

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

In re)
)
)
 DETERMINATION OF ROYALTY) **DOCKET NO. 14-CRB-0001-WR**
 RATES AND TERMS FOR) **(2016-2020)**
 EPHEMERAL RECORDING AND)
 DIGITAL PERFORMANCE OF SOUND)
 RECORDINGS (WEB IV))
)

**INTRODUCTORY MEMORANDUM TO THE
WRITTEN DIRECT STATEMENT OF SOUNDEXCHANGE, INC.**

SoundExchange, Inc. (“SoundExchange”), through its undersigned counsel, respectfully submits this Introductory Memorandum to its Written Direct Statement in accordance with 37 C.F.R. § 351.4. This Memorandum provides an overview of the evidence presented in SoundExchange’s written direct case and briefly summarizes the testimony of its witnesses.

SOUNDEXCHANGE’S ROYALTY RATE PROPOSAL

SoundExchange proposes that the appropriate royalty rate for eligible nonsubscription transmissions and transmissions made by a new subscription service pursuant to 17 U.S.C. § 114 and the making of ephemeral recordings to facilitate such performances pursuant to 17 U.S.C. § 112 for the period between 2016 to 2020 for commercial webcasters be the greater-of the following per-performance rate and percentage of revenue:

	Per-Performance Rate	Percentage of Revenue
2016	\$0.0025	55%
2017	\$0.0026	55%
2018	\$0.0027	55%
2019	\$0.0028	55%
2020	\$0.0029	55%

For noncommercial webcasters, SoundExchange proposes a minimum fee of \$500 per station or channel, up to a maximum usage of 159,140 aggregate tuning hours. The same performance rates for commercial webcasters shall apply to usage by noncommercial webcasters in excess of 159,140 hours per month.

The royalty fee for ephemeral copies shall be included within, and constitute 5% of, all such royalty payments. SoundExchange proposes corresponding amendments to the definition of revenue and other necessary terms as explained more fully in SoundExchange's Proposed Rates and Terms.

SUMMARY OF WRITTEN DIRECT CASE

Since the Copyright Royalty Board last heard evidence and set rates for the webcasting industry, the market has evolved considerably. The market for music streaming services, and webcasting services in particular, has engendered widespread adoption by consumers, who are rapidly shifting their music consumption habits from "owning" copies of music (be they digital or physical) toward a model of music "access" via streaming services. Relatedly, over the past rate term, the industry has seen increasing "convergence" between programmed and customized webcasting services (also referred to as "non-interactive") and on-demand streaming services (also referred to as "interactive"), in both functionality and in the ways in which consumers engage with such services. As witnesses from record labels explain, consumers are likely to view these alternative streaming services as relatively close substitutes for one another.

Drawing from a thick market of available directly licensed agreements,¹ economist Dr. Daniel L. Rubinfeld concludes that directly-negotiated licenses for on-demand streaming

¹ SoundExchange has sought to analyze and present to the CRB Judges all relevant market evidence regarding direct licenses for the audio streaming of sound recordings. Unfortunately, shortly prior to the deadline for the submission of the parties' Written Direct (footnote continued)

services are the most comparable benchmarks for this rate-setting proceeding and that greater reliance upon such agreements than in prior proceedings is warranted. As noted, interactive and non-interactive markets are converging. Non-interactive services with a substantial degree of customization and personalization now come closer to replicating the *lean-forward* experience of on-demand services in a *lean-back* way. Further, music streaming services of all types are commonly available on mobile devices. Accordingly, webcasting services and on-demand streaming services are currently in competition for the same group of consumers. Moreover, these benchmark agreements are between willing buyers and sellers outside the direct shadow of the statutory license, involve the same or similar parties as the statutory license, and can be readily adjusted for any differences in rights compared to the statutory license. Lastly, no other market agreements are more comparable.

Dr. Rubinfeld further concludes that the market data supports a “greater-of” rate structure that includes a minimum per performance rate and a percentage of the revenues of the service. Indeed, a “greater of” structure has been almost uniformly followed by willing buyers and

Statements, Apple Inc. (“Apple”) – which acquired Beats Music, LLC (“Beats”) following the commencement of these proceedings – and Spotify USA Inc. (“Spotify”) raised pre-discovery objections to SoundExchange’s inclusion of information relating to certain Beats and Spotify agreements in its direct case on the basis of confidentiality provisions in those agreements. Despite our best efforts to obtain Apple and Spotify’s consent to the submission of this information, the parties have not yet reached a resolution of this issue. As a result, SoundExchange has had to redact references to certain information pertaining to Beats and its predecessor MOG, Inc., and Spotify from its Written Direct Statement. SoundExchange will continue to work with Apple and Spotify to resolve their objections so that it can provide complete information to the Judges. As soon as these issues are resolved, SoundExchange will submit the redacted information.

Relatedly, SoundExchange intended to submit information relating to the major record labels’ agreements with Apple for its iTunes Radio service as part of its Written Direct Testimony. The record companies asked Apple to waive certain contractual provisions in these agreements that limit or prohibit the submission or reliance upon them in connection with this proceeding. Apple refused to do so. Accordingly, SoundExchange has not submitted information relating to these agreements for the Judges’ consideration.

willing sellers in directly negotiated agreements between music streaming services and record companies. Witnesses from record labels explain that this rate structure accomplishes three key critical goals in today's rapidly evolving market: (1) guarantees a minimum return on investment as each use of a sound recording on one streaming service replaces a use of a sound recording on another streaming service; (2) allows the record companies to share in the upside of music streaming services when their very success is built on the investment and creative contribution of the record labels and musicians; and (3) preserves the inherent value in music.

Dr. Rubinfeld thus bases his assessment of the market rates for the statutory license upon a deep set of directly-licensed on-demand agreements. In so doing, he accounts for certain quantifiable terms that rights owners are able to obtain in the market but that are not required under the statutory license, including advances or minimum guarantees that ensure a base level of compensation, and marketing and promotional guarantees that protect and promote the market share of that record label. Dr. Rubinfeld's analysis is conservative in that there are other forms of valuable consideration, including equity guarantees, holdback rights for exclusive streaming partners, data usage for analysis, and security guarantees that deter privacy and protect content, which cannot be readily accounted for in a set of proposed rates.

The consideration that record labels and artists receive in exchange for the right to use sound recordings must be viewed in the overall context described above. The shift in the recorded music industry from an "ownership" model – in which consumers bought permanent copies of sound recordings – to an "access" model – in which consumers buy access to streaming services without buying an actual copy, has meant that webcasting revenues are now primary, not ancillary, revenue for copyright owners. This trend is likely to continue over the next rate term: As revenues attributable to webcasting and streaming are growing, revenues from

other sources, such as the sale of permanent downloads and CDs, are declining. Record company witnesses, including Dennis Kooker, President, Global Digital Business and U.S. Sales, for Sony Music Entertainment, explain how this change has impacted their business. Specifically, they explain how record companies have recognized and embraced this transition in consumer behavior, and how the royalty rate for webcasting must be set in this broad context of streaming as primary revenue to ensure that copyright owners can cover the costs of providing a wide range of music from new and established artists to an enormous and diverse group of consumers, and also receive a reasonable return on their investment. For artists, the impact of the transition is even greater. As they grow to depend more and more on revenues from webcasting, the rate must be commensurate to ensure that creativity is not deterred by rates too low to allow artists to make a living.

The testimony also describes the time, money, energy, and of course creativity that goes into the creation of every recording. Artist representative Fletcher Foster, President, CEO and Founder of Iconic Entertainment Group, explains the creative but arduous process involved in every recording. Raymond M. Hair, Jr., President of the American Federation of Musicians, testifies about the importance of the revenue stream from the statutory license to recording artists and musicians, who make a living by patching together revenue from many different sources to allow them to continue to make music. The record labels also invest substantial capital and take a huge risk on every artist. Independent record label witnesses Simon Wheeler, Director of Digital at the Beggars Group, Darius Van Arman, co-founder and co-owner of the Secretly Group of labels, and Jeff Harleston, General Counsel and Executive Vice President of UMG Recordings, Inc. explain the extraordinary efforts that are required by record labels' A&R departments to find and develop talent, giving musicians an opportunity to showcase their art.

Without the contributions of artists, record labels, and the countless other creative and industry professionals who bring recordings to life and to market, the webcasting industry would have nothing to stream. Webcasting services generate revenue from playing the music that others have worked so hard to create.

Finally, the efficient and effective operation of the statutory license simply would not be possible without SoundExchange. SoundExchange has administered the statutory license effectively for more than ten years and continues to enjoy the broad support of the industry. Accordingly, it should continue to be designated the sole collective.

**SUMMARY OF THE WRITTEN TESTIMONY OF
SOUNDEXCHANGE’S WITNESSES**

SoundExchange’s written direct case includes the written testimony of the following ten fact and four expert witnesses and one prior designated testimony.

I. FACT WITNESSES

Dennis Kooker is the President, Global Digital Business and U.S. Sales, for Sony Music Entertainment (“Sony”). The Global Digital Business Group handles digital distribution and sales initiatives on behalf of each of Sony’s various label groups in the United States. Mr. Kooker’s testimony provides a broad overview of a number of issues relevant to these proceedings, including the state of the market for streaming services, how statutorily licensed streaming services substitute for the sale of physical and digital records, and how such services undermine the ability of non-statutory services to attract paying subscribers.

Mr. Kooker’s testimony first describes the substantial investments that a record company must make to discover, produce, manufacture, distribute and market sound recordings, and how a record company depends on realizing returns from those recordings in

order to continue to support the process of creating new music. His testimony further describes the myriad challenges that Sony and the record industry more generally face as a result of the industry's transition from a model of consumers "owning" copies of music and toward a model of music "access."

Specifically, while the record industry has generally embraced the transition to streaming models, Mr. Kooker's testimony describes the significant challenge in realizing reasonable returns from online streaming services models, particularly those that have been unable to convert users from "free" to paid subscriptions. His testimony discusses why statutory services – particularly those that offer customized radio offerings – generally fail to promote the sale of recorded music or subscriptions to paid offerings. Mr. Kooker further describes the increasing convergence between services that operate exclusively under the statutory license and non-statutory services. The functionality and consumer offerings provided by each type of service have become much more similar over the last few years and are likely to continue to converge – and how this further disincentives "free-to-listen" users from subscribing to paid tiers on licensed services.

Finally, Mr. Kooker's testimony describes a number of important elements of Sony's agreements with streaming services. These elements include monetary and non-monetary consideration that provide substantial consideration that the statutory license fails to provide.

Ron Wilcox is Executive Counsel, Business Affairs, Strategic and Digital Initiatives for Warner Music Group ("WMG"). Mr. Wilcox has been involved in negotiating agreements with digital service providers since the advent of Internet distribution. His testimony describes, amongst other issues, WMG's general approach to negotiating with digital services, including online streaming services.

First, Mr. Wilcox overviews the unique features of WMG's experimental trial deal with Clear Channel (now iHeartMedia) concerning Internet simulcast and non-simulcast transmissions. Mr. Wilcox describes the unique circumstances that gave rise to that deal, and also a number of important deal terms that provide substantial consideration to WMG. In addition, Mr. Wilcox explains that, in negotiations with streaming services, neither WMG nor streaming services generally negotiate rates for or separately allocate payments on account of the ephemeral copies such services need to operate.

Furthermore, Mr. Wilcox explains that audit rights are an important component of WMG's streaming agreements. His testimony describes the technical and industry-specific expertise required to conduct a royalty audit and explains why WMG's agreements generally do not require that a certified public accountant perform royalty audits with its digital partners. Finally, Mr. Wilcox explains the efficiency benefits of having a single licensing collective for the statutory license, and why SoundExchange should be that collective.

Aaron Harrison is Senior Vice President, Business & Legal Affairs, Global Digital Business, UMG Recordings, Inc. ("Universal"). He is responsible for negotiating Universal deals with numerous digital services, including online streaming services. Mr. Harrison's testimony discusses key monetary and non-monetary terms in Universal's deals with streaming services. These facts confirm the relevance of on-demand streaming service agreements as providing the applicable benchmarks for determining the rates and terms that willing buyers and willing sellers would negotiate for the rights granted under the statutory license. Mr. Harrison also explains why rates for on-demand streaming services have decreased over the past few years as these services seek to compete with statutory services that pay much less in royalty costs. He notes that statutory rates must increase over the next rate term for the market to reach

equilibrium.

Simon Wheeler is the Director of Digital at the Beggars Group, one of the largest collections of independent record labels in the world. Based on his quarter of a century of experience working on negotiating license agreements for sound recordings on behalf of independent record labels and artists, Mr. Wheeler describes what is required for an independent record company to directly license its sound recordings and the market value of independent record company sound recordings. He identifies the current music industry shift from a purchasing business model to an access business model, including how customized webcasting substitutes for other revenue in that model and how promotion is different in that model. Mr. Wheeler's testimony concludes by explaining why strong statutory license rates are important for independent record companies who directly license their sound recordings.

Darius Van Arman is the co-founder and co-owner of Secretly Group, a collection of prominent independent record labels in the United States, as well as their affiliated companies, including independent distributor SC Distribution. His testimony offers the perspective of the independent record company community in the United States, by explaining the various ways that independent record companies distribute their sound recordings, the challenges that independent record companies face in the directly-licensed market, and the resulting importance of a strong statutory license rate. Mr. Van Arman also explains why SoundExchange should be designated the sole collective to collect and distribute statutory royalties.

Raymond M. Hair, Jr. is the President of the American Federation of Musicians. Mr. Hair testifies about the contribution and the significance of the royalty in this proceeding from the perspective of the musicians he represents. In particular, Mr. Hair describes the perspective

of not only the featured artists who rely on royalties from SoundExchange, but of the non-featured artists who perform as session musicians as well. Finally, Mr. Hair describes the reasons why he believes SoundExchange should remain the sole collective for the purpose of collecting and distributing royalties.

Fletcher Foster is the President, CEO and Founder of Iconic Entertainment Group. Mr. Foster has spent thirty years in the music industry. He has worked across all aspects of the business. His testimony describes the creative process an artist undertakes to create a sound recording. He also describes the substantial investment and risk that a recording artist faces. Finally, Mr. Foster describes the importance of the performance royalty at issue in this proceeding to the recording artist, in particular over the next rate period.

Jeffrey S. Harleston is the General Counsel and Executive Vice President for Business and Legal Affairs for North America for the group of companies that are known as the Universal Music Group (collectively, “UMG”). Mr. Harleston describes the work of a record label, in particular the significant investment and attendant risks inherent in creating and releasing sound recordings. Mr. Harleston also explains that the risk of failure and loss in that endeavor falls squarely on record labels and artists—not digital services. Digital services benefit by having the ability to play the music that record labels release that is popular – without having to bear any of the risks inherent in creating it, and without having to bear any of the losses record labels incur in artist investment. Mr. Harleston concludes that digital services that build their business on record company and artist content should pay a fair price for that content that appropriately reflects this disparity in creative contribution, investment, costs and risks.

Michael Huppe is the President and Chief Executive Officer of SoundExchange. Mr. Huppe explains the growth that the webcasting industry has seen since SoundExchange

started distributing royalties in 2003 and the incredible importance that these royalties have for record labels and artists. His testimony also explains the numerous contributions that SoundExchange has made to the music industry. In particular, the efficient and diligent process that SoundExchange uses ensures that it manages the statutory payments in a manner that returns the greatest amount of revenues to the rightsholders and artists.

Jonathan Bender is the Chief Operating Officer of SoundExchange. His testimony provides background information about SoundExchange and its operations, and describes its processing and distribution of royalties over the last rate period. Mr. Bender also explains why SoundExchange should be the sole collective for collecting and distributing royalties, and provides support for SoundExchange's proposals with respect to the minimum fees, treatment of ephemeral royalties, and terms of the statutory licenses at issue in this proceeding.

II. EXPERT WITNESSES

Daniel L. Rubinfeld, Robert L. Bridges Professor of Law, Professor of Economics, Emeritus, University of California, Berkeley, and Professor, NYU Law School, presents testimony providing the economic basis for SoundExchange's rate proposal. Dr. Rubinfeld analyzes the market for music webcasting and provides his expert opinion on reasonable rates for the statutory licensee fees to be set in this proceeding for the period 2016-2020.

Dr. Rubinfeld begins his analysis with an overview of recent developments in the Internet music industry. He explains that there has been increasing convergence in functionality and the ways in which consumers engage with "non-interactive" or programmed and/or customized webcasting services, on the one hand, and "interactive" or on-demand streaming services, on the other hand. As a result, consumers are likely to view alternative services as relatively close substitutes for each other. Dr. Rubinfeld then

describes his proposed rate structure – a greater-of formula that includes a percentage of revenues and a per-play rate – and why that structure is economically appropriate for the commercial webcasting market and supported by nearly all the market agreements.

Dr. Rubinfeld analyzes directly licensed agreements and performance data under those agreements for webcasting services that were in operation between 2011 and 2014 and which fall into the following categories: Category A – on-demand or “interactive” services; Category B – programmed and/or customized webcasting or “non-interactive” services, including WMG’s agreement with iHeartMedia for the iHeartRadio service and labels’ agreements with Nokia for the MixRadio service; and Category C – streaming music video services including YouTube and Vevo. In analyzing comparability, Dr. Rubinfeld considers, consistent with the Judges’ approach in the decision on remand in *Webcasting III*, whether the agreements are between (1) willing buyers and sellers that are (2) farthest removed from the influence of the statutory license, but which (3) involve the same or similar parties as the statutory license, and (4) provide the same or similar rights as the statutory license.

Dr. Rubinfeld concludes that the directly licensed agreements between record companies and the Category A set of “on-demand” services are the most appropriate benchmarks for this proceeding, for several reasons. These agreements – representing the majority of directly licensed services – were all struck between willing licensees and licensors. Moreover, because they specify functionality that is not DMCA-compliant, direct licensing was required; this minimized the effect of the statutory shadow because the service could not immediately fall back to the statutory license if an agreement was not reached. As a result, the agreements in Category A are not directly influenced by the existing statutory license rates.

In setting forth his rate proposal based on the Category A set of interactive services, Dr. Rubinfeld provides a series of calculations using contractual and performance data for these services. Dr. Rubinfeld's analysis takes into account and adjusts for quantifiable consideration that is not captured by the rate, the value that consumers place on interactivity, the number of royalty-bearing plays in comparison to statutory services, the differences between independent and major record company deals, and the anticipated growth of statutory and directly-licensed services. This results in a set of per-play rates ranging from \$.0025 through \$.0029 for the rate period. With respect to the percentage of revenue prong, Dr. Rubinfeld observes that these agreements provide record companies with the minimum revenue share that ranges between 50 percent and 60 percent of the services' revenues (based on the record company's share of total streams), with the majority falling between 55 percent and 60 percent. Dr. Rubinfeld conservatively selects 55% for the percentage of revenue prong.

Dr. Rubinfeld further concludes that the other potential benchmark agreements possess a number of characteristics that make them less suitable as comparable benchmarks. He nonetheless analyzes and explains the appropriate weight and consideration that should be given to the iHeartRadio agreement between iHeartMedia and WMG as well as the streaming video services such as YouTube and Vevo.

Dr. Rubinfeld concludes that his rate proposal based upon the on-demand or "interactive" service agreements, when appropriately adjusted, meets the objectives set forth by the Judges in the Commencement Notice for this proceeding, as well as the principles and critiques of prior analyses put forward by the Judges in prior webcasting proceedings.

Thomas Z. Lys, Ph.D., is the Eric L. Kohler Chair in Accounting and Professor of

Accounting and Information Management at the Kellogg School of Management, Northwestern University. Dr. Lys's testimony supports SoundExchange's rate proposal, including the rate structure, audit, and payment terms.

After analyzing the music streaming agreements of 63 service-label pairs, Dr. Lys concludes that the market evidence overwhelmingly supports a rate structure that pays the greater of (i) the fee calculated under a per-performance rate and (ii) a percentage of the webcaster's revenue. Based on his analysis of the 63 service-label pairs, Dr. Lys also concludes that willing buyers and willing sellers would agree to the following payment terms: payment within 30 days of the end of a monthly reporting period and a monthly 1.5% interest rate applied to any late payments. In addition, Dr. Lys concludes that audit rights are a key to ensuring that stakeholders are compensated correctly and that virtually all private agreements contain such rights. Finally, Dr. Lys proposes an approach, consistent with the approach adopted by the Judges in PSS/Satellite II (Docket No. 2011-1 CRB), to account for the performance of directly-licensed sound recordings or sound recordings that otherwise do not require a license.

David Blackburn, Ph.D., is Vice President for NERA Economic Consulting and is based in NERA's Washington, DC office. Dr. Blackburn has examined the development and behavior of webcasters, particularly those using digital sound recordings pursuant to statutory licenses in the United States. His testimony explains that webcasting has been a vibrant and growing industry and is expected to continue as such. He also observes that webcasters often forego short-run profitability in favor of user and market share growth. Dr. Blackburn also analyzed whether statutory webcasting serves a primarily promotional role for other record label revenue sources, and found little support for that proposition. Rather,

the evidence suggests that statutory webcasting does not increase sales of digital downloads and, in fact, serves to cannibalize industry revenue earned through directly-licensed interactive streaming services.

Daniel McFadden, Ph.D., is Emeritus Professor of Economics at University of California at Berkeley and Presidential Professor of Health Economics at the University of Southern California. Dr. McFadden conducted a conjoint survey to determine the value that future consumers of digital streaming services place on the features of those services. Specifically, Dr. McFadden determined that the value that future consumers place on features that are not available under the statutory license, such as the ability to play tracks on-demand, the ability to listen to tracks “offline” and the ability to skip songs in an unlimited manner, represent only a relatively small proportion of the overall willingness to pay for streaming services. The results of Dr. McFadden’s survey confirm the interactivity adjustment Dr. Rubinfeld applies to the on-demand set of benchmark agreements in his calculations of the proposed rates for this proceeding.

III. DESIGNATED TESTIMONY FROM *WEBCASTING III*

George S. Ford, Ph.D., is the President of Applied Economic Studies, a private consulting firm specializing in economic and econometric analysis. SoundExchange designates Dr. George S. Ford’s testimony from Docket No. 2009-1 CRB *Webcasting III*. Consistent with 37 C.F.R. § 351.4(b)(2), SoundExchange includes a copy of Dr. Ford’s Written Direct Testimony and a transcript of Dr. Ford’s trial testimony.

Dr. Ford’s testimony supports SoundExchange’s rate proposal for ephemeral copies under Section 112(e) of the Copyright Act. Dr. Ford concludes that ephemeral copies clearly have economic value and that, based on economic theory and marketplace evidence, the value of

those ephemeral copies is best expressed as a fixed percentage of the overall royalty rate paid by webcasters for combined activities under Sections 112(e) and 114.

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