2. The Rulings by the Register of Copyrights and the Judges

As noted *supra*, during the proceeding, the Judges referred to the Register of Copyrights the legal question of whether Music Choice's internet transmissions qualify as a preexisting service. Order at 1 n.2. As recounted by the D.C. Circuit, the Register's Ruling in response to that referral concluded, and the Judges acted upon it as follows:

> "[A]s a matter of law, internet transmissions are categorically excluded from the *unconditional* grandfathered rate.…"

The Register went on to set out a non-exhaustive six-factor test to guide the Board's determination of whether Music Choice's internet transmissions qualify for the *conditional* grandfathered rate.[13]

> In the Final Determination setting rates for the 2018 to 2022 period, the CRB Judges applied the Register's legal opinion and excluded Music Choice's internet transmissions from the unconditional grandfathered rate…
>
> The [CRB Judges] went on to apply the Register's six-factor test and determined that Music Choice's internet transmissions are also excluded from the conditional grandfathered rate.

Music Choice, 970 F.3d at 422 (citations omitted) (emphases added).

3. The D.C. Circuit Decision

Based upon its consideration of the facts, law, and procedural history in this proceeding, as discussed *supra*, the D.C. Circuit vacated and remanded the Judges' rulings regarding Music Choice's internet transmissions. In this regard, the D.C. Circuit held as follows:

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[13] The first four factors of the Register's six-factor test asks whether there was a similarity between Music Choice's internet transmissions and its preexisting cable transmission regarding (1) impact on phonorecord sales, (2) quantity and nature of sound recording use, (3) content offered to user groups, and (4) users' consumption of and experience with the product's feel, form, and functionality. Factor (5) inquires about the relation between Music Choice's internet offering and its pre-July 31, 1998 investments which Congress sought to protect. Factor (6) relates to the degree, if any, to which Music Choice's internet offering takes advantage of capabilities of the internet that are limited in the cable television transmission. Final Determination, 83 FR at 65226-27.

1. Because *the text and structure of the DMCA directly contradict the Register's interpretation*, we vacate the Register's legal opinion and the part of the Board's Final Determination that relies upon it.
2. Under the DMCA, a "subscription digital audio transmission" "*shall* be subject" to the unconditional grandfathered rate if it is (1) "made by a preexisting subscription service" and (2) offered "*in the same transmission medium used by such service on July 31, 1998*." 17 U.S.C. 114(d)(2)(B). *If a transmission meets both statutory elements, the Board must determine the royalty in accordance with the unconditional grandfathered rate.* Contrary to the Register's conclusion, *neither element categorically excludes internet transmissions.*
3. The plain language of the DMCA grandfathers a covered entity's *program offerings* that were "in existence ... on or before July 31, 1998." 17 U.S.C. 114(j)(11). *It is undisputed* that Music Choice had been providing some digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998. Those internet transmissions that are part of the same "service" fall within the scope of the DMCA's preexisting service definition (citing *Muzak LLC,* 854 F.3d at 716 (declining to impose extra-textual conditions on the plain meaning of the DMCA's preexisting subscription service definition)).
4. [T]he DMCA applies the unconditional grandfathered rate to transmissions made "in the same transmission medium." 17 U.S.C. 114(d)(2)(B). This provision does not distinguish between different transmission media, and there is no suggestion in the text that a "transmission medium" excludes internet transmissions. The "transmission medium" clause, like the preexisting service definition, focuses on *the actual preexisting entity and program offering,* not the manner of transmission. Thus, internet transmissions "shall be subject" to the grandfathered rate if they were "made by" a preexisting service on July 31, 1998. *Id.*
5. The CRB Judges retain discretion to determine whether parts of Music Choice's current program offerings, which include "mobile applications and internet-exclusive channels, should be excluded from the grandfathered rate."
6. On remand, the CRB Judges must determine the "precise scope" of Music Choice's program offerings as they actually existed on July 31, 1998, in order to "sort through" whether Music Choice's offering of internet-exclusive channels and mobile access "are eligible for the grandfathered rate …."

Music Choice, 970 F.3d at 424-428 (emphases added).

C. Parties' Arguments on Remand[14]

1. SoundExchange's Opening Brief

a. SoundExchange's Factual Arguments

1. The internet transmissions that Music Choice now seeks to pay for at a PSS rate were not within the scope of the company's offerings as they actually existed on July 31, 1998. SoundExchange, Inc.'s Opening Brief on Remand at 8 (SX Opening Br.) (eCRB nos. 25375, 25374).
2. Music Choice's documents that are most contemporaneous with the period on and before July 31, 1998 – including website excerpts, testimony by its CEO, David Del Beccaro, and other documents – show that Music Choice did not offer subscription internet transmissions until April 1999, *i.e.*, after the July 31, 1998 grandfathering date. *Id.* at 9-10.
3. More particularly, in testimony years prior to this SDARS III proceeding, Mr. Del Beccaro stated that the internet transmissions Music Choice offered in 1999 included only four channels on a free, *nonsubscription* basis (discontinued on March 5, 2001) and that Music Choice in fact did not launch any subscription-based internet service until April 26, 2000. SX Opening Br. at 9 (citing Testimony of David J. Del Beccaro at 5-6, *In Re Rate Setting for the Digital Performance Right in Sound Recordings and Ephemeral Recordings (Web I)*, Docket No. 2000-9 CARP DTRA 1 & 2 (Apr. 11, 2001)).
4. Documents created during the relevant period corroborate this testimony. Specifically, an archived version of Music Choice's website, accessible via the "Internet Archive's Wayback Machine" (Wayback Machine), indicates that Music Choice did not offer streaming music on its website, nor did it tout its streaming capabilities on or before July 31, 1998. *Id.* Further, the "Frequently Asked Questions" (FAQ) page that appeared on the Music Choice site from 1996 to 2000 describes Music Choice as a "CD quality music service that comes into your home or business via cable or DIRECTV." *Id.* at 10. Thus, "[t]he evidence does not indicate that Music Choice was offering its consumers internet service as we understand it today." *Id.*
5. Although Music Choice, through one distributor, made transmissions via "broadband," it was "extremely limited" and not technically the same as transmissions over the "internet." *Id.* at 11.
6. Although Music Choice made program offerings in 1996 (*i.e.*, pre-July 31, 1998) through an "internet service," it was "limited" – provided on a trial basis to users of a proprietary network in Jacksonville, Florida – Continental Cablevision (Continental). More particularly, according to a contemporaneous press release, Continental's customers who purchased this [Music Choice] broadband service—branded as "Highway1"—would receive broadband access to ten Music Choice audio channels. *Id.*

[14] The parties did not set out separate or numbered proposed finding of fact or conclusions of law in their respective briefs (nor were they required to do so). For clarity, the Judges have separated out herein the parties' arguments in their briefs, as between their factual and legal points and, for clarity, the Judges have numbered those points. The evidence on which the parties rely, obtained both pre-remand and post-remand, is cited *infra* in the Judges' numbered paragraphs reciting the parties' respective arguments.

7. In contrast to the offering Music Choice claims is grandfathered, Highway1 did not offer any internet-exclusive channels. Further, there is no evidence of how many Jacksonville customers, if any, actually purchased Highway1 or accessed Music Choice through it. *Id.* at 11-12.
8. This offering did not involve any internet transmissions by Music Choice. Rather, Music Choice transmitted its audio channels to Continental and other cable companies via satellite. Continental then retransmitted the Music Choice program offering to the subscribers to its branded Highway1 broadband service only over Continental's own local broadband network. *Id.* at 12.
9. These were not internet transmissions because they were not transmitted via what is understood to constitute the "internet," *i.e.*, "a series of interconnected networks that each has its own user," and is distinct from any one individual privately-owned network. Music Choice's alleged internet transmissions connected to the internet through cable providers, and the private network transmissions cannot themselves "meaningfully" be said to be internet transmissions. *Id.* at 12 n.8.
10. Moreover, "[a] Continental subscriber would need a cable modem and digital tuner to convert the Continental signal into an analog signal that could play on a connected device." *Id.* This was a "primitive" means of transmission "which bears no resemblance to how Music Choice provides internet service today," transmitting its signal to distributors directly over the internet. *Id.*
11. There is no sufficient evidence to support Music Choice's claims that a handful of cable providers other than Continental also transmitted Music Choice's service to their customers prior to July 31, 1998. More particularly, Music Choice has produced no documents identifying which other providers, if any, offered its internet transmissions at that time. *Id.* at 13. Music Choice's only purported support for such other cable provider transmissions is Mr. Del Beccaro's much later deposition testimony, in which he (a) could not identify any other market in which Continental's Highway1 broadband service was offered, (b) could not identify any other Music Choice distributor that offered a similar internet service offering on or before July 31, 1998, and (c) stated that no one else at Music Choice would be able to provide this information. *Id.* at 13-14.
12. Based on the foregoing, Music Choice's current internet offerings cannot "fairly be characterized as included in the service offering Music Choice provided on July 31, 1998." Rather, the foregoing evidence demonstrates that the service was only available by cable and satellite, not available over the internet at all until 1999, and not available on a subscription basis until 2000. *Id.* at 15.
13. The following additional facts further demonstrate Music Choice's current internet service is dissimilar to the "limited" subscription service offering Music Choice made available through Continental prior to July 31, 1998. Specifically, the 1998 service:

    (a) did not include internet-exclusive channels;

    (b) did not offer mobile access, whether through a smart phones mobile app or otherwise; and

    (e) was unavailable over Wi-Fi

Id. at 15-16.

14. The "precise scope" of Music Choice's internet transmissions, prior to July 31, 1998, was extremely limited and did not include internet transmissions similar to those it makes today. *Id.* at 18-19.

b. SoundExchange's Legal Arguments

1. The D.C. Circuit opinion did not suggest that the Judges' Determination was incorrect in ruling that Music Choice could not pay royalties at the PSS level for its internet transmissions. Rather, the appellate decision merely requires the Judges to provide additional analysis and reasoning to support that ruling. *Id.* at 5.
2. The D.C. Circuit held that Music Choice's claim of a right to pay royalties at the PSS level for its internet transmissions could not be rejected on a categorical basis (*i.e.*, merely if they were made available over the internet), and the Judges must consider this royalty issue in light of the facts of the provider's particular offering. *Id.* (citing *Music Choice*, 970 F.3d at 427-28).
3. To that end, the D.C. Circuit directed the Judges to "determine the precise scope of Music Choice's service offering as it actually existed on July 31, 1998," and to "assess whether Music Choice's service offerings, including its mobile application and internet-exclusive channels, are a part of the service offering Music Choice provided on July 31, 1998." *Id.* (citing *Music Choice*, 970 F.3d at 427-28).
4. The Judges retain discretion to determine whether parts of Music Choice's current service offering should be excluded from the grandfathering of the PSS rate. *Id.; Music Choice*, 970 F.3d at 428 n.9.
5. The D.C. Circuit panel declined to review the Register's six-factor test. *Id.* (citing *Music Choice*, 970 F.3d at 420 & 427 n.9). However, the appellate panel neither questioned the Register's six-factor test nor indicated any doubt as to the correctness of the Judges' application of that test by which they rejected application of the "conditional" grandfathering provision. *Id.* at 5 (citing *Music Choice*, 970 F.3d at 427 n.9.)
6. On remand, the Judges must examine whether Music Choice's current internet transmissions are part of the same "service" it transmitted or before July 31, 1998. Only transmissions that can fairly be characterized as included in the "service offering" Music Choice provided on July 31, 1998, are entitled to the grandfathered PSS royalty rate. *Id.* at 7.
7. Pursuant to the D.C. Circuit decision, the Judges must determine "the precise scope of Music Choice's service offering as it actually existed on July 31, 1998." *Id.* (citing *Music Choice*, 970 F.3d at 427-28).
8. For purposes of this analysis, "medium" refers only to "the basic telecommunications service through which that offering is being delivered to the user." *Id.*-, (quoting Register's Ruling at 59659).
9. If, on remand, the Judges find that a transmission is made by a PSS in a different transmission medium that does not satisfy the standard in ¶ 8 above, then Music Choice cannot qualify for the PSS rate under the "unconditional grandfathered rate." Rather, Music Choice must seek to qualify under the "conditional grandfathered rate." *Id.*

10. The Court instructed the Judges to consider whether, on or before July 31, 1998, Music Choice (a) made internet transmissions "available outside the home", through smart phone applications, mobile services, or otherwise and (b) included internet-exclusive channels as part of its offering. *Id.* at 7-8.

11. Neither the "unconditional" nor the "conditional" statutory grandfathering provisions allow Music Choice to avail itself of the PSS rates and terms for the transmissions, channels and applications referenced in ¶ 10 above. *Id.* at 15-16.

2. Music Choice's Response Brief

a. Music Choice's Factual Responses

1. It was undisputed on the record that Music Choice had been making internet transmissions of channels to its subscribers before July 31, 1998. Music Choice's Responsive Brief on Remand at 5-6 (MC Responsive Br.) (eCRB nos. 25713, 25715).

2. This assessment is supported by testimony from Mr. Del Beccaro at the hearing in this proceeding that Music Choice launched its first internet-based transmissions of its customer audio service in 1996 and has continued transmitting via the internet to this day. *Id.* at 7 (citing May 18, 2017 Hearing Tr. at 4599:2-18 (Del Beccaro)).

3. SoundExchange introduced no evidence to contradict that testimony. *Id.* Further, on remand, Mr. Del Beccaro has submitted additional testimony with more details about the launch and development of Music Choice's internet transmissions, and Music Choice submitted documents corroborating that testimony – all of which have not been refuted by contrary evidence from SoundExchange. *Id.*

4. Mr. Del Beccaro's *Web I* testimony on which SoundExchange relies to claim he contradicted his more recent testimony "was not about the service offering at issue in this proceeding." *Id.* at 8. Rather, Mr. Del Beccaro's *Web I* testimony related to a *non-subscription, advertising supported service* that Music Choice launched on its website in 1999, which would have to pay royalties under the new non-subscription webcasting license created by the DMCA. *Id.* Moreover, notwithstanding SoundExchange's representations to the contrary, Mr. Del Beccaro did not say in his *Web I* testimony that the nonsubscription service was the only form of internet transmission that Music Choice offered in 1999; it merely discusses the launch of the non-subscription service in 1999 and its discontinuance in 2001. *Id.* at 9. Indeed, because the subscription internet transmissions Music Choice had offered since 1996 were already covered by the PSS license, there was no reason for Mr. Del Beccaro to have discussed the history or launch of that service in *Web I*. *Id.*

5. SoundExchange misconstrues Mr. Del Beccaro's deposition testimony in this proceeding regarding the fact that Music Choice's service historically was transmitted via satellite uplink and through digital tuners. This testimony discussed merely *one* historical way in which its channels were transmitted through cable television providers, and thus does not prove that Music Choice was not also making internet transmissions prior to July 31, 1998. *Id.* Indeed, Mr. Del Beccaro clearly testified in his deposition that this was not the only way for subscribers to obtain Music Choice prior to July 31, 1998, and had specified that subscribers could then also receive the channels via internet. *Id.* at 9-10, citing Deposition of David Del Beccaro, Tr. 67:24-68:12 (Del Beccaro Dep.).

6. Authentication issues aside, the Wayback Machine[15] printouts in fact corroborate that Music Choice was transmitting its music channels via the internet in 1998. *Id.* at 11-12. For example, on the FAQ page from Music Choice's website, Music Choice notes that it was available as of October 23, 1996, as part of Continental Cablevision's High Speed *Internet* Service in Jacksonville, Florida. *Id.* at 12 (emphasis added).
7. SoundExchange ignores a press release on Music Choice's website that announces a September 23, 1996 launch of the consumer music channels on Continental's Highway1 high-speed internet service. *Id.* Instead, SoundExchange relies on seemingly random pages it claims are from Music Choice's website from July 5, 1998, for the proposition that Music Choice did not offer access to its service through the internet prior to July 31, 1998. But there is no reason to expect that such pages—which did not even look like a home page--would have information about music streaming functionality on them. *Id.* Moreover, the absence of a refence to music streaming on "two random pages" does not demonstrate what else was on the Music Choice website on that date. *Id.* Moreover, the reference date for the website pages—July 5, 1998—does not even come from Music Choice's website, but rather from the Wayback Machine's date index, which does not establish when the page was actually first published. *Id.* at 12-13.
8. SoundExchange also wrongly relies on an article from a European trade periodical describing internet services that Music Choice Europe offered in 1997. But that article relates to a different company with a different service in a different part of the world, "Music Choice Europe," in whose operation Music Choice was not involved (although it was involved in the creation of that foreign business operation). Nevertheless, the article indicates that the Music Choice Europe service was launched in early 1997 (*i.e.*, pre-July 31, 1998) on Telecom Finland's Quicknet *internet* service, corroborating Mr. Del Beccaro's testimony that *in the relevant time frame* there existed technical capabilities that generated *actual internet transmissions* of music channels via apps installed by subscribers to receive the service. *Id.* at 13.
9. SoundExchange's argument that Music Choice's high-speed *internet* offering did not include *internet* transmissions is thus absurd. *Id.* Even though the channels then were transmitted through a cable modem, they were still internet transmissions. Moreover, Music Choice's internet offering was not limited solely to cable modems in 1998 or thereafter. *Id.* Rather, Music Choice launched its internet-based offering on Continental Cablevision's Jacksonville system in September of 1996, and it continued to operate the offering after July 31, 1998. *Id.* at 13-14.
10. That first launch was initially marketed as part of Continental's "high speed internet service", which was provided to subscribers using a "cable modem" to connect the user's computer to the internet. *Id.* at 14. These cable modems were not fundamentally different from any other type of modem used to connect to the internet, including those built into mobile devices. *Id.* The goal of the service was to provide internet transmissions to the subscriber. Even if Music Choice's transmissions to cable

[15] The "Wayback Machine" is a project of the "Internet Archive," an independent nonprofit organization, providing copies of websites at particular moments in the past. SX Opening Br. at 9 n.6. *See also* InternetArchive.org ("The Wayback Machine is an initiative of the Internet Archive, a 501(c)(3) non-profit, building a digital library of Internet sites and other cultural artifacts in digital form." *See* InternetArchive.org (last retrieved May 7, 2024)).

subscribers in 1998 had been limited to subscribers' cable modems, they would still have been internet transmissions. *Id.* (citing Del Beccaro Responsive Decl. ¶¶ 21-23). Nevertheless, Music Choice's internet transmissions were not limited to cable modems. *Id.*

11. Music Choice's internet offering subsequently expanded to many other affiliates and systems throughout the country. *Id.* at 13-14 (citing Del Beccaro Opening Decl. ¶¶ 10-18). Some of these other early launches via Multichannel Video Programming Distributor (MVPD) affiliates who provided Music Choice's channels to their high-speed internet subscribers did not limit access to the cable modem, but rather also allowed access from any internet-connected device. *Id.* (citing Del Beccaro Opening Decl. ¶ 45). The few affiliates that did link access to a cable modem soon abandoned that restriction. *Id.* By July 31, 1998, several other Music Choice affiliates were offering internet access to the channels to regular television and high-speed internet subscribers from any internet-connected device. Music Choice contends that regardless of the type of modem used, transmissions received via any modem connected to the internet are internet transmissions. *Id.*

12. Even assuming *arguendo* that Music Choice's pre-1998 internet transmissions were limited to one Jacksonville system, *the D.C. Circuit* has already rejected the Register's view that there was some kind of *materiality threshold* for whether a PSS was using a particular medium enough in 1998. *Id*. at 14-15. The threshold question is whether Music Choice was transmitting via the internet at all on that date. *Id.* at 14-15.

13. Mr. Del Beccaro never said that Music Choice's MVPD affiliates offered Music Choice's channels exclusively through a local network. *Id.* at 16. Rather, Mr. Del Beccaro repeatedly testified that the Music Choice channels were transmitted over the internet before and during 1998 and were not limited to devices connected to a cable modem or to high-speed internet subscribers. *Id.* Further, any purported lapses in Mr. Del Beccaro's memory in response to questioning regarding the details of which affiliates and systems launched the internet service on which dates prior to July 31, 1998, amounted to an "impossible and pointless memory test that no CEO or other witness could reasonably have satisfied." *Id.* Notwithstanding his inability to identify specific dates, Mr. Del Beccaro was clear that Music Choice had launched and was providing its internet offering in 1996 and that, by July 31, 1998, the service was available through many different affiliates and systems. *Id.*

14. SoundExchange also incorrectly claims that Mr. Del Beccaro was unable to point to any documents supportive of his testimony regarding the launch dates of Music Choice's internet service. Rather, Mr. Del Beccaro confirmed that Music Choice had produced documents with at least some of this information. *Id.* at 17.

15. In addition to the launch of Music Choice's service through Continental's Jacksonville system in 1996, Mr. Del Beccaro testified (after his memory was refreshed by documents Music Choice had produced to SoundExchange) that, by July 31, 1998, the channels were available via internet through five additional Music Choice affiliates – Time Warner, Adelphia, Comcast, MediaOne, and Cox. *Id.* at 17-18. Accordingly, his written testimony is not inconsistent with his deposition testimony, but rather is consistent with documentary evidence submitted with Music Choice's opening brief. *Id.* at 18. This

consistency belies the supposed inconsistency between Mr. Del Beccaro's earlier and later testimony.

16. With regard to the issue of whether its music channels transmitted via the internet were available outside the home in 1998, Mr. Del Beccaro's written testimony sets forth which subscribers could receive Music Choice channels from locations outside the home. *Id.* at 19; (citing MC Opening Br. at 12-14). Specifically, Mr. Del Beccaro testified that, although there were no smart phones back in 1998, subscribers could have had internet access to Music Choice channels on their cell phones if they had internet access on those phones in 1998, because cell phones were internet-connected. *Id.* at 20. Mr. Del Beccaro further testified at his deposition that forms of wireless communication, such as microwave and satellite technologies, allowed subscribers to listen to Music Choice wirelessly. *Id.*

17. The only support SoundExchange offers to the contrary is a cite to Mr. Del Beccaro's deposition testimony in which he testified that the Music Choice service was available outside the home in cars through DIRECTV. *Id.* at 20. But Mr. Del Beccaro was uncertain whether that service was available in 1998, and he was likewise unaware of any "Walkman" type device that would allow a subscriber to listen to the service while jogging. *Id.* Thus, this testimony is not a clear statement that the service was not available in any way outside the home. *Id.*

18. Music Choice has always required subscribers to use "apps" to receive its music channels, whether transmitted via cable, satellite, or internet. *Id.* Mr. Del Beccaro explained in his testimony that any access from outside the home in 1998 would necessarily use an app to receive the channels, whether the app was a web browser or a special purpose software application. *Id.* at 21. Any differences between Music Choice's channels via internet before and after July 31, 1998, fall well within the standard. *Id.*[16]

19. The nature of Music Choice's program offering on its audio channels is exactly the same as it was as of July 31, 1998. *Id.* at 22. The only changes relate to the technologies and interfaces used to receive the channels. *Id.*

20. The technology and interface changes to Music Choice's service do not constitute changes in the medium of transmission for the service. *Id.* The programming transmitted to subscribers on the audio channels is exactly the same as it was in 1998: multiple channels of non-interactive, curated, radio-type, commercial-free music audio provided to consumer subscribers via internet. *Id.*

21. Notwithstanding SoundExchange's arguments to the contrary, none of the improvements Music Choice has made since 1998 (*e.g.*, evolution of internet-connected mobile phones to smartphones, introduction of Wi-Fi and smartphone apps) change the fundamental nature of the programming heard on the music channels. All of these improvements were driven by Music Choice's need to adapt to new technologies and market conditions so it

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[16] The asserted "standard" to which Music Choice refers is whether the internet channels are "fundamentally" the same service Music Choice was offering in 1998 and which "evolved" to take advantage of technological advancements. *See id.* at 9.

could develop and grow its service, which the Register recognized as allowed for an existing service offering. *Id.* at 23 (citing Register's Ruling at 59658-59).

22. The number of channels and channel lineup provided to a given subscriber has always been variable, even on television, in part because Music Choice provides its affiliates with a master set of channels and each affiliate can select among them its preferred channels, lineups, and number of channels, varying by the type of cable box utilized by the affiliate. *Id.* at 23.

b. Music Choice's Responses to SoundExchange's Legal Arguments

1. The entirety of SoundExchange's argument regarding internet transmissions rests on the false premise that a PSS is statutorily limited to the "precise scope" of its service offerings as they existed on July 31, 1998. *Id.* at 2.
2. SoundExchange's view is inconsistent with the relevant legislative history, the structure of the PSS grandfather provisions as recognized by the D.C. Circuit, and the original CARP determination. *Id.* at 2-3.
3. Congress recognized in creating the PSS designation that a small group of companies had launched the first digital radio-type services and created the market for such services under prior rules and grandfathered those services under the original rules so that they could continue to grow their businesses. *Id.* at 3. To this end, Music Choice states that in the first PSS rate-setting proceeding, the Librarian of Congress noted Congress's intent to protect the PSS's "need for access to the works at a price that would not hamper their growth." *Id.* (citing Final rule and Order, *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, Docket No. 96–5 CARP DSTRA, 63 FR 25394, 25409 (May 8, 1998) ("Librarian's *PSS I* Determination")).
4. In 1998, the Register rejected a similar argument by SoundExchange to limit the scope of the PSS license, explaining that – in light of the pioneering investments made by PSS – Congress intended for the grandfather provisions to allow those companies "to develop their businesses accordingly." *Id.* citing Final Order, Designation as a Preexisting Service, 71 FR 64639, 64645 (Nov. 3, 2006); *Muzak*, 854 F.3d at 715 (in a concession to the businesses that invested under the more favorable pre-1998 rates, the Act provides a grandfather clause allowing a PSS to pay rates according to the old method); and *Music Choice v. Copyright Royalty Bd.*, 774 F.3d 1000, 1004 (D.C. Cir. 2014) (PSS license intended to protect the investment of noninteractive services that had come into existence before the recognition of the digital performance right)).
5. In the current proceeding, the D.C. Circuit held that the structure of the PSS grandfather provisions evinces Congress's intent to allow the PSS to expand into entirely new transmission media without losing PSS status. *Id.* at 3-4 (citing *Music Choice*, 970 F.3d at 421, 426). Thus, the statute's premise for allowing for expanded service offerings means that a PSS such as Music Choice may continue to develop its service after July 31, 1998, and avail itself of the PSS rates. *Id.* at 4.
6. The Register's Ruling expressly held that service offerings offered in the same transmission media used on July 31, 1998, have significant ability to evolve, improve, and adapt to new technologies inherent in those media. *Id* at 4 (citing Register's Ruling at 59658 (the only restriction is that the existing service offering as it is today must be

fundamentally the same type of offering that it was on July 31, 1998, *i.e.*, noninteractive, residential[17], cable or satellite digital audio transmission subscription service)). This aspect of the Register's Ruling was not remanded. Accordingly, SoundExchange cannot make this argument anew on remand.

7. The Register also stated that an existing service offering can adapt to and take advantage of benefits of significant technological changes in existing media. *Id.* (citing Register's Ruling at 59659).
8. With respect to existing service offerings in new media, the Register rejected SoundExchange's argument that a PSS must remain exactly as it was in 1998. *Id.* at 4-5 (citing Register's Ruling at 59658).
9. The only limitation on the evolution of Music Choice's PSS is that the service must remain a non-interactive digital audio service that is transmitted to consumer subscribers (as opposed to business subscribers) through cable, satellite, or internet. *Id.* at 5.
10. Music Choice's service at issue easily meets this test, and any changes to that service over the past twenty-five years are of the types allowed for an existing service offering. *Id.*
11. On appeal, the D.C. Circuit did not create a new legal standard for existing offerings by a PSS. *Id.*
12. Neither party appealed those parts of the Register's Ruling dealing with the ability of a PSS to develop an evolving service offering. *Id.*
13. Rather, the D.C. Circuit's holding was very limited – vacating and remanding (on the internet-related issues) because of the error in statutory interpretation by the Register and the Judges' statutory interpretation in categorically excluding Music Choice's internet transmissions from unconditional grandfathering. *Id.*
14. The D.C. Circuit did not discuss – let alone overrule – the Register's legal analysis regarding the ability of existing offerings to expand and evolve under the umbrella of the grandfathered PSS royalty rates. Rather, the Court instructed on remand that the Judges would have to reconsider -- using the correct legal standard – the degree to which Music Choice's contemporaneous internet transmissions as identified in the hearing were within the scope of the PSS license. *Id.* at 6.
15. Thus, the Judges are directed on remand to analyze those transmissions to determine if they constituted what the Register denominated as "existing service offerings" or "expanded service offerings." *Id.*
16. Under this analysis, the Judges must determine whether the channels offered as shown during the hearing are part of the same service that was offered in 1998. *Id.*
17. The following types of facts are relevant: (a) the nature of the service, (b) the nature of the transmission media, and (c) the various features actually available on July 31, 1998. *Id.* (citing *Music Choice*, 970 F.3d at 427-28).

[17] Music Choice argues that the term "residential" as applied to its service (and all other television programming services) refers to the type of subscriber, to distinguish it from commercial subscribers, rather than to distinguish it from mobile subscribers.

18. The D.C. Circuit decision did not require that the current offering be identical to the offering as it existed in 1998. *Id.* This would have been inconsistent with the Court's acknowledgement of Congress's intent to allow the PSS to develop and grow their services in an existing transmission medium (the unconditional grandfathering) and its acknowledgement that a PSS may expand into new transmission media (the conditional grandfathering). *Id.*
19. Moreover, if such a requirement of an "identity" between Music Choice's July 31, 1998 service and its post-July 31, 1998 services could arguably be implied in the D.C. Circuit decision, any such implication would have been dicta. *Id.*
20. Although the Court directed the Judges to sort through the relevance of SoundExchange's suggestion that the Judges consider the extent of any availability of Music Choice's service as of July 31, 1998, outside the home – including through the use of "apps" – the Court did not indicate what weight, if any, the Judges should give to such facts, or provide a new legal standard for evaluating whether any changes were – or were not – so significant as to render the current channels a different service. *Id.* at 6-7.
21. The Register's legal standard required the Judges to determine whether the contemporary internet transmissions remained part of an existing service offering, and that standard is satisfied because Music Choice channels provided via the internet were – and remain – fundamentally part of its non-interactive digital audio transmission service provided to consumer subscribers. *Id.*
22. The D.C. Circuit opinion holds that "Music Choice ha[s] been providing some digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998." *Id.* (quoting *Music Choice*, 970 F.3d at 428).
23. The documents that SoundExchange proffers from the Wayback Machine are neither admissible nor probative, because they do not come from Music Choice's actual website, but rather from a third party's alleged indexing of limited pages from certain dates. *Id.* at 10. Moreover, SoundExchange has not submitted testimony or other evidence establishing the accuracy of these documents nor even established how the Wayback Machine created these images. *Id.*
24. Further, there is no merit to SoundExchange's argument that the Wayback Machine has a blanket exemption from authentication requirements. None of the cases that SoundExchange cites to supports the admissibility of Wayback Machine printouts approved the admission of those printouts solely based on testimony of trial counsel who printed them out. Rather, authentication was required for each such printout, such as testimony from a representative of the Internet Archive, comparison to actual copies of the relevant website or other properly authenticated documents, or testimony from witnesses with personal knowledge of the website at issue at the relevant time vouching for the accuracy of the Wayback Machine printout. *Id.* at 10 & n.1. In support of this point, absent such authentication, courts have declined to admit screenshots from the Wayback Machine or similar internet archives when only submitted with an attorney's declaration. *Id.* at 11. The correct legal issue is whether Music Choice's post-July 31, 1998 internet transmissions were, and remain, fundamentally the same service Music Choice was offering in 1998. *Id.* Consistent with previous rulings by the Register and the D.C. Circuit, its existing service offering is permitted to change, evolve, improve and

take advantage of technological advancements in the existing transmission media without constituting a new or different service offering, so long as its music service remains a non-interactive digital audio transmission service transmitted to consumer subscribers through cable, satellite, or internet. *Id.* at 21.

25. The Judges should reject SoundExchange's suggestion to merely "re-issue the vacated portion of the Final Determination" and continue to evaluate Music Choice's internet transmissions as an expanded service offering under the Register's six-factor test for a "conditional" grandfathering *Id.* at 21 n.3. That test only applies to expanded service offerings, which in turn only applies to offerings transmitted in a new medium of transmission. *Id.* But because Music Choice was transmitting via internet on July 31, 1998, its music mobile access feature is not a different, non-internet medium of transmission, rendering irrelevant the "expanded service offering rubric …." *Id.*
26. The Register's six-factor test was premised on the same error that led the D.C. Circuit to vacate the Register's ruling and should not be followed. *Id.* More particularly, it was legal error for the Register to create a legal test for the evaluation of expanded service offerings that went beyond the statutory PSS definition and the criteria enumerated in 17 U.S.C. 114(d)(2)(C), inappropriately inserting herself in "fact-finding" to create "this now-irrelevant test." *Id.* at 21-22 n.3 (citing *Music Choice*, 970 F.3d at 427 n.9).
27. The statutory license at issue in this proceeding only covers the music performed on the channels and no separate license is needed from the record companies for Music Choice's interfaces or technologies. *Id.* at 22.
28. SoundExchange wrongly argues that the transmission of certain music channels exclusively via the internet (*i.e.*, that are not also transmitted via television) is sufficient to render those channels a totally different service. As to that issue, the Register expressly ruled that an existing service offering is allowed to add or remove channels without becoming a different service. *Id.* (citing Register's Ruling at 59658). As explained *supra*, even on television, the number of Music Choice channels and lineups received by a subscriber can change constantly. *See id.* at 23-24. Thus, in the context of an existing service offering, there is no reason the statutory grandfathering provisions should be construed to require that the exact same channels be transmitted to all subscribers within or across every medium of transmission. In any event, during the rate period covered by this proceeding, Music Choice has not made available via the internet channels that are not also available on the television. *Id.* at 24.

3. Music Choice's Opening Brief

a. Music Choice's Factual Arguments

1. Although Music Choice has greatly improved its music channels since 1998, Music Choice is still fundamentally the same bundle of non-interactive digital audio channels transmitted to consumer subscribers. Music Choice's Opening Remand Brief at 3 (eCRB nos. 25392, 25390) (MC Opening Br.).
2. Music Choice's service has been available outside the home (on desktop and portable computers) since 1996 and Music Choice was already investing in technology to enable access on mobile internet devices prior to 1998. *Id.*

3. Cable and satellite television industry "standards and practices" recognize mobile internet access to television channels as part and parcel of the cable and satellite television service offered by MVPDs. Music Choice's channels and interface offered via internet today are fundamentally the same as those offered on the television. *Id.* Therefore, there are no grounds upon which to find those transmissions are a completely different offering. *Id.*
4. This point was provided by Mr. Del Beccaro in his hearing testimony that Music Choice was making internet transmissions in 1998 (citing May 18, 2017 Hearing Tr. at 4599:2-18). SoundExchange's evidence does not contradict that testimony. *Id.* at 9.
5. On remand, Mr. Del Beccaro provided further detail, explaining that Music Choice (1) expanded its service from traditional cable systems to other types of MVPDs, such as telephone company systems and satellite television providers; and (2) beginning in the early 1990s began working on ways to transmit its music channels over the internet and "first achieved this on a test basis in 1993 or 1994." *Id.* at 9-10 (citing Del Beccaro Decl. ¶¶ 7-9).
6. Music Choice was the first music service to multicast over the internet, launching that feature as part of its consumer subscription service in 1996. *Id.* (citing Del Beccaro Decl. ¶ 8).
7. Music Choice sometimes referred to this internet feature as a "cable modem" offering because MVPDs were beginning to offer high speed internet access via devices called "cable modems." *Id.* Using Music Choice's internet-based feature, consumers who received internet service from their MVPD could access Music Choice music channels on any device connected to the internet, which, prior to July 31, 1998, typically meant access via a computer. *Id.* Further, subscribers, after logging into a portal using either a web browser or a separate software application, could "select from various Music Choice channels and listen while surfing the web or doing anything else on their connected devices." *Id.* (citing Del Beccaro Decl. ¶¶ 8-9).
8. The first system to launch the internet feature was Continental Cablevision's Jacksonville system, which began providing the Music Choice service via internet in September 1996. *Id.* at 10.
9. In 1996 and 1997, other MVPDs, including Time Warner Cable, Adelphia, Comcast, MediaOne, and Cox began providing Music Choice's music channels via internet. *Id.* (citing Del Beccaro Decl. ¶ 10). By July of 1998, internet access was available in multiple regions through the MVPDs named above, and others. *Id.* at 10-11 (citing Del Beccaro Decl. ¶ 11). The following Music Choice records from the time purportedly substantiate Mr. Del Beccaro's testimony. *Id.* at 11 (citing Del Beccaro Decl. ¶¶ 12-18):
   (a) In 1995 Music Choice sought public performance licenses from major performance rights organizations to cover internet transmission of Music Choice's service. *Id.* (citing Del Beccaro Decl. ¶ 7, Ex. MC 10).
   (b) Business records from prior to 1998 contain references to the launch, roll-out, and success of Music Choice's internet feature. *Id.* (citing Del Beccaro Decl. ¶ 15-16, Exs. MC 12 and 13).

(c) Affiliate agreements prior to 1998 obligate Music Choice to carry the internet feature under certain circumstances. *Id.* (citing Del Beccaro Decl. ¶ 18, Ex. MC 15).

(d) Internal Music Choice documents created during the years after it launched its internet offering (*e.g.*, internal and marketing presentations) include references to Music Choice having made its first music multicast over the internet in 1996. *Id.* Further, third-party source material from shortly after the relevant time period likewise recognized that Music Choice was operating an internet service in 1995, at the time when the DMCA was enacted. *Id.* at 12 (citing *Everything You Always Wanted to Know about Digital Performance Rights but Were Afraid to Ask*, 48 J. Copyright Soc'y U.S.A. at 223 nn. 195 &198 (2000), a 2000 article in the Journal of the Copyright Society of the USA noting that Music Choice provides service via cable, satellite, or the internet).

10. Music Choice's service was available outside the home on July 31, 1998. But the distinction between inside and outside the home is legally irrelevant, because the distinction between existing and expanded service offerings is solely based on the media of transmission, and therefore the location where the transmission is received is irrelevant. *Id.* at 12. Nevertheless, internet transmissions of Music Choice's PSS music channels have always been available outside the home, including on July 31, 1998. *Id.* (citing Del Beccaro Decl. ¶ 43). Specifically, the first version of Music Choice's service was marketed to MVPDs' high speed internet customers and in 1996 was "typically received on a computer because computers were the most common devices connected to the internet at that time." *Id.* That is, to access the Music Choice service on a computer, a subscriber:

    (a) could use either a web browser or a separate software application to allow the user to enter login credentials. *Id.* at 12-13 (citing Del Beccaro Decl. ¶ 43).

    (b) could log in by utilizing the websites of certain Music Choice affiliates, or' log in through Music Choice's internet server. *Id.* at 13.

    (c) once authenticated, could listen to Music Choice's music channels so long as the computer remained connected to the internet. *Id.* (Music Choice contends that there was nothing about this implementation that necessarily limited access to within the subscriber's home. *Id.* (citing Del Beccaro Decl. ¶ 44)).

    (d) could link to some (but not all) affiliates using cable modems, which were provided to commercial and consumer locations so the service could be available to consumer subscribers at their workplace (but the affiliates "quickly eliminated any restriction and allowed access to high speed internet and television subscribers using any internet-connected device.") *Id.* (citing Del Beccaro Decl. ¶ 45).

    (e) by July 31, 1998, could use any internet-connected device to access Music Choice channels on "several different Music Choice MVPD affiliates." *Id.*

11. Portable laptops could access the internet by 1998 and, although other types of mobile internet-connected devices were not yet widely available, many were in development and Music Choice had begun working on ways to make its service available on such devices prior to July 31, 1998. *Id.* at 14 (citing Del Beccaro Decl. ¶¶ 46-47). By 2000, Music

Choice had begun transmitting its music channels to subscribers using the earliest mobile internet devices, but the work to develop software and other technology to transmit to these devices had begun before July 31, 1998. *Id.* (citing Del Beccaro Decl. ¶¶ 48).

12. The only restriction on the evolution of a PSS's existing service offering is that it must remain fundamentally the same type of offering (*i.e.*, it must be a non-interactive, cable, satellite, or internet digital audio transmission service offered to consumer subscribers). Music Choice's transmissions of its music channels to subscribers via the internet satisfies that requirement. *Id.* at 16.
13. The fact that Music Choice was transmitting its service via internet in 1998 allowed it to develop the internet features going forward to take advantage of improvements in internet-related technology just as it has been allowed to develop its cable and satellite features to take advantages of changes in those technologies. *Id.* Thus, it is unnecessary for its internet-based channels to be the same as its television-based channels in order to remain an existing service offering.
14. Nevertheless, the channels and user interface received on computers, tablets, and phones are fundamentally similar for all subscribers and almost identical for most. *Id.* at 17 (citing Del Beccaro Decl. ¶¶ 31-39). For a short time, including during the hearing, Music Choice did make additional channels available via the internet that were not available on the television, but this situation was transitory and driven by timing differences in technological implementations. According to Music Choice, currently every channel transmitted via the internet is available on the television, and the screen interfaces are essentially identical for most subscribers. *Id.* (citing Del Beccaro Decl. ¶¶ 29, 31-37).
15. The key fact is whether the MVPD industry treats the new technology as part of that transmission medium. *Id.* at 18. Because Music Choice's existing service offering included internet, the test for that service is whether the improvements and new features are within the industry understanding of an internet service today and internet services are commonly available outside the home, including on mobile devices. *Id.*
16. Mobile access to Music Choice's music channels is "unquestionably consistent with current industry understanding of the internet as a transmission medium." *Id.* at 18-19. Its mobile access is also consistent with current industry norms for residential cable and satellite services recognized by the MVPD industry, which provide their networks and channels on a "TV Everywhere**"** basis. *Id.* at 19. Such access is provided "as an integral part of a consumer's television service at no additional charge to the consumer." MVPDs and networks offer authenticated subscribers streaming access to live and on-demand content through various websites and apps. *Id.* (citing Del Beccaro Decl. ¶ 55).
17. When cable and satellite companies provide access outside the home, the FCC treats it as part of their MVPD offering. By contrast, the FCC calls other types of companies that provide video programming via the internet "Online Video Distributors." *Id.* at 20. Through this distinction, the FCC recognizes that cable and satellite television providers may provide their subscribers with access to programming (including Music Choice's channels) outside the home via internet transmissions, as an integral part of their "residential" cable and satellite service, rather than as a different Online Video Distributor service. *Id.* The only differences between the service Music Choice delivers via internet now versus 1998 reflect "service enhancements attributable to improvements and changes

to *internet* technology" that mirror features and functionality used by other internet services and other channels available to consumer MVPD subscribers; such changes, in Music Choice's view, do not alter the fundamental nature of the service. *Id.* at 21 (emphasis added).

18. There is nothing about delivery via an app that fundamentally changes the nature of internet transmissions. *Id.* An app is neither a different medium (which continues to be the internet) nor a different service. The term "app" refers to a computer program that performs a function, in the present case to allow for listening to Music Choice on all platforms, even on a television. *Id.*

19. Accordingly, Music Choice has always had to develop and utilize software applications (apps) to deliver its service, *regardless of whether transmitted by television signal or internet*. *Id.* at 22 (emphasis added). More specifically, Music Choice had to create an app to run its service on a cable box and, in 1996, when it first launched the cable modem and other internet-based access features for its service, consumers had to use apps to interface with the channels, whether through a web browser or a special purpose application installed on the user's computer to access the channels via web services. *Id.* These pre-DMCA technological developments were investments that the DMCA sought to recognize and protect with the PSS designation and were foundational to future continued investments in the same service lines. *Id.* (citing Del Beccaro Decl. ¶ 64).

b. Music Choice's Legal Arguments

1. The D.C. Circuit vacated the Register's legal opinion that Music Choice's internet transmissions could not be grandfathered. *Id.* at 8.
2. The D.C. Circuit vacated the sections of the Judges' Final Determination that found Music Choice's internet transmissions were outside the scope of the PSS license. *Id.* at 2.
3. The D.C. Circuit has ruled that Music Choice's internet transmissions fall within the scope of the PSS license. *Id.*
4. The D.C. Circuit noted that it was *undisputed* that Music Choice had been transmitting its music channels via the internet since well before July 31, 1998. *Id.* at 2-3.
5. The Register's Ruling – in the portion not vacated and remanded – concluded that a PSS has broad leeway to significantly develop, expand, and improve its service. *Id.* at 3.
6. The Register's Ruling held that an existing offering is allowed to take advantage of new features and capabilities enabled by subsequent advancements in the same transmission media used in 1998 and be grandfathered under the existing rate standard. *Id.*; *see also* Register's Ruling, 82 FR at 59,658-59 & n.78.
7. Improvements in wireless mobile internet access fall within that allowance. *Id.*
8. Although the erroneous interpretation of the statute in the Register's Ruling was the foundation for the D.C. Circuit's vacating and remanding of the Final Determination, the D.C. Circuit did not reject any other aspect of the Register Ruling's basic analytical framework regarding the grandfathering issue (nor were any other aspects appealed by any party). Thus, these unrejected and unappealed elements of the Register's Ruling provide helpful guidance with respect to the applicable legal framework on remand. *Id.* at 6.

9. The three statutory categories of service offerings that the Register's Ruling identified and characterized are: (1) an existing service offering (*i.e.*, a noninteractive audio subscription service offered as of July 31, 1998, that is still offered today in the same transmission medium used on that date); (2) an expanded service offering (*i.e.*, a noninteractive audio subscription service offered as of July 31, 1998, that is still offered today but in a different transmission medium than one used by the PSS in 1998, "where only transmissions similar to the existing service offering are provided"); and (3) a different service offering (*i.e.*, an offering that is neither an existing nor an expanded service offering). *Id.* at 6-7. Under this framework, grandfathered rates would apply to categories (1) and (2). While the grandfathered license requirements in section 114(d)(2)(B) would apply to category (1), the more detailed license requirements in section 114(d)(2)(C) would apply to category (2). *Id.* at 7.
10. Regarding a PSS's ongoing changes, it is the Register's view that

    > an existing service offering can grow and expand significantly within the same transmission medium [it used as of July 31, 1998] while remaining a PSS offering. The Register has found no indication that Congress meant to freeze existing service offerings exactly as they were on July 31, 1998, in order for them to continue to qualify for the grandfathering provisions. The user interface can be updated, certain functionality can be changed, the number of subscribers can grow, and channels can be added, subtracted, or otherwise changed. The only restriction is that the existing service offering as it is today must be fundamentally the same type of offering that it was on July 31, 1998—*i.e.*, it must be a noninteractive, residential, cable or satellite digital audio transmission subscription service.

    Id. at 8 (quoting Register's Ruling at 59658).
11. The term "residential" as applied to Music Choice's service and all other television programming services refers to the type of subscriber-consumers, as opposed to business subscribers. Thus, Music Choice's *mobile* internet service is within the scope of the license because it is a non-interactive digital audio service that is transmitted to *consumer* subscribers. *Id.* at 8.
12. The D.C. Circuit acknowledged that "Music Choice had been providing some digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998." *Id.* at 9 (quoting *Music Choice*, 970 F.3d at 425).
13. Mobile access from outside the home does not transform Music Choice's internet transmissions into a fundamentally different service. *Id.* at 17. This is because, by analogy, MVPDs do not have separate "mobile" or "outside-the-home" subscribers-only residential and commercial subscribers. *Id.* (citing Del Beccaro Decl. ¶¶ 52-53; 57).
14. Moreover, this usage of the term "residential" is consistent with the CARP's usage in the original PSS proceeding, a distinction that was relevant because the music services originally provided to commercial subscribers were not statutorily required to obtain a public performance license and were not covered by the PSS license or any statutory compulsory license. *Id.* at 17.

15. A term with a specific meaning within the MVPD industry, such as "residential," should be given that meaning in the PSS regulations and not a different, colloquial meaning of the term. *Id.* at 18.

16. Improvements and added features associated with a PSS's mobile access are allowable changes under the Register's Ruling. The changes and improvements Music Choice has made to its mobile offering (as the Register's Ruling noted) are legally analogous to the switch by a cable company from coaxial to optical fiber, in that in both circumstances the PSS has not expanded into a new transmission medium. *Id.* at 18 (citing Register's Ruling, 82 FR at 59659).

4. SoundExchange's Response Brief

a. SoundExchange's Response to Music Choice's Factual Arguments

1. Music Choice's claim that it was making its current internet transmissions and offerings **prior** to July 31, 1998, is belied by the more contemporaneous testimony of Mr. Del Beccaro and all of the other available evidence concerning the history of Music Choice's business. SoundExchange, Inc.'s Responsive Brief at 2 (eCRB nos. 25726, 25727) (SX Responsive Br.).

2. In *Web I*, which commenced after 1998, Mr. Del Beccaro testified that Music Choice did not begin making any internet transmissions until after July 31, 1998. *Id.* (citing *Web I*, WDT of David J. Del Beccaro at 5 ("Music Choice began delivering its service on the Internet in April of 1999")). Moreover, Music Choice's website from the relevant period and other documents obtained in discovery confirm that Music Choice provided no streaming option prior to 1999. *Id.* at 2-3 (citing, among other documents, Del Beccaro Dep. Tr. at 124: 17-135:13 (purportedly stating he was unsure whether customers could stream music on Music Choice's website in 1998)).

3. Music Choice's current internet service differs from what it provided in 1998, for example, by streaming over the *public* internet and providing subscriber access on mobile devices and apps. *Id.* at 3.

4. Music Choice simply "rehashes semantic arguments about access from outside the home and the use of apps that the Judges rejected last time [*i.e.*, in the Final Determination] they considered this issue." *Id.* More particularly, the Judges previously determined that Music Choice's internet transmissions must be excluded from the conditional grandfathered rate "to the extent they are available outside a subscriber's residence". *Id.* n.2 (citing *Music Choice* at 422).

5. Music Choice's brief confirms that the Jacksonville offering, although admittedly started in 1996, was limited to the Jacksonville area, and also technologically distinct from the *type of internet service* that Music Choice provides today. *Id.* at 4.

6. Music Choice's use of the term "multicast" (and sometimes "cable modem offering") in its reference to the Jacksonville offering is telling. *Id.* at 4 and n.3. "Multicast" is a term of art that refers to a specific set of transmission protocols typically used on private networks. *Id.* at 5.

7. There is a distinction between "multicasting," which Music Choice did as early as 1996, and transmitting sound recordings over the internet, which Music Choice did not do at that

time. Specifically, a "multicast" occurs when a single signal is sent out that can be received by more than one end user at one time. *Id.* (citing Del Beccaro Dep. Tr. at 59:8-11). By contrast, the typical method of internet transmission used over the public internet is via a "unicast," whereby a separate stream is sent to each recipient. *Id.* & nn. 4-5 (citing, *inter alia*, *Cascades Streaming Technologies v. Big Ten Network*, 2016 WL 2344578 (N.D. Ill. May 4, 2016)).

8. Music Choice does not and cannot claim that its pre-1998 Jacksonville offering was transmitted over the public internet via unicasting. *Id.* at 6.
9. Music Choice's Jacksonville offering was a "far cry" from the type of internet transmissions that Music Choice and other webcasters offered after July 1998. *Id.* Specifically, Music Choice wrongly contends that there are sufficient similarities between the service it offered pre-July 31, 1998 and the one it has been offering subsequently. For example, Music Choice's pre-July 31,1998 alleged internet service was available outside of the home and was therefore portable. But Music Choice conflates the mobility associated with today's smart phones with the ability to unplug and carry a modem to another location or to log on from computers in the workplace, schools, and libraries. *Id.*
10. But this argument is untethered from the facts of the Jacksonville offering, which was available only to Continental Cablevision residential subscribers over its network through their cable modems. *Id.* at 6-7. Although it was possible to access the public internet from many workplaces by 1998, there is no indication that Continental Cablevision residential broadband subscribers could access Music Choice from their offices because those offices "presumably were not where they received their Continental Cablevision residential cable service." *Id.* at 7.
11. The suggestion that usage outside the home (*e.g.*, in someone's office) is tantamount to the type of ubiquitous user experience available today "defies reason." *Id.* By way of example, the type of mobility available today relates to the ability of users to listen to music while running or driving in a car. *Id.* Moreover, Music Choice concedes that it did not begin transmitting to mobile phones or other mobile internet devices until after 1998. *Id.* (citing MC Br. at 14).
12. Music Choice admits that its service included internet-exclusive channels at the time of the current proceeding, yet asks the Judges to ignore this fact as "transitory". *Id.* (citing MC Br. at 17). But despite Music Choice's claims that the internet-exclusive channels were transitory, nothing prevents Music Choice from reverting to its prior practice and offering internet-only channels again as soon as this litigation concludes. *Id.* at 8. However, the D.C. Circuit directed the Judges to consider whether or not Music Choice offered internet-only channels as of July 31, 1998. *Id.* (citing *Music Choice*, 970 F.3d at 420, 428). Thus, ignoring this issue would disregard the D.C. Circuit's direction to determine the "precise scope" of Music Choice's 1998 service. *Id.* (citing *Music Choice*, 970 F.3d at 427).
13. Music Choice's argument – that apps available on smart phones today should be deemed equivalent to the software used to play its pre-1998 multicasts – is a "syllogistic fallacy." *Id.* at 8-9.
14. Likewise, Music Choice wrongly claims that its development of mobile apps for smart phones and other modern portable devices was among the investments that the DMCA

sought to recognize and protect with the PSS designation. *Id.* at 9. But the D.C. Circuit held that the PSS designation extends only to the service as it actually existed in 1998. *Id.*

15. Music Choice fails to acknowledge the difference in the geographic reach and customer base of the Jacksonville multicast offering (limited to Continental Cablevision customers in Jacksonville) compared to Music Choice's current internet offering (available nationwide through numerous MVPDs and publicly accessible websites). *Id.* Music Choice's current internet service cannot be fairly characterized as falling within the limited scope of the pre-1998 multicast offered to Continental Cablevision customers in Jacksonville. *Id.*

16. Beyond the Jacksonville offering, Music Choice has provided no credible proof of any internet transmissions prior to July 31, 1998. *Id.* at 11. Indeed, Music Choice has not identified a single document that indicates that it transmitted its service over the internet before July 31, 1998, nor did it subpoena any MVPD partner seeking to corroborate its claims. *Id.* Moreover, although Music Choice has produced internal planning documents from the 1990s, it has not produced a single document that would support its claims regarding Time Warner, Adelphia, Comcast, MediaOne, Cox, or any other MVPD that it claims provided Music Choice's music service over the internet prior to July 1998. *Id.* Instead, Music Choice offers a far-from-credible declaration from Mr. Del Beccaro and "a mountain of irrelevant evidence that does not speak to pre-1998 internet transmissions." *Id.*

17. Mr. Del Beccaro's declaration regarding MVPDs through which Music Choice purportedly offered internet service prior to July 31, 1998, is self-serving and at odds with his *Web I* testimony and his deposition testimony in the current proceeding. *Id.* at 12. That is, Mr. Del Beccaro has taken the following three different positions:

    (a) First, in *Web I* he purportedly[?] testified that Music Choice began delivering its service over the internet in April of 1999 *and* offered only four channels on a free, nonsubscription basis, a service that it discontinued in March 2001. *Id.* (citing Ex. R to SX Opening Br., Testimony of David J. Del Beccaro 5, *Web I*, (Apr. 11, 2001)).

    (b) Second, in his May 5, 2021 deposition in the remand proceeding, he testified that he could not recall with any specificity when Music Choice first provided for distribution of its product over the internet. *Id.* (citing Del Beccaro Dep. Tr. 49:3-4).

    (c) Third, in his declaration, filed a month after his deposition, he purportedly claimed that the first system to launch internet-based access to Music Choice's music channels was Continental Cablevision's Jacksonville system and by July 1998 the internet access feature was widely available through various MVPDs (*e.g.*, Time Warner Cable, Adelphia, Comcast, MediaOne, and Cox). *Id.* at 13 (citing Del Beccaro Decl. ¶¶ 10-11).

    Such unexplained and inconsistent testimony lacks credibility. *Id.*

18. In an interrogatory answer, provided prior to Mr. Del Beccaro's deposition, Music Choice stated:

> As of July 31, 1998, Music Choice was making its audio channel available to any of its Distributors as part of their consumer internet

> offerings to their individual subscribers. And by that date, Music Choice was actively transmitting the internet service through several Distributors, including Continental, Time Warner, Adelphia, MediaOne, Comcast, and Cox.

Id. at 14 (citing Ex. I to SX Opening Br. at 11, Response to SX Interrogatory No. 3, and Del Beccaro Dep. Tr. 166:22-167:6 (indicating that Del Beccaro's memory was the primary basis for the response)).

19. For all of this information to have been true, Mr. Del Beccaro would have had to have remembered the names and dates of each of the MVPDs listed in the interrogatory response on March 31, 2021, forgotten all of the information by May 5, 2021, the date of his deposition testimony, and then recalled it again in time to provide his declaration that accompanied Music Choice's brief. *Id.*

20. The Judges should disregard Mr. Del Beccaro's self-serving testimony. Not only does it lack credibility, but SoundExchange has had no opportunity to explore (a) whether any of the MVPDs he mentioned in his declaration transmitted Music Choice's service over the public internet as opposed to private networks, (b) how many customers subscribed to each, (c) the geographic areas they covered, (d) the technology they used, and (e) the investments Music Choice had made in them. *Id.*

21. Music Choice's documentary evidence is also deficient. Specifically, the documents on which Music Choice's brief and Mr. Del Beccaro's declaration rely are of two types: those reflecting Music Choice's intention to develop and offer an internet service and those that refer to such service after July 31, 1998. But neither is probative as to the issue at hand. *Id.* at 15. Music Choice's *intentions* are not relevant; rather what is relevant are the types of services that *actually existed* and which Music Choice *actually provided* on July 31, 1998. *Id.* at 16. Indeed, the fact that Music Choice can document its internet service offerings in 2000 and 2002 but not those it offered in 1998 raises questions about whether a service offering in 1998 actually existed. *Id.*

22. Rather, probative evidence (*i.e.*, prior testimony of Music Choice's CEO and statements on Music Choice's website) demonstrates that Music Choice was not making internet transmissions prior to July 31, 1998, so Music Choice's argument should not prevail regardless of which party has the burden of proof. *Id.* at 18 n.12.

23. Music Choice makes its own "categorical argument" which lacks merit. More particularly, (a) Music Choice's status as a PSS, (b) Congressional intent to allow a PSS to evolve to some extent, and (c) the fundamental changes to Music Choice's service over the last 23 years are all irrelevant to its PSS eligibility. These points are irrelevant because "PSS evolution and 'industry norms' have nothing to do with an inquiry into eligibility for an 'unconditional grandfathered rate'[, which] depends on the medium used by a service on July 31, 1998.'" *Id*. at 19.

24. Because Music Choice was not using the internet to make transmissions before 1998, or at least "not the same kinds it makes today," its subsequent internet transmissions cannot fairly be characterized so as to support Music choice's attempt to obtain unconditional grandfathering. *Id.*

25. There is no credible evidence that in 1998 Music Choice was available outside the home; it was only available by cable, satellite, and, in Jacksonville, via multicast transmissions over Continental Cablevision's broadband network. *Id.* at 19-20.

b. SoundExchange's Response to Music Choice's Legal Arguments

1. The D.C. Circuit provided the Judges with a clear mandate on remand to determine whether or not Music Choice's current internet transmissions fall within "the precise scope of Music Choice's service offering as it actually existed on July 31, 1998." *Id.* at 1 (quoting *Music Choice*, 970 F.3d at 427-28).
2. Thus, the Judges must compare Music Choice's current internet service with the service it was offering in 1998 and determine which parts (if any) of that service were a part of Music Choice's service on July 31, 1998. *Id.*
3. Only those transmissions that can fairly be characterized as included in the service offering Music Choice provided on July 31, 1998, are entitled to a grandfathered PSS royalty rate today. *Id.* at 1-2.
4. Rather than crediting the contrary self-serving declaration that Mr. Del Beccaro submitted in this remand proceeding, the Judges should credit the relatively contemporaneous evidence from *Web I* and Music Choice's website." *Id.* at 3.
5. "Music Choice … tries to hang its hat on the D.C. Circuit's statement that it is 'undisputed that Music Choice was making some internet transmissions' before July 31, 1998. … The suggestion that there is no dispute about this issue – which is squarely presented on remand – appears to be based on the fact that SoundExchange did not respond to one passing reference in Mr. Del Beccaro's testimony in the underlying proceeding. At the time, there was no indication that this passing reference was material to the rate proposals, and there is no basis for Music Choice's plainly incorrect assertion that SoundExchange agrees with it." *Id.* at 15 n.10.
6. Music Choice "did not," prior to July 31, 1998, make "internet transmissions" *Id.* However, even if it had done so before July 31, 1998 – and it did not – its current transmissions cannot fairly be characterized as included in the ["]service offering["] it provided on July 31, 1998. *Id.* at 3.
7. As to the "conditional" grandfathering issue, the D.C. Circuit did not question the Register's six-factor test or the Judges' application of that test to determine that Music Choice is not eligible to pay PSS rates under that test. *Id.* at 3 n.2. Moreover, the remand record confirms that the "precise scope" of Music Choice's internet service demonstrates that it remains ineligible for the *conditional* grandfathered PSS rates under either section 114(d)(2)(C) as well as the *unconditional* grandfathered rates under or 114(d)(2)(B). *Id.* at 4.
8. Music Choice – as the party seeking to pay a grandfathered PSS rate for its internet transmissions – bears the burden to show that its current internet transmissions are within the scope of its service as of July 31, 1998. *Id.* at 9. But Music Choice does not even attempt to make such a showing with respect to many of the features that distinguish its old service offering from its new (*e.g.*, current ability to create one or more user profiles, filter kids' content based on ratings, access video content, and search for desired content). *Id.* at 9-10, 17.

9. As a matter of law, grandfather clauses like the one Music Choice relies on should be construed narrowly. *Id.* at 17 (citing, *inter alia*, *Muzak*, 854 F.3d at 719).
10. The D.C. Circuit held that the question of whether or not an internet offering is encompassed in a service's pre-1998 offering cannot be determined categorically. *Id.* at 18 (citing *Music Choice*, 970 F.3d at 425). Under the D.C. Circuit's direction, the Judges must consider "the precise scope of Music Choice's service offering as it actually existed on July 31, 1998" and whether the service qualified for the unconditional or conditional grandfathered rates. *Id.* at 18-19 (citing *Music Choice*, 970 F.3d at 427-28).
11. With respect to eligibility for the *conditional* grandfathered rate, the Judges have already determined (after applying the Register's six-factor test) that Music Choice's internet transmissions must be excluded from the conditional grandfathered rate "to the extent they are available outside a subscriber's residence," such as through mobile applications. *Id.* (citing *Music Choice*, 970 F.3d at 422 (quoting Final Determination at 65227)). This ruling in the Final Determination cannot be altered because the D.C. Circuit did not question the Register's six-factor test, nor did it give any indication that it doubted the Judges' previous conclusion that Music Choice is not eligible under the test. *Id.* (citing *Music Choice*, 970 F.3d at 429 n.9).
12. Consistent with the Judges' findings and the D.C. Circuit's instruction, Music Choice is eligible for neither the unconditional nor the conditional grandfathered rates. *Id.* at 20.

D. The Judges' Analysis and Rulings

1. Application of the D.C. Circuit Decision

a. The D.C. Circuit's Statutory Ruling

The Judges begin their legal analysis by focusing first on the following key aspects of the D.C. Circuit's statutory holding and concomitant remand instructions:

> Under the DMCA, a "subscription digital audio transmission" "shall be subject" to the unconditional grandfathered rate if it is (1) "made by a preexisting subscription service," and (2) offered "in the same transmission medium used by such service on July 31, 1998." 17 U.S.C. § 114(d)(2)(B). If a transmission meets both statutory elements, the Board must determine the royalty in accordance with the unconditional grandfathered rate.
>
> [T]he DMCA's definition of a preexisting subscription service is broad enough to include internet transmissions that were in fact occurring as of July 31, 1998, because it includes any "service that performs sound recordings by means of noninteractive audio-only subscription digital audio transmissions, which was in existence and was making such transmissions to the public for a fee on or before July 31, 1998." 17 U.S.C. § 114(j)(11).
>
> We have held that the term "service" in "preexisting subscription service" refers to both the business *entity* making the transmissions (*i.e.*, Music Choice) and to the "*program offering*" the entity provides (*i.e.*, *the Music Choice digital audio service*). *Muzak*, 854 F.3d at 715.
>
> Therefore, for a digital audio transmission to qualify as a "preexisting subscription service," *first*, it must be made by a business *entity* that was in existence on or

> before July 31, 1998, and *second*, the relevant "*program offering*" must have been in existence on July 31, 1998.
>
> [A]ll agree that Music Choice fulfills the first prong. The question is whether the word "service" in the DMCA covers Music Choice's program offerings transmitted via the internet. *It is undisputed that Music Choice had been providing some digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998.* Those internet transmissions that are part of the same "service" fall within the scope of the DMCA's preexisting service definition.
>
> [T]he DMCA applies the unconditional grandfathered rate to transmissions made "in the same transmission medium." 17 U.S.C. § 114(d)(2)(B). This provision does not distinguish between different transmission media, and there is no suggestion in the text that a "transmission medium" excludes internet transmissions. The "transmission medium" clause, like the preexisting service definition, focuses on the actual preexisting entity and program offering, not the manner of transmission. Thus, internet transmissions "shall be subject" to the grandfathered rate if they were "made by" a preexisting service on July 31, 1998. *Id.*

Music Choice, 970 F.3d at 425-26 (emphases added).

The Judges must hew to these holdings.[18] As the D.C. Circuit has held:

> The decision of a federal appellate court establishes the law binding further action in the litigation by another body subject to its authority. The latter is without power to do anything which is contrary to either the letter or spirit of the mandate construed in the light of the opinion of (the) court deciding the case …. These principles, so familiar in operation within the hierarchy of judicial benches, *indulge no exception for reviews of administrative agencies*.

City of Cleveland, Ohio v. Fed. Power Comm'n, 561 F.2d 344, 346 (D.C. Cir. 1977) (cleaned up) (emphasis added); *see also U.S. Postal Service v. Postal Regulatory Comm'n*, 747 F.3d 906, 910 (D.C. Cir. 2014) (applying holding in *City of Cleveland*).

b. Applying the D.C. Circuit's Statutory Holdings and Instructions

The starting point in the Judges' legal analysis on remand is the D.C. Circuit's unequivocal holding and command regarding the unambiguous plain meaning of the applicable statutory language regarding the "unconditional" grandfathering of PSS rates pursuant to 17 U.S.C. 114(d)(2)(B). To repeat:

> Under the DMCA, a "subscription digital audio transmission"… "*shall* be subject" to the unconditional grandfathered rate if it is (1) "made by a preexisting subscription service," and (2) offered "in the same transmission medium used by such service on July 31, 1998." 17 U.S.C. § 114(d)(2)(B). If a transmission meets

[18] Moreover, these holdings are unambiguous. As discussed in more detail *infra*, the Judges accordingly reject SoundExchange's oblique suggestion that the D.C. Circuit may have erred in holding that Music Choice had been making internet transmissions on and prior to July 31, 1998. Moreover, the Judges cannot exercise their legal authority as an administrative body to ignore, revisit, or contradict the D.C. Circuit's enunciation of the applicable law. As also discussed *infra*, the Judges view SoundExchange's position on this statutory issue as little more than an attempted legal and factual end-run around Judge Rao's opinion on behalf of the unanimous D.C. Circuit panel.

> both statutory elements, the Board *must* determine the royalty in accordance with the unconditional grandfathered rate.
>
> . . .
>
> [T]he DMCA's definition of a preexisting subscription service is broad enough *to include internet transmissions that were in fact occurring as of July 31, 1998.*
>
> . . .
>
> It is *undisputed* that Music Choice had been providing some digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998.

Music Choice at 425-26 (emphasis added).

(1) Because the D.C. Circuit Held that Music Choice Made Internet Transmissions on and before July 31, 1998, SoundExchange's Attempt to Re-argue that Issue is Improper and Rejected

Because the D.C. Circuit found as an undisputed fact that Music Choice had been providing some digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998, neither SoundExchange nor the Judges can revisit that decision on remand. *See City of Cleveland*, 561 F.2d at 346 ("[t]he decision of a federal appellate court establishes the law binding further action in the litigation …."). As Music Choice maintains, SoundExchange has wrongly argued that "there is a factual dispute where the D.C. Circuit found none." MC's Responsive Br. at 7-8.

The Judges agree. As Music Choice has further explained:

> SoundExchange['s] . . . claim[] that Music Choice's pre-July 1998 internet transmissions were limited to the one Jacksonville system … [e]ven if true, . . . would be irrelevant. *[T]he D.C. Circuit expressly rejected the Register's view that there was some kind of materiality threshold for whether a PSS was using a particular medium "enough" in 1998[.] [T]he threshold question is merely whether Music Choice was transmitting via the internet at all on that date.*

Id. at 14-15 (emphasis added).

However, SoundExchange stubbornly declines to give up the ghost and accept the D.C. Circuit decision as to this issue. Instead, it self-servingly mischaracterizes the proceeding record as somehow "limited" regarding this fundamental issue, and that "despite" how that record appeared to the D.C. Circuit panel, the appellate judges got it wrong. SX Opening Br. at 15.

An obvious procedural point puts this SoundExchange argument to rest: To challenge the D.C. Circuit's decision, SoundExchange was required to petition the panel for rehearing pursuant to Fed. R. App. P. 40, or petition for rehearing *en banc* pursuant to Fed. R. App. P. 35. SoundExchange did neither.

Clearly unwilling to take the proper appellate step, and equally reluctant to *explicitly* claim appellate error on remand, SoundExchange takes several oblique swipes at Judge Rao's opinion. SoundExchange buries two challenges to Judge Rao's opinion in a footnote, arguing first that the D.C. Circuit's ruling was merely a "suggestion." Next, SoundExchange speculates as to why the D.C. Circuit found this issue to be "undisputed", and then SoundExchange affords

itself absolution for "the fact that" it "did not respond" as to this issue at the hearing with the remarkable assertion that it found this issue to be not "material." SX Responsive Br. at 15 n.10.

Further, SoundExchange's argument contradicts Judge Rao's opinion in order to provide itself an improper hook upon which to re-visit this ruling. Specifically, SoundExchange argues: "Even if Music Choice had made internet transmissions before July 31, 1998 – and it did not …." as its basis to maintain on remand that what was found by the D.C. Circuit as "undisputed" is somehow now a matter of dispute. SX Responsive Br. at 3.

Moreover, there can be no doubt regarding the correctness of the D.C. Circuit's ruling that the fact of Music Choice's internet transmissions was "undisputed." The record of the proceeding, which was part of the appellate record, clearly provided the D.C. Circuit with the basis for this ruling. *See* Music Choice's Proposed Findings of Fact (MC PFF) ¶ 521 (eCRB no. 4725) (citing Del Beccaro WRT, Trial Ex. 57, p. 25) ("Music Choice subscribers have had access to Music Choice audio channels *through internet transmissions since 1996* . . ..") (emphasis added). SoundExchange did not dispute this proposed finding at the hearing. *See* SoundExchange, Inc. and Copyright Owner and Artist Participants' Replies to Music Choice's Proposed Findings of Fact (SX RPFF) ¶ 521; *see also* MC PFF ¶ 60 ("Music Choice has been an innovator throughout its existence [and] was the first provider to multicast its broadcast *over the Internet when it began its internet transmissions in 1996*.") (emphasis added); SX RPFF at 60 (not denying this factual assertion). Clearly, SoundExchange has no basis to suggest now, on remand, that the D.C. Circuit erred in ruling that it was "undisputed" that Music Choice had made internet transmissions on and prior to July 31, 1998.

Further, not only did the D.C. Circuit decision put this issue to rest, SoundExchange's impermissible attempt to revisit this issue is (to say the least) weak tea, unsupportive of its position that the appellate panel erred. In this regard, SoundExchange makes the following deficient arguments questioning this holding by the D.C. Circuit, each followed by the Judges' analysis, setting forth its reasons for rejecting those arguments:

a. Music Choice's distributions through Continental were not *technically* the same as transmissions via the internet, but rather are better described as "broadband" transmissions that were "extremely limited." *Id.* SX Opening Br. at 11, 18.

    The Judges' Analysis: The Judges agree with Music Choice that this SoundExchange argument lacks coherence, is not supported by "a shred of evidence" to support the purported distinction, and fails to clearly explain why a broadband transmission is not the same as, or at least evidence of, an "internet" transmission. *See* MC Responsive Br. at 15. Moreover, there is no dispute that Music Choice distributed its product to Continental (which branded the product as "Highway1" and was available over the internet, as discussed *infra)*.

b. Music Choice's current internet service differs from what it provided on and before July 31, 1998, because "the current service is available for streaming over the *public* internet, available on mobile devices and apps, and available to customers nationwide." SX Responsive Br. at 3.

    The Judges' Analysis: The D.C. Circuit did not distinguish between types of internet transmissions, such as public or private, when applying the express statutory grandfathering provision, holding that Music Choice satisfied this

requirement because "[i]t is undisputed that Music Choice had been providing *some* digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998." *Music Choice*, 970 F.3d at 425 (emphasis added). SoundExchange wrongly implies, without adequate support, that internet transmissions to some members of the public were insufficient to satisfy the "same transmission medium" grandfathering requirement of former section 114(d)(2)(B) on which the D.C. Circuit relied to find it "undisputed" that Music Choice had made internet transmissions on and prior to July 31, 1998.

Moreover, SoundExchange argues only that Music Choice's pre-July 31, 1998 "Jacksonville offering" was merely "technologically distinct" and a "far cry" from the "*type"* of "internet transmission" Music Choice later utilized. SX Responsive Br. at 4, 6. But a different "type" of internet transmission is still an internet transmission.[19]

c. Music Choice relies on the fact that its Jacksonville product was made available on and before July 31, 1998, via "multicast" transmissions, rather than via "unicast" transmissions. *Id.* at 4-5, but "multicast" is "a term of art that refers to a specific set of transmission protocols *typically* used on private networks". *Id.* at 5.[20]

The Judges' Analysis: Once again, SoundExchange's argument misses the mark, in that the D.C. Circuit decision did not distinguish among subsets of internet transmissions, such as, for example, "multicast" vs. "unicast". Further, if, as SoundExchange avers, "multicast" transmissions are "*typically*" associated with "private" networks, that neither demonstrates that such transmissions are not also associated with "public network" transmissions nor that they are not internet transmissions.

d. "[P]rior to July 31, 1998, Music Choice was not actually transmitting in the internet medium *as it is today*." SX Opening Br. at 15 (emphasis added). SoundExchange makes this point on two other occasions in its initial brief. *See Id.* at 10 ("The evidence does not indicate that Music Choice was offering its consumers internet service *as we understand it today*.") (emphasis added); *id.* at 17 (acknowledging Music Choice made "internet transmissions in 1998" (in the course of arguing the lack of breadth of such internet transmissions *at that time*)).

The Judges' Analysis: The clear syntax of this quoted sentence reveals that even SoundExchange acknowledges that Music Choice was making transmissions through the "medium" of the "internet," but that the "internet medium" "as it is today" merely differs from the "internet medium" as it existed prior to July 31, 1998.

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[19] Moreover, as noted *infra*, a PSS's adoption of technological improvements does not prevent grandfathering. In fact, the purpose of the grandfathering is to allow technological modernization within a transmission medium in order to protect and reward early investment by these first-movers.

[20] More particularly, SoundExchange states that a "unicast" transmission is a "one-to-many" transmission, whereas a "multicast" transmission is a one-to-one transmission, that may occur multiple times from one transmitting source to a different recipient. SX Responsive Br. at 5-6 & n.4.

e. It is incorrect for Music Choice to equate relatively "primitive" technological versions of cable modems, digital tuners, apps, and other software with the post-July 31, 1998 technologies by which Music Choice program offerings were transmitted via the internet. *See, e.g.*, SX Opening Br. (summarized in "SoundExchange's Initial Factual Arguments" ¶¶ 9 & 13 *supra*) and SoundExchange's Remand Response Brief (summarized in SoundExchange's Response to Music Choice's Factual Arguments ¶¶ 3 & 9, *supra*).

   The Judges' Analysis: The Judges do not find merit in this argument. SoundExchange's comparison of so-called "primitive" and other early technologies utilized by Music Choice with its post-July 31, 1998 technological methods of transmitting its program offerings simply underscores Music Choice's use of developing technologies within the same transmission medium. That evolution reflects the purpose of the protection and reward functions of the statutory unconditional grandfathering provision discussed *infra*, *i.e.*, to allow a PSS to develop its internet transmissions under the grandfathered royalty rate structure.[21] In this regard, the Judges agree with Music Choice that its internet transmissions (1) were accessible by subscribers on and prior to July 31, 1998, through Continental (MC Opening Br. at 9-11, Del Beccaro Opening Decl. ¶¶ 10-11, *supra*), (2) could be developed to take advantage of certain improvements in internet-related technology (MC Opening Br. at 16), (3) could be delivered via an "app," which is a computer program that allows subscribers to listen to Music Choice on all its platforms, including the internet, and is neither a transmission by a different medium nor the offering of different programming (MC Opening Br. at 21 (" [A]n 'app' is not a different medium of transmission, nor is it a different service. … [T]he term 'app' is merely a shortened version of the term 'software application' … an executable computer program that … provide[s] the interface for users to listen to the music channels [b]ut not unique to access outside the home, or even unique to its internet transmissions.")).

f. Music Choice's transmissions via its Jacksonville distributor, Continental, of its branded "Highway1" music service were not bona fide internet transmissions. SX Opening Br. at 11.

   The Judges' Analysis: SoundExchange ignores contemporaneous documents, *viz*., an "FAQ" page[22] and a press release, both announcing a 1996 launch of Music Choice's channels on Continental's Highway1 high-speed internet service and stating that Music Choice was making internet services. MC Opening Br. at 12, *supra*.

g. Music Choice's claim that several of its other cable system distributors, in addition to Continental, made internet transmissions on and prior to July 31, 1998, is

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[21] The Judges neither endorse nor criticize this preferential treatment of a PSS compared with an NSS or other noninteractive service subject to statutory market-based rates. Rather, the Judges recognize the Congressional intent to provide this statutory protection to PSSs to encourage early entrants into a nascent industry.

[22] Question 4 of the FAQ (Frequently Asked Questions), on a document dated April 18, *1997*, asked: "How do I get Music Choice?" and the exact answer was: "MUSIC CHOICE is also available as part of Continental Cablevision's High Speed *Internet* Service in Jacksonville, Florida." SX Opening Br. Ex C (emphasis added).

> unsupported by the evidence. Essentially, SoundExchange is making a *de minimis* argument – that Continental's transmissions were too meager to invoke the grandfathering provisions. SX Opening Br. at 8-11.
>
> > **The Judges' Analysis**: As Music Choice correctly maintains, that Judge Rao's opinion does not set a "materiality threshold" in terms of the extent of Music Choice's internet transmissions on or before July 31, 1998. MC Responsive Br. at 15. *See Music Choice*, 970 F.3d at 425 ("It is undisputed that Music Choice had been providing *some* digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998.") (emphasis added).

In sum, even if the D.C. Circuit had not already conclusively ruled that Music Choice had made internet transmissions on and prior to July 31, 1998, SoundExchange has failed to provide support for its assertion that the remand record would generate a contrary result.[23]

Accordingly, nothing in the remand record on which SoundExchange relies now calls into question the appellate panel's holding that it is "undisputed" that "Music Choice had been providing some digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998." *Music Choice*, 970 F.3d at 425.[24]

c. The D.C. Circuit's Application of the Muzak Precedent

The D.C. Circuit next turned its attention from the "unambiguous" and "plain meaning" of the statutory language and the "undisputed" fact of Music Choice's internet transmissions on and before July 31, 1998, discussed *supra,* to the application of applicable judicial precedent, *viz.*, *Muzak*. That is, although Judge Rao's opinion holds that, as a statutory matter, Music Choice's internet transmissions *qua* transmissions could be unconditionally grandfathered at the royalty rates for a PSS, it did not simply vacate and *reverse* the Final Determination based on this ruling. Rather, the appellate panel also *remanded* the matter for the CRB Judges to determine a *second* issue pertaining to the *Muzak* precedent: whether Music Choice's "*program offerings*" otherwise qualified for the unconditional grandfathered rate under a second condition established by the D.C. Circuit in *Muzak*. *See Music Choice,* 970 F.3d at 430.

More particularly, the D.C. Circuit remanded in this regard – rather than reversed – because it relied on *Muzak* as precedent for the principle that, under the DMCA, for a PSS to qualify for the unconditional grandfathered rate, it must not only satisfy the "same medium"

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[23] In the parties' dueling factual and legal assertions, laid out *supr*a, they also make evidentiary and credibility challenges. Music Choice objects to the foundation provided for proffered evidence from the "Wayback Machine," (*see* MC Responsive Br. at 8), and SoundExchange asserts, as noted in the text, *supra*, that Music Choice has failed to provide sufficient evidence that Music Choice made internet transmissions through cable systems other than Continental prior to July 31, 1998. *See* SX Opening Br. at 8-11. Because these evidentiary challenges relate to the issue of whether Music Choice commenced internet transmissions on or before July 31, 1998, they are thus mooted by the D.C. Circuit's ruling.

[24] As noted *supra*, because the Judges do not adopt SoundExchange's argument that they can or should revisit and abandon the D.C. Circuit's ruling that it was "undisputed" that Music Choice had made internet transmissions on and before July 31, 1998, Music Choice is only able to seek *unconditional* grandfathering under 17 U.S.C. 114(d)(2)(B), given that Music Choice at all times satisfied the "same transmission medium" condition. Alternately stated, Music Choice cannot avail itself of the *conditional* grandfathering provision of 17 U.S.C. 114(d)(2)(C), which only applies when the PSS transmissions after July 31, 1998, were made "other than in the same transmission medium used by such service on July 31, 1998." *Id.* Accordingly, the issues regarding the application of the Register's six-factor test for application of the statutory *conditional* grandfathering are moot.

requirement (the internet for present purposes) and be the same service "*entity*" transmitting on and prior to July 31, 1998, but also that the "*program offering* must qualify before the transmissions are eligible for the favorable rate." *Muzak*, 854 F.3d at 719 (emphasis added).

As noted at the outset of this Determination, *Muzak* holds that the word "service" in the statutory definition of a PSS refers not only to the "business entity," but also to its "program offerings" – *i.e.*, the grandfather rates must "inhere" to "the business" *and* the "product," to wit, the "program offering." *Muzak*, 854 F.3d at 716, 719.[25]

(2) The Remand Instructions Require the Judges to Decide how Muzak's "Program Offering" Condition Affects the Grandfathering of Music Choice's Provision of Internet-Exclusive Channels and/or Mobile Access

As noted *supra*, by remanding instead of reversing, the D.C. Circuit in the instant case clearly did not rule on SoundExchange's argument that Music Choice's internet-based mobile service and/or its internet-exclusive channel should be grandfathered. Importantly, *City of Cleveland, supra*, contrasts the remand analysis of undecided appellate issues from those that the reviewing court had conclusively decided and as to which the agency below is bound to follow, holding that the "law of the case" doctrine "*does not apply to points not decided on a previous appeal* …." *City of Cleveland,* 561 F.2d at 348 (emphasis added).

Here, the D.C. Circuit clearly and purposefully did not decide whether Music Choice's internet-exclusive channels and/or mobile phone access could be grandfathered under the PSS rates and terms. More specifically, the D.C. Circuit acknowledged that SoundExchange had raised a "question" regarding grandfathering "transmissions … outside the home" and that SoundExchange had "suggested" that Music Choice's internet-exclusive channels likewise may not be grandfathered. *Music Choice*, 970 F.3d at 428. *See also* SX Opening Br. at 16 (arguing that, as of July 31, 1998, "Music Choice did not include internet-exclusive channels[,] … was not available on smart phones[,] … was not available through a mobile app[,] … [was] not available on any device outside the home[,] … [and] was not available over Wi-Fi.").

(3) The Judges Reject SoundExchange's Assertion that the D.C. Circuit Implied that Music Choice's Provision of Mobile Access and/or Internet-Exclusive Channels could not be Unconditionally Grandfathered

The D.C. Circuit could not and did not address SoundExchange's questions or suggestions regarding mobile access and internet-exclusive channels, in light of the categorical rejection by the Register and the CRB Judges of the grandfathering of any of Music Choice's internet transmissions. *Music Choice*, 970 F.3d at 427 ("Because the Final Determination categorically excluded internet transmissions from the unconditional grandfathered rate, the [CRB Judges] had no occasion to assess … Music Choice's … mobile application and internet-exclusive channels ….").

Thus, the Judges find unhelpful SoundExchange's assertion that the D.C. Circuit decision "did not suggest that the [CRB] Judges' ultimate conclusion" regarding these issues

[25] In *Muzak*, the D.C. Circuit found the use of the word "service" in the DMCA to be "dreadfully ambiguous," in some provisions referring to the "*entity*" and in other to the "program offerings." *Muzak*, 854 F.3d at 714. To resolve that ambiguity, the D.C. Circuit analyzed the statutory context, legislative history, and a prior regulatory interpretation of the definition of the word "service" in deciding that the word "service" had this dual meaning. *Muzak*, 854 F.3d at 716.

"was incorrect." SX Opening Br. at 5. Indeed, not only can no such negative inference be drawn from the D.C. Circuit decision, that decision *expressly* states, without foreshadowing the post-remand result, that the Judges "must *sort through these issues* on remand …." *Music Choice*, 970 F.3d at 428 (emphasis added). Thus, the Judges decline SoundExchange's invitation to infer from the D.C. Circuit's decision that they merely need "to provide additional analysis and reasoning" to buttress their prior rejection of any of the grandfathering sought by Music Choice. SX Opening Br. at 5.

Quite the contrary, the Judges, on remand, must abide Judge Rao's opinion in the instant case by applying the *Muzak* precedent, to decide "whether the word 'service' in the DMCA" covers Music Choice's challenged "*program offerings* transmitted via the internet." *Music Choice,* 970 F.3d at 425 (emphasis added).[26]

d. Application of the Muzak "Program Offering" Test

In light of Judge Rao's reliance on *Muzak*, the facts of that case are informative as to the appropriate legal application of the grandfathering test in the present case. Accordingly, the salient facts in *Muzak* are itemized chronologically below:[27]

> 1996: Muzak operated as a PSS since 1996, before the 1998 enactment of the DMCA. Muzak provided *program offerings* through its own music channels, branded as "DishCD" when made available to customers of the Dish Network, a satellite television provider.

[26] It is important to clarify semantic aspects of the arguments as to this issue. After acknowledging that the term "service" has a second statutory meaning (in addition to denoting the "entity" itself), *Muzak* refers *seven times* to the "*program* offerings" as constituting this second meaning of "service." *See Muzak*, 854 F.3d at 716-719. The Judges thus understand "program offerings" and "service offerings" to be synonymous in the present context, and that the phrase "service offering" does not create a new and broader pre-condition (beyond "program offering") for the grandfathering provisions to apply.

Indeed, it would be quite the muddle if the Judges were to infer from Judge Rao's opinion an invention, out of whole cloth, without explanation or definition, of a *new* grandfathering requirement involving a distinct separate categorical grandfathering condition – "service offerings" – which differed from and added onto *Muzak's* "program offerings" condition. Moreover, the entire tenor of Judge Rao's decision is to apply a jurisprudence that adopts (1) the plain meaning of the textual language of the DMCA and (2) D.C. Circuit precedent, as set forth in *Muzak*. In this regard, it bears emphasis that *neither the statutory grandfathering language nor Muzak use the phrase "service offering." See generally Sault Ste. Marie Tribe of Chippewa Indians v. Haaland,* 25 F.4th 12, 17 (D.C. Cir. 2022) (Rao, J.) (courts rely on clear statutory text to discern Congressional intent); *End Citizens United PAC v. Fed. Election Comm'n*, 90 F.4th 1172, 1179 (D.C. Cir. 2024) (Rao, J.) (court shall act consistent with "binding precedent").

Moreover, as noted *supra*, *Muzak* expressly found that the use of the word "service" in the DMCA was "dreadfully ambiguous." It would be irrational for the Judges nonetheless to apply that "dreadfully ambiguous" word and use a new (and tautological!) phrase – "service offering" – to define a "service." Thus, the Judges reject SoundExchange's invitation to recast Judge Rao's opinion as a form of judicial activism that conjures up the existence of a new, amorphous, and non-statutory grandfathering condition into the DMCA or into the *Muzak* precedent, beyond the "program offering" and "transmission medium" conditions.

[27] The detail of this chronology is contained in the decision of the district court, entered after reversal by the D.C. Circuit. *SoundExchange, Inc. v. Muzak, LLC*, 322 F.Supp.3d 72, 74-75 (D.D.C. 2018). The appellate decision summarized this chronology in a manner wholly consistent with the more detailed district court decision. *See Muzak*, 854 F.3d at 714-716.

> 2011: Muzak was purchased by Mood Media Corporation (Mood), which thereafter operated Muzak as a wholly owned subsidiary.
>
> 2012: Mood acquired DMX, one of Muzak''s competitors, which also made music program offerings to customers of a different satellite television provider – DirecTV – branded as "SonicTap." Before being acquired by Mood, DMX was not a PSS, and thus was not entitled to pay the lower PSS rate, but rather paid the higher rate as a "New Subscription Service" (NSS).[28] Upon Mood's acquisition of DMX, Mood continued to pay the higher NSS royalties for the music transmitted via the SonicTap-branded *program offering*.
>
> 2012-May 2014: Mood consolidated its assets, sunset the DMX service, and assigned DMX's DirecTV agreement to Mood's other affiliate, Muzak.
>
> May 2014: Upon the full absorption by Muzak of DMX, Muzak began to pay the lower PSS rate for all of its subscription service transmissions, including the transmission of the SonicTap-branded *program offering* acquired from DMX – which had previously paid the higher NSS rate.

Muzak, 322 F.Supp.3d at 74-75. In consideration of the actions taken by Mood and Muzak, regarding DMX, the D.C. Circuit stated the following:

1. "[T]he case is close [and] the controlling statute is dreadfully ambiguous" [and] "quite unclear." … "We conclude … that the better interpretation of the statute is that the term 'service' contemplates a double limitation; both the business and the *program offering* must qualify before the transmissions are eligible for the favorable rate."
2. "Mood-Muzak's acquisition of DMX, if allowed to expand Muzak's grandfather eligibility to 'services' other than DishCD, threatens the very purpose of the [DMCA] [which was] … to move the industry to market rates."
3. "If Mood-Muzak were permitted to pay the grandfather rate for transmissions made to customers who subscribed to a "service" that was previously provided by DMX, what would prevent – assuming no antitrust barriers – the complete elimination of the market-rate regime by Mood-Muzak's acquisition strategy[?]"
4. "The grandfather provisions were intended to protect prior investments the three business entities [including Music Choice] had made as pioneer music service[s] that incurred both the benefits and risks that came with [their] investments."
5. "[B]ut "when Muzak expand[ed] its operations and provide[d] additional transmissions to subscribers to a different 'service,' (*i.e.*, SonicTap), this [was] an entirely new investment."

Muzak, 854 F.3d at 714, 716, 719 (emphasis added).

[28] This "DMX" is not the same entity called "DMX" that participated in the original rate-making proceedings in 1996 and had been a PSS.

e. Application of Muzak to the Present Case

Although the Judges *must* apply *Muzak's* "program offering" test, as also adopted by Judge Rao's opinion and *Muzak*, *that instruction does not require that the "program offering" test inexorably lead to the same result when applied to distinguishable facts*. Indeed, in Judge Rao's opinion, she did not *direct* the Judges simply to apply *Muzak* by rejecting the grandfathering sought by Music Choice.[29] Rather, the D.C. Circuit instructed the Judges to use their "discretion" to "sort through" the issues of whether Music Choice's program offering of 25 internet-exclusive channels and its provision of mobile access to its subscribers are eligible to be grandfathered. *Music Choice*, 970 F.3d at 428.[30]

Judge Rao's opinion and *Muzak* thus require the Judges to weigh two statutory policies: (1) protecting the investments of pioneer PSS entities and (2) moving the industry to market-based rates.[31] This weighing, unsurprisingly, is a fact-dependent exercise.[32]

The parties have addressed the two policies. As would be expected, Music Choice has urged the Judges to give primacy to the policy behind the grandfathering of the section 801(b)(1) rate standard for the named PSSs, whereas SoundExchange advocates for the elevation of the policy to move toward a market-based regulated rate under the willing buyer/willing seller standard of section 114(f)(2)(B).

More particularly, Music Choice argues as follows:

> With the passage of the DMCA, in recognition of the PSS' *legitimate business expectancies as pioneers who launched the very first digital music services under a different legal and licensing landscape than those that would enter the market in the future*, Congress continued to apply the Section 801(b)(1) policy-based rate standard to the PSS, *even while it moved future market entrants to a marketplace standard. Music Choice v. Copyright Royalty Bd*., 774 F.3d 1000, 1004 (D.C. Cir.

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[29] That is, the D.C. Court could have affirmed the Judges' decision on other grounds, noting that the Judges' categorical disallowance of grandfathering for internet transmissions was incorrect, but constituted harmless error given the holding in *Muzak*.

[30] It is noteworthy that the Register, like the D.C. Circuit, did not view *Muzak* as dispositive with regard to the present case:

> [T]he preexisting services must be limited to the three named entities in the [DMCA] Conference Report, *i.e.*, DMX …, Music Choice … and [DiSHCD] (operated by Muzak). … *What offerings by these entities may constitute PSS offerings, however, has continued to be unsettled*, but is now resolved by this memorandum opinion."

Register's Memorandum Opinion on Novel Material Questions of Law at 14 (Register's Memo Opinion) (eCRB no. 1652) (emphasis added). (Of course, how the Register "resolved" this issue was rejected by the D.C. Circuit, as discussed *supra*.)

[31] The Final Determination noted that the Register had identified these two conflicting statutory policy goals. Final Determination, 83 FR at 65226 ("The Register observed that the DMCA's amendments to section 114 of the Copyright Act were designed to move the industry to market rates. … Nevertheless, the Register noted that Congress intended for PSS entities to be able to expand their service offerings to some limited extent and still have those service offerings be considered PSS offerings.").

[32] Because Judge Rao's opinion sets forth the CRB Judges' *particular* tasks, without relying on any *general* canons of construction applicable to statutory grandfathering provisions, the Judges understand that their remand duty is to engage in this weighing of statutory policies, rather than to engage in their own *broad* application of principles of statutory construction.

2014) (noting that legislative purpose of PSS license is "to protect the investment of noninteractive services that had come into existence before the recognition of the digital performance right."); Conference Report of the Committee of Conference on the Disagreeing Votes of the Two Houses on the Digital Millennium Copyright Act, H.R. Rep. No. 105-796 at 80–81 (1998); Designation as a Preexisting Service, 71 Fed. Reg. 64,639, 64,645–46.

The legislative history's reference to the "existing operations" of the PSS does not mean that Congress intended to limit PSS status to the PSS offerings as they existed in 1998 or otherwise to freeze the PSS in time. One of the very purposes for applying the Section 801(b)(1) policy-based rate standard to the PSS was to protect the PSS' "need for access to the works at *a price that would not hamper their growth*." *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings (Final Rule and Order)*, 63 Fed. Reg. 25,394, 25,409 (May 8, 1998).

As the Register explained in an earlier legal referral on the scope of the PSS license:

> While it would appear . . . that *Congress's purpose in grandfathering these services was to preserve a particular program offering, it was not its only purpose* or even necessarily its major goal. . . . It understood that *the entities so designated as preexisting had invested a great deal of resources into developing their services* under the terms established in 1995 as part of the Digital Performance Right in Sound Recordings Act of 1995, and that *those services deserved to develop their businesses accordingly*. Designation as a Preexisting Service, 71 Fed. Reg. at 64,645.

. . .

[I]in this proceeding the Register emphasized that a PSS must be permitted to *evolve and develop the features of its service within the general transmission media it used in 1998*, noting that an offering by a PSS

> can grow and expand significantly within the same transmission medium while remaining a PSS offering[ ]… [t]o continue to qualify for the grandfathering provisions. The user interface can be updated, certain functionality can be changed, the number of subscribers can grow, and channels can be added, subtracted, or otherwise changed. Register's Ruling, 82 Fed. Reg. at 59,658.

. . .

MC Opening Br. at 14-17 (emphases added).

On the other hand, SoundExchange's opposing policy point is succinct, focusing only on the DMCA's statutory policy goal of moving toward market-based regulated royalty rates for noninteractive subscription services. On this issue, SoundExchange finds that goal to be dispositive:

[T]he Judges should continue to apply of the principle that grandfather provisions be interpreted narrowly in order *to ensure that webcasters compete on level terms,*

> *eliminate distortions in the market, and effectuate the goal of shifting rates towards those that reflect arms-length market transactions.*

SX Responsive Br. at 17-18 (emphasis added).

The Judges apply these economic policy concerns to the present issues by considering the proper application of the *Muzak* precedent. In so doing, the Judges further note that, in a prior action, the Register noted the additional grandfathering policy of seeking to "reward" each identified PSS for its early entry into the noninteractive sector: "Grandfathering provisions are frequently included in statutes to ensure continuity and to *reward* the investment and efforts of those who were the first to take on the struggles and risks of novel enterprises or methods." *See* Designation as a Preexisting Subscription Service, 71 Fed. Reg. 64639, 64646 (Nov. 3, 2006) (emphasis added).

The Judges next proceed to examine and contextualize *Muzak's* facts and the D.C. Circuit's reasoning in that case in light of these conflicting statutory policy concerns.

In *Muzak*, the facts demonstrated that the actions of Mood-Muzak constituted an attempt at what is known as "regulatory arbitrage." Simply put, "regulatory arbitrage" is "the reduction of regulatory costs via manipulation of regulatory treatment." K. Garcia, *Copyright Arbitrage*, 107 Calif. L. Rev. 199, 201 (2019). In more detail, this form of arbitrage

> exploit[s] the gap between the economic substance of a transaction and its legal or regulatory treatment, taking advantage of the legal system's intrinsically limited ability to attach formal labels that track the economics of the transactions with sufficient precision, and also as a means to reduce costs or capture profit opportunities created by differential regulations or laws. Regulatory arbitrage allows regulated entities to invest in close economic substitutes but with lower regulatory costs. Regulatory arbitrage is conventionally viewed as the inevitable result of inherent ambiguity and incompleteness of legal rules.
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> . . .
>
> Copyright is a notoriously complicated statutory regime that regulates industries, such as music, film, and publishing, whose business models have been dramatically impacted by technology. This makes the field ripe for regulatory arbitrage….

Id. at 202-03.

In *Muzak*, corporate reshuffling by the parent company, Mood, provided Mood-Muzak with a facial technical justification for switching from the higher market-based NSS rates to the lower PSS rates for DMX. However, that stratagem constituted a textbook example of the sort of arbitrage described above – seeking favorable regulatory treatment untethered to the statutory purpose and to the economic substance of DMX's market participation.

By contrast, in the present case, Music Choice has not engaged in the same *specific* conduct. Unlike the defendant in *Muzak*, it is not disputed that Music Choice has grown *organically*, moving forward through internal development, rather than through corporate acquisition and asset manipulation. Moreover, in *Muzak,* unlike in the present case, Mood-Muzak was seeking to move *backwards, away* from the *higher* market-based NSS royalties that were already being paid by Mood for DMX's SonicTap branded program offering and *to* the *lower* PSS royalties paid under the section 801(b)(1) paradigm.

In *Muzak*, therefore, Mood's conduct was understood by the D.C. Circuit as using its wholly-owned PSS, Muzak, in an attempt by Mood to actually *reverse* the statutorily-designed movement toward market-based rates, rather than to further the statutory grandfathering purpose of protecting a PSS that was an early risk-taking investor.[33]

The Judges conclude that *Muzak* is applicable, persuasive, and consequential in the present proceeding. In this regard, the Judges focus on and emphasize the following rhetorical question (quoted *supra*) by the D.C. Circuit in *Muzak*:

> If Mood-Muzak were permitted to pay the grandfather rate … what would prevent—assuming no anti-trust barriers—*the complete elimination of the market-rate regime* by Mood-Muzak''s … strategy.

Muzak, 854 F.3d at 719 (emphasis added).

As a matter of statutory policy, this ruling in *Muzak* is particularly instructive in the present remanded case, notwithstanding the difference between Mood-Muzak's regulatory arbitrage strategy and Music Choice's selection of program offerings. That is, the Judges must consider whether grandfathering in the present case threatens – to use the *Muzak* test – "the complete elimination of the market-rate regime," a consequence which, *per Muzak*, is not outweighed by the statutory policy undergirding PSS grandfathering. In considering this weighing issue, the Judges must parse Music Choice's post-July 31, 1998 challenged expansions, to determine whether, as to each – internet-exclusive channels or the provision of mobile access to subscribers, applying the statutory grandfathering policy would pose an unacceptable threat to the other statutory policy of moving toward market-based rates.[34]

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[33] From a purely economic perspective, Mood could have argued that Muzak should not have been required to engage in organic growth rather than growth via the SonicTap acquisition and asset transfer, in order to realize the grandfathering benefits of PSS royalty rates – if it would have been less expensive and more efficient to grow through those corporate transactions and maneuvers, *i.e.*, a PSS should not have to incur greater expense by growing organically to avail itself of the grandfathering provisions. But there is no indication in *Muzak* that such an argument was proffered and, in any event, Mood-Muzak's machinations appear inconsistent with the statutory goal of moving to market-based rates because they would have allowed SonicTap royalties to move *backward* from NSS rates to PSS rates. (Moreover, if Mood assumed Muzak would pay the higher NSS rates, it could have instead factored in those higher NSS rates and offered to pay a lower purchase price to acquire DMX and its SonicTap branded music program to account for those higher costs, rather than engage in regulatory arbitrage that undermined the statutory purpose of moving to market-based rates.)

[34] It bears emphasis that this weighing exercise is inevitable under the plain language of the statute. Any grandfathering rate protection of a PSS would be inconsistent with a move toward market-based rates, just as any move toward market-based rates for a PSS would be inconsistent with protecting its investments. The Judges thus are required to weigh these conflicting policy goals. (The need for the CRB Judges, and their predecessors, to balance conflicting policy goals has been an ongoing feature of music industry rate regulation. *See, e.g.*, 17 U.S.C. 801(b)(1) (superseded by the Music Modernization Act) (requiring that royalty rates – including the PSS rate at issue here – balance four separate and conflicting objectives)).

To be clear, the Judges do not herein endorse or express a preference for either of these statutory policies. The Judges note only that each policy – "market development through protection" and "market exposure through competition" – is at the very least economically rational. "Market protection" of early entrants is a form of "industrial policy," which has been defined as "government policies that explicitly target the transformation of the structure of economic activity in pursuit of some public goal [such as] to stimulate innovation …." R. Juhász, N. Lane & D. Rodrik, *The New Economics of Industrial Policy*, 16 Ann. Rev. Econ. 213, 216 (2024). (Such protection is analogous to protection of domestic "infant" industries in order to promote innovative technologies in the context

(4) Distinguishing SoundExchange's Separate Grandfathering Challenges to Music Choice's Internet-Exclusive Channels and its Provision of Mobile Access to its Subscribers

(a) Introduction

As explained *supra*, in order to abide the D.C. Circuit's instruction to "sort through" SoundExchange's challenges to the grandfathering of Music Choice's offerings, the Judges must weigh the two competing statutory policies – the ongoing support of early entrants into the digital audio sector, on the one hand, and the move toward market-based rates on the other. As also detailed *supra*, a reasonable and appropriate application of *Muzak* requires the Judges to consider whether the changes in Music Choice's business would threaten to undermine either of

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of international competition. *See, e.g.*, R. Lipsey, *Policy Implications of Alternative Economic Paradigms: Some Surprises from Endogenous Technological Changes,*" Discussion Paper 12-16, Department of Economics, Simon Fraser University (2012) ("The standard infant industry argument … in the [neoclassical] textbooks is … the industry needs assistance to grow large enough to … fully exploit existing major economies of scale [and when] that technology is subject to continuous endogenously generated change, infant industry protection … establish[es] a dynamic industry that can hold its own in fierce international competition where technological change is one of the main weapons.")); *see also* H. Pack & K. Saggi, *Is There a Case for Industrial Policy? A Critical Survey*, 21World Bank Research Observer, 267, 269 (identifying the "Infant Industry Argument" as a "precursor of modern industrial policy.").

Also, such "market protection" is defended as protecting "first movers" from the actions of "second movers" who, after the earlier entrant has engaged in costly trial-and-error investments in initial technologies and business strategies, can free ride off the "first mover" by avoiding the latter's costly errors. *See, e.g.*, C.H. Au, *et al.*, *Disrupting the Disruptor: The Role of IS in Facilitating Second-Mover Advantage* 1, Thirty Ninth Int'l Conf. on Info. Systems, (2018) (available on Google Scholar) ("Early-mover advantages are short-lived … because the contextual conditions are in a state of constant flux, which tend to reveal the early-movers' limitations … creat[ing] opportunities for 'second-movers,' who can avoid the uncertainty in the competitive environment and lower costs by imitating, and often improving on, the business models of the early-movers.").

The policy logic merging the infant industry and second-mover problems is that, unless the first-mover is protected, firms will be reluctant to make the initial foray.

On the other hand, the policy of "market exposure" has a more neoclassical pedigree. Competition in a market where government policy does not favor any firm, for any reason, incentivizes every firm to seek out efficient inputs at the lowest cost, and to make investments that generate dynamic competitive effects (the policy logic of "creative destruction"). *See, e.g.*, P. Aghion, *et al., Industrial Policy and Competition*, 7 Am. Econ. J. 1 (2015) (summarizing the widespread criticisms by economists of a mid-20th century policy of "promoting new infant industries … [which] came into disrepute in the 1980s mainly on the ground that industrial policy *prevents competition* and allows governments to pick winners … in a discretionary fashion, thereby increasing the scope for capture of governments by vested interests." (emphasis in original)). Also, conflicting with a "first mover's" relative disadvantage is a "first mover" benefit compared to later entrants, in terms of, for example, network effects arising from a captive early customer base or favorable relationships with dependent input suppliers. *See* M. Lieberman & D. Montgomery, *First-Mover Advantages*, 9 Strategic Mgmnt. J. 41, 44, 45 n.8 (1988).

The DMCA essentially pitted these two broad polices against each other in the context of the PSS grandfathering issue. It is also noteworthy that Congress – not the CRB Judges or any other administrative actor – ultimately eliminated this tension in 2018 by enacting the Music Modernization Act, eliminating the section 801(b)(1) rate standard on which a grandfathered PSS could rely, and adopted the market-based willing buyer/willing seller royalty rate standard for, *inter alia*, any digital music service that previously had been identified as a PSS. Music Modernization Act § 103 (2018). The Judges understand this aspect of the MMA to confirm that the CRB Judges, as administrative jurists, had no authority to simply ignore either of the two competing statutory policies (which would *de facto* constitute an amending of the DMCA). Rather the Judges were required to weigh the application of each policy, and only Congress could change the law and – *de jure* – end the "market protection" policy created by the statutory grandfathering of the section 801(b)(1) royalty standard.

these competing statutory policies.[35] In performing this analysis, the Judges are particularly mindful of the D.C. Circuit's concern in *Muzak* that the policy benefits of grandfathering must be subordinated if grandfathering would threaten to eviscerate the policy of moving toward market-based rates.

Accordingly, the Judges consider *infra* each of the two Music Choice expansions challenged by SoundExchange.

(b) Music Choice's Internet-Exclusive Channels

According to the hearing and remand records, in addition to its 50 channel cable TV-based program offering, after July 31, 1998, and for some time thereafter, Music Choice was making an additional program offering of 25 internet-only channels available to authenticated television subscribers. Final Determination at 7 (record citations omitted); *Music Choice*, 970 F.3d at 427; SX Opening Br. at 11, 16; *see also* MC Responsive Br. at 23-24 (not denying the existence of these internet-exclusive channels when arguing for the applicability of grandfathering to these channels). As of July 31, 1998, Music Choice had not provided subscribers with channels that were available only on its internet transmissions, leading to SoundExchange's argument that these transmissions should not be grandfathered. *Music Choice*, 970 F.3d at 428.

Thus, as a factual matter, Music Choice failed to establish that it had offered internet exclusive channels as of, or *on*, July 31, 1998. The D.C. Circuit was clear in its legal interpretation and directive "for a digital audio transmission to qualify as a 'preexisting subscription service,' first, it must be made by a business entity that was in existence on or

[35] The Judge's duty on remand to carefully distinguish the two grandfathering challenges is clear. As the D.C. Circuit's decision states, "On remand, the [CRB Judges] must engage in a 'precise scope' analysis, in order to 'sort through' the 'grandfathered rate' issues." *Music Choice*, 970 F.3d at 427–28. With regard to this "precise scope" analysis, the Judges reject SoundExchange's tacit argument that the Judges should essentially engage in a *policy-blind comparison* of the aspects of Music Choice's business as of July 31, 1998, and thereafter, and then decline to grandfather any precise aspects that did not exist in that earlier period. *See, e.g.*, SX Responsive Br. at 1. Rather, the Judges understand their duty on remand to "sort through" the relevant provisions of the DMCA and the *Muzak* precedent by examining the "precise scope" of the aspects of Music Choice's business challenged by SoundExchange – the 25 internet-exclusive channels and the expanded mobile service – through the conflicting policy lenses of the DMCA, and as informed by *Muzak* and Judge Rao's opinion in this case.

In making these policy-based analyses, the Judges eschew the parties' vague characterizations of the challenged aspects of Music Choice's business (internet-exclusive channels and mobile access). Music Choice describes these aspects as not "fundamentally" different from its business on and before July 31, 1998. *See, e.g.*, the Judges' paragraphs 1, 15 & 16, *supra,* summarizing Music Choice's factual arguments in their Initial Remand Brief. SoundExchange is equally vague, claiming that these Music Choice business features cannot be "fairly characterized" as the same as those that existed on or before July 31, 1998. *See, e.g.*, the Judges paragraphs 15 and 24, supra, summarizing factual responses in SX Responsive Br. and *Id*. at paragraphs 3 and 6, summarizing SoundExchange's legal responses. Such proffered semantic tests fail to capture the essence of the legal task: to weigh the conflicting statutory policy concerns between grandfathering a PSS and moving the noninteractive sector to market-based rates.

The Judges also find little benefit from the parties' reliance on asserted industry norms and standards, or on regulatory approaches in other contexts. MC's Opening Br. at 18-19. The DMCA, particularly as understood in Judge Rao's opinion and in *Muzak*, makes it clear that the policy concerns expressed in the DMCA must be applied in a manner that focuses instead on the competing interests of grandfathering a PSS and moving the broader noninteractive sector market to market-based regulatory royalty rates.

before July 31, 1998, and second, the relevant 'program offering' *must have been in existence on* July 31, 1998." *Music Choice*, 970 F.3d at 425 (emphasis added).[36].

For grandfathering purposes, the Judges distinguish between Music Choice's program offering of internet-exclusive channels and its program offering of channels that have been available via *both* television and the internet. The record does not suggest that the *specific facts* in *Muzak* that led to the rejection of the grandfathering attempt are present here. (Music Choice did not acquire these internet-exclusive channels from another entity and then attempt *that* arbitrage stratagem).

However, the Judges determine that Music Choice's offering of internet-exclusive channels constitutes a *different* yet still pernicious reach for regulatory arbitrage. More precisely, through its attempt to grandfather PSS rates and terms for its program offering of internet exclusive channels, Music Choice is seeking the advantage of PSS categorization to gain economic advantage over internet competitors, *e.g.*, internet custom radio services and simulcasters who pay market-based rates under 17 U.S.C. 114(f)(2)(B). Moreover, this advantage is not offset or counterbalanced by a furtherance of the statutory policy of protecting a PSS's investments, as explained below.

Music Choice's internet-exclusive channels, if grandfathered under the PSS rates, would compete with the noninteractive services that pay royalties under the market-based rate standard set forth in section 114(f)(2(B).[37] In this regard, the Judges find compelling the following argument made by SoundExchange to the D.C. Circuit:

> Music Choice's internet transmissions are made through a service that—in the realities of today's marketplace—is a direct competitor to other webcasting services like Pandora that are not entitled to PSS rates. Congress enacted the PSS rate regime as a shield to protect pre-1998 investments, not as a sword to give Music Choice an unfair competitive advantage over other webcasting services in today's market for online music regardless of the nature of its webcasting.
>
> * * *
>
> Music Choice's internet offering [of] streams [of] 25 additional channels of audio programming over and above the 50 channels that are also available through its residential cable service … constitutes a change in the quantity and nature of the use of the use of the sound recordings by Music Choice[,] indicat[ing] that Music Choice was

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[36] Further, Music Choice subsequently claimed that the internet-exclusive channels existed only for a short time and were not also transmitted via television because of technical/contractual issues. MC Opening Br. at 16-17. SoundExchange argues that these points are irrelevant, and, in any event, Music Choice remained able to utilize internet-exclusive channels at any time during the rate period. SX Responsive Br. at 7-8. The Judges agree with SoundExchange and determine that Music Choice's subsequent alleged elimination of internet-exclusive channels did not moot this issue because it was capable of reinstatement during the rate period. *See In re Sealed Case*, 77 F.4th 815, 826 (D.C. Cir. 2023) ("a court can decide an otherwise-moot matter if the dispute is capable of repetition yet evading review.").

[37] To be precise, the royalty rates set by the Judges pursuant to 17 U.S.C. 114(f)(2) (B) are based on a market that reflects the workings of an "effectively competitive" market. *See, e.g.*, Final Rule and Order, Determination of Royalty Rates and Terms for Ephemeral Recording and Webcasting Digital Performance of Sound Recordings *(Web IV)*, 81 FR 26316 (May 2, 2016) (*Web IV* Final Determination).

> not merely intending to replicate that residential television service offering over the Internet.

SoundExchange's Corrected Brief in Support of Appellees at 32-33, *Music Choice v. CRB et. al,* No. 19-1011 (D.C. App. Ct. 2020); *Music Choice*, 970 F.3d at 418 (citing Final Determination).

The Judges recognize that, on the other hand, allowing Music Choice to benefit from the grandfathering provision in connection with its internet-exclusive channels would certainly enhance, to some degree, Music Choice's investments in the "noninteractive audio-only subscription digital audio" sector in which Music Choice is situated. *See* 17 USC 114(j)(11). Thus, grandfathering would serve to further the protectionist policy favoring the specifically-identified PSSs, which include Music Choice. But that would constitute protection of the PSS *qua* entity, whereas pursuant to *Muzak* the issue is whether the PSS's *program offering* should be protected.

On balance, the Judges find that grandfathering the PSS rates for internet- exclusive program offerings would undermine the broader statutory policy the D.C. Circuit identified in Muzak – by "threatening … the complete elimination of the market-rate regime" by its strategy. *Muzak*, 854 F.3d at 719. More precisely, if the Judges permitted the grandfathering of internet-exclusive program offerings, a PSS could in essence use the expanded set of channels providing that new program offering as a Trojan Horse to enter the broader noninteractive service sector at section 801(b)(1) royalty rates, below the market-based regulated rates paid by internet custom radio providers and terrestrial radio simulcasters under 17 U.S.C. 114(f)(2)(B)).

In the weighing of the policies of (1) moving toward market-based rates vs. (2) protecting a particular PSS and its program offerings, the Judges conclude that, with regard to Music Choice's internet-exclusive channels, the market-based policy controls. That is, from an economic perspective, once Music Choice introduced a program offering of internet-exclusive channels, it was *differentiating its product offering* based on whether it was available on television or via the internet. In so doing, Music Choice sufficiently frayed the link between its prior program offerings and its internet-exclusive program offering so as to run afoul of the policy balance expressed in *Muzak*.

Accordingly, Music Choice cannot avail itself of the statutory grandfathering provisions in connection with its internet-exclusive program offering.

(c) Mobile Services

Music Choice's non-exclusive internet program offerings are accessible to listeners through mobile services. More precisely, Music Choice's mobile *program offerings* are identical in nature to its *program offerings* made via cable television. Moreover, the listeners must subscribe to Music Choice in order to access its music and channels. *Music Choice,* 970 F.3d at 425. The Judges find that Music Choice offered service "outside the home" including on portable computers, and thus offered sufficiently "mobile" service offering on July 31, 1998. And, while the Judges find that "smartphone applications" were not part of the service offering on July, 31, 1998, other sufficiently similar software applications (*e.g.* web browsers) were part of the outside the home offering on July, 31, 1998. Furthermore, the Judges understand the SoundExchange argument regarding Music Choice's "mobile" service and "smartphone" service to be a single challenge. *See* SX Opening Br. at 17 (stating mobile apps allow for mobile service "on a smartphone [or] tablet").

Having determined that, (aside from any internet exclusive channels, discussed *supra*) Music Choice's provision of mobile *access* is not a new "program offering", but rather it is part and parcel of Music Choice's business as it existed on and before July 31, 1998: a noninteractive audio-only subscription digital audio entity transmitted through the media of television and the internet, providing program offerings of music. Accordingly, from a *legal* perspective, Music Choice's provision of mobile *access* does not implicate *Muzak's* "*program offering*" definition of a "service".[38]

From an *economic policy perspective,* Music Choice's provision of mobile access to its television subscribers allows it to protect its ongoing programming investments by adopting the mobile streaming of its preexisting and ongoing program offerings – televised music channels. As Music Choice maintains, mobile streaming of televised channels was necessary to allow its television service to evolve in a manner that could compete with the "TV Everywhere" approach that is "an integral part of a consumer's television service [available] at no additional charge to the consumer." MC Opening Br. at 19.

Moreover, by way of comparison, the DMCA does not make a qualifying "nonsubscription" service or a "new subscription service" (NSS) subject to the market-based rates of section 114(f)(2)(B) *because* access is made available via mobile devices as well as non-portable devices. Further, the delivery mechanism by which a consumer receives access to a PSS's program offerings transmitted via the internet is not a grandfathering condition under the statute or under *Muzak's* additional "program offering" holding. Also, the Judges do not routinely distinguish between mobile and non-portable noninteractive services when setting royalty rates pursuant to 17 US.C. 114(f)(2)(B).[39] *But cf.* Final Determination After Remand,

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[38] The Judges also find that, as a *factual* matter, Music Choice has been offering its (non-internet exclusive) programming "outside the home," and thus in a mobile manner consistent with the then-current technology since on or before July 31, 1998. *See Music Choice,* 970 F.3d at 422, 428 (framing the remand question as whether Music Choice's "transmissions were available outside the home," and noting that explicitly "mobile applications" are only one type of a service "outside a subscriber's residence"). More particularly, the record reflects that Music Choice's service has been available outside the home – on desktop and portable computers – since 1996. That is, with regard to the issue of whether its music channels transmitted via the internet were available outside the home prior to July 31, 1998, Mr. Del Beccaro's written testimony identifies which subscribers could receive Music Choice channels from locations outside the home. *See* MC Opening Br. at 12-14 (and record citation therein). Further, Mr. Del Beccaro testified that, although there were no *smart* phones back in 1998, subscribers could have had internet access to Music Choice channels on their *cell* phones if they had internet access on those phones, because cell phones were internet-connected. *Id.* at 20 (citing SX Opening Br. Ex. G, Tr. 22:12-23:14). Finally, Mr. Del Beccaro testified at his deposition that forms of wireless communication, such as microwave and satellite technologies, allowed subscribers to listen to Music Choice wirelessly. *Id.* (citing SX Opening Br. Ex. G, Tr. 23:17-23; 45:17-46:17).

Accordingly, the record provides sufficient support for the finding that Music Choice was providing its service outside of the home prior to July 31, 1998. But, as noted in the accompanying text, Music Choice's adoption of the technological development in telephony was precisely the type of improvement in an existing offering for which grandfathering was appropriate.

[39] The Judges recognize, as SoundExchange argues, the hypothetical potential for Music Choice's internet provision of mobile access of its existing program offerings transmitted via cable television *and* the internet to compete with noninteractive services. But that argument proves too much: Judge Rao's opinion holds that such internet transmissions were in fact grandfathered pursuant to the 1998 DMCA, making their competitive potential objectively a knowable feature of the statutory grandfathering provisions. In any event, because the extent of grandfathering of PSSs was at least uncertain, later entrants into the noninteractive commercial space paying the

Phonorecords III, 88 FR 54406, 54485, tbl.2 (Aug. 10, 2023) (for section 115 mechanical royalties for musical works (not sound recordings), the Judges have adopted a benchmark agreement differentiating rates on several bases, including whether the listener can access the music via portable devices).

In this regard, the Judges note, as quoted *supra*, that PSS grandfathering has been characterized by the Register not merely as "protection" for early investor PSSs in noninteractive technologies but also as a "reward." Music Choice (and the other identified PSSs) took an economic and financial plunge by serving as first-movers – making risky investments in return for a statutorily-sheltered market position pursuant to section 801(b)(1). Thus, the Judges find that the statutory intent to "reward" (as well as to "protect") Music Choice's early entry and investments further tips the policy balance, and thus the Judges reject SoundExchange's attempt to preclude extending grandfathering to internet transmissions of Music Choice's program offerings to subscribers via mobile access.[40]

Finally, the Judges reject SoundExchange's argument that grandfathering is inappropriate because "portable" or "mobile" devices are distinguishable from "residential" devices. In the original CARP proceeding for the PSS, the panel used the term "residential" to distinguish between the services' *consumer and business* subscribers, not to distinguish among different forms of consumer access. *See* Trial Ex. 929, Report of the Copyright Arbitration Royalty Panel ¶ 44 (referencing "residential" cable subscribers), ¶ 46 ("The services also transmit sound recordings to commercial subscribers."), *Determination of Statutory License Terms and Rates for Certain Digital Subscription Transmissions of Sound Recording*, Docket No. 96-5 CARP DSTRA (Nov. 12, 1997) (CARP Report).

IV. The Audit Issue

With regard to the audit issue, the D.C. Circuit stated the following:

1. To verify royalty payments made by Music Choice to SoundExchange, the existing and long-standing regulatory requirement provided for an audit of Music Choice's royalty payments, a requirement that could be satisfied not only by a SoundExchange-initiated audit, but also through an audit initiated by Music Choice itself (a "defensive audit"), undertaken by independent auditors in accordance with "generally accepted auditing standards [GAAS]." *Music Choice*, 970 F.3d at 422 (citing Final Determination at 65262, 65268).
2. In the Final Determination, the CRB amended this standard so that an audit initiated by Music Choice that purported to satisfy the regulatory requisites would only be "an

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market-based rates had the opportunity to rationally "bake-in" the cost of such uncertain grandfathered competitive advantages on behalf of the three PSSs. *Cf. Web IV* Final Determination, 81 FR at 26326, 26329 (a party "bakes-in," *i.e.*, rationally "internalizes," relevant facts when making decisions as to" ROI" (return on investment). Thus, any potential competitive advantage posed by Music Choice's provision of mobile access to its subscribers while paying PSS royalty rates is part and parcel of the grandfathering policy, which could only be eliminated by Congress (which Congress accomplished by adopting the section 114 market-based rates language to PSSs via the 2018 Music Modernization Act. *See* 17 U.S.C. 114(d)(2)(b) & (f)(1)(B) (current)).

[40] As noted *supra*, the Judges' *identification* of this policy of relative favoritism should not be mistaken for the Judges' endorsement of same. It is beyond the Judges' regulatory remit to adjudge policy decisions that Congress has set forth by statute or the D.C. Circuit has enunciated in case law.

acceptable verification procedure for all parties with respect to the information *that is within the scope of the audit.*" *Id.* at 428 (emphasis in original).

3. By this amendment to the regulation, SoundExchange was "permitted to *round out* the findings [of Music Choice''s independent audit] with its own audit, limited to the points omitted from the scope of the defensive audit." *Id.* (quoting Final Determination at 65262) (emphasis added).
4. This auditing change was long sought by SoundExchange and consistently opposed by Music Choice. *Id*. at 422-23.
5. This amendment made a "consequential revision" to the audit procedure, because previously Music Choice's "defensive audit" was deemed to satisfy the regulatory audit requirement if it stated that it was conducted by an independent auditor pursuant to GAAS. *Id.* at 428.
6. Under the revision though, SoundExchange is given permission to conduct audits of any matter outside the "scope of the audit." *Id.* (citing Final Determination at 65262).
7. "This alteration imposes a new condition on Music Choice, by allowing additional audits beyond the independent audit that was previously deemed an 'acceptable verification procedure.' 37 C.F.R. § 382.7(e) (2013)." *Id.* This new condition thus added "more stringent audit requirements" than had previously existed for the verification of Music Choice's royalty payments to Sound Exchange. *Id.* at 420.
8. Although the CRB Judges and SoundExchange maintain that the amendment is a mere "clarification" rather than a change, the CRB Judges and their predecessors have "long understood the audit as a *kind of safe harbor* for preexisting services like Music Choice." *Id.* at 428 (emphasis added).
9. In 1997, when the CARP and the Librarian of Congress first provided for the "defensive audit" procedures, the CARP stated that "defensive audits" would balance the "'fair opportunity to audit for copyright owners'[41] against the burden and expense of auditing upon the Services." *Id.* at 428-29 (citing CARP Report ¶ 194 (*adopted* Librarian's *PSS I* Determination, 63 FR 25394; and Final Rule and Order, *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services (SDARS III)*, 78 FR 23054, 23074 (Apr. 17, 2013).
10. Supporting the substantive nature of this change is Music Choice's record testimony—unacknowledged by the CRB Judges—that this change would upset Music Choice's "reliance on the previous audit procedure." *Id.* at 429 (citing evidence suggesting that "Music Choice has availed itself of [the 'defensive audit'], and has expended significant resources in doing so.").
11. Not only was the Final Determination's amendment of the audit provision a substantive change, the CRB Judges also: (a) failed to recognize that they were changing the substance of the regulatory process; and (b) failed to provide any reason for the new policy. *Id.*

[41] In 1997, no collective, such as SoundExchange, was statutorily authorized to represent sound recording copyright owners. The importance of this fact is addressed *infra*.

12. Rather, the CRB Judges stated only that they could "see no reason not to" make the change. *Id.* (citing Final Determination at 65262). But "an agency's *ipse dixit* cannot substitute for reasoned decision-making." *Id.*

13. The Final Determination failed to acknowledge the CRB Judges' own prior rejection of a substantially identical proposal in its 2013 PSS proceeding. There, as here, "SoundExchange failed to rebut Music Choice's argument that the change would 'permit SoundExchange to use auditors that are employees or officers of a sound recording owner or performing artists, the objectivity of which might be suspect.'" The CRB Judges rejected SoundExchange's position because it did not "adequately address" this issue. In the present proceeding, the CRB Judges "[did] not acknowledge this prior position, and d[id] not point to any evidence that these concerns have been ameliorated, and d[id] not present any new reasons for adopting the amended audit procedure that it previously rejected." *Id.*

14. The CRB Judges also failed to address the CARP's initial reasoning for instituting the "defensive audit" procedure, which sought to balance the preexisting services' burden and expense against copyright holders' audit rights. Instead, the Final Determination strikes a different balance in favor of SoundExchange, but without acknowledging or addressing the reasons for the policy shift. *Id.*

15. The CRB Judges might be able to "justify [their] change in position," by going beyond their "scant explanation and casual disregard for [their] former position" in a manner which "satisf[ies] the APA's requirements for rational decisionmaking." *Id.* at 429-30.

16. In sum, the CRB Judges "acted arbitrarily and capriciously" in adopting the new audit verification language. *Id*. at 421-22.

17. Accordingly, the Final Determination was vacated and remanded for the CRB Judges "to reconsider the amended audit procedure," and to provide a reasoned explanation if they find the revised definition is justified." *Id.* at 421, 430.

A. The Parties' Arguments on Remand

Set forth below are the proposed factual findings and legal conclusions advanced by the parties regarding the dispute regarding the audit language:[42]

1. SoundExchange's Opening Brief

a. SoundExchange's Factual Arguments

1. Consistency of terms across license categories promotes efficient statutory license administration. SX Opening Br. at 21.

2. Sweeping defensive audit provisions are not the industry standard. Moreover, neither Music Choice's agreements with Multichannel Video Program

[42] As with the "grandfathering" issue discussed *supra*, the parties did not break down their submissions into separate categories of proposed factual findings and legal conclusions (nor were they directed to do so). The Judges make a distinction herein between the parties' basic factual and legal arguments for purposes of organization and analysis. (Additionally, some of the parties' more granular arguments are set forth *infra* in connection with the discrete issues to which they apply.)

Distributors ("MVPDs") nor the sound recording license agreements produced by record labels permit licensees to avoid audits by conducting an audit on their own. *Id.* at 20 n.14.

3. "Defensive audits" can differ from work conducted by auditors at SoundExchange's request in terms of:

   --the procedures employed,

   --the level of rigor,

   --the scope of the audit, and

   --the degree of access to documents and information that auditors are afforded.

   Id. at 21.

4. Such differences affect the extent to which an audit uncovers unpaid or underpaid royalties. *Id.* A SoundExchange witness, Lewis Stark, an independent auditor who had led previous audits of Music Choice (and Muzak) on SoundExchange's behalf, testified that Music Choice's use of "defensive audits" has frustrated SoundExchange's ability to assess the accuracy of its royalty payments. *Id.* (citing Ex. A (Declaration of Lewis Stark[, CPA]) ¶¶ 7-11 ("Stark Decl.")).
5. Mr. Stark concluded that the process employed by Music Choice's internal auditor, BDO, in other audits differs from the process that Mr. Stark would have conducted for SoundExchange. *Id.* Mr. Stark characterizes his own process only "colloquially" as "audits" or "royalty audits." *Id.* (citing Stark Decl. ¶ 2).
6. The objective of an audit like the one BDO has conducted is designed only to assess whether or not a company's royalty statements are "fairly presented in all material respects," which is different from the goal of an audit procedure designed to verify the accuracy of the calculations underlying a licensee's royalty payments. *Id.* at 21-22 (citing *Web IV* Determination at 26401-02 ("A Service's recent financial audit need not preclude a business audit that focuses on the Service's royalty policies and procedures.")).
7. Since the original PSS I CARP decision, licensees have "frequently and significantly" miscalculated or underpaid their royalties. *Id.* at 22. These miscalculations and underpayments were revealed by past royalty verification procedures implemented by SoundExchange's auditors, totaling millions of dollars of unpaid royalties by Music Choice and Muzak. *Id.*
8. These experiences highlight why the "defensive audit" approach does not work. *Id.* at 22. That is, defensive audits create "perverse incentives, which risk encouraging sloppy accounting or outright gamesmanship." *Id.* at 23.
9. The proposed amendment would reduce such incentives, enabling SoundExchange to initiate audits that will provide artists and copyright owners confidence that PSS providers are paying them what they are owed and minimize the waste of time and resources that follow from disputes that arise under the current provision. *Id.*

10. The structure and procedures around statutory royalty payments have changed since the PSS defensive audit provision was first adopted. *Id.* At that time, SoundExchange did not exist and all copyright owners, potentially tens of thousands of them, were treated as "interested parties" with an individual right to audit licensees. *Id.* In that context, the potential burden on licensees such as Music Choice was much greater than it is currently since, in the absence of a defensive audit, a service might have to "fend off" numerous audits from interested party copyright owners. This risk is now mitigated because the audit right has been limited to only the designated collective—SoundExchange. *Id.* Moreover, in a one-on-one context, when the parties to a license privately and directly agree that a licensor will have an audit right, the agreements do not allow the licensee to "negate that right" with its own "cramped-scope" audit. *Id.* at 24.
11. Music Choice has a history of non-compliance with requests from independent auditors that SoundExchange has engaged. *Id.* In the first such examination, SoundExchange's independent auditors identified an alleged net liability of more than [REDACTED]. In the second examination, Music Choice purportedly [refused to provide the auditors with access to information they requested, citing, among other reasons, its defensive audit.]. *Id.* n.15.
12. More particularly, previous audits by SoundExchange's auditors discovered that Music Choice had systemically underpaid statutory royalties for its business establishment service ("BES") by millions of dollars, a matter that is the subject of pending litigation. *Id.*
13. Music Choice "appears" to be using similar tactics that it purportedly used with respect to the BES license (*i.e.*, refusing to provide SoundExchange's auditors with access to requested information) to avoid cooperating with SoundExchange's auditor, Prager Metis, in a current, ongoing audit. *Id.*
14. Although the D.C. Circuit instructed the CRB Judges to consider whether this amendment to the audit provision would upset Music Choice's "reliance" on the previous audit provision by investing in "defensive audits," no such reliance interest exists. That is, "the change at issue here is largely prospective" and Music Choice obviously has not demonstrated an investment in its own "defensive auditing" that was threatened by this change. *Id.* at 24.

b. SoundExchange's Legal Arguments

1. Allowing a PSS to conduct narrow self-audits and avoid oversight by SoundExchange would frustrate the purpose of the audit provision as a whole. *Id.* at 21. Without the "scope" limitation in the proposed new language, Music Choice could commission and present defensive audits that "obscure its methods of calculation" and thus would be "insufficient to identify underpayments of royalties." *Id.* at 21.
2. The audit provision amendment makes clear that when Music Choice conducts a so-called "defensive audit" of its royalty payments, such an audit is an adequate substitute for a SoundExchange audit *of the same scope*. *Id.* at 19. There is ample justification for the amendment in the record. *Id.* at 20.

3. The proposed additional language harmonizes the PSS regulations with those applicable to other categories of licensees, *i.e.*, the regulations relating to audits of SDARS and webcasters. *Id.*

4. Under proposed 37 CFR 380.7(d), the audit must be conducted by a "Qualified Auditor," defined as "an independent Certified Public Accountant." Accordingly, Music Choice's argument that SoundExchange might use non-independent auditors (*i.e.*, employees or officers of a sound recording owner or performing artist) is a strawman. *Id.* at 24.

5. The change to the regulation is crafted "narrowly enough" to avoid upsetting any reliance issue, because (a) the change is largely prospective and, (b) even if the amendment is adopted, the regulation does not prevent Music Choice from continuing to conduct "defensive audits" and determine the scope of the audits itself, "which means that those investments would dictate the amount of protection the defensive audit procedure affords." *Id.* at 24-25.

2. Music Choice's Response to SoundExchange's Opening Brief

a. Music Choice's Response to SoundExchange's Factual Arguments

1. SoundExchange repeats the same arguments that the D.C. Circuit has already rejected. MC Responsive Br. at 24-25.

2. The only new evidence SoundExchange has submitted to support the change to the audit provision is the testimony of its outside accountant, Lewis Stark. Mr. Stark purports to identify alleged deficiencies in "defensive audits" conducted by BDO for Music Choice, but those purported deficiencies are not related to the "scope" of the audits and therefore do not support the proposed change to the audit provision. *Id.* at 25-26.

3. Mr. Stark's testimony is riddled with mischaracterizations and falsehoods relating to the BDO audits, which also demonstrates Mr. Stark's lack of objectivity and independence. *Id.* at 26.

4. BDO conducted its audit pursuant to rules relating to the "scope" of an audit set forth in GAAS, as required by the PSS regulations. *Id.* (citing Declaration of Russell Potts in Support of Music Choice's Responsive Brief on Remand ¶ 2 ("Potts Responsive Decl.")).

5. For whatever financial statement is being audited, the "scope" of an audit is "the entirety of the financial data contained in that statement, and the entire financial statement is covered by the auditor's opinion as to accuracy." *Id.*

6. GAAS provides that if management of the audited company attempts to limit the scope of an audit, the auditor must request that the company remove the limitation. If the company does not do so, the auditor must either issue a qualified opinion, disclaim any opinion, or withdraw from the engagement. *Id.* (citing Potts Responsive Decl. ¶ 5).

7. However, Music Choice's independent auditors have never issued a qualified opinion, disclaimed an opinion, or withdrawn from engagement. *Id.*
8. The "scope" of these audits was the entirety of Music Choice's PSS royalty payments pursuant to the PSS regulations for the audited year. *Id.*
9. Mr. Stark's complaints regarding audits of Music Choice are not related to the "scope" of an audit and therefore do not support SoundExchange's requested change to the regulations *Id.* at 26-27.
10. Mr. Stark is not an independent auditor as that term is understood by CPAs and regulated by the American Institute of Certified Public Accountants (AICPA) but is instead a "mouthpiece for SoundExchange's most extreme positions." *Id.* at 27.
11. Mr. Stark tacitly acknowledged that he does not conduct audits as CPAs and AICPA understand that term. *Id.* Rather, Mr. Stark avoids using the more stringent GAAS and instead uses the "Consulting Standard," which requires him to put the interests of his client before independence or objectivity. *Id.*
12. Mr. Stark also states that he uses the term "audit" to describe his work only in a "colloquial" sense of the word, *see* Stark Decl. ¶ 2, thereby tacitly acknowledging that he in fact does not conduct audits pursuant to GAAS, as the PSS regulations expressly and plainly require. *Id*. Thus, Mr. Stark admits that his forensic royalty "examinations" do not satisfy the requirements of the PSS regulations. *Id.* at 28.
13. In prior audits of Music Choice, Mr. Stark was given access to BDO's auditors, audit reports, and work papers, and he and his team met with BDO and received answers to questions they asked. Music Choice subsequently asked Mr. Stark if he needed additional information, and he indicated that he did not, although he noted that he might in the future and that he might "perform additional procedures at a later date." *Id.* These facts belie Mr. Stark's present claims that Music Choice did not cooperate with his investigation and that the BDO audits were deficient. *Id.*
14. Mr. Stark wrongly claims that Music Choice refused to cooperate in connection with prior audit work and investigation conducted by his firm, Prager Metis, regarding prior Music Choice payments related to its PSS service. *Id.* (citing Stark Decl. ¶¶ 7-9). In fact, Music Choice had requested assurances from Mr. Stark and SoundExchange that any procedure would comply with the requirement that it be conducted as an independent audit pursuant to GAAS, but neither SoundExchange nor Mr. Stark replied to that request. Rather, SoundExchange proposed to delay the audit. *Id*. n.4 (citing Potts Responsive Decl. ¶ 20).
15. Mr. Stark admits that Music Choice tendered the BDO defensive audit reports as the regulations require. However, he falsely claims that Music Choice otherwise failed to cooperate with his evaluation of the audits by

refusing to provide copies of "most" of the work papers to Prager Metis, and instead only allowed Mr. Stark to view a subset of those papers on the computer at Music Choice's offices. *Id.* at 29.

16. Mr. Stark's Prager Metis team indeed conducted a comprehensive on-site review of work papers at BDO's offices where the team reviewed any work papers it desired and was able to discuss them with BDO and Music Choice. *Id.*
17. BDO also answered follow-up questions from Prager Metis via email and provided pdf copies of BDO work papers that Prager Metis had requested, except for two "cash reconciliation" work papers that Prager Metis requested. *Id.*
18. Music Choice refused to produce its "cash reconciliation" documentation because Music Choice decided that they were not relevant to the PSS royalty calculation and were unrelated to testing that BDO relied upon for these audits. *Id.*
19. Neither Music Choice nor BDO refused to answer any Prager Metis questions related to the PSS royalty payments during this investigation. *Id.*
20. After receiving the results of Prager Metis's investigation, SoundExchange failed to identify flaws in those audits and dropped demands to conduct further testing. *Id.* Moreover, in a memorandum discussing the results of its review, Prager Metis concluded that["[b]ased on BDO's reputation and professional competence, we could rely on BDO's professional judgment and the procedures they performed."] *Id.* (citing Declaration of Margaret Wheeler-Frothingham., Ex. MC 25, p. 3 (October 7, 2021)).
21. SoundExchange [has used BDO for its own financial statement audits.] *Id.* at 29-30.
22. SoundExchange is correct that the work papers of Music Choice's auditors (BDO), by their nature, did not include all of the underlying data and materials that BDO used to verify the accuracy of payments. However, Prager Metis admitted "it is typical that audit files exclude the original source documents reviewed for testing purposes." *Id.* at 30.
23. Prager Metis's memo did not identify any errors or flaws in the BDO audits, but stated that it would prefer to conduct additional procedures that BDO had not performed. *Id.* Such procedures were either irrelevant and outside the "scope" of an audit of the PSS or duplicate testing of issues already done by BDO. *Id.*
24. Prager Metis sought to justify a duplicative audit of the same payments without demonstrating a deficiency, error, or failure to follow GAAS by BDO. *Id.* Rather, SoundExchange instructed Mr. Stark not to [accept BDO's audits but instead to use the review to find reasons for SoundExchange to insist on additional testing.] *Id.* This underscored

SoundExchange's and Mr. Stark's use of the AICPA's Consulting Standard which – unlike the applicable GAAS – obligated Mr. Stark to place SoundExchange's "strategic objective" over any duty of objectivity or independence. *Id.*

25. The alleged deficiencies that Mr. Stark purports to have uncovered are either misleading or false. *Id.* Mr. Stark "complains that the BDO audits 'only' provide opinions that Music Choice's statements of PSS royalty payments were 'presented "fairly in all material respects."'" *Id.* (citing Stark Decl. ¶ 9). Mr. Stark "seems to claim that this shows that BDO did not test whether the royalty payments were accurate." *Id.* at 30-31.

26. The language of BDO's opinion is standard, dictated by GAAS, and understood by CPAs as reflecting a determination of accuracy. *Id.* at 31. In addition, the work papers provided to Prager Metis show that BDO otherwise tested the accuracy of the PSS royalty payments and their compliance with the PSS regulations and the answers to follow-up questions by Prager Metis further explain the ways in which BDO tested the accuracy of the payments. *Id.*

27. Mr. Stark falsely claims that BDO only opined on whether Music Choice's royalty statements complied with Generally Accepted Accounting Principles ("GAAP"). This is false because Music BDO's audit reports and work papers make clear that the statements of royalty payments were tested for accuracy in compliance with the PSS regulations – which invoke *GAAS, not GAAP*. *Id.* at 31 n.5 (citing Potts Responsive Decl. ¶ 14).

28. Turning to a specific and technical auditing issue, SoundExchange is incorrect in claiming that the use by Music Choice's auditor, BDO, of a "sampling methodology" rendered unreliable its audit of the royalty payments. *Id.* In fact, sampling is a standard technique under GAAS and is used in essentially all audits to test both efficiently and accurately. *Id.* Moreover, Mr. Stark himself uses sampling for his royalty examinations. *Id.*

29. With regard to another technical auditing issue, Mr. Stark wrongly asserts that the BDO audit reports do not explain the "materiality" standard used. *Id.* (citing Stark Decl. ¶ 9). In fact, the materiality standard is well known by CPAs and is established by GAAS; it requires an independent auditor to use "professional judgment" as to whether a misstatement found would influence the judgment of a "reasonable user of the audited statements." *Id.* (citing Potts Responsive Decl. ¶ 16). Moreover, if an error identified by the auditor is so small as to not be material to a reasonable user of the royalty statements, the auditor can still give an opinion that the statement is accurate. *Id.* Further, Mr. Stark did not allege that Prager Metis asked BDO for information regarding how it implemented the materiality standard or that, if it did, BDO refused to answer such questions. *Id.*

30. SoundExchange falsely claims that the materiality standard prohibited BDO from presenting schedules that showed discrepancies they found. *Id.*

at 32 (citing Stark Decl. ¶ 2). But SoundExchange neglects to acknowledge that a BDO audit report that was disclosed to Mr. Stark included a small underpayment of interest, which Music Choice subsequently paid. *Id.* (citing Potts Responsive Decl. ¶ 17 & Ex. MC 23). This was the only error found for 2015, a year in which it paid millions of dollars in PSS royalties. *Id.*

31. Mr. Stark falsely finds fault with what he claims to have been BDO's failure to (a) identify which gross receipts were included or excluded from the royalty payment calculations, (b) assess whether Music Choice accurately interpreted the PSS regulations, and (c) allocate revenue between PSS and non-PSS services. *Id.* (citing Stark Decl. ¶ 9). BDO work papers provided to Prager Metis, which disclose that – in testing the accuracy of the statements of PSS royalty payments – BDO (a) verified the accuracy and completeness of gross revenues related to the PSS, (b) independently assessed payment compliance with the PSS regulations, and (c) disclosed the methodology for any allocations between different services. *Id.* (citing Potts Responsive Decl. ¶ 18 & Ex. MC 21). Moreover, Mr. Stark and his team had an opportunity to discuss these issues with BDO in a meeting and via email. *Id.*

32. Mr. Stark wrongly claims that BDO, its own auditor, had initially proposed to provide a different "scope" of work, similar to the type of examination that Mr. Stark employs, which Music Choice rejected. *Id.* at 32-33.

33. What Music Choice rejected was a proposal by BDO, its own auditor, that Music Choice did not believe to be in compliance with the "more stringent requirements of the PSS regulations." *Id.* at 33. Instead, Music Choice contends that it insisted on a more – not less – rigorous audit methodology than BDO had proposed. *Id.*.

34. Music Choice notes that Mr. Stark lists tasks that he would have performed had he been allowed to conduct an additional audit. *Id.* (citing Stark Decl. ¶ 10). Music Choice contends that these tasks either were already done by BDO or would not apply to an audit of the PSS royalties due to the PSS royalty formula. *Id.* (citing Potts Responsive Decl. ¶¶ 21-29). Music Choice contends that Mr. Stark had ample opportunity to review BDO's reports and work papers and ask BDO questions and did not identify a single error in BDO's audit nor does he explain why repeating the same process that BDO followed would yield a different result. *Id.*

35. Mr. Stark and SoundExchange have made "conclusory" and "off-the-mark allegations" regarding "massive underpayments" by Music Choice. These allegations are false and irrelevant, because they relate to the business establishment ("BES") license – not the PSS license. *Id.* Moreover, these allegations involve an interpretative dispute between Music Choice and SoundExchange regarding the BES license that "will appropriately be

resolved in federal civil litigation." *Id.* at 33-34. The interpretive issue would have been obvious from the work papers of a "defensive audit"—and the BDO audit work papers disclosed the allocations between PSS and non-PSS services. This BES audit issue does not justify changing the defensive audit provision. *Id.* at 34.

36. SoundExchange misleadingly claims that prior audits have uncovered millions of dollars of unpaid royalties by Music Choice and Muzak. *Id.* The "audit" by the firm RZO LLC (RZO) on behalf of SoundExchange was not an independent audit pursuant to GAAS. Rather, it was conducted by a SoundExchange board member. Moreover, the net Music Choice portion of this alleged liability, more than $[REDACTED] as cited in the audit, was "almost entirely made up of invalid claims" that were ultimately settled for $[REDACTED]. *Id.* (citing MC Opening Br. at 26-31).

37. As for the allegations regarding Muzak, those involved Muzak's attempt to pay royalties under the PSS rate for a non-PSS service that it acquired. *Id.* That dispute would have been uncovered even if Muzak had conducted defensive audits. *Id.*

b. Music Choice's Response to SoundExchange's Legal Arguments

1. SoundExchange bears the burden of submitting evidence of a significant need for its proposed change to the PSS audit provision in light of (a) the long-standing duration of the existing provision, (b) the CARP's policy rationale for creating the provision, (c) the CRB Judges' prior refusal to grant SoundExchange's request for the same change, and (d) Music Choice's long reliance on that provision. *Id.* at 24 (citing *Music Choice*, 970 F.3d at 428-30).

2. Thus, the CRB Judges can only effect the change in audit language by identifying specific and sufficient evidence-based justifications for the change. *Id.* at 25.

3. The CRB Judges must also identify a relevant change in circumstance other than one the Judges previously rejected as a basis to depart from the CARP's 2001 prior policy judgment, which balanced the then-existing interests of the PSSs and copyright owners. *Id.*

4. Any such justification must be sufficient to overcome Music Choice's "reliance" on the defensive audit protection for many years. *Id.*

5. SoundExchange wrongly asserts that the Judges need not consider Music Choice's "reliance interest" because the proposed change in the "defensive audit" provision is "largely prospective." *Id.* at 35. This argument ignores the D.C. Circuit's holding that the Judges erred in *not* considering Music Choice's reliance interest. *Id.* (citing *Music Choice*, 970 F.3d at 429).

6. Any regulatory change that takes away a long-established benefit is largely prospective. Thus, SoundExchange's reasoning would effectively negate any reliance interest. *Id.*

7. Further, the proposed regulatory change would read the fourth policy factor out of the applicable statutory rate standard. *Id.* Music Choice asserts that it has established that it has long relied on defensive audits and continues to do so. *Id.*

8. The purpose of the "defensive audit" provision is to allow a licensee that proactively commissions its own audits by an independent auditor pursuant to GAAS to avoid an intrusive and disruptive audit by SoundExchange. *Id.* at 28-29 (citing *Music Choice*, 970 F.3d at 428-29).

9. None of the policies cited by the CARP when creating the "defensive audit" provision have changed, *id.* at 35, except that since the time of the first CARP the regulations now only allow audits by SoundExchange and none by licensors. *Id.* (citing SX Opening Br. at 23-24). But this change does not thus justify overturning the CARP's decision because the CARP's discussion of "defensive audits" did not expressly mention the potential for a large number of interested parties to flood the PSS with audits. Moreover, the CARP had already limited audits of any PSS to one per year. *Id.* (citing CARP Report ¶ 210).

3. Music Choice's Opening Brief

a. Music Choice's Factual Arguments

1. Rather than abide by the regulatory conditions, SoundExchange has previously hired partisan forensic accountants who do not follow GAAS and instead operate under a different consulting standard that requires the opposite of independence. MC Opening Br. at 4. The resulting examinations are burdensome and vexatious, including false and misrepresented findings of underpayments in an attempt to wrongly maximize and inflate SoundExchange's claims. *Id.*

2. Since 2005, when SoundExchange hired a member of its own board of directors (without disclosure to Music Choice) as a so-called independent auditor who fabricated massive claims, Music Choice has relied on "defensive audits" and the result has been a "near-perfect record of timely PSS payments." *Id.* In only a handful of instances were slightly late payments found where the interest had not been fully paid, and Music Choice promptly remitted those payments "sooner than they would have been paid under a SoundExchange audit." *Id.*

3. The fact that Music Choice's auditors use a sampling methodology does not render the "scope" of its "defensive audits" incomplete. Sampling is widely used and consistent with GAAS. As a result, there is no justification to change the existing regulatory language. *Id.*

4. "Defensive audits" benefit royalty recipients by permitting licensees to identify inadvertent underpayments or late payments before they would be found by a SoundExchange audit. *Id.* at 25.

5. The need for "defensive audits" was "hypothetical" at the time the first PSS regulations were issued. *Id.* at 26.

6. However, the hypothetical "defensive audit" became necessary in 2005 when SoundExchange abused the audit process from its very first audit of Music Choice. *Id.* More particularly, in 2005, when SoundExchange commenced its audit of Music Choice's PSS royalty payment for 2001 through 2003, Music Choice "had not yet availed itself of the defensive audit right." *Id.* Yet, SoundExchange's conduct, and that of the accounting firm it hired, RZO, was "so outrageous, unduly disruptive, and burdensome" that Music Choice subsequently began paying for its own "defensive audits" and has continued to do so ever since. *Id.* (citing Potts Decl. ¶¶ 28-29).

7. More granularly, RZO (a) did not conduct an "independent audit" as that term is understood by CPAs and the AICPA, (b) failed to use independent auditors, and (c) failed to disclose "the extent of its accountant's lack of independence." *Id.* at 26-28. RZO also misinterpreted the term "gross revenues" and utilized "improper extrapolation methods." *Id.* at 30.

8. In 2017, SoundExchange also "sought to begin another 'audit' of both Music Choice's PSS and its BES …." Relying on the "defensive audit" provisions in the PSS regulations, Music Choice refused to allow SoundExchange to conduct its own audits for Music Choice's PSS for the periods at issue. *Id.* at 31.

9. Music Choice also complained about the conduct of the auditors (Prager Metis) that SoundExchange had hired to review Music Choice's BES royalty payments (which are outside the scope of the current proceeding). *Id.* at 32.

10. SoundExchange has not identified any way in which Music Choice's "defensive audits" are insufficient. Rather, "[t]he scope of every audit commissioned by Music Choice encompasses the entirety of Music Choice's payments for the PSS license in a given year, and the auditor's resulting opinion covers the entirety of those payments—irrespective of the sampling approach commonly used." *Id.* at 33-35.

b. Music Choice's Legal Arguments

1. The D.C. Circuit made clear that SoundExchange needed to present real evidence of a substantial need to make the change it seeks, but such evidence has not been provided. MC Opening Br. at 3-4.

2. The CARP implemented the challenged audit provision at Music Choice's request in the first CARP proceeding to provide a fair balance of the parties' legitimate interests. *Id.* at 23.

3. The CARP recognized the importance of requiring that royalty verifications be conducted by independent and qualified auditors pursuant to GAAS. *Id.* (citing Trial Ex. 979 (CARP Report) ¶¶ 191, 194, 210).

4. The defensive audit provision protects PSS licensees by ensuring that the audit process will not be unduly disruptive, costly, or harassing. *Id.* at 24. To that point, the D.C. Circuit reiterated in the present case what the CARP stated in 1997 when it created the audit procedures: that allowing the PSS to conduct their own audits rather than being subject to outside copyright owner audits would balance the fair opportunity to audit against the burden and expense of auditing upon the

Services. *Id.* (citing *Music Choice*, 970 F.3d at 428-29; CARP Report ¶ 194; and Librarian's *PSS I* Determination, 63 FR at 25394). By requiring defensive audits to proceed by the same standard—requiring independent, qualified auditors pursuant to GAAS—the challenged audit provision also protects the interests of the Collective and royalty recipients. *Id.*

5. The CRB Judges in the present case recognized the importance of these requirements by adopting language in the "Qualified Auditor" definition that links the independence requirement to the AICPA's Code of Conduct. *Id.* (citing Final Determination at 65261).

6. Any change to the audit language "[a]t the very least … would need to be clarified to expressly state that the use of sampling and other methodologies consistent with GAAS do not change the scope of the audit." *Id.* at 35 (emphasis added).

4. SoundExchange's Response to Music Choice's Opening Brief

a. SoundExchange's Response to Music Choice's Factual Arguments

1. Music Choice's audits are insufficient to ensure the accuracy of royalty payments. SX Responsive Br. at 22.

2. Music Choice's allegations of SoundExchange misconduct through the acts of its auditors in prior audits are irrelevant to any question at issue in this proceeding. *Id.* at 23.

3. Nevertheless, "almost everything Music Choice has to say" about prior audits is incorrect, claiming that:

   -- prior audits "did not require auditor independence, or even that an audit be conducted by a CPA." *Id.* at 23 (citing Librarian's *PSS I* Determination, 63 FR at 25414-15 (May 8, 1998)).

   -- "those standards were referred to only in the so-called defensive audit provision, not the provisions concerning audits by interested parties (or SoundExchange)." *Id.* at 24 (citing Librarian's *PSS I* Determination, 63 FR at 25415; 37 CFR 382.7(d)).

   --to the extent that any audit standards may have been required in 2001-2003 or 2005, they were obviously not the current ones cited by Music Choice. Further, auditing standards change frequently. *Id.* at 24.

4. Further, the regulations that applied when the alleged misconduct occurred were "quite different from the current regulations" in that, among other things, they did not require auditor independence, or even that an audit be conducted by a CPA. *Id.* at 23.

5. This dispute is not about sampling, as Music Choice suggests, but about whether an audit not designed to determine the accuracy of royalty payments should substitute for one that is designed for that purpose. *Id.* at 24.

b. SoundExchange's Response to Music Choice's Legal Arguments

1. Music Choice's argument misses the mark, which is that the challenged audit provision relates to the issue of the extent to which an audit conducted by a PSS can foreclose SoundExchange's right to verify a service's royalty payments with an independent audit. The proposed regulatory change narrowed that provision by clarifying that a service's own audit only has preclusive effect with respect to the information that is within the "scope" of the audit, as was already the case for SDARS and webcasters. *Id.* at 20.

2. Although the D.C. Circuit found that the Judges' *explanation* of the rationale for the change was lacking, the court's opinion did not call the *substantive decision* into question. *Id.* at 20-21 (citing *Music Choice*, 970 F.3d at 429-30).

3. The following are ample justifications for the Judges to reach the same conclusion they did originally:

    --to align the PSS audit provisions with those applicable to other service types;

    --to recognize the changed regulatory and industry landscape, where now a PSS is not exposed to multiple audits from multiple copyright owners, but rather a single audit from the collective, SoundExchange; and

    --to provide meaningful oversight to incentivize a PSS to pay what it owes and to protect against underpayment.

    Id. at 21.

4. Although Music Choice asserts that GAAS should govern an audit commissioned by SoundExchange, those standards were always applicable only to the PSS's "defensive audits"–-not the audits by SoundExchange or other interested parties. *Id.* at 24.

5. To the extent that SoundExchange may even have been bound by any audit standards previously (including in 2001-2003, and 2005 when prior SoundExchange audits were conducted) they were not the current ones cited by Music Choice. *Id.* at 24.

6. The only legal question at issue now is the preclusive effect of a PSS provider's "defensive audit" and whether the CRB Judges should continue with their prior decision to give them "preclusive effect only 'with respect to the information that is within the scope of the [defensive] audit." *Id.* at 24.

7. Music Choice does not engage with the question of whether an audit not designed to determine the accuracy of royalty payments should substitute for one that is designed for that purpose. Thus, Music Choice provides the CRB Judges with no basis to reject their previous decision. *Id.* at 24-25.

B. The Judges' Analysis and Rulings

1. Introduction

To re-focus on the overarching issue, the disputed proposed change in the regulatory audit language is set forth again below, in italics, following the undisputed language:

> § 382.7(d) The audit. *** The auditor shall determine the accuracy of royalty payments or distributions, including whether the Payor made an underpayment or overpayment of royalties. An audit of books and records, including underlying paperwork, performed in the ordinary course of business according to generally accepted auditing standards[43] by a Qualified Auditor, shall serve as an acceptable verification procedure for all parties *with respect to the information that is within the scope of the audit.*

Final Determination, 83 FR at 65268 (emphasis added).

As noted *supra*, the D.C. Circuit held that the disputed change which the CRB Judges had sought to adopt was "substantive in nature" because it "explicitly [gave] SoundExchange the green light to 'round out the findings with its own audit, limited to the points omitted from the scope of the defensive audit.'" *Music Choice*, 970 F.3d at 429 (quoting Final Determination, 83 FR at 65262).[44] Accordingly, the CRB Judges, on remand, have analyzed the record evidence and arguments of counsel, both at the hearing stage and in the remand proceedings, to determine the appropriate and precise substance of this change. More specifically, the Judges understand the issue on remand as *whether the disputed change in the regulatory language can and should be integrated with the long-standing regulatory audit language to which it is intended to be grafted.*

To examine the nature of this substantive change, the Judges first consider the "audit verification procedure" as it has existed in § 382.6(e), prior to the proposed change. The D.C. Circuit noted the "long understood" position of the Librarian of Congress, the Register, and the CRB Judges (and their predecessors) that pursuant to § 382.6(e) "the audit [served] as a *kind of safe harbor* for preexisting services like Music Choice." *Music Choice*, 970 F.3d at 428 (emphasis added). The CRB Judges not only are duty bound to abide by this holding, but they

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[43] GAAS are promulgated by the Auditing Standards Board ("ASB"), a committee of the AICPA. The ASB develops and issues standards in the form of SASs [Statements on Auditing Standards] through a process that includes deliberation in meetings open to the public, public exposure of proposed SASs, and a formal vote. The SASs are codified in AU-C sections. An AICPA member who performs an audit must comply with GAAS, pursuant to the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct. *See* AICPA AU-C §200.A57.

In addition to setting forth objectives and requirements which an auditor must follow, "an AU-C §contains related guidance in the form of applications and other explanatory material." AU-C 200.A63.43 GAAS requires an auditor to "have an understanding of the entire text of an AU-C section, *including its application and other explanatory material,* to understand its objectives and to apply its requirements properly." AU-C-200.21 (emphasis added). Some of the GAAS objectives, requirements, applications and explanatory materials that appear to be applicable to the present proceeding are discussed *infra*.

[44] The D.C. Circuit noted that SoundExchange had described its disputed supplemental regulatory language as merely a "clarification," a characterization which Judge Rao's appellate opinion rejected because the added language could have the effect of eliminating what the CRB and its predecessors have "long understood"--that the existing language served "as *a kind of safe harbor* for preexisting services." *Id.* (emphasis added).

are also in full agreement that the audit verification procedure had the effect of a "*kind of* safe harbor" for Music Choice and any other PSS.[45]

The Judges must therefore now examine precisely what *kind* of "safe harbor" was provided by § 382.6(e). This analysis was not undertaken at the hearing stage. Indeed, the D.C. Circuit stated that the Final Determination had provided only a "scant explanation" and evinced a "casual disregard" for the audit verification procedure set forth § 382.6(e). *Music Choice*, 970 F.3d at 429.

Having examined the parties' record evidence and arguments presented at the hearing and remand stages, the Judges find that the substantive change effected by the contested supplemental language in proposed § 382.7(d) can and should be adopted in the regulations. More particularly, the Judges determine, for the reasons set forth in their *Analysis, infra*, that pursuant to this supplemental language:

1. A report on a "defensive audit" from Music Choice that *in fact* satisfies the requisites of the present § 382.6(e) (substantively reiterated in proposed § 382.7(d)) continues to serve as a "kind of safe harbor" because it provides an acceptable verification of royalty payments; and
2. SoundExchange may challenge Music Choice's claim that its "defensive audit" *in fac*t satisfies these regulatory requisites, by supplementing that "defensive audit" with information not "within the scope of the audit" proffered by Music Choice, which – when considered together with the Music Choice audit – SoundExchange claims to provide for an audit report that does meet these regulatory requisites.

More particularly, Music Choice's "defensive audit report" would serve as an acceptable verification procedure *if* its "defensive audit report" delivered to SoundExchange was:

1. Inclusive of the "underlying paperwork,"
2. Performed "in the ordinary course of business,"
3. Performed according to "generally accepted auditing standards," and
4. Performed by "an independent and Qualified Auditor"

See 37 CFR § 382.7(d) (proposed by SoundExchange); *see also* 37 CFR § 382.6(e) (current).[46]

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[45] The CRB Judges analyze *infra* the import of the D.C. Circuit opinion's use of the qualifying phrase – "*kind of*" – in connection with the remand consideration of the disputed proposed audit language.

[46] Aside from the regulatory language in dispute, the substance of the audit requisites is identical in both the proposed and current regulations, notwithstanding some linguistic changes proposed by SoundExchange. In this regard, it is noteworthy that current § 382.6(e) expressly requires the use of an "independent" auditor, whereas the proposed new regulatory language does not. However, the new definitional language (unchallenged on appeal) in § 382.1 states, "*Qualified Auditor* means a Certified Public Accountant independent within the meaning of the American Institute Certified Public Accountants Code of Professional Conduct." *See also* GAAS, AC-U Section 200.15 ("The auditor must be independent of the entity when performing an engagement in accordance with GAAS unless (*a*) GAAS provides otherwise or (*b*) the auditor is required by law or regulation to accept the engagement and report on the financial statements. When the auditor is not independent and neither (*a*) nor (*b*) is applicable, the auditor is precluded from issuing a report under GAAS."). Thus, the "independence" requisite remains in the regulations, now incorporated by reference in the new language*, i.e.*, the "auditor independence" requirement

2. Analysis

a. The New Verification Language Improves the Audit Process

The regulatory change, as explained in this Remand Determination, marginally alters the prior regulatory approach. Previously, if SoundExchange did not agree with the findings in Music Choice's "defensive audit," SoundExchange lacked any process *under the regulations* by which to present Music Choice with a challenge to this "defensive audit." The CRB Judges find that the proposed new language is a measured and appropriate approach that invokes the wise maxim that – in such matters – it is most appropriate to "trust but verify."[47]

More specifically, the appended supplemental audit verification language has only a marginal effect because – even without it – SoundExchange, *without dispute*, has always possessed the juridical right to contest Music Choice's "defensive audit," in an action commenced in a court of competent jurisdiction, such as the U.S. District Court for the District of Columbia.[48] That is, neither Music Choice's nor its auditor's *ipse dixit* as to the satisfaction of the regulatory audit conditions would be dispositive. *See* Corrected Proposed Findings of Fact and Conclusions of Law of SoundExchange, Inc. and Copyright Owner and Artist Participants ¶ 2305 (noting that its new language "says nothing about – and does not preclude" a challenge to a disputed audit). In response, Music Choice did not disagree (eCRB nos. 4734, 4729). *See* Music Choice's Reply to SoundExchange's Proposed Conclusions of Law and Findings of Fact ¶ 2305. (eCRB no. 40, 45). Moreover, in *Web IV*, the Judges expressly refused to adopt a regulation that

continues to apply to audits commissioned by SoundExchange or Music Choice *because* GAAS applies to their audits.

The other linguistic changes were not raised on appeal, not discussed by the D.C. Circuit and not challenged on remand. Thus, although the D.C. Circuit "vacate[d] the revised audit provision as arbitrary and capricious without stating whether the vacating extended to the entirety of the new language, *Music Choice*, 970 F.3d at 430, the CRB Judges have no basis or authority to revisit the other linguistic change made by § 382.7(d) which, in any event, do not alter the substance of § 382.6(e).

[47] Former President Ronald Reagan made "trust but verify" a "signature phrase[]." Martin Klimke et al., *Trust but Verify: The Politics of Uncertainty and the Transformation of the Cold War Order, 1969-1991* at 4 (2016).

[48] Previously, parties have properly invoked the jurisdiction of the U.S. District Court for the District of Columbia in similar contexts. *See SoundExchange, Inc. v. Music Choice*, 2021 WL 5998382 at *1, 3, 7 (D.D.C. Dec. 20, 2021) (original jurisdiction "cognizable" in federal district court for a civil action commenced by SoundExchange against Music Choice to recover unpaid royalties allegedly discovered by SoundExchange's auditor engaged to verify royalty statements for "Business Establishment Services"); *SoundExchange , Inc. v. Sirius XM Radio Inc.*, 65 F. Supp. 3d 150, 153, 157 (D.D.C. 2014) (district court acknowledged its jurisdiction over a claim that a licensee had underpaid statutory royalties for satellite radio transmissions). (In both cited cases, the respective district court judges elected to stay the proceedings and refer issues to the CRB to clarify the application of relevant regulations under the doctrine of "primary jurisdiction." The referral to an agency presupposes the existence of original jurisdiction in the federal district court. *See generally Reiter v. Cooper*, 507 U.S. 258, 268 ("(1993) ("[P]rimary jurisdiction … is a doctrine specifically applicable to claims *properly cognizable in court* ….") (emphasis added)). Here though, it should be noted that in this Remand Determination the Judges have now explained the meaning of their regulatory language, which continues to refer to GAAS as the auditing standard for a court to apply. The CRB Judges adoption of GAAS standards is consistent with their standard across the regulatory spectrum within their jurisdiction, and, more broadly, consistent with the efficient and common adoption of *private* commercial and professional standards, as opposed to an administrative "reinventing of the wheel." *See generally* Harold I. Abramson, *A Fifth Branch of Government: The Private Regulators and Their Constitutionality*, 16 Hastings Const. L.Q. 165 (1989).

would have precluded any party from contesting the results of an audit. Instead, the Judges unambiguously ruled as follows:

> [A]ny attempt to seek a remedy based upon an auditor's findings, and any attempt to challenge those findings, must be made in a court of competent jurisdiction, or through any private alternative dispute resolution procedure to which the affected parties may have agreed.

Web IV Determination at 26401 & n.228.

The supplemental audit verification language does nothing to compromise the right of Music Choice or SoundExchange to contest audit results, but rather maintains their ability to do so in a court of competent jurisdiction. Rather, by this measured regulatory change, SoundExchange may (in the words of the Final Determination at 83 FR 65262) "round out the findings with its own audit," to attempt to demonstrate that Music Choice's "defensive audit" in fact failed to satisfy the regulatory criteria (*e.g.*, not merely because SoundExchange found the GAAS standard insufficient or otherwise desired to engage in non-GAAS procedures) Final Determination, 83 FR at 65262.

The Judges thus determine that the supplementary language at issue on remand in § 382.7(d) *can and should* appropriately coexist with the long-standing regulatory language to which it has been grafted. That is, the new language does not undermine the "kind of safe harbor" that the regulations previously afforded.

More particularly, notwithstanding assertions by Music Choice and its auditor that the latter's "defensive audit" was GAAS-compliant and *facially* satisfied the regulatory audit requirements (as noted *supra*), SoundExchange without dispute had the right to make a judicial challenge to this self-declaration. *Thus, the regulation never was a fully protective or dispositive safe harbor. Cf.* Susan C. Morse*, Safe Harbors, Sure Shipwrecks*, 49 U. Cal. D. L. Rev. 1385, 1387, 1391 (2016) ("A safe harbor *guarantees* compliance for described behavior.") (emphasis added). More particularly, a *bona fide* "safe harbor" constitutes an *ex ante* rule, in contrast to a "standard," which must be applied *ex post* to the facts in dispute. *See id.* at 1390-92.

Here, under the existing rule, the "defensive audit" by Music Choice's auditor enjoyed some *ex ante* safe harbor protection by claiming to meet the regulatory requisites, but remained subject to *ex post* judicial review to determine whether the self-declared regulatory compliance in fact complies with the GAAS. Accordingly, the regulatory requisites serve in this context not as a conclusive "rule," but rather as "standard" which the reviewing court must find was met – in order to establish not merely a "*kind of*" safe harbor, but rather a *full-fledged* safe harbor. *See* Andrew Stumpff Morrison*, Case Law, Systematic Law, and a Very Modest Suggestion,* 35 Stat. L. Rev. 159-180, 179 n.37 (2013) ("safe harbors [can] combine a standard with a rule.").

Alternately stated, a *bona fide* safe harbor enunciates a clear "*per se*" *rule*, whereas a regulation that applies a complex *standard* derived from an industry institution is not a "*per se*" safe harbor rule, but rather a *de facto* "rule of reason." This point is particularly relevant to the application of GAAS, because – as shown in detail *infra*, GAAS is a compendium of provisions almost talmudic in detail. *See generally* Amy L. Doolan, *Ethical Issues in Accounting: A Teaching Guide*, 6 Am. J. Bus. Ed. 133 (2013) (Although "GAAS … [is] regarded as authoritative literature … despite this authoritative status, the guidelines provide no specific requirements for auditors' decisions like determining sample size, selecting sample items from a

population, or evaluating the results of evidence gathered. … [S]tandards like the GAAS are not step-by-step procedures for conducting an audit, nor are they intended to be; [they] are the guidelines from which procedures are derived, … requir[ing]a high-level of subjective, professional judgment on the part of the auditor."); Robert Fonfeder et al., *Internal Controls in The Talmud: The Jerusalem Temple*, 30 Acctg. Hist. J. 73 (2003) (comparing auditing standards to Talmudic law); *see also* David J. O'Regan, *The Auditor's Companion* at 135 (2024) ("GAAS does not provide "[c]ookbook rules … to cover every possible combination of circumstances" and thus GAAS requires auditors "to exercise professional judgment [within] a framework [that] provide[s] guidance for exercising judgment in all significant aspects of audit practice.").

To make this point in a most practical manner, it is instructive to compare how the parties would resolve an audit dispute with and without the supplementary language:

Without the supplementary language, the following three steps occur:

1. Music Choice commissions an audit report that purports to be from a Qualified Auditor.
2. The audit report purports to include the underlying paperwork.
3. The audit report declares that the audit was performed according to GAAS in the ordinary course of business.

At such a stage, the Music Choice-commissioned "defensive audit" would have *facially* satisfied the regulatory requirements qualifying this audit "as an acceptable verification procedure for all interested parties," *i.e.*, including SoundExchange. However, as noted *supra*, the *ipse dixit* representations by Music Choice and its auditor that these conditions have been satisfied do not end the inquiry. That is, if SoundExchange believes that any or all of these conditions had not been satisfied, it could challenge the "defensive audit" as failing to satisfy the regulatory requirements. As there is no jurisdiction for this challenge to be made before the CRB, the challenge would need to be made (as noted *supra*) in a court of competent jurisdiction, such as the U.S. District Court for the District of Columbia.

Such a challenge would include a case-in-chief by SoundExchange proffering facts which dispute the assertions by Music Choice that its "defensive audit" has met the statutory requisites. If SoundExchange (after having engaged in the necessary discovery) succeeded in proving its case, which would have entailed introducing an adverse audit report that it had commissioned, the District Court could find that it was this SoundExchange-commissioned "expanded scope" audit – not the Music Choice-commissioned audit – that satisfied the regulatory requisites and was thus the "acceptable procedure" for identifying any underpayments royalties that needed to be adjusted.[49]

By contrast, *with the supplementary language*, in addition to the three numbered items above, a fourth item would be added:

4. If SoundExchange chooses to challenge Music Choice's "defensive audit" as non-GAAS compliant (or non-compliant with any of the other required regulatory elements) it can do so, *at the regulatory level*, by engaging an auditor to perform

[49] This process (*i.e.*, absent the new supplemental language) incentivizes the parties to engage in expensive litigation in order to resolve audit disputes, an economic transaction cost, which can be avoided or minimized by the new audit verification language, as discussed *infra*.

> an audit that has a different "scope"[50] than the Music Choice "defensive audit" and provide it to Music Choice.[51]

As in the first scenario described above, at such a stage, the Music Choice-commissioned "defensive audit" would have *facially* satisfied the regulatory requirements, qualifying this audit "as an acceptable verification procedure." However, as also noted *supra*, the *ipse dixit* representations by Music Choice and its auditor that these conditions have been satisfied would not end the inquiry. If SoundExchange believes that any or all of these conditions were not satisfied, it could challenge the "defensive audit" as failing to satisfy the regulatory requirements.

This fourth point becomes possible*, because of the supplementary regulatory language set forth in § 382.7(d)*. Rather than needing to commence a proceeding at once in a court of competent jurisdiction, SoundExchange could elect to – in the words of the Final Determination – "round out the findings with its own audit, limited to the points omitted from the scope of the defensive audit," Final Determination at 65262, and these auditing "points" – when considered in the context of Music Choice's "defensive audit" – would present a potential alternative verification procedure "with respect to the information that is within the scope of the audit." Final Determination, App. A (§ 382.7(d)).[52]

To be clear, nothing in this supplemental "rounding-out" process would permit SoundExchange to undertake audit work that fails to meet the express conditions for a verifying audit, *which have remained unchanged from the long-standing regulation, § 382.6(e), to the proposed new regulation § 382.7(d)*. Alternatively stated, regardless of the party that commissions the audit report, the report must satisfy the same requisites.[53]

Reciprocally, Music Choice's "defensive audit" would serve as the "acceptable verification procedure" if, upon a legal challenge by SoundExchange, the finder of fact determines that the Music Choice "defensive audit" has satisfied all the regulatory conditions. That is, it would be irrational that an audit which has satisfied all the regulatory requisites for an "*acceptable*" verification procedure could nonetheless be found "*unacceptable.*"

This approach should not be understood as handing SoundExchange merely a *pyrrhic* victory. Rather, if SoundExchange can convince Music Choice that its audit meets the regulatory requisites and Music Choice's "defensive audit" does not, the parties can settle their

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[50] The concept of "scope" in a GAAS audit is discussed *infra*.

[51] Music Choice and its auditors of course would need to cooperate with the reasonable requests for information made by SoundExchange's auditors acting pursuant to this regulatory provision, just as they would be required if SoundExchange noticed its intent to audit in the first instance. *See* 37 CFR 382.7(f) ("The auditor must review tentative written findings of the audit with the appropriate agent or employee of the [PSS] in order to remedy any factual errors and clarify any issues relating to the audit ….")

[52] The Final Determination also states that the supplemental language is intended "to meet the specific needs of SoundExchange" if SoundExchange asserts that "the scope of the defensive audit is too narrow" to meet those needs. *See* Final Determination, 83 FR at 65262. *The Judges strongly disagree with this rationale*. The supplemental language is intended to make certain that the purpose of the audit process – to verify royalty payments – is discharged by a process that meets the *regulatory* requirements, which invoke GAAS, not SoundExchange's subjective "needs" (nor, for that matter, those of Music Choice).

[53] SoundExchange does not agree that it is, or should be, subject to GAAS. The Judges discuss and reject that notion *infra*.

differences efficiently, without incurring the transaction costs of litigation (as discussed *infra*). And, if the parties do not settle, SoundExchange can still attempt to prove in a court of competent jurisdiction that the Music Choice-commissioned audit in fact did not satisfy all the regulatory conditions,[54] by relying on its "rounded out" auditing of the Music Choice audit. Nor should this approach be misunderstood as creating a legal jeopardy that Music Choice did not face previously, given that it is undisputed that SoundExchange always could have challenged Music Choice's "defensive audit" in court.[55]

b. SoundExchange's Alternate Interpretation of the Modified Audit Verification Section is Meritless

As noted *supra*, SoundExchange's position regarding the interpretation of the language modifying the audit procedure explicitly rejects the idea that its enlarged-scope audit, like Music Choice's "defensive audit," must also be GAAS-compliant. Specifically, SoundExchange maintains:

1. The audit commissioned by SoundExchange is not subject to the same "generally accepted" standards regulatory procedures that bind the "defensive audit" commissioned by Music Choice. Stark Decl. ¶¶ 2, 14.
2. The processes which SoundExchange advocates for itself admittedly do not comprise *actual* audits; its expert witness, Mr. Stark, elects to describe them only "*colloquially* … as "audits" or "royalty audits." Stark Decl. ¶ 2 (emphasis added).
3. SoundExchange's alternative approach is both distinguishable in purpose and different in "scope" from a GAAS-compliant audit. Stark Decl. ¶ 2.
4. "The royalty verification procedures that Prager Metis conducts on behalf of SoundExchange … have a different purpose and scope than the type of audit BDO performed for Music Choice," in that a "royalty verification procedure … quantif[ies] the difference between what a licensee actually paid and what it should have paid—and explain[s] the reasons for this difference as opposed to just expressing an opinion about whether royalty statements were presented fairly." Stark Decl. ¶¶ 2-3.

The Judges reject SoundExchange's arguments in this regard for several reasons.

First, the plain and unambiguous language of § 382.7(d), like its predecessor, § 382.6(e), contains *only one set of audit standards for any audit commissioned by either the collective (SoundExchange) or a PSS (here, Music Choice)*. SoundExchange's suggestion that its audits under this regulatory structure – whether as initial audits or, under SoundExchange's proposed new "scope of the audit" language, as "rounded-out" versions of Music Choice's "defensive audits" – are not subject to GAAS (or, for that matter, to *any standard*) is unsupported by the text

[54] The condition that would be most likely be at issue is whether the audit was performed pursuant to "GAAS," because, as discussed *infra*, this condition implicates multiple sub-issues and requires the exercise of professional judgment by the auditor. (In this regard, because audits of music copyright licensees are regular regulatory occurrences, any such audit is clearly undertaken in the "ordinary course of business.")

[55] Further, by completing an "expanded scope" audit in the regulatory process, SoundExchange and Music Choice would be able to economize by avoiding the "transaction costs" of litigation, as discussed *infra*.

of the regulation. The Judges categorically reject SoundExchange's remarkable assertion that its relatively terse supplemental phrase ("with respect to the information that is within the scope of the audit") – tacked on to the end of the regulation – could be contorted into freeing SoundExchange from the requirements plainly stated not only in the prior regulation (§ 382.6(e)) but also in SoundExchange's own proposed regulation (§ 382.7(d)).[56]

Second, as explained in depth *infra*, GAAS provides an expansive landscape of alternatives for a GAAS-compliant audit that apply to different scenarios – including royalty audits. There is no reason to assume – and certainly no persuasive record facts or testimony – to suggest that SoundExchange must be permitted to ignore GAAS requirements and engage in a non-GAAS "royalty verification procedure" in order to conduct sufficient auditing of Music Choice's royalty payments. In this regard, the Judges reject SoundExchange's argument that it needs to engage in investigations that are not within GAAS because Music Choice *might* rely on a purportedly GAAS-compliant financial statement typically provided to the investment community. This argument is a strawman – not only because there is no persuasive evidence that Music Choice in fact has done so,[57] but also because (as discussed *infra*) GAAS addresses various types of audits, not just "general purpose financial audits."

Third, SoundExchange claimed its proposed PSS audit language harmonizes with the identical "scope of the audit" language contained in the regulations governing other forms of distribution of sound recordings. But there is nothing in the record to indicate that those other regulations were promulgated only as a response to "defensive audits," as opposed to setting forth the general rule, across the various forms of distribution, that *any and all audits* must be GAAS-compliant and satisfy the other express regulatory standards. Thus, SoundExchange's attempt to avoid the GAAS requirements for its own audit work is inconsistent with its own "harmonization" rationale.[58]

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[56] As the Final Determination reasonably noted, the purpose of the new supplemental language was to allow SoundExchange to "round-out" the scope of a PSS's GAAS-compliant audit — the Final Determination does not so much as suggest that this new language liberates SoundExchange to commission its own non-GAAS compliant audit.

[57] SoundExchange's argument in this regard is admittedly merely speculative. *See* Proposed Findings of Fact and Conclusions of Law of SoundExchange, Inc. and Copyright Owner and Artist Participants ¶ 2303 ("SXPFF") ("[I]t *appears* that Music Choice may contemplate cutting off SoundExchange's audit right with an annual financial statement audit. … a different process from what is reasonably required to confirm a licensee's royalty payments.") (emphasis added). *See also* Music Choice's Reply to SoundExchange's Proposed Conclusions of Law and Findings of Fact ¶ 2303 ("MCRPFF") ("SoundExchange cites no record evidence for its fanciful speculation that Music Choice 'may contemplate cutting off SoundExchange's audit right with an annual financial statement.' … Music Choice has already provided copies of its defensive audits of its PSS payments in connection with a pending notice of intent to audit served by SoundExchange, so it knows very well that Music Choice is not seeking to rely on its consolidated business audits."); Declaration of Russell Potts ¶ 12 & Ex. MC 8 ("Potts Opening Decl.") (acknowledging the difference between a broader GAAS audit report for the "investment community" and a "Special Purpose GAAS audit report regarding royalty payments, and attaching a prior BDO audit report for Music Choice claiming to constitute such a "Special Purpose" audit report).

[58] The D.C. Circuit held that SoundExchange's argument, accepted in the Final Determination, that harmonizing the PSS audit language with the audit language for other services, was an insufficient basis to adopt the amended regulatory language. SoundExchange's "harmonization" argument here is somewhat different, relating to the standards (or alleged lack thereof) applicable to its own auditing work. But as explained in the accompanying text, that argument lacks merit.

Fourth, SoundExchange appears to argue that the express "independent" auditor requirement contained in § 382.6(e) is unnecessary, because the independence of the "Qualified Auditor" *is what GAAS requires*! But if, as SoundExchange posits, SoundExchange's audits are not subject to GAAS, its auditor need not be independent of SoundExchange. The Judges thus further reject SoundExchange's position, which seems to reduce to a self-serving argument demanding "*independent auditor for thee, but not for me.*"

Fifth, SoundExchange may implicitly be suggesting that its new "scope of the audit" language itself creates a distinction between the "scope" of a GAAS-compliant audit and investigative auditing work which SoundExchange might elect to undertake with regard to the information generated by a Music Choice-commissioned "defensive audit."[59] But, as the Judges examine in detail *infra*, GAAS itself addresses the concept of "scope" as a dynamic principle as it relates to the audit work required in a GAAS-compliant audit – varying depending upon the nature of the audit task.

Sixth, as the Final Determination correctly noted, the purpose of the new supplemental language was to allow SoundExchange to "round-out" the scope of a PSS's GAAS-compliant audit. Final Determination, 83 FR at 65262. Nothing in the Final Determination so much as suggested that the phrase comprising the supplemental language would give broad license to SoundExchange to generate or engage in its own non-GAAS auditing work. Moreover, that issue was never the subject of appeal and thus was not addressed, let alone vacated, on appeal.

Seventh, and finally, a review of SoundExchange's Proposed Findings of Fact and Conclusions of Law submitted at the hearing reveals that it did not seek to avoid the GAAS requirements at the hearing. Further, in its Opening Brief on remand, SoundExchange did not assert that it had the right to engage in auditing conduct that was not part and parcel of a GAAS-compliant audit. In fact, only in its Responsive Brief did SoundExchange assert that its auditing-related works under the PSS regulations could and should be untethered to GAAS. As a procedural matter, it is improper for a party to attempt to assert a new argument in its responsive briefing. *See Johnson v. Copyright Royalty Bd.*, 969 F.3d 363, 377–78 (D.C. Cir. 2020) (it is inappropriate to "consider an argument that was not raised before the agency at the time appropriate under its practice. … It is doubtful that a reply brief is the appropriate time or place …."). This is a salutary rule, because such a *procedural* strategy sandbags the adverse party, who then has no procedural right to respond to the new argument. And here, in any event, SoundExchange's *substantive* argument lacks support for all the reasons set forth in this section of the Remand Determination.[60]

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[59] For example, in the past SoundExchange's auditors have conducted a self-described "royalty examination," rather than an "audit," applying the AICPA's "Consulting Standards," not GAAS. *See* Potts Opening Decl. ¶¶ 17 & 44. SoundExchange did not submit a declaration rebutting this point.

[60] The Judges are also struck by the *chutzpah* of SoundExchange's argument that it was Music Choice that was procedurally derelict, by not challenging SoundExchange's right to ignore the GAAS regulatory requirement. *See* SX Responsive Br. at 23 n.15. But as noted in the text *supra*, SoundExchange had not made that express argument until it filed its final (responsive) brief, as to which Music Choice lacked a procedural right file a surreply.

Relatedly, the Judges also note that SoundExchange argues that "[t]o the extent that any audit standards may have been required" of its audits in earlier periods, those standards may not be applicable, because "auditing standards change frequently." *Id.* at 24. However, the two citations on which SoundExchange relies for this point actually apply to changes *within* GAAS, rather than *from* GAAS to another standard. *See id*. n.17 (citing Gerald W. Hepp &

c. The New Regulatory Language Economizes on Transaction Costs

Litigating auditing disputes is expensive.[61] The new supplementary audit language will be beneficial to both parties, by reducing transaction costs associated with litigation.[62] Under the new regulatory language, as adopted and explained herein, the parties will each be able to examine the allegedly GAAS-compliant audit generated on behalf of the other. That information will allow the parties to evaluate the relative merits of its audit and that of its adversary, and thus to better weigh the likelihood of success or failure if litigation were to ensue. This would allow the parties to better negotiate and attempt to settle their dispute, without the need for expensive litigation, including discovery and trial.[63]

Further, the regulatory audit framework requires that "[t]he auditor must review tentative written findings of the audit with the appropriate agent or employee of the [PSS] in order to remedy any factual errors and clarify any issues relating to the audit…." 37 CFR 382.7(f). Thus, the new supplemental language permitting auditing work by SoundExchange's auditor to create an enlarged GAAS-compliant scope automatically triggers consultation comparing and contrasting the audits and their dueling scopes prior to any potential litigation – thereby allowing an exchange of information to reduce uncertainty and the expensive transaction cost of audit litigation.

Alan Reinstein, *Major Revisions to the Auditor's Report*, CPA Journal (Apr. 2021); American Institute of CPAs, *Recently Issued Auditing and Attestation Standards: Information and Resources*, https://www.aicpa.org/interestareas/frc/auditattest/auditing-standards-information-andresources.html (last visited August 5, 2024). As for changing standards *within* GAAS, the court adjudicating an audit dispute would need to identify the GAAS standards applicable for the audited year at issue.

[61] Eldar Maksymov et al., *Toward a More Complete Theory of Audit Dispute Resolution: Insights from Prominent Attorneys* 26 (Sep. 21, 2017)(working paper)(on file with Arizona State University). https://gattonweb.uky.edu/Faculty/Payne/ACC603/Maksymov%20et%20al.%20...Insights%20from%20Prominent%20Attorneys.pdf ("[P]ursuing/defending claims against auditors is extremely expensive (and time consuming) [because] audit litigation cases are very complex and document intensive, … the discovery process [is] particularly long[, and] one or both sides … typically hire experts to help assess the merits of a case, develop the case, and potentially testify."); *see generally* Robert J. Rhee, *A Price Theory of Legal Bargaining: An Inquiry into the Selection of Settlement and Litigation under Uncertainty,* 56 Emory L.J. 619, 622 (2006) ("Viewed in the unflattering light of the standard economic theory, the enormous legal and judicial infrastructure supporting the institution of civil litigation is a monument to economic waste.").

[62] *See Maksymov*, *supra* (Procedural rules governing audit disputes are beneficial when they allow "both parties' understanding [to] become more similar as time passes and information is shared and the chance of settlement increases …."); *see also Nat'l Broadcasting Co. v. Copyright Royalty Tribunal*, 848 F.2d 1289, 1296 (D.C. Cir. 1988) (noting that an appropriate administrative ruling allows parties "to order their affairs to minimize … litigation cost.").

[63] Because this Remand Determination allows for a voluntary and more balanced exchange of audit information, the impact of mandatory initial disclosures in federal district court is analogous and instructive. After this information-sharing rule was adopted in 1993, "initial disclosure decreased litigation expense" and the new rule "increased … the prospects of settlement." Thomas E. Willging et al., *An Empirical Study of Discovery and Disclosure Practice under the 1993 Federal Rule Amendments*, 39 B.C. L. Rev. 525, 535 (1998).

d. The Substantive Richness of GAAS Underscores the Benefit of the New Regulatory Language[64]

It is instructive to appreciate how the nature and richness of GAAS complements the change in the audit verification regulation.[65] A fact-finder cannot necessarily determine easily – let alone *a priori* – which of the competing auditors' approaches has satisfied GAAS in a particular case. These standards are too detailed and nuanced to generate an obvious judgment in a complicated case. In this regard, the D.C. Circuit has noted

> the dangers associated with treating … GAAS as if [it] constituted a clear and simple code. The complexity of … generally accepted auditing standards is belied, and perhaps obscured, by the[] familiar acronym[]. … Judgments must be made about specific transactions. [R]easonable … auditors can disagree about those interpretations and judgments.

Checkosky v. S.E.C., 23 F.3d 452, 479 (D.C. Cir. 1994). *See also* James F. Strother, *The Establishment of Generally Accepted Accounting Principles and Generally Accepted Auditing Standards*, 28 Vand. L. Rev. 201 (1975); Doolan, *supra*, at 133 (In an audit, "decisions about sampling and evidence gathering and materiality in evidence evaluation are … estimates that require a high-level of subjective, professional judgment on the part of the auditor.").[66]

The D.C. Circuit has further echoed and amplified this point, stating that an auditor's judgment

> must be "'guided by sound' auditing principles, among which are a 'thorough ... search for evidential matter,' … and an 'attitude that includes a questioning mind and a critical assessment of audit evidence."' [GAAS] "states that the 'amount and kinds of evidential matter required to support an informed opinion are matters for the auditor to determine *in the exercise of his or her professional judgment* after a careful study of the circumstances in the particular case.'"

McCurdy v. S.E.C., 396 F.3d 1258, 1263 (D.C. Cir. 2005) (emphasis added). To exercise this judgment, the D.C. Circuit has taken note that GAAS declares that it is an "auditor's obligation to plan, supervise, and gather evidence in conducting an audit." *Id.*; *Dearlove v. S.E.C.*, 573 F.3d 801, 804 (D.C. Cir. 2009).

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[64] The Judges' discussion herein of the requisites of GAAS is intended to show generally that the richness of GAAS underscores why the supplemental regulatory language is a salutary change that allows for the presentation of competing approaches to the application of GAAS in connection with the auditing of a PSS by SoundExchange. *However, this discussion is not intended to find or determine which elements of GAAS do or should apply to the parties' dispute.* Under the regulatory structure adopted herein, the parties are able to pursue their understanding of the appropriate application of GAAS, exchange their commissioned audits, and either settle their dispute or seek relief in a court of competent jurisdiction, which will decide how GAAS shall be applied in the particular case.

[65] For an explanation of how GAAS are derived, *see* note 43 *supra*.

[66] The gathering of evidence, and the concepts of "materiality" and "sampling," are discussed *infra* in the context of GAAS.

e. Several GAAS Provisions Appear to Address Issues Raised by the Parties' Positions Raised on Remand, Underscoring the Appropriateness of the Supplemental Language

The foregoing statements by the D.C. Circuit regarding audits and auditors underscore the benefit of the new regulatory language, which recognizes GAAS not as a "simple code," but rather as a compendium of concepts, whose application may differ among auditors. To better appreciate the broad statements by the above D.C. Circuit decisions regarding GAAS, and their potential application to the amended audit verification language as issued in the present proceeding, set forth below are GAAS provisions potentially relevant to competing audits under the amended regulatory language.[67]

(1) AU-C §200: Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards

At a high level, it bears emphasis that although "GAAS are written in the context of an audit of financial statements … [t]hey are to be adapted *as necessary in the circumstances when applied to other engagements conducted in accordance with GAAS, such as … compliance audits ....*" AU-C 200.02. This adaptation will guide the "form of opinion expressed by the **auditor", which "depend[s] upon the applicable financial reporting framework and any** *applicable law or regulation*." AU-C 200.09.

To discharge these high-level duties, GAAS provides that the auditor should:

> "plan and perform an audit with *professional skepticism*, recognizing that c*ircumstances may exist that cause the financial statements to be materially misstated*";
>
> "exercise professional *judgment* in planning and performing an audit of financial statements";
>
> identify "the applicable financial reporting framework and any applicable law or regulation" applicable to the audit opinion at issue;
>
> "obtain reasonable assurance [by] obtain[ing] *sufficient appropriate audit evidence* to reduce audit risk to an acceptably low level *and thereby enable the auditor to draw reasonable conclusions* on which to base the auditor''s opinion"; and
>
> comply with all AU-C sections relevant to the audit [*i.e.*] w*hen … the circumstances addressed by the AU-C section exist.*

Au-c §200 (subsections .02; .08, .09; .17-.20) (emphasis added).

In connection with AU-C §200, the following explanatory sections also appear to be germane to the present regulatory change:

[67] *See* note 64 *supra*.

> Pursuant to AU-C §200.A58, an auditor fulfills the overall GAAS objectives by giving appropriate consideration *to specific topics* raised by the auditing assignment (emphasis added).
>
> Pursuant to AU-C §200.A64, the auditor should be guided by the more precise and relevant material contained in the "application and other explanatory material" when he or she "exercise[s]… professional judgment in the circumstances consistent with the objective of the AU-C section."
>
> Pursuant to AU-C §200.A75, "because *the circumstances of audit engagements vary widely* and all such circumstances cannot be anticipated in GAAS, *the auditor is responsible for determining the audit procedures necessary to fulfill the requirements of GAAS and to achieve the objectives ….*" (emphasis added).
>
> Also pursuant to AU-C §200.A75, "in the circumstances of an engagement, there may be particular matters that require the auditor *to perform audit procedures in addition to those required by GAAS to meet the objectives specified in GAAS.*"

The CRB Judges particularly focus below on AU-C-200.09, which states that, under GAAS, the auditor must identify the "framework" applicable to the assignment.

(2) General Purpose GAAS Audits vs. Special Purpose/Special Consideration GASS Audits

Among those frameworks are two whose applicability appears to be relevant to a point raised by SoundExchange. On the one hand, a GAAS audit may be undertaken in the more typical "general purpose framework," which is "designed to meet the common financial information needs of a wide range of users." AU-C §200 Definition of Terms (Practitioner Guide to GAAS App. A). On the other hand, another GAAS-compliant audit could be based on financial reporting on some "other basis," such as to audit a single item or category of items in a financial statement. Indeed, in certain audit contexts, the auditor's "single most important task" may be to investigate *a single item*. *McCurdy*, 396 F.3d at 1264.

Among such other items subject to audit is a "schedule of royalties," which can generate what appears to be characterized by GAAS as a "Special Considerations" audit. *See* AU-C §805.[68] Although undertaken in a different manner than a general purpose audit – when performed appropriately it will (as with a general purpose audit) include in the auditors' "Basis for Opinion" the statement that the auditors "conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS)." *Compare* AU-C §§805 ("Illustration 4. An Auditor's Report on a Specific Element, Account, or Item of a Financial Statement Prepared in Accordance with a Special Purpose Framework") *with id.* ("Illustration 1. An Auditor's Report on a Single Financial Statement Prepared in Accordance with a General Purpose Framework").

These provisions indicate that SoundExchange does not require an audit that abandons the GAAS processes. But, so too do these provisions appear to undermine any intimation that a Music Choice auditor's simple claim to have conducted a GAAS-compliant audit would be sufficient to prove that the audit had applied correct GAAS standards *applicable in the* Special

[68] *Cf.* Potts Opening Decl. ¶ 12 & Ex. MC 8 (describing the BDO "defensive audit" done on behalf of Music Choice as a "Special Purpose" audit under AU-C §§800).

Purpose, Special Considerations, and/or regulatory context, should a court of competent jurisdiction find that one or more of these "special" or "regulatory" contexts exists. [69]

(3) GAAS "Objectives" vs. GAAS "Procedures"

The Judges also particularly focus on the guidance contained in AU-C §200.A75, referenced *supra*. This provision advises an auditor to apply procedures even if not required by GAAS, if they are necessary *to meet the objectives specified in GAAS.*

This elevation of GAAS's "objectives" over its specified "procedures"—*within GAAS itself* – suggests that, in a court of competent jurisdiction, under the amended regulatory language as described herein, both SoundExchange's enlarged-"scope" auditing work and Music Choice's objection thereto would receive consideration *within the framework of a GAAS-based audit*. [70]

(4) The "Scope" of a GAAS Audit

The "scope" of a GAAS audit is a primary issue because the new regulatory process is based solely on SoundExchange's new proposed language, which allows SoundExchange to engage in audit work regarding information beyond the "scope" of the Music Choice-commissioned putative GAAS audit. The parties' positions regarding the meaning of audit "scope" in this context are set forth below.

(a) Music Choice's Position Regarding Audit "Scope"

Music Choice makes the following arguments regarding the concept of audit "scope" as it relates to the dispute over the regulatory language at issue in this proceeding:

1. Pursuant to GAAS, the "scope" of Music Choice's defensive audits is not limited and is no different from the "scope" of SoundExchange's audits.
2. Although SoundExchange and its witness, Mr. Stark, "pepper their submissions with the term 'scope,' the alleged deficiencies they assert are not related to the actual scope of the BDO audits. [Rather,] as required by the PSS regulations, BDO conducted its audits pursuant to GAAS."
3. GAAS has specific rules relating to the scope of an audit, which provide that, for whatever financial statement is being audited, the scope of an audit is the entirety

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[69] Although the labeling by Music Choice's auditor (BDO) of an audit as a "Special Purpose" audit does not make it so, it is noteworthy that SoundExchange's responsive filing ignored the "Special Purpose" description of the BDO audit and its differentiation from a general purpose financial statement prepared for the investment community, as explained in both Mr. Potts' opening declaration and the BDO audit attached as Ex. MC 8 thereto.

[70] This interplay between rules and exceptions underscores the Talmudic nature of GAAS noted *supra*. *See Rules and Exceptions*, The Jerusalem Post (Feb. 14, 2008) https://www.jpost.com/jewish-world/judaism/rules-and-exceptionsgeneral (noting that in the Talmud "rules are not sources of law, they are organizing principles and hence prone to exemptions. … Even if the rule is qualified, there is no guarantee that all the exceptions have been listed.") (last accessed Aug. 6, 2024); see *also* D. Fischer & H. Friedman, *Use of Stories in the Jewish Talmud to Emphasize Substance over Form* (in The Routledge Handbook of Accounting Ethics (2020)) (available at DFischer, HH Friedman - 2019 - researchgate.net) (last accessed Aug. 6, 2024) ("The lesson from the Talmud is that rules are sometimes not enough to ensure an ethical society. In fact, rules can sometimes cause the exact opposite of the original intent behind them. It is therefore critical that the accounting profession develop an infrastructure to revisit professional and ethical rules to ensure that they are still serving the original purpose.").

of the financial data contained in that statement, and the entire financial statement is covered by the auditor's opinion as to accuracy.

4. In fact, GAAS specifically provides that if management of the audited company attempts to limit the scope of the audit in any way, the auditor must request that the company remove the limitation. If the company does not do so, the auditor must either issue a qualified opinion, disclaim any opinion, or withdraw from the engagement. Notably, Music Choice's independent auditors have never issued a qualified opinion, disclaimed an opinion, or withdrawn from the engagement.
5. The scope of these audits in each instance was the entirety of Music Choice's PSS royalty payments pursuant to the PSS regulations for the audited year. Thus, Mr. Stark's vague and conclusory complaints about the "scope" of BDO's audits are unfounded.
6. His more specific complaints (misleading and false) regarding those audits are not related to "scope," and therefore do not support SoundExchange's requested change to the regulations.
7. The preference by SoundExchange's auditor, Mr. Stark, in prior audits, to conduct certain additional procedures (that it claimed BDO had not performed) was actually his desire to engage in certain procedures duplicative of the GAAS-compliant work of Music Choice's own auditor, BDO, and thus his desires were outside the scope of an audit of a PSS, as well as irrelevant and unnecessary.
8. In particular, SoundExchange's criticism of the use of "sampling" by Music Choice's auditors is unrelated to the "scope" of the audit. Sampling involves the selection of a sub-set of the data that comprises the "scope" of the audit, and is a common testing tool utilized by auditors, including SoundExchange's auditor. SoundExchange's position on the effect of sampling on the "scope" of an audit "would effectively destroy the defensive audit provision because all audits use sampling because, per SoundExchange's assertion, any sampling would render a defensive audit incomplete and allow SoundExchange to conduct its own audit, defeating the entire purpose of the defensive audit.[71]

MC Responsive Br. at 26-30; MC Opening Br. at 21-23; 34-35; Potts Responding Decl. ¶¶ 2-3; 5-6.

(b) SoundExchange's Position Regarding Audit "Scope"

1. The new regulatory language at issue "simply confirmed the unremarkable proposition that an audit of narrow scope undertaken by a licensee could not be used to foreclose SoundExchange from initiating an audit of information outside the audit's scope." SX Opening Br. at 5 n.4.
2. This change clearly provides that when a PSS licensee like Music Choice conducts a "defensive audit" of its royalty payments that audit is an adequate substitute for a SoundExchange audit *of the same scope*. *Id.* at 19.

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[71] "Sampling" is discussed separately *infra*.

3. A “defensive audit” may differ from an independent audit conducted at SoundExchange’s request in numerous ways, including the procedures employed, the level of rigor, the scope, and the degree of access to documents and information that auditors are afforded. *Id.* at 21.
4. The remand question is whether a “defensive audit” by a PSS provider should only have preclusive effect with respect to the *information* that is within the scope of the audit. *Id.*
5. The “scope” of the audit SoundExchange has sought in previous royalty audits, which apparently is the “scope” it understands to be covered by its proposed regulatory language, would allow it to obtain additional information by engaging in the following steps:

   • Reviewing and analyzing Music Choice’s PSS royalty calculations and the assumptions used to create its royalty statements.

   • Reconciling receipts from PSS customers to the Statements of Account (royalty statements) provided to SoundExchange.

   • Evaluating whether Music Choice correctly classified categories of transmissions as eligible for the PSS rate, including by examining a sample of customer contracts to see how Music Choice treats fees paid by customers of multiple services and testing any allocation of royalties among different services.

   • Conducting customer continuity testing to determine whether the data Music Choice provided included all payments required from each customer during the period.

   • Reconciling Music Choice’s cash receipts and balances to revenue recorded on its trial balance and financial statements to confirm that revenue was complete and properly accounted for.

   • Determining whether Music Choice improperly excluded revenue in the same manner as SoundExchange claims it did for its BES 2015 and 2016 royalties.

   • Conducting additional accuracy and completeness tests.

   Stark Decl. ¶ 10.

SoundExchange also argued at the hearing stage that Music Choice’s determination as to the “scope” of the audit cannot be the final word, no matter how “cramped” that scope may be. SX PFF ¶ 2300. And yet, SoundExchange claims that Music Choice seeks to establish the finality of whatever audit “scope” it or its auditor chooses. *Id.* ¶ 594. In response, Music Choice treats this argument as a strawman – acknowledging that its right to utilize a “defensive audit” does not allow it to improperly limit the scope of that audit. MC RPFF ¶ 2300.

(c) GAAS Provisions regarding Audit “Scope”

The parties’ arguments, itemized above, regarding the impact of a different “scope” for a SoundExchange audit compared to Music Choice’s “defensive audit,” appear to raise issues to be decided under GAAS. To address the issue of audit “scope,” it is helpful to again contextualize the regulatory language at issue.

The disputed supplemental regulatory language pertains to the situation where Music Choice has produced a "defensive audit" which it claims to satisfy the regulatory requirements – including, notably here, compliance with GAAS. This disputed and now adopted supplemental language allows Sound Exchange to challenge the acceptability of that "defensive audit" as a regulatory-compliant "verification," by rounding-out that "defensive audit," but only through SoundExchange's engagement of its own auditor with respect to the information that is not "within the *scope of the audit*." Final Determination, App. A, § 382.7(d) (emphasis added). As the CRB Judges explained:

> A report of a Qualified Auditor will include a description of the scope of the audit …. SoundExchange should be permitted *to round out the findings with its own audit, limited to the points omitted from the scope of the defensive audit.*

Final Determination, 83 FR at 65262 (emphasis added).

The "scope" of an audit is a term of art utilized in the auditing profession. In particular, the GAAS standards state that the auditor's set of "overall responsibilities … explain the … *scope* of an audit," *i.e.*, the parameters of the "scope" need to allow the auditor to meet the "overall objectives" of the audit. AU-C §201.01. Thus, in the present case, it appears that for an audit to satisfy GAAS it must have a scope that meets the regulatory objective, *i.e.*, to verify the royalty payments and thereby facilitate the collection of any underpayments or return of any overpayments. *See also Strother*, *supra,* at 209 n.22 ("auditing procedures" are part of the "scope" of an audit examination).

It is in this regulatory context that the GAAS concept of audit "scope" is relevant. That is, the points each party has raised, *supra*, in connection with the meaning of the "scope" of the audit, and how a Music Choice "defensive audit" purportedly undertaken pursuant to GAAS may or may not properly be expanded by SoundExchange in order to be consistent with GAAS.[72]

(5) Materiality in a GAAS-Compliant Audit

SoundExchange raises the question of whether Music Choice's GAAS-compliant audits apply a proper "materiality" threshold for audits intended to verify royalty payments. SX Opening Br. at 2, 4. The parties' respective positions on this issue are summarized below.

(a) SoundExchange's Position on "Materiality"

With regard to the application of the concept of materiality in the present context, SoundExchange advances the following points:

` 1. The objective of an audit such as the one BDO conducts for Music Choice is designed to assess whether or not the company's royalty statements are fairly presented, in all material respects. Stark Decl. ¶ 2. But this is different from the purpose of an audit

[72] The Judges note that SoundExchange seems to identify two different understandings of how "scope" applies in audits of Music Choice. SoundExchange seems to consider the proper "scope" as calling for a special intensive review of royalty collections and payments, whereby the auditor would be using, metaphorically, a *micro*scope to examine the relevant books and records. But it seems to complain that Music Choice has used, metaphorically, a review that is "telescopic," looking at the royalty data without identifying the finer detail. By contrast, Music Choice's auditor has identified its work as a "Special Purpose" audit and thus denies that its "scope" is insufficiently detailed. This is the type of issue that a court of competent jurisdiction would need to resolve.

> procedure "designed to verify the accuracy of the calculations underlying a licensee's royalty payments." SX Opening Br. at 21.
>
> 2. However, an auditor's opinion that a royalty statement has been presented *fairly* is not tantamount to a finding that every number on the royalty statements is accurate. Accordingly, although the audit may be GAAS-compliant. It does not and cannot offer an opinion which makes "a specific determination that royalties were correctly calculated or paid." *Id.* at 2.
>
> 3. What constitutes a "material" difference can also vary based on the context that an auditor has in mind. … [A] royalty underpayment of several hundred thousand dollars might not be material with respect to Music Choice's overall financial condition as a company; but that same amount might be very material from the perspective of SoundExchange[,] …the recording artists and [the] copyright owners [*i.e.*, record companies] to whom it distributes royalties*.* *Id.* at 2 n.2.
>
> 4. BDO's Music Choice audits (1) only provided an opinion as to whether Music Choice's PSS royalty statements were presented "fairly in all material respects" and (2) did not explain the materiality standard used*.* *Id.* at 4.

(b) Music Choice's Position on Materiality

With regard to this issue of materiality, Music Choice argues in response to Sound Exchange with the following points:

> 1. The language of BDO's opinion is standard language that is dictated by GAAS, and understood by CPAs as reflecting a determination of accuracy. MC Responsive Br. at 31 (citing Potts Responsive Decl. ¶ 15).
>
> 2. Although Mr. Stark complains that the audit reports do not "explain the materiality standard used," the reason for the lack of an explanation is a "simple" one: "The materiality standard is well known by CPAs and is established by GAAS." *Id.* (citing Potts Responsive Decl. ¶ 16).
>
> 3. Pursuant to GAAS, the materiality standard requires an independent auditor to use professional judgment as to whether a misstatement found would influence the judgment of a reasonable user of the audited statements*.* *Id.* Thus, if an error found is so small that it would not matter to a reasonable user of the royalty statements, the auditor can still give an opinion that the statement is accurate. *Id.*
>
> 4. Mr. Stark does not allege that his auditing/accounting firm (Prager Metis) ever asked BDO for any information regarding how it implemented the materiality standard, much less that it refused to answer such questions. *Id.*
>
> 5. Music Choice's auditor-witness, Mr. Potts, attached as an exhibit, MC 8, a 2016 BDO audit which states that:
>
> > (a) it was conducted "in accordance with auditing standards generally accepted in the United States of America [*i.e.*, GAAS] [which] require that we plan and perform the audit to obtain reasonable assurance about whether the schedule is free from material misstatement"; and

(b) expressed the opinion that the schedule of royalties in the audit response "presents fairly, in all material respects, the monthly residential Gross Revenues of Music Choice and the monthly statutory royalties owed and paid to SoundExchange for the period from January 1, 2016 through December 31, 2016 …." Potts Opening Decl., Ex. MC 8.

6. This audit report also stated that the audit was undertaken and prepared pursuant to GAAS's "Special Purpose Framework", *i.e.*, "in accordance with the [PSS] Regulations." *Id.*

7. Mr. Stark wrongly complains that the BDO audit only provides BDO's "opinion" that Music Choice's statements of PSS royalty payments were "presented fairly in all material respects," and thus "does not go to the accuracy of the statements." Mr. Potts asserts that this is untrue, because, under GAAS, the purpose of the opinion that the audited statements are presented "fairly" is to establish accuracy. To this end, as noted *supra*, BDO's audit report clearly states the purpose of the audit is to determine whether the schedule of PSS payments is free from *material* misstatement. Potts Responsive Decl. ¶ 15.

8. Although the "materiality standard" is not explained in the BDO audit reports of Music Choice, that is of no import because "the materiality standard is part of GAAS . . . ." The standard is applied by the "independent auditor[s] … [using] [their] professional judgment to determine whether any misstatement found would influence the judgment of a reasonable user of the audited statements." *Id.* (citing AU-C §320.02). Non-GAAS examinations (such as those favored by SoundExchange's auditor, Mr. Stark) are duplicative and "try to uncover *immaterial* errors, which would not even influence the judgment of a reasonable user of the statements, [and] [demonstrate[] why the defensive audits are necessary." *Id.* ¶ 16.

9. In any event, and contrary to Mr. Stark's assertion, the materiality standard does not "prohibit" Music Choice's auditors from disclosing "immaterial" errors they have identified – as evidenced by a BDO audit report that identified a 2015 Music Choice underpayment of [$[REDACTED]] for interest owed on a late payment, a year in which Music Choice paid over [$[REDACTED]] in PSS royalties to SoundExchange. Moreover, Mr. Potts notes that Mr. Stark failed to explain "why such errors would not be reflected in the auditors' work papers, even if they had been left out of the audit report." *Id.* ¶ 17.

(c) The Flexibility of the GAAS Standards and the Impact on "Materiality" Issues

According to GAAS, a matter is "material" if its misstatement or omission creates "a substantial likelihood that, individually or in the aggregate, [it] would influence the judgment made by a reasonable user based on the financial statements. AU-C §320.02. *See also* J. Flood, *Practitioner's Guide to GAAS* 123 ("overview" of AU-C §320 ("Materiality in Planning and performing an Audit")) (Wiley 2021) ("the concept of 'materiality' recognizes that some matters are more important for the fair presentation of the financial statements than others.… The auditor's responsibility is to plan and perform the audit to obtain reasonable assurance that the auditor detects all material misstatements….").

More particularly, GAAS distinguishes between the application of "materiality" for a "financial statement taken as a whole" and materiality for an audit of one or more "specific elements" of a financial statement. In the former case, the overall audit strategy should establish materiality "for the financial statements as a whole," whereas, for the latter, the auditor "*should determine materiality for each individual element rather than the aggregate of all elements* …." AU-C §320.14.

This particular point appears to be relevant in the present case. Here, the audit is not undertaken for the purpose of assisting general users (such as investors or lenders) who need to consider the financial statements "as a whole." Rather, the purpose of the audit is to verify royalty payments by Music Choice. Thus, any materiality threshold would appear to need to relate to the needs of those users who require the audit of the specific element subject to the audit, *viz.*, the royalty payments.

In this regard, the concept of materiality dovetails with the issue, discussed above, as to whether a GAAS-compliant audit would need to be a Special Purpose or a Special Considerations-based audit. That is, under GAAS, the level of materiality may need to be based upon the proper scope of the audit. More particularly, the GASS explanatory materials relating to Special Purpose audits of a specific element of a financial statement also specifically address "materiality" concerns – contrasting them from the "materiality" concerns generated by the broader financial statements:

> The *materiality* determined for a … specific element of a financial statement *differs from the materiality determined for the entity's complete set of financial statem*ents; this will affect *the nature, timing, and extent of the audit procedures* and the evaluation of uncorrected misstatements. … In the case of *an audit of one or more specific elements* of a financial statement, the auditor's opinion is on each of the specific elements; … paragraph .14 requires the auditor to *determine materiality for each individual element reported on rather than the aggregate of all elements or the complete set of financial statements. Consequently, an audit of one or more specific elements of a financial statement is usually more extensive than if the same information was being considered in conjunction with an audit of the complete set of financial statements.*

AU-C §805.A19 (emphasis added). This explanatory material appears to address the "scope" of the audit, noting that the unique "materiality" concerns relate to the "nature" and the "extent" of the audit "procedures," which are intended to obtain evidence necessary for a "Special Purpose" audit.

Accordingly, the Judges' regulatory change adopted in this Remand Determination allows SoundExchange to enlarge the scope of the "defensive audit" to make an argument (in a court of competent jurisdiction) that applies GAAS (rather than rejects it) in a manner that SoundExchange asserts lowers the materiality threshold. Likewise, Music Choice could argue for a different materiality threshold consonant with the type of audit that satisfies GAAS.[73]

[73] The Judges are perplexed by two of Music Choice's points regarding the "materiality" issue. First, Music Choice claims that SoundExchange's auditors never asked Music Choice's auditors about the materiality level(s) set in the "defensive audit." But the materiality level(s) must be set pursuant to GAAS, regardless of whether an adverse party 's auditor has requested that information. Second, Music Choice notes that GAAS does not "prohibit" a party

(6) GAAS on Sampling

According to Music Choice, SoundExchange's remand argument in support of its proposed new audit language is seemingly premised on its criticism of the past use of "sampling" by Music Choice's auditor, BDO, when attempting to verify royalty payments in the course of BDO's "defensive audits." MC Responsive Br. at 4, 34-35. According to Music Choice though, sampling of accounts or other relevant items is not only acceptable but is in fact a common technique utilized in GAAS audits:

> Sampling is the process of selecting a subset of the total data within the scope of the audit and testing that subset and extrapolating the results out to the entire dataset. This methodology is commonly used in audits and many other types of accounting work, and is certainly within GAAS. In most instances it would be wildly inefficient, if not practically impossible, to test all of the data subject to audit. Sampling methodologies have been developed to allow for efficient but accurate audits. Part of the independent and objective judgment a CPA must exercise pursuant to AICPA ethics rules and GAAS relates to using appropriate sampling methodology to generate efficiency without sacrificing accuracy.
>
> Moreover, SoundExchange's own forensic accountants use sampling when conducting their non-audit "examinations." SoundExchange can hardly claim it is prejudiced by an independent auditor's standard use of the very same methodology it instructs its own forensic accountants to employ.

Id. at 34-35 (citations omitted).

Music Choice further argues that "[t]he use of sampling should not . . . be misconstrued as somehow limiting the 'scope' of the audit [which encompasses] the entirety of [Music Choice's] payments for the PSS license in a given year[,] [a]nd the auditor's resulting opinion covers the entirety of those payments, irrespective of the sampling approach commonly used." *Id.* at 35 (citing Potts Opening Decl. ¶ 33). According to Music Choice, "SoundExchange's position on the "scope" of an audit would effectively destroy the defensive audit provision because all audits use sampling. " *Id.* at 35. That is, under SoundExchange's position, "any sampling would render a defensive audit incomplete and allow SoundExchange to conduct its own audit for the same rate period[,] defeat[ing] the entire purpose of the defensive audit." *Id.*

SoundExchange responds tersely to Music Choice's "sampling" argument, averring only that "[t]his is not an issue about sampling as Music Choice suggests in the concluding pages of its brief." SX Responsive Br. at 24.

Under the Judges' analysis and understanding of SoundExchange's proposed new audit language, as discussed *supra*, the "sampling" critique would need to be evaluated in the context of whether its use and the manner of its use are in accordance with GAAS. To that end, as explained below, the Judges find that the use of "sampling" in an audit does not appear to be prohibited by GAAS -- and in fact under GAAS appears, as Music Choice argues, to be expressly part of the auditor's toolkit.

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or its auditor from disclosing even "immaterial" errors. But there is obviously a difference between *voluntarily* disclosing "immaterial" errors and being subject to a *requirement* of disclosure, which would occur if the materiality threshold were low enough to treat the error in question as "material."

Of course, consistent with the Judges' discussion of the meaning of the amended regulatory audit language in this Remand Determination, SoundExchange may perform audit work that it claims to alter the "scope" of Music Choice's "defensive audit" -- work that utilizes either different sampling techniques or eschews some or all sampling approaches. Then, if the parties are unable to resolve their dispute, this issue may be contested in court where the finder of fact will need to decide which approach to sampling satisfies the requisites of GAAS.

As with regard to other particular audit topics discussed *supra*, GAAS devotes an entire section, AU-C §535, to the specific concept and appropriate use of "audit sampling":

> [AU-C §535] applies when the auditor has decided to use audit sampling in performing audit procedures. It addresses the auditor's use of statistical and nonstatistical sampling when designing and selecting the audit sample, performing tests of controls and tests of details, and evaluating the results from the sample.
>
> The objective of the auditor, when using audit sampling, is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

AU-C §535.01 & .04.

More particularly, GAAS specifically defines "sampling" for purposes of conducting a GAAS-compliant audit as follows:

> *Audit sampling (sampling).* The selection and evaluation of less than 100 percent of the population of audit relevance such that the auditor expects the items selected (the sample) to be representative of the population and, thus, likely to provide a reasonable basis for conclusions about the population. In this context, *representative* means that evaluation of the sample will result in conclusions that, subject to the limitations of sampling risk, are similar to those that would be drawn if the same procedures were applied to the entire population.

AU-C §530.05 (italics in original).

GAAS appears to distinguish between *bona fide* sampling (statistical and nonstatistical) and a less rigorous consideration of a portion of potential audit evidence, by providing the following guideline:

> There may be audit procedures *that are not considered audit sampling* comprising an account balance or class of transactions. *For example, an auditor may examine only a few transactions from an account balance or class of transactions* to (*a*) gain an understanding of the nature of an entity's operations or (*b*) clarify the auditor's understanding of the entity's internal control. In such cases, the guidance in this section is not applicable.

AU-C §530.A3 (emphasis added).

Another sub-issue within the broader issue of sampling under GAAS is the use of "stratified" samples of accounts or other items. In this regard, GAAS provides the following definition:

> *Stratification***.** The process of dividing a population into subpopulations, each of which is a group of sampling units that have similar characteristics.

AU-C §530.05.

Stratification, like all elements of audit sample design, "should consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. AU-C §530.06, .0A11. Also, GAAS provides that the auditor should select items for the sample (whether or not stratified) in such a way that the auditor can reasonably expect the sample to be representative of the relevant population and likely to provide the auditor with a reasonable basis for conclusions about the population. AU-C §530.08.

In the present case, it appears as though some stratification might be deemed appropriate under GAAS, given that sound recording copyright owners may have different strata of royalties due, such that a potential misstatement of an underpayment could be deemed "immaterial" under GAAS for certain strata of copyright owners, yet "material" for other strata. *Cf.* Stark Decl. ¶ 2 n.2 ("What constitutes a "material" difference can also vary based on the context that an auditor has in mind. … [A] royalty underpayment of several hundred thousand dollars might not be material with respect to Music Choice's overall financial condition as a company; but that same amount might be very material from the perspective of SoundExchange and the recording artists and copyright owners to whom it distributes royalties.").

In sum, the Judges do not see SoundExchange's argument, as portrayed by Music Choice, as seeking to invalidate Music Choice's "defensive audits" if they utilize sampling. Rather, the issue of sampling under GAAS is nuanced, and appears to include sub-issues as to (a) whether sampling as an evidence-gathering approach is appropriate for Music Choice audits and, (b) if it is, (i) what type and extent of sampling is necessary and (ii) whether stratification of the sample might be appropriate. The new regulatory language adopted by this Remand Determination allows the parties to join on these audit topics at the regulatory level, in order to try to resolve their dispute without the need for an expensive judicial resolution of the matter.

(7) Alleged Inconsistency between Music Choice and its Auditor (BDO) regarding the Audit Work to be Undertaken

GASS covers the situation where the outside auditor "becomes aware that management has imposed a limitation on the *scope* of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation," or qualify or disclaim its opinion. AU-C-705.11

Here, SoundExchange has maintained that "BDO [Music Choice's auditor], in connection with a previous audit assignment, "initially proposed to conduct a different type of royalty audit (which appeared to be more aligned with Prager Metis' approach) but was not permitted to do so by Music Choice." Stark Decl. ¶ 2 n.1. SoundExchange also relies on a document from its auditors' files containing the auditors' notes regarding "2014 audit planning documents":

> Correspondence in the file indicated that the audit was originally going to be done under consulting standards but Music Choice (MC) wanted Generally Accepted Auditing Standards (GAAS) used. Note: The consulting standard is the proper standard for a compliance exam. GAAS only enable the auditor to express an opinion on whether the amounts being auditing are presented fairly, in all material respects, with respect to the governing rules. BDO issued unqualified opinions in its audit reports for every year.

SX Opening BR. (Ex. B. Declaration of Andrew Cherry, Esq.) (Cherry Decl.) (attaching SoundExchange document Bates Number SXREMAND00000415).

Music Choice dismisses the relevancy of its declination of its own auditors' proposed approach, arguing as follows:

> What Mr. Stark fails to tell the Judges is [that] because the regulations clearly require that an audit be a real audit, conducted pursuant to GAAS … the alternative examination initially proposed by BDO – d[id] not comply with the more stringent requirements of the PSS regulations. Indeed, when BDO was instructed on the need to perform a full audit under GAAS, it noted that the more rigorous requirements under that standard required additional testing. Potts Responsive Decl. at ¶ 19 & Ex. MC 24. Thus, contrary to Mr. Stark's insinuation, Music Choice insisted on a more – not less – rigorous audit methodology.

MC Responsive Br. at 33.

Moreover, Music Choice notes that its outside auditor thereafter agreed to Music Choice's approach and issued its opinion that the audit was GAAS-compliant, *i.e.*, it did not qualify or disclaim its opinion and did not request that Music Choice's management remove the limitation. *Id* .at 26.

This issue underscores the value of the new regulatory language. The fact that Music Choice's auditor, BDO, did not press Music Choice on this issue, disclaim or qualify its opinion, or decline the engagement, are facts and decisions that implicate GAAS. By allowing SoundExchange to verify at the regulatory level the specifics of this issue through audit work potentially different in scope than the BDO audit performed on behalf of Music Choice, the amended regulation places the parties in possession of information that would "level the playing field," so to speak, allowing for a potential resolution and settlement without having to incur the expense of litigation.[74]

f. None of the Additional Miscellaneous Issues Support a Different Ruling

(1) Introduction

The parties have raised several additional issues on remand, some of which were identified in the D.C. Circuit ruling. Each of these issues is discussed below. As explained, none of them serve as a basis to qualify the CRB Judges' ruling, as set forth above, supplementing the audit verification procedure.

(2) *PSS I* Does Not Require a Different Result

The D.C. Circuit stated in its ruling remanding this proceeding back to the CRB Judges: "[T]he [CRB Judges] failed to address CARP's initial reasoning for instituting the defensive audit procedure, which sought to balance the preexisting services' burden and expense against copyright holders' audit rights." *Music Choice*, 970 F.3d at 429. Accordingly, the D.C. Circuit remanded with the instruction that the CRB Judges consider whether they "can justify [their]

[74] The question of whether the "consulting standards" rather than the GAAS "procedures" should be utilized in these audits appears to implicate the GAAS issue identified *supra*, regarding the potential elevation of GAAS "objectives" over GAAS "procedures."

change in position." *Id.* The foregoing analysis in this Remand Determination provides substantial justification for this change. Additionally, the Judges take note below of the difference between the burden Music Choice (and other PSSs) faced when PSS I was decided, compared with the absence of that burden under the present audit procedure.

As noted *supra*, in 1998, the Librarian adopted a regulation recommended by a 1997 CARP report, allowing a PSS to engage its own auditor to conduct a "defensive audit" that would constitute acceptable verification of the statements of account. Librarian's *PSS I* Determination, 63 FR at 25406 , adopting in part and rejecting in part Notice and Order, *Determination of Statutory License Terms and Rates for Certain Digital Subscription Transmissions of Sound Recordings, Report of the Copyright Arbitration Royalty Panel,* Docket No. 96–5 CARP DSTRA, (November 28, 1997) ("CARP *PSS I* Report").[75]

When *PSS I* was being considered by the CARP, the Librarian, and the D.C. Circuit, there was no statutory authority for a collective to represent the body of sound recording copyright owners who could audit a PSS. By allowing verification via a PSS's "defensive audit" – in lieu of an audit commissioned by record companies and other sound recording copyright owners – Music Choice (and the other two PSSs) were spared the potential burden of having to respond to multiple audit requests from these copyright owners. In this regard, the CARP stated:

> RIAA represents a collective that consists of more than 275 record labels. The members of the RIAA collective, which was established to administer rights granted by the DPRSRA, are responsible for the creation of more than 90 percent of all legitimate sound recordings sold in the United States. …
>
> . . .
>
> The [CARP] also agrees with the Services' position, *consistent with the principle of limiting unnecessary expense and disruption*, that where a Service can provide an audit already performed in the ordinary course of business by an independent auditor, pursuant to generally accepted auditing standards, such audit and underlying work papers should serve as the audit on behalf of all interested persons *unless it can be shown that the auditor did not follow generally accepted auditing standards.* This procedure would result in fair opportunity to audit for copyright owners, while reducing the burden and expense of auditing upon the Services.

CARP *PSS I* Report ¶¶ 20, 194 (emphasis added).

Music Choice notes, though, that the CARP Report does not *explicitly* mention a concern for a large number of copyright owners potentially "flooding" a PSS with notices of intent to audit. Specifically, Music Choice argues:

> [N]owhere within the CARP's discussion of defensive audits does it mention the potential for a large number of interested parties to flood the PSS with audits. … CARP Report, ¶ 194. Nor would such a justification make sense. Under the

[75] The Librarian's *PSS I* Determination adopted the audit verification procedures set forth in the CARP *PSS I* Report. The D.C. Circuit subsequently upheld the Librarian's rate determination but remanded certain terms – unrelated to the audit verification provisions – for lack of supporting evidence. *Recording Industry Ass'n of America, Inc.* v. *Librarian of Congress,* 176 F.3d 528 (D.C. Cir. 1999).

> original regulations, the CARP had already limited all audits of any one PSS to one per year.

MC Responsive Br. at 35. *See also* MC RPFF ¶¶ 2299, 2301 ("The … regulatory language providing parties the opportunity to defensively audit … was created … to shield the PSS from the burden of intrusive, repetitive audits, while still providing protection to copyright owners. … The CARP made the purpose of the defensive audit provision quite clear, and it was not based on the absence of SoundExchange.")

The Judges agree with SoundExchange that the CARP intended to engage in a trade-off; allowing a PSS to avoid the burden of multiple audits by conducting "defensive audits" unless it *"can be shown that the auditor did not follow generally accepted auditing standards."* That is, the Judges find the CARP's adoption of the PSS "defensive audit" device to have been a reasonable tradeoff that served to efficiently reduce transaction costs that would be imposed on a PSS by a plethora of audits. Although the absence of a collective was not noted by the CARP in *PSS I* (it would have been unusual to take note of something that did not yet exist!), the CARP regulations indicated it was concerned that multiple copyright owners could demand annual audits, saddling every PSS with crippling verification costs. The "defensive audit" provision cut-off that burdensome potentiality.[76]

The Judges further agree with SoundExchange that the need for this tradeoff has been ameliorated by the change effected by the Final Determination (unchallenged on appeal) that the only "Verifying Entity" that could audit a PSS's Statements of Account was the collective, *i.e.*, SoundExchange, thereby preluding the harm generated by multiple copyright owners individually seeking to audit Music Choice (or any PSS). *See* SX PFF ¶ 2301 ("[When] the CARP created the defensive audit right, SoundExchange did not exist … and all copyright owners were treated as 'interested parties' with a right to audit [so] it was reasonable to give licensees an opportunity to conduct a single defensive audit …. Now, however, … only SoundExchange would have the right to audit, mitigating th[is] potential audit burden on licensees …..."); *see also* SX Opening Br. at 23 ("This risk was mitigated when the audit right was later limited to only the designated Collective—*i.e.*, SoundExchange." (citing 37 C.F.R. § 382.7(a))).

Accordingly, the Judges find that the hardship generated by multiple audits no longer exists and does not now serve as an impediment to adoption of the amended audit procedure.[77]

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[76] Music Choice relies on ¶ 210 of the CARP Report setting forth its audit verification rules. But that paragraph provides that "[*i]nterested persons* shall file *a* notice of intent to audit … [and] [o]nly one audit of any Service shall be allowed with respect to financial records for any given year," and that a qualifying "defensive audit" conducted pursuant to GAAS would "serve as the audit on behalf of *all interested persons*." (emphasis added). Clearly, this provision was cutting off audits from multiple "interested persons," not, as Music Choice suggests, limiting the number of audits to one per year. *Accord, id.* ¶ 194.

[77] The Judges are puzzled by Music Choice's claim that the insertion of the "defensive audit" right in *PSS I* was merely "hypothetical," *see* MC Opening Br. at 26, but became necessary in 2005 when SoundExchange abused the audit process from its very first audit of Music Choice. Nothing in *PSS I* suggests that the CARP thought the "defensive audit" process was "hypothetical"; rather, there was an actual fear that Music Choice would be inundated by multiple audits which would saddle it with significant transaction costs. In fact, the CARP Report in *PSS I* notes that it was the Services' position that a defensive audit process be adopted to "reduc[e] the burden and expense of auditing upon the Services." CARP Report ¶ 194. *See also id*. ¶ 37 (citing the same record testimony and noting

PSS I is noteworthy for two other reasons. First, as the quoted portion of the CARP *PSS I* Report sets forth, compliance with GAAS was necessary for the PSS's "defensive audit" to be binding. As explained in this Remand Determination, this is an important basis for the present ruling, because satisfaction of GAAS by the PSS's "defensive audit" is a prerequisite for the dispositive effect of that audit, and its auditor's mere *ipse dixit* that these standards have been satisfied cannot be sufficient. Second, although *PSS I* did not set forth a standard for the audits by the copyright owners, the regulation was subsequently changed. Specifically, § 382.6(e) eliminated the separate reference to the PSS's "defensive audit," and, without distinguishing who was conducting the audit, that the audit must meet the regulatory requisites, which include satisfying GAAS. Thus, as noted *supra*, the GAAS requirement has long been made applicable to all PSS audits, not merely the "defensive audits," and further, the PSS regulations did not allow for audits by copyright owners or SoundExchange to be standardless.

For the foregoing reasons, the rulings in *PSS I* are not inconsistent with the Judges' Remand Determination.

(3) SDARS II Does Not Require the Judges to Reject the Amended Audit Procedure

The D.C. Circuit also ruled as follows, in support of its decision to remand the audit verification issue:

> The Final Determination does not acknowledge the [CRB Judges'] rejection of a substantially identical proposal in its 2013 proceeding. There, the parties presented similar arguments for the same change and the [CRB Judges] rejected SoundExchange's position because it did not "adequately address[]" flaws pointed out by Music Choice. 78 Fed. Reg. at 23,074. Specifically, the [CRB Judges] noted that SoundExchange failed to rebut Music Choice's argument that the change would "permit SoundExchange to use auditors that are employees or officers of a sound recording owner or performing artists, the objectivity of which might be suspect." *Id.* The [CRB Judges] do[] not acknowledge this prior position, do[] not point to any evidence that these concerns have been ameliorated, and do[] not present any new reasons for adopting the amended audit procedure that it previously rejected.

Music Choice, 970 F.3d at 429.

Music Choice argues that the Judges should follow their ruling in *SDARS II*, where the CRB Judges rejected SoundExchange's same substantive arguments. *See* MC PFF ¶ 596; MCRPFF ¶ 73. The Judges disagree. The *SDARS II* Determination does not shed any *substantive* light on how this audit issue should be addressed on the present remand. The same substantive SoundExchange request to change to language pertaining to the PSS audits was rejected – *not on the merits* – but because SoundExchange had failed to present evidence

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that the "auditing procedures" were proposed by the Services through the testimony of the same witness). Accordingly, the record reflects that the "defensive audit" was not hypothetical, but rather was adopted as a tradeoff to avoid the transaction cost problem arising from multiple audits from copyright owners.

addressing the merits of the issue. *See Music Choice*, 970 F.3d at 429.[78] It would thus be irrational for the Judges on remand to rely on the reasoning in *SDARS II*, when the rationale there – *the absence of support for the change – is the same as the reason why the D.C. Circuit vacated and remanded as to this issue in the present case*.

Moreover, each rate proceeding is conducted *de novo*, based on the factual record and the legal arguments contained in that proceeding. SoundExchange had the clear right to present new arguments regarding this audit issue, both at the hearing (which were deemed insufficient on appeal) and in the remand, and Music Choice had the right to oppose the change, which it exercised at the hearing and on remand.

Finally, if the Judges were to adopt Music Choice's argument that the Judges rely on *SDARS II* – where SoundExchange's failure to provide evidence or arguments sufficient to effect this change was dispositive – then that "absence of evidence or argument" rationale from a prior determination would effectively serve as a permanent bar as to any request to consider new evidence or arguments. That is clearly wrong.

(4) SoundExchange Bears the Burden of Proof for the Regulatory Change and has Met that Burden

The Judges agree with Music Choice that, under the general rule set forth in the Administrative Procedure Act ("APA"), 5 U.S.C. 556(d), SoundExchange, as "the proponent" of the rule amending the audit procedure, bears the burden of proving that it should be adopted. *See* MC Opening Br. at 22 (arguing that SoundExchange has not carried its burden to show that this change in the audit provisions is justified). Moreover, as the Supreme Court has held, the APA's use of the phrase "burden of proof" comprises both the "burden of persuasion (*i.e.,* the obligation to persuade the trier of fact of the truth of a proposition) [and the] burden of production (*i.e.,* the obligation to come forward with evidence to support a claim)." *Director, Off. of Workers' Comp. Programs, Dep't of Lab. v. Greenwich Collieries*, 512 U.S. 267, 268 (1994).

Thus, SoundExchange was required to meet these evidentiary and procedural burdens in order for the supplemental audit verification language to be made a part of the audit-related regulations. As indicated by the Judges' analysis, *supra*, they have determined that SoundExchange has met these burdens, albeit in a manner that supports the adoption of this supplemental language with the meaning as explained in this Remand Determination.

(5) The Judges Reject SoundExchange's Assertion that the Judges Need Only "Justify" Their Prior Ruling on the Audit Procedure language, Rather than Consider Whether that Ruling is Correct

The Judges reject SoundExchange's cramped characterization of the audit-related remand issue as merely requiring them to provide the appropriate justification for their prior ruling, as

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[78] Specifically, Judge Rao's opinion states, with regard to the prior proceeding, *SDARS II*: "[T]he parties presented similar arguments for the same change and the [CRB Judges] rejected SoundExchange's position because it did not '"adequately address[]' flaws pointed out by Music Choice [including] … that … SoundExchange failed to rebut Music Choice's argument that the change would 'permit SoundExchange to use auditors that are employees or officers of a sound recording owner or performing artists, the objectivity of which might be suspect." *Id.* Here, the Judges have mooted Music Choice's concern regarding the independence of the auditor by ruling via incorporation by reference that the GAAS standards for auditor independence govern the auditing work undertaken by SoundExchange.

though that ruling was a *fait accompli*. Because the original decision as to this issue was vacated, the Judges cannot and do not conduct their remand analysis with any preconceived presumption that their earlier ruling was correct, but rather consider anew whether the disputed supplemental audit language is appropriate as a matter of law and policy. To do so, the Judges have considered *infra* the arguments made by the parties, including the declarations from their auditing-witnesses, claims of misconduct in prior audits and more granular issues regarding the auditing process.

(6) The Judges Reject Music Choice's Reliance Argument

As noted *supra*, one reason for the D.C. Circuit's decision to vacate and remand the Final Determination was that the CRB Judges had "failed to respond" to Music Choice's claim of its "reliance interests" arising from the previous audit standard, "a matter Music Choice specifically raised on the record during the proceeding." *Music Choice*, 970 F.3d at 429. In this regard, the appellate panel noted that the CRB Judges had failed to acknowledge Music Choice's assertion "that this change would upset its reliance on the previous audit procedure, citing Music Choice's argument that it had previously 'availed itself of [the external independent audit], and has expended significant resources in doing so.'" *Id.* Judge Rao's opinion was grounded specifically on the holding in *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 222 (2016), that when an agency "deemed it necessary to overrule its previous position," it could not dismiss a party's claim of "decades of industry reliance on the … prior policy" with a mere "summary discussion" [which] fell short of the agency's duty to explain why it deemed it necessary to overrule its previous position."

On remand, as noted *supra*, as to its "reliance" claim, Music Choice argued:

(1) SoundExchange failed to satisfy its burden to submit evidence of a significant need for its proposed change to the PSS audit provision in light of Music Choice's long reliance on that provision. MC Responsive Br. at 24.

(2) In fact, SoundExchange proffered no sufficient evidence demonstrating the necessary justification to overcome Music Choice's "reliance" on the defensive audit protection for many years. *Id.* at 25.

(3) The CRB Judges need not consider whether the largely prospective nature of the proposed change in the "defensive audit" provision overcomes Music Choice's asserted "reliance interest," because such consideration by the CRB Judges would ignore the D.C. Circuit's holding that the CRB Judges had erred in *not* considering Music Choice's "reliance interest." *Id.* at 35.

(4) Any regulatory change that takes away a long-established "*benefit*" is prospective and thus the change in the audit procedure would effectively negate any "*reliance*" interest. *Id.*

(5) Music Choice relied on the "defensive audit" provision to avoid an intrusive and disruptive audit by SoundExchange. *Id.* at 28-29. More particularly, since 2005, when SoundExchange hired a member of its own board of directors (without disclosure to Music Choice) as a so-called independent auditor who fabricated massive claims, Music Choice has previously relied on "defensive audits" to protect itself from SoundExchange's use of non-independent auditors who fabricated massive claims of

underpayments, when Music Choice had only made some late payments without fully paying the required interest. MC Opening Br. at 4.

(6) The proposed regulatory change would read the fourth policy factor out of the applicable statutory rate standard. *Id.* Music Choice has long relied on defensive audits, and has continued to do so, as a protective measure covered by the fourth policy factor of 17 U.S.C. 801(b)(1). *Id.* at 35.

On remand, and as also noted *supra*, as to Music Choice's "reliance" claim, SoundExchange maintained:

(1) Music Choice lacks any "reliance" interest on the previous audit provision because there is no evidence that it had invested in "defensive audits" in a manner that would operate prospectively, and "the change at issue here is largely prospective." SX Opening Br. at 24.

(2) The change to the regulation is crafted "narrowly enough" to avoid upsetting any reliance issue, because not only is the change largely prospective but also the amendment to the regulation does not prevent Music Choice from continuing to conduct "defensive audits" and benefit from any past investments it made in the defensive audit procedure. *Id.* at 24-25.

After considering the parties' remand arguments on the issue of Music Choice's claim of "reliance" on the existing regulatory audit language, the Judges reject Music Choice's "reliance" argument, for the reasons set forth below.

First, there is no persuasive record evidence of actual investments made by Music Choice that would have prospective effect. In each audit year, if Music Choice wanted to avail itself of the "defensive audit" opportunity, a new audit would need to be undertaken. Thus, there would be *new* incremental costs associated with an analysis of Music Choice's books and records which would not constitute prior investments.[79]

Second, although Music Choice does not itemize any particular investments, the Judges recognize that its auditors (assuming it utilizes the same auditors year-over-year) would perhaps obtain general knowledge regarding the statements of account and other books and records necessary to conduct their GAAS audit. But the Judges do not consider any such potential efficiencies realized from such auditor knowledge to be a

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[79] Although, as noted elsewhere in this Remand Determination, under the APA the burden of proving that a new regulation should be adopted is borne by the party seeking its adoption, that allocation of burden cannot apply to the claim by a party opposing the new regulation that it had relied on the existing regulation. More particularly, the "reliance" claim does not factually relate only to the new regulation, but also to the facts associated with performance under the old regulation. To that extent, the APA's designation of burden of proof for the new regulation is hardly dispositive. (The claim of "reliance" on the former regulation is in the nature of an affirmative defense). The opposing party, Music Choice here, would be in the possession of the evidence, if any, of such reliance on the prior regulation that would cause prospective injury if altered, and as a matter of common sense and necessity, that party would need to bear the burden of production in that regard. Once such evidence had been produced and established a *prima facie* case, the party proposing the new regulatory language, SoundExchange here, would need to explain why the evidence of reliance, on balance, was insufficient to preclude adoption of the new regulatory language, and would bear the burden of proof in that regard. As explained herein, Music Choice's thin arguments in support of its claim of "reliance" have clearly been successfully rebutted by SoundExchange, which has thus met its burden.

sufficient basis to reject the new amendment to the audit procedure.[80] As SoundExchange notes, after the amended process is in effect, Music Choice and its auditors can still engage in "defensive audits," realizing the efficiencies that may have been generated from past "defensive audits." Further, this Remand Determination would still afford Music Choice the opportunity to successfully rely on its "defensive audit," just as it had previously, if, in a judicial action it could demonstrate that its "defensive audit" was consistent with GAAS and the other regulatory requisites.

Third, the CRB Judges are mystified by Music Choice's assertion that they cannot consider Music Choice's "reliance claim" without running afoul of the D.C. Circuit decision, which found that the CRB Judges had erred by *not* considering that claim. Indeed, the D.C. Circuit expressly held that "[p]erhaps the agency can justify its change in position …. We remand for the [CRB Judges] to … *reconsider* the audit definition and provide a reasoned explanation if the Board determines the revised definition is justified." *Music Choice*, 970 F.3d at 429-30 (emphasis added). Music Choice has somehow construed the D.C. Circuit's mandate to "reconsider" this audit issue as a directive to *not* consider it.

Fourth, the CRB Judges reject Music Choice's sweeping assertion that a regulatory change that eliminates a "benefit" is *ipso facto* equivalent to the deprivation of a "reliance" interest. Such a claimed equivalency is overbroad, in that regulations typically allow, command, or restrict some form of conduct. Because some persons or entities will benefit from the regulation (and others may suffer a cost or other detriment) an amendment thereto can remove or reduce a benefit.

Further, to claim, as Music Choice does, that any "benefit" generates a "reliance" interest which must be preserved is an extreme statement that conflicts with the Supreme Court's administrative law jurisprudence, which provides that when a party has asserted that the benefit it realizes from a regulation has ripened into a "reliance" interest, the agency and the courts must nonetheless weigh the costs and benefits of the change, rather than automatically reject the change simply because a reliance-based benefit has been identified. *See Dep't of Homeland Sec. v. Regents of the Univ. of California,* 591 U.S. 1, 32 (2020) ("even if DHS ultimately concludes that the reliance interests rank as serious, they are but one factor to consider. DHS may determine, in the particular context before it, that other interests and policy concerns outweigh any reliance interests. Making that difficult decision was the agency's job. … [I]t *was* required to assess whether there were reliance interests, determine whether they were significant, and weigh any such interests against competing policy concerns.") (emphasis in original).

Fifth, Music Choice's assertion that it has relied on the "defensive audit" provision to avoid intrusive and disruptive auditing work by SoundExchange is an insufficient basis to reject the amended audit language. As an initial matter, it is not an established fact that SoundExchange's prior auditing work was improper, although there is certainly evidence that indicates SoundExchange and its auditors may not have

[80] The Judges see this "efficiency" argument as similar to SoundExchange's argument that it would be "efficient" if each regulated form of sound recording distribution was governed by the same auditing procedure, an argument that the D.C. Circuit found insufficient. Claims of "efficiency" can obscure the value of regulations that have a salutary intent – here, to verify royalty payments without generating undue burden.

complied with GAAS when engaging in prior audit work. But the old regulation was put into place to protect Music Choice (and the other PSSs) from the "transaction cost" burden of audits by multiple copyright owners every year, before a collective (SoundExchange) had been created and empowered as the exclusive entity to commission audits of a PSS on behalf of copyright owners. Under the amended regulatory procedure, Music Choice can still seek to put the brakes on any SoundExchange auditing work that fails to comport with GAAS or the other regulatory requisites, and to challenge any audit arising out of that deficient work. But, in the weighing process, the Judges have found it vital that both SoundExchange and Music Choice have the opportunity to "verify" (not merely "trust") the other party's commissioned audit, as either or both could be deficient. Moreover, as noted *supra*, SoundExchange undisputedly always had the right to challenge Music Choice's "defensive audit" in court, and, if that "defensive audit" satisfied the regulatory requisites, it would be dispositive. That has not changed.

Finally, the Judges reject Music Choice's claim that the new regulatory auditing language "would read the fourth policy factor out of the applicable statutory rate standard," ending Music Choice's long reliance on "defensive audits" as a protective measure covered by the fourth policy factor of 17 U.S.C. 801(b)(1). To be clear, this fourth factor says nothing about the existence of "defensive audits," but rather provides that, for, *inter alia*, a PSS, the "rates … shall be calculated to achieve the … objective[of] minimiz[ing] any disruptive impact on the structure of the industr[y] … and on generally prevailing industry practices." 17 U.S.C. 801(b)(1)(D).

As an initial matter, the Judges note that the regulations governing auditing procedures are not rate regulations, but rather regulatory terms, as to which the four policy factors are not statutorily applicable.[81] Thus, Music Choice's argument is not statutorily supported. Further, whether Music Choice ever mistakenly assumed that this fourth factor regarding "disruption" was applicable to the auditing procedures is hardly relevant. A mistaken understanding of unambiguous statutory language cannot suffice to create an enforceable "reliance interest."

Further, even if Factor D did apply to terms, the change in the audit terms would not meet the Judges' long-standing interpretation of the "disruption" standard set forth in 17 U.S.C. 801(b)(1)(d), which is as follows:

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

[81] 17 U.S.C. 801(b)(1) requires both rates and terms (and their adjustments) to be "reasonable," but that does not implicate the four itemized factors. With regard to the "reasonableness" of the new regulatory audit language, the Judges' reasoning throughout the entirety of this Remand Determination as to that issue demonstrates the reasonableness of the new supplementary language.

Final rule and order, *Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, 88 FR 54406, 54414 (Aug. 10, 2023) (adopted and incorporated in Final Determination After Remand).

Music Choice has made no attempt to demonstrate how the change in the regulatory auditing language would meet the Judges' understanding of the statutory "disruption" objective set forth at 17 U.S.C. 801(b)(1)(d). Thus, even if this section did apply to terms as well as rates, Music Choice's cursory argument is underdeveloped and fails to show how this standard would have been implicated by the regulatory audit procedures.[82]

(7) The Judges Give Minimal Weight to Audit Procedures Contained in Private Agreements between Record Companies and Services, in the Absence of any Evidence that those Contract Terms were not Impacted by the "Must Have" Market Power of the Record Companies

The Judges place minimal weight on the terms of private audit agreements entered into by major or other record companies and other services, as proffered by SoundExchange. The record does not reflect the extent to which those audit terms and arrangements may be the product of the licensors' "Must Have" market power, *i.e.*, their complementary oligopoly power.[83] Thus, their usefulness as potential benchmarking evidence is diminished. However, the Judges do accord some weight to the private agreements, in that they do offer some support for the Judges finding herein that defensive audit provisions with the broad effect sought by Music Choice are not the industry standard, and thus are generally consistent with the Judges' separate rationale for their construction of the effect of a defensive audit in the adopted amendment to 37 CFR 382.7(d).[84]

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[82] In fact, if any of the four statutory objectives were applicable, it would be Factor B, which requires the Judges to set rates that provide a "fair return" to copyright owners and a "fair income" to copyright users, because these two "fairness" goals are consonant with the amended audit procedure, which better allows for verification of accurate royalty payments and receipts.

[83] *See Web V* Final Determination, 86 FR 59452, 59455 (Oct. 27, 2021) (noting that the Judges' finding in the prior *Web IV* proceeding of such complementary oligopoly power in the unregulated market, which prevents "effective competition", remains applicable when that finding is "not challenged" in a subsequent proceeding relying on transactions in that market); *aff'd NRBNMLC v. Copyright Royalty Bd.*, 77 F.4th 949, 970 (D.C. Cir. 2023) (the presence of such market power can extend to contract terms that "by definition" were not "reflective of what a willing buyer and seller would agree to in an effectively competitive environment."), *cert. denied sub nom. Nat'l Religious Broadcasters v. Copyright Royalty Bd.*, 144 S. Ct. 2682 (June 24, 2024).

This concern covers regulatory terms as well as specific rates. Indeed, in the present proceeding (regarding SDARS rates, not PSS rates), the Judges rejected a license term (requiring a "greater-of" rate calculation) because they were "troubled by the lack of a cogent explanation from the licensors' economic witnesses as to the merits, on balance, of a greater-of rate formula" that would have rebutted the Judges' prior finding that "licensors can and would … exploit their 'must have' status for a special competitive advantage." *SDARS III*, 83 FR at 65228. *See also* Final Determination after Remand, *Phonorecords III*, 88 FR 55406, 55428 (Aug. 10, 2023) (declining to import a similar term from the unregulated interactive market [which] is based on ''agreements which were all negotiated in a market characterized by the lack of effective competition.").

[84] *See, e.g.*, SX PFF ¶ 2304; Trial Ex. 114-018A at § 4(c) (SoundX_000107216).

(8) The Judges Find Little Value in the Parties' Disputes Regarding Prior Audits and their Extreme *Characterizations of Each Other's Conduct*

Both parties make *ad hominem* arguments which are unrelated to the issue of whether the disputed supplementary audit language should be adopted. SoundExchange claims that Music Choice can use and has used the "defensive audit" process to conceal underpayments. In fact, SoundExchange has claimed that through one of its own audits (with which Music Choice cooperated) its auditor found that Music Choice had failed to pay over $[REDACTED] in royalties due and owing. However, Music Choice reviewed that auditing work and found that figure to be inflated by improper claims, and the parties ultimately settled that dispute via a total payment by Music Choice to SoundExchange of only $[REDACTED]. *See* Potts Opening Decl. ¶¶ 24, 26-27.[85]

Reciprocally, Music Choice avers that – when it provided SoundExchange the opportunity to conduct an audit – SoundExchange violated the regulatory requirements that the auditor be "independent," *i.e.*, unrelated to SoundExchange, and that the audit comply with GAAS -- thereby embroiling Music Choice in an intrusive, expensive, and unlawful audit process. *Id.* ¶¶ 15-17. According to Music Choice, SoundExchange's true purpose in this regard was to engage in "harassment" of Music Choice. *Id.* ¶ 28.

These accusations of "prior bad acts" in connection with earlier audit activity are not particularly relevant to the present issue. Indeed, as is common when a party proffers such evidence, it is usually not admitted, let alone given any weight. *Cf.* FED. R. EVID. 404(b)(1) ("Evidence of any other crime, wrong, or act is not admissible to prove a person's character in order to show that on a particular occasion the person acted in accordance with the character."). Here too, the Judges do not find the accusations of improper conduct in prior audits to be worthy of evidentiary weight. Moreover, the Judges find it would be prohibitively inefficient to revisit and examine the parties' conduct in connection with audits in years past, and the Judges eschew any such "hearings-within-hearings." Such analyses would be of little assistance for the Judges in their consideration of the amended audit regulatory language.

Rather, the only relevance of the parties' extreme criticisms of each other's conduct in past audit disputes is that it underscores the need for both parties to be bound by the same GAAS (and other) standards in the regulations, and for SoundExchange to be able to generate – in the regulatory process – an audit of different "scope" that could contest whether a Music Choice "defensive audit" had satisfied the regulatory standards, including compliance with GAAS. Alternately stated, the Judges find that the supplemental audit language, as understood and explained by the Judges in this proceeding, would ameliorate the parties' concerns regarding these prior acts, by allowing them to confront these issues at the regulatory stage, where information regarding their disagreements regarding the appropriate audit scope of a GAAS-compliant audit could be discovered and exchanged, in order to aid them in reaching a potential resolution without the need for costly litigation.

V. Conclusion

In sum, the Judges construe the new audit language at issue as providing a regulatory procedure for SoundExchange to undertake its own audit work – after Music Choice has

[85] On the one hand, the figures suggest a possibly inflated claim by SoundExchange. On the other hand, the fact that Music Choice paid a six-figure sum to resolve the SoundExchange audit-based claims suggests that allowing SoundExchange to engage in auditing work of an enlarged scope is warranted.

completed its "defensive audit."[86] SoundExchange's audit work in this regard must meet all the requirements set forth in § 382.7(d) and is otherwise limited by the precise words of the new audit language to an evaluation of information that was not within the scope of Music Choice's audit.

After the Music Choice "defensive audit" and SoundExchange's supplemental-scope auditing work have been completed, Music Choice's "defensive audit" would remain "facially acceptable." If SoundExchange was unsuccessful in using its commissioned "expanded scope" audit work, pursuant to § 382.7(d), to override Music Choice's "defensive audit" in a court of competent jurisdiction, the results of Music Choice's "defensive audit" would control. Simply put, when the litigation concludes, a Music Choice-commissioned "defensive" audit report that satisfies the regulatory conditions would continue to serve as an ultimate safe harbor, as it aways has, subsequent to any litigation challenge by SoundExchange.

However, if a court of competent jurisdiction were to find that the supplementary SoundExchange-commissioned audit work demonstrated that Music Choice's "defensive audit" had failed to meet the regulatory requisites, and that SoundExchange's "expanded scope" audit did satisfy those requisites, then the results of SoundExchange's properly "expanded scope" audit would control.

Accordingly, the Judges adopt SoundExchange's proposed amendment to 37 CFR 382.7(d), with the meaning as set forth in this Remand Determination.

The Judges in their discretion may grant rehearing on such matters as they deem appropriate. 17 U.S.C. § 803(c)(2). Participants in this proceeding have 15 days from the date of issuance of this Initial Determination After Remand to request rehearing.

Within ten days, the affected parties shall file a joint proposed public version of this Initial Determination for public viewing.

[86] Of course, if the parties cooperate, SoundExchange could conduct its GAAS-compliant audit in lieu of a Music Choice "defensive audit."

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David P. Shaw
Chief Copyright Royalty Judge

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David R. Strickler
Copyright Royalty Judge

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Steve Ruwe
Copyright Royalty Judge

DATED: February 3, 2025.