

Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In the Matter of:

**Digital Performance Right in Sound
Recordings and Ephemeral Recordings**

**Docket No. 2009-1
CRB Webcasting III**

**PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW
OF LIVE 365, INC.**

Angus M. MacDonald
Abraham J. Yacobian
HOVANESIAN & HOVANESIAN
301 Colorado Blvd., Suite 514
Pasadena, CA 91101
Fax: (626) 795-8900
angusm@hovlaw.com
abrahamy@hovlaw.com

David D. Oxenford
DAVIS WRIGHT TREMAINE, LLP
1919 Pennsylvania Ave., NW, Suite 800
Washington, DC 20006
Fax: (202) 973-4499
davidoxenford@dwt.com

Counsel for Live365, Inc

September 10, 2010

TABLE OF CONTENTS

- A. Proposed Findings of Fact of Live365, Inc.
- B. Proposed Conclusions of Law of Live365, Inc.

Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In the Matter of:

**Digital Performance Right in Sound
Recordings and Ephemeral Recordings**

**Docket No. 2009-1
CRB Webcasting III**

**PROPOSED FINDINGS OF FACTS
OF LIVE 365, INC.**

Angus M. MacDonald
Abraham J Yacobian
HOVANESIAN & HOVANESIAN
301 Colorado Blvd., Suite 514
Pasadena, CA 91101
Fax: (626) 795-8900
angusm@hovlaw.com
abrahamy@hovlaw.com

David D. Oxenford
DAVIS WRIGHT TREMAINE, LLP
1919 Pennsylvania Ave., NW, Suite 800
Washington, DC 20006
Fax: (202) 973-4499
davidoxenford@dwt.com

Counsel for Live365, Inc.

September 10, 2010

TABLE OF CONTENTS

I.	THE PROCEEDINGS	1
A.	SUBJECT OF THE PROCEEDINGS	1
B.	PARTIES TO THE PROCEEDINGS	2
C.	THE DIRECT CASES	2
D.	THE REBUTTAL CASES.....	4
II.	THE STATUTORY CRITERIA FOR SETTING RATES AND TERMS	6
III.	PREDICTIONS MADE IN THE <i>WEBCASTING II</i> PROCEEDING VERSUS THE REALITIES OF THE WEBCASTING INDUSTRY	7
IV.	THE STATE OF THE INDUSTRY	12
A.	THE CURRENT ECONOMICS OF THE WEBCASTING INDUSTRY	12
1.	Live365 Has Put Forth Witnesses With Direct Knowledge Of The Economics Affecting The Statutory Industry; SoundExchange Has Put Forth None.....	12
2.	The Statutory Webcasting Industry Is Dominated By Advertising-Based Listening.....	15
3.	The Decline In Advertising Rates And Its Impact On The Economic Health Of the Statutory Webcasting Market.....	16
4.	Statutory Webcasters’ Necessary Reliance On Ad Networks Results In Lower Yield And Higher Costs Of Sale	18
5.	Excess Inventory Is Further Driving Down CPM Rates And Reducing Revenue Generation	20
6.	Subscription Revenues In Webcasting Are Declining	22
7.	Listenership Growth Has Flattened Over The Last Year.....	23
8.	Consolidation of Listenership	25
9.	Any Growth In The Statutory Webcasting Market Is Heavily Skewed By One Entity: Pandora.....	26
10.	Audience Growth Does Not Equate To Increased Revenues	28
11.	Demographic Targeting Has Not Materialized In An Impactful Way	29
12.	New Platform Launches Does Not Necessarily Increase Revenues Per Play	30
B.	AD-SUPPORTED SERVICES ARE STRUGGLING UNDER THE WEIGHT OF ROYALTY PAYMENTS AND CHALLENGING ECONOMIC CONDITIONS	31
C.	EVERY DOLLAR OF REVENUE EARNED BY PANDORA, THE MOST SUCCESSFUL STATUTORY WEBCASTER (AND LARGEST “WILLING	

	BUYER”), WOULD HAVE BEEN PAID TO COVER THE SOUND RECORDING ROYALTY IN 2009	33
D.	THE MAJORITY OF THE STATUTORY WEBCASTING INDUSTRY PAYS UNDER A WSA AGREEMENT AND NOT THE PRESCRIBED STATUTORY RATES	34
V	LIVE365’S RATE PROPOSAL	35
A.	DR. FRATRIK’S MODEL ANALYZES THE ACTUAL REVENUE AND COSTS OF A “REPRESENTATIVE” COMMERCIAL WEBCASTING SERVICE TO DERIVE THE VALUE OF THE COPYRIGHTED WORK ON A PER-PERFORMANCE BASIS, RATHER THAN RELYING ON UNPROVEN AND UNTESTED PROJECTIONS	35
B.	KEY ASSUMPTIONS TO DR. FRATRIK’S MODEL	36
C.	ECONOMICS OF DR. FRATRIK’S MODEL.....	37
1	Dr Fratrik’s Subscription Revenue Per ATH Calculation Is Based On Live365’s Historical Numbers And Confirmed In Data Provided By SoundExchange’s Expert, Dr. Pelcovits	38
2.	Dr. Fratrik’s Advertising Revenue Per ATH Calculation Is Based On Reliable Industry Estimates.....	39
3.	Dr. Fratrik’s Total Revenue Per ATH Calculation Is Based On The Ratio Between Subscription And Non-Subscription Performances In The Non-Interactive Webcasting Market	39
4.	Costs Calculation in Dr. Fratrik’s Model.....	40
5.	An Operating Margin of 20% Is Appropriate For The Statutory Webcasting Industry.....	40
D.	AN APPROPRIATE RATE FOR THE INDUSTRY IS \$.0009 PER PERFORMANCE	41
E.	DR. FRATRIK HAS PROVIDED THE COURT WITH UPDATED NUMBERS FOR 2009 IN HIS APPENDICES.....	42
F.	UNLIKE DR. PELCOVITS, DR. FRATRIK EMPLOYED PROPER ECONOMIC THEORY BY CONDUCTING A REALITY CHECK ON HIS CALCULATIONS.....	43
VI.	RATE PROPOSAL FOR AGGREGATION SERVICES	44
A.	BENEFITS OF AGGREGATION SERVICES	44
B.	EXAMPLES OF BENEFITS PROVIDED BY AGGREGATION SERVICES IN ROYALTY CONTRACTS.....	46
C.	DISCOUNT FOR AGGREGATION SERVICES.....	47
VII.	SOUNDEXCHANGE’S RATE PROPOSAL IS NOT BASED ON THE WILLING BUYER / WILLING SELLER STANDARD	47

A.	SOUNDEXCHANGE HAS PUT FORTH NO SUPPORTABLE EVIDENCE FOR ITS RATE PROPOSAL	47
B.	SOUNDEXCHANGE HAS MADE NO SHOWING THAT INCREASED RATES YEAR AFTER YEAR ARE JUSTIFIED	49
VIII.	DR. PELCOVITS' INTERACTIVE SERVICES BENCHMARK IS FRAUGHT WITH ERRORS	50
A.	NATURE OF MODEL FOR BENCHMARK METHOD	50
B.	DERIVATION OF INTERACTIVE SERVICES BENCHMARK	51
C.	DR. PELCOVITS FAILS TO EXAMINE THE IMPACT OF HIS RATES ON A WILLING BUYER	52
D.	DR. PELCOVITS' BENCHMARK APPROACH IGNORES THE REALITY OF THE INDUSTRY – THE VAST MAJORITY OF THE LISTENING IS DONE THROUGH AD SUPPORTED SERVICES, NOT SUBSCRIPTION SERVICES	54
E.	DR. PELCOVITS EXACERBATES HIS ERRORS BY SELECTIVELY CHOOSING DATA TO INFLATE HIS RECOMMENDED ROYALTY RATE	56
1.	Failure To Analyze Data From Independent Labels Results In An Inflated Royalty Rate	56
2.	Dr. Pelcovits' Data Shows A Lower Effective Per Play Rate Over Time Than The Number Used In His Calculations	58
3.	Selective Use Of Data In Dr. Pelcovits' Calculations	59
F.	DR. PELCOVITS' USE OF A HEDONIC REGRESSION MODEL IS NOTHING MORE THAN SMOKE AND MIRRORS TO CONFIRM AN ANALYSIS THAT CLEARLY HAS PRODUCED AN UPWARDLY BIASED RESULT	59
G.	EVEN IF THE COURT FINDS THE HEDONIC ANALYSIS RELEVANT, DR. PELCOVITS' REGRESSION TECHNIQUES ARE FRAUGHT WITH ERRORS RESULTING IN ENTIRELY UNRELIABLE CONCLUSIONS	61
1.	Improper Use Of Fixed Effects	61
2.	Failure To Provide A Confidence Interval	62
IX.	THE WSA AGREEMENTS ARE NOT APPROPRIATE BENCHMARKS	63
A.	SOUNDEXCHANGE IS NOT A WILLING SELLER	64
B.	BECAUSE SOUNDEXCHANGE IS A COLLECTIVE OF COMPETING SELLERS – AND NOT A WILLING SELLER – IT CAN NEGOTIATE RATES THAT ARE HIGHER THAN WHAT RECORD COMPANIES COULD NEGOTIATE INDIVIDUALLY	65
C.	THE NAB IS NOT A WILLING BUYER	65

D.	THE PERFORMANCE COMPLEMENT WAIVERS ARE VALUABLE TO THE NAB SIMULCASTERS, AND THAT VALUE SHOULD BE CONSIDERED IN RELYING ON THE NAB DEAL AS A BENCHMARK	66
E.	SIRIUS XM IS A SUBSCRIPTION SERVICE, AND NOT COMPARABLE TO OTHER WEBCASTING SERVICES, WHICH ARE PRIMARILY ADVERTISING-SUPPORTED.....	68
F.	THE NAB AND SIRIUS XM HAVE SUBSTANTIALLY DIFFERENT ECONOMIC STRUCTURES	69
G.	THE WSA AGREEMENTS WERE ENTERED INTO UNDER THREAT OF PENDING LITIGATION IN THE CRB	73
H.	THE NAB RECEIVED A DISCOUNT IN 2008 & 2009 AS A BENEFIT FOR HIGHER RATES IN 2011-2015.....	74
I.	THE NAB AND SIRIUS XM HAVE SUBSTANTIAL INCENTIVES TO RAISE THEIR RIVALS' COSTS	75
X.	NON-INTERACTIVE WEBCASTING HAS SIGNIFICANT PROMOTIONAL VALUE	77
A.	NON-INTERACTIVE WEBCASTING POSITIVELY IMPACTS MUSIC SALES.....	77
B.	OTHER EVIDENCE OF THE PROMOTIONAL VALUE OF STATUTORY WEBCASTING.....	79
C.	WEBCASTING IS NOT A SUBSTITUTE FOR MUSIC SALES	80
D.	IMPACT ON ROYALTY RATE	81
XI.	CREATIVE CONTRIBUTION, TECHNICAL CONTRIBUTION, CAPITAL INVESTMENTS, COSTS AND RISKS BY LIVE365 AND OTHER WEBCASTERS	81
XII.	PROGRAMMING FACTORS NECESSITATE A DOWNWARD REDUCTION OF THE CURRENT STATUTORY RATES.....	83
XIII.	COMPETITIVE FACTORS NECESSITATE A DOWNWARD REDUCTION OF THE CURRENT STATUTORY RATES.....	84
XIV.	MINIMUM FEE UNDER SECTION 114(f).....	85
XV.	ROYALTY RATE FOR EPHEMERAL RECORDINGS UNDER SECTION 112(e).....	86
XVI.	PROPOSED REGULATIONS AND TERMS	86

I. THE PROCEEDINGS¹

A. SUBJECT OF THE PROCEEDINGS²

1. This is a rate-setting proceeding convened under 17 U.S.C. § 803(b) *et seq.* and 37 C.F.R. § 351 *et seq.*, in accord with the Copyright Royalty Judges' Notice announcing the commencement of this *Webcasting III* proceeding (Docket No. 2009-1), with a request for Petitions to Participate. *See* 74 Fed. Reg. 318-19 (Jan. 5, 2009). The purpose of this proceeding is to determine the reasonable rates and terms for certain digital performances of sound recordings by means of an eligible nonsubscription transmission or a transmission made by a new subscription service under Section 114 of the Copyright Act, and for the making of ephemeral recordings in furtherance of these digital performances under Section 112. *See id.* The rates and terms set in this proceeding apply to the period of January 1, 2011 to December 31, 2015. *See id.*, 17 U.S.C § 804(b)(3)(A).

2. Numerous petitions to participate, which were due by February 4, 2009, were filed. Pursuant to an August 31, 2009 Order, all participants who had not filed a notice of withdrawal from the proceeding were directed to file a Notice of Intention to Submit a Written Direct Statement. *See* 8/31/2009 Order on Notice of Intent. The participants were ultimately reduced to six parties.

¹ To the extent that any of the following proposed findings of fact are considered to be proposed conclusions of law, Live365 requests that they be deemed as such; likewise, Live365 requests that any proposed conclusion of law determined to be a factual finding shall be regarded as a proposed finding of fact to the extent appropriate.

² In these Findings, "WDT" refers to a witness's written direct testimony, filed with the CRB on September 29, 2009. "AWDT" and "CAWDT" refer to a witness' amended and corrected/amended testimony, respectively. "WRT" is the corresponding abbreviation for a witness's written rebuttal testimony filed with the CRB on June 7, 2010. Oral testimony shall be abbreviated herein by reference to the date of the transcript, the page and line numbers, and the witness name in parenthesis – e.g., 7/28/10 Tr. at 222:1-8 (Smallens).

B. PARTIES TO THE PROCEEDINGS

3. After the expiration of the mandatory negotiation period, the parties were directed to submit their written direct statements on or before September 29, 2009. The parties who submitted direct cases in the proceedings were: (i) SoundExchange, Inc. (“SoundExchange”), (ii) Live365, Inc. (“Live365”), (iii) RealNetworks, Inc. (“RealNetworks”); (iv) Intercollegiate Broadcasting System, Inc. & Harvard Radio Broadcasting Co., Inc. (collectively “IBS”), (v) College Broadcaster Inc. (“CBI”), and (vi) Royalty Logic, LLC.

4. Shortly before the commencement of the direct case hearing, RealNetworks withdrew from this proceeding. *See* 4/16/2010 Notice of Withdrawal by RealNetworks, Inc.

C. THE DIRECT CASES

5. The participants filed Written Direct Statements on September 29, 2009. Discovery was then conducted in the direct case phase from December 1, 2009 to January 29, 2010. *See* 11/10/2009 Discovery Schedule Order. Oral testimony was taken at the direct case hearing from April 19 to April 28, 2010.

6. Live365’s direct case consisted of the testimony of the following three witnesses: Dr. Mark Fratrick, Mr. Johnnie Floater, and Ms. Dianne Lockhart.

7. Dr. Fratrick is a Vice President of BIA/Kelsey (“BIA”), which has been analyzing the broadcast industries for over 26 years. *See* Live365 Trial Ex. 30 (hereinafter “Fratrick CAWDT”) at 1-2. Dr. Fratrick supervises the research efforts of BIA related to the radio, television and newspaper industries, and is responsible for BIA’s advertising revenue survey for these industries. *See* Fratrick CAWDT at 1; 4/27/10 Tr. at 1071:6-16 (Fratrick). Prior to joining BIA, Dr. Fratrick was an economist at the National Association of Broadcasters (“NAB”) for nearly 16 years. *See* 4/27/10 Tr. at 1070:20-1071:3 (Fratrick). Before his tenure at the NAB, Dr.

Fratrik was an economist at the Bureau of Economics at the U.S. Federal Trade Commission. *See* Fratrik CAWDT at 3. Dr. Fratrik obtained a Ph.D. in economics from Texas A&M University in 1981. *See* Fratrik CAWDT at 4. The Copyright Royalty Judges admitted Dr. Fratrik as an expert in industrial organization with an expertise in the broadcast and media industries. *See* 4/27/10 Tr. at 1076:8-1077:4 (Fratrik).

8. Mr. Floater is the General Manager of Media at Live365. *See* Live365 Trial Ex. 29 (hereinafter “Floater CWDT”) at 1. Mr. Floater oversees the operation and revenue generation of Live365’s internet radio streaming business. *See* Floater CWDT ¶1. Mr. Floater has been at Live365 since October 2004. *See* Floater CWDT ¶6. Prior to joining Live365, Mr. Floater held various staff and management roles in the terrestrial radio business, including commercial and public radio. *See* Floater CWDT ¶2.

9. Ms. Dianne Lockhart is the owner and operator of Solace Radio, a webcasting station streamed through Live365’s network. *See* Live365 Trial Ex. 33 (hereinafter “Lockhart WDT”) at 1. Ms. Lockhart launched her first webcasting station in 2005. *See* Lockhart WDT at 2. Prior to webcasting, Ms. Lockhart had been in the terrestrial broadcasting industry for approximately 25 years in various capacities – including on-air talent, sales manager, news director, producer and commercial production manager. *See* Lockhart WDT at 2.

10. SoundExchange’s direct case consisted of testimony of the following witnesses:

- Mr. Dennis Kooker, who is an Executive Vice President and General Manager at Sony Music Entertainment – *see* SX Trial Ex. 1 (hereinafter “Kooker CWDT”);
- Dr. Michael D. Pelcovits, who is a Principal at Microeconomic Consulting & Research Associates – *see* SX Trial Ex. 2 (hereinafter “Pelcovits ACWDT”);

- Kim Roberts Hedgpeth, who is the National Executive Director of the American Federation of Television and Radio Artists – *see* SX Trial Ex. 3 (hereinafter “Hedgpeth WDT”);
- Dr. George Ford, who is the President at Applied Economic Studies – *see* SX Trial Ex. 4 (hereinafter “Ford AWDT”);
- Ms. Barrie Kessler, who is the Chief Operating Officer at SoundExchange – *see* SX Trial Ex. 5 (hereinafter “Kessler CWDT”); and
- Mr Tucker McCrady, who is an Associate Counsel at Warner Music Group – *see* SX Trial Ex. 7 (hereinafter “McCrady WDT”).

11. IBS’s direct case consisted of the testimony of the following witnesses:

- John E. Murphy, who is the General Manager of WHUS Radio – *see* IBS Trial Ex. 1;
- Benjamin Shaiken, who is a student at University of Connecticut – *see* IBS Trial Ex. 2; and
- Frederick J. Kass, who is the director of operations at IBS – *see* IBS Trial Ex. 4;

D. THE REBUTTAL CASES

12. The participants filed Written Rebuttal Statements on June 7, 2010. *See* 3/3/2010 Discovery Schedule Order. Discovery was then conducted on the rebuttal evidence from June 14, 2010 to July 16, 2010. *See id.* Oral testimony was taken at the rebuttal case hearing from July 28, 2010 to August 2, 2010.

13. Live365’s rebuttal case consisted of the testimony of two expert witnesses: Dr. Michael Salinger and Mr Alexander “Sandy” Smallens.

14. Dr. Salinger is a Professor of Economics at the Boston University School of Management and is a Managing Director of LECG, a company that provides economic analysis for legal and regulatory proceedings. *See* Live365 Rebuttal Ex. 1 (hereinafter “Salinger WRT”), ¶1 From July 2005 through June 2007, Dr. Salinger took a leave of absence from Boston University to serve as the Director of the Bureau of Economics at the U.S. Federal Trade Commission. *See* Salinger WRT ¶2. Dr. Salinger received a Ph.D. in economics from the Massachusetts Institute of Technology in 1982. *See* Salinger WRT ¶7. The Copyright Royalty Judges admitted Dr. Salinger as an expert in industrial economics and statistics in this proceeding. *See* 7/28/10 Tr. at 12:8-14 (Salinger).

15. Mr. Smallens is the founder and managing director of Audiation, Inc., a digital media consultancy. *See* Live365 Rebuttal Ex. 2 (hereinafter “Smallens CWRT”), ¶1 Prior to starting Audiation, Mr. Smallens had been a digital media executive in various media companies – including major broadcast radio companies, record labels, and digital advertising companies – for 17 years. *See* Smallens CWRT ¶1. Mr. Smallens is a songwriter and musician, and graduated from Yale University, where he was the Editor-in-Chief of the campus’ music magazine. *See* Smallens CWRT ¶¶5-6. The Copyright Royalty Judges admitted Mr. Smallens as an expert in the webcasting industry with specific expertise in online advertising. *See* 7/28/10 Tr at 161:1-4, 163.13-14 (Smallens).

16. SoundExchange’s rebuttal case consisted of the testimony of two witnesses:

- Dr. Janusz Ordover, who is a Professor of Economics at New York University – *see* SX Trial Ex. 45 (hereinafter “Ordover WRT”), and
- Mr. Kyle Funn, who was the Manager for Licensing & Enforcement at SoundExchange – *see* SX Trial Ex. 46 (hereinafter “Funn WRT”).

17. IBS's rebuttal case attempted to admit the testimony of Frederick J. Kass and the exhibits attached to Mr. Kass' written rebuttal testimony. The Copyright Royalty Judges determined that IBS' filing of Mr. Kass' testimony was in violation of 37 C.F.R. § 350.4(d), and therefore, denied admission of Mr. Kass' testimony as well as the exhibits attached to his testimony. *See* 7/29/10 Tr. at 302-303; *see also* 8/18/10 Order Denying IBS' Motion for Reconsideration of The Rulings Excluding Its Rebuttal Case.

II. THE STATUTORY CRITERIA FOR SETTING RATES AND TERMS

18. As discussed in greater detail below and in Live365's Proposed Conclusions of Law, the CRJs are required to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B); *id.* § 112(e)(4).

19. In determining such rates and terms, the CRJs "shall" base their decision on the "economic, competitive and programming information presented by the parties," including:

- (i) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings; and
- (ii) the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.

17 U.S.C. § 114(f)(2)(B); *id.* § 112(e)(4).

20. On the other hand, the CRJs simply "may" consider the rates and terms for comparable types of digital audio transmission services and comparable circumstances under voluntary license agreements. *See* 17 U.S.C. § 114(f)(2)(B); *id.* § 112(e)(4).

21. Sections 114(f) and 112(e) direct the CRJs to include “a minimum fee for each type of service.” 17 U.S.C. § 114(f)(2)(B); *id.* § 112(e)(4).

III. PREDICTIONS MADE IN THE *WEBCASTING II* PROCEEDING VERSUS THE REALITIES OF THE WEBCASTING INDUSTRY

22. There were numerous assumptions and predictions made in the *Webcasting II* proceeding regarding the economics of the webcasting industry – most of which did not come to fruition. *See* Fratrick CAWDT at 8-15; 4/27/10 Tr at 1097:2-5 (Fratrick).

23. Predictions made by several of the SoundExchange experts indicated an industry poised for rapid growth. Fratrick CAWDT at 8 (citing SoundExchange’s experts in *Webcasting II*). For example, James Griffin, a SoundExchange witness in *Webcasting II*, stated in his direct statement that when compared to the information presented in the CARP proceeding of 2005, “we know much more about the webcasting business, that it is booming and only expected to get better ” Fratrick CAWDT at 8 (citing Testimony of James H. Griffin, Docket No. 2005-1 CRB DTRA, at 5).

24. Dr. Pelcovits in *Webcasting II* displayed great confidence that ad-supported webcasting services would be able to not only support the royalty rate he put forth based on interactive subscription services, but would be *more* lucrative on a per-hour basis than subscription services:

As Dr. Brynjolfsson discusses, ad-support services have a higher up-side than subscription services and, as webcasters begin earning revenues closer to those of terrestrial radio... [A]d-supported webcasting, on a per listener hour basis, will be more lucrative than subscription webcasting.

Fratrick CAWDT at 8-9 (quoting Rebuttal Testimony of Michael Pelcovits, Docket No. 2005-1 CRB DTRA, at 15).

25. Webcasting had grown from the time of the earlier Copyright Arbitration Royalty Panel, and the expectation in *Webcasting II* was that usage was going to continue to skyrocket. Fratrik CAWDT at 11. Along with the expected increase in usage of webcasting services, experts for SoundExchange predicted tremendous increases in both the subscription and advertising revenues that would be generated. Fratrik CAWDT at 8-11

26. These experts' predictions on the expected growth, while optimistic, were not unique at the time of the proceeding and were in fact in line with independent assessments of the future of this industry by various analysts. Fratrik CAWDT at 9.

27. However, as discussed further below, that expected growth in listeners and the resulting advertising and subscription revenues to commercial webcasters have not materialized. Fratrik CAWDT at 9. By comparing those projections to the actual industry levels, one can appreciate the changing economics of this industry. Fratrik CAWDT at 9.

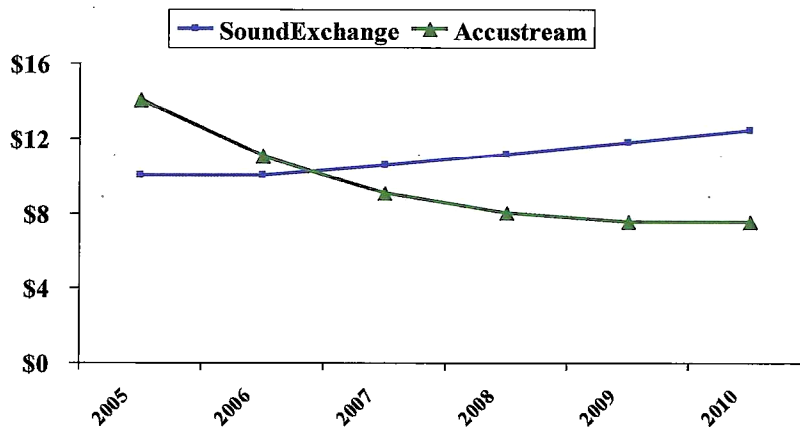
28. What was overlooked, especially in those optimistic advertising revenue growth estimates, was the tremendous increase in competition from all advertising sources. Fratrik CAWDT at 11. The advertising market has seen an explosion in the number of available options for national and local businesses to get their messages out. Fratrik CAWDT at 11, 4/27/10 Tr. at 1099:20-1100:20.

29. Excess inventory across the Internet radio advertising industry and the opportunities available for advertisers to get their messages out to the public has depressed, or at the very least, restricted the increases of CPM rates that webcasters can charge for their advertising inventory. Fratrik CAWDT at 11; 4/27/10 Tr. at 1101:8-20 (Fratrik).

30. For example, SoundExchange's expert provided estimates of advertising rates – expressed in cost-per-thousands (CPMs) – for 2005 through 2010. Fratrik CAWDT at 12 (citing

Testimony of Erik Brynjolfsson, Docket No. 2005-1 CRB DTRA, at 29). Figure 1 below shows the comparison of Audio CPMs between two different sources: (1) the projections of SoundExchange in 2005 for the period 2005-2010, and (2) the estimates of AccuStream iMedia Research (a digital media industry research firm) in 2009 for the same period, including actual figures for 2005-2008. Fratrick CAWDT at 12; *id.*, Exhibit 3 (AccuStream report).

Figure 1
Analysis of Audio Advertising CPMs



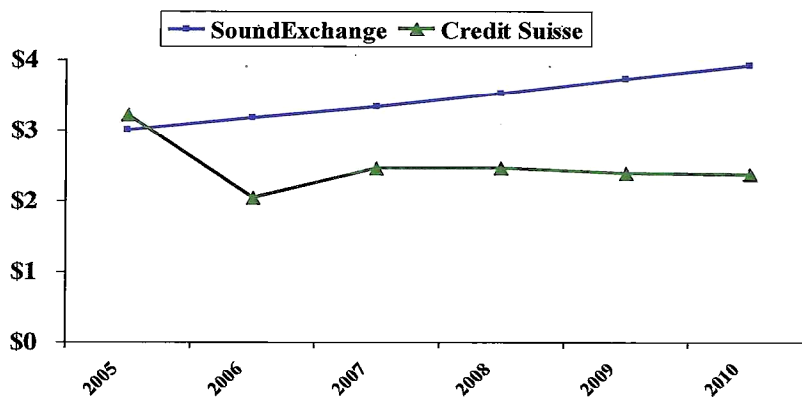
Fratrick CAWDT at 12.

31. SoundExchange's expert in *Webcasting II* predicted an average 4.5% compound annual growth rate in CPMs for audio advertising during this time period, while AccuStream estimated that the actual compound annual growth rate for that period was negative 11.7%.

Fratrick CAWDT at 12; 4/27/10 Tr. at 1097:6-17 As a point of comparison, Live 365 over the first three years of this time period has seen a 30% decrease in audio advertising CPMs, going from an average of \$4.73 in 2006, to an average of \$3.25 by 2009. *See Floater CWDT*, ¶10; 4/26/10 Tr. at 884:3-886:16 (Floater); 4/27/10 Tr at 1098:11-20 (Fratrick).

32. The value of other advertising inventories sold by webcasters was also predicted to grow at very high rates. Fratrick CAWDT at 13. Display advertisements sold by webcasters were expected to be a very strong growth area. Fratrick CAWDT at 13. Figure 2 below shows the comparison of display advertising CPMs between two different sources: (1) the projections of SoundExchange's expert (Dr. Brynjolfsson) in 2005 for the period 2005-2010, (2) and the recent estimates of the investment banking firm Credit Suisse in early 2009 for the same period. Fratrick CAWDT at 13; *id.*, Exhibit 4 (Credit Suisse report).

Figure 2
Analysis of Display Advertising CPMs



Fratrick CAWDT at 13.

33. Instead of an average 5.5% compound annual growth rate as SoundExchange's expert predicted, Credit Suisse revealed a compounded annual growth rate of negative 5.9% for the entire time period. Fratrick CAWDT at 14; 4/27/10 Tr. at 1097:18-1098:7 (Fratrick). As a point of comparison, Live365 has also seen an average annual decrease of 20.1% from 2005 to 2008 in the CPMs that they receive for this form of advertising. Fratrick CAWDT at 14 n.16; 4/26/10 Tr. at 884:3-886:16 (Floater). And this trend continues today. 4/26/10 Tr at 884:2-886:16 (Floater)

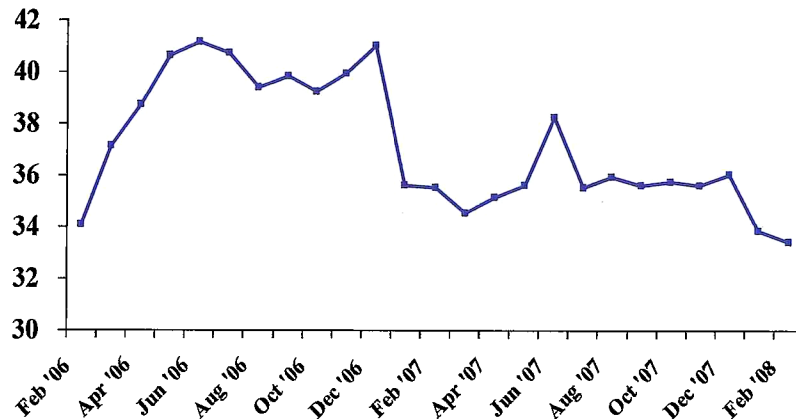
34. Further, the expectation of listener growth has not come to fruition, especially for commercial webcasting. Fratrick CAWDT at 14. Some analysts expected a tremendous increase in the number of listeners in webcasting. Fratrick CAWDT at 14. For example, Bridge Ratings in early 2007 predicted that average monthly internet radio listeners would increase by 29.0% in 2008, followed by a 24.8% increase in 2009, leading to a total listening level of 116.1 million listeners. Fratrick CAWDT at 14 (citing Bridge Rating report).

35. Similarly, SoundExchange's expert witness in *Webcasting II*, James Griffin, cited Bridge Ratings for the proposition that "Listenership – by all accounts – is projected to grow substantially ... Industry analyst Bridge Ratings predicts that by 2010, 187 million people will listen to webcasting." Fratrick CAWDT at 14 n.19 (citing written testimony of James Griffin).

36. Yet, total listening levels did not increase to the levels predicted. According to Arbitron/Edison Research in its annual survey of audiences, total monthly listenership was only 69 million as of late 2008. Fratrick CAWDT at 14; *id.*, Exhibit 6 (citing Arbitron Inc./Edison Research's *The Infinite Dial 2009*); 4/27/10 Tr. at 1102:1-22 (Fratrick). Indeed, listenership levels from 2009 to 2010 have been flat. 7/28/10 Tr. at 184:7-15 (Smallens).

37. The decrease in listenership was also documented in an analysis conducted by JP Morgan of the number of unique listeners going to pure-play Internet radio sites. Fratrick CAWDT at 14; *id.*, Exhibit 7 (JP Morgan report). From a high of 41.1 million unique listeners going to pure-play sites in June 2006, that number decreased by 18.7% in only 20 months (33.4 million unique listeners as of February 2008). Fratrick CAWDT at 14-15; 4/27/10 Tr. at 1103:1-10 (Fratrick). Figure 3 below reveals this trend.

Figure 3
Unique Visitors to Pure Play Internet Radio
Sites: February '06 – February '08



Source: JP Morgan, "Radio Broadcasting, Internet Radio Scorecard February '08, April 10, 2008"

Fratik CAWDT at 15.

38. Given that the lofty expectations from the *Webcasting II* proceeding have not been fulfilled, it follows that the rates for the next five years should be set lower than the rates determined by the CRB in *Webcasting II*. Fratik CAWDT at 9.

IV. THE STATE OF THE INDUSTRY

A. THE CURRENT ECONOMICS OF THE WEBCASTING INDUSTRY

1. Live365 Has Put Forth Witnesses With Direct Knowledge Of The Economics Affecting The Statutory Industry; SoundExchange Has Put Forth None

39. Live365 has produced four witnesses with direct knowledge of the economics affecting statutory webcasting. Johnie Floater has worked nearly six years for Live365 overseeing the operation and revenue generation of Live365's Internet Radio Streaming Business. Floater CWDT ¶1, 4/26/10 Tr. at 873:16-875:21 (Floater). Dr. Mark Fratik spent nearly 16 years

at the NAB as an economist and for the past ten years, has worked at BIA Kelsey Group supervising the research efforts of the radio, television and newspaper industries. 4/27/10 Tr. at 1070:20-1071:16 (Fratik). Dr. Fratrik has been admitted by this Court as an expert in industrial organization with an expertise in the broadcast and media industries. 4/27/10 Tr. at 1076:8-1077:4 (Fratik). Diane Lockhart has owned and operated statutory webcasting stations since 2005. Lockhart WDT at 2. Sandy Smallens has been admitted by this Court as an expert in the webcasting industry with a specific expertise in online advertising. 7/28/10 Tr. at 161:1-4, 163:13-14 (Smallens).

40. On the other hand, SoundExchange has produced no witnesses that have direct knowledge of the economics affecting statutory webcasting. In a half-hearted attempt to address the state of the webcasting industry, SoundExchange offered the testimony of Dr. Pelcovits. Pelcovits ACWDT at 6-14. Dr. Pelcovits, however, acknowledged that he is not a webcasting industry expert, and that examination of firms and behaviors in the industry is not a major focus of his practice. 4/19/10 Tr. at 170:6-20 (Pelcovits).

41. Dr. Pelcovits presented his analysis of the industry without having spoken to any executives at any webcasting companies. 4/19/10 Tr. at 172:3-172:6 (Pelcovits); *see also* Smallens CWRT at ¶10. Nor did Dr. Pelcovits review any financial statements of any pure webcaster. 4/19/10 Tr. at 172:7-13 (Pelcovits).

42. Dr. Pelcovits merely relied upon various secondary and tertiary sources for his conclusion of a “robust and evolving market for webcasting.” Pelcovits ACWDT at 11; *see also* Smallens CWRT at ¶10. As Chief Judge Sledge stated:

And you’re not an expert in the industry, so the only thing you know is what you have read and studied, and what you’ve cited to us doesn’t support what you’ve said about these services.

4/19/10 Tr. at 212:21-213:2 (Pelcovits).

43. Dr. Pelcovits cited to an Impact Lab report for the proposition that “more than \$350 million will be spent on advertising on internet radio as a medium by 2011.” Pelcovits ACWDT at 11. However, Impact Lab merely recited a report issued by ZenithOptimedia, which contained advertising revenue spending estimates. 4/19/10 Tr. at 187:16-22 (Pelcovits).

44. Significantly, the estimate of advertising revenue spend in ZenithOptimedia’s report was adjusted downward *twice*: once in July 2009 (two months before Dr. Pelcovits filed his written statement); and again in October 2009 (one month after the filing of his written statement but before the filing of his amended statement). 4/19/10 Tr. at 188:22-189:7, 190:6-9 (Pelcovits). Yet, Dr. Pelcovits failed to observe these downward reductions in the advertising revenue estimates for the industry. *Id.*

45. Dr. Pelcovits also cited a report titled “Digital Radio Ad Spending Surges Amid Medium’s Downturn” for the proposition that “the robust market for advertising on internet radio has led to a surge in spending on digital advertising to \$101 million in the radio industry for the first quarter for 2009.” Pelcovits ACWDT at 11. However at trial, Dr. Pelcovits admits this report is not limited to streaming advertising, but “all form of advertising.” 4/19/10 Tr. 184:2-18 (Pelcovits).

46. Dr. Pelcovits pointed to Last.fm as an entity that was able to “succeed in the market.” Pelcovits ACWDT at 10. However when asked about Last.fm at trial, Dr. Pelcovits:

- did not know the amount of the investments made in Last.fm before its sale;
- did not review any financial statement of Last.fm;
- did not speak with anyone at Last.fm;
- did not know their current valuation; and

- did not know whether Last.fm was profitable at the time it was sold.

4/19/10 Tr. at 194:13-195:10 (Pelcovits).

47. Dr. Pelcovits cited to other entities – namely, Slacker Radio and Pandora – in his industry assessment. Pelcovits ACWDT at 10, 12. Like Last.fm, Dr. Pelcovits failed to review financial statements or speak with representatives of these companies before rendering his observations about their “success.” 4/19/10 Tr. at 197:22-198:10, 204:9-205:14 (Pelcovits).

2. The Statutory Webcasting Industry Is Dominated By Advertising-Based Listening

48. It is undisputed that the vast majority of listening in the statutory webcasting industry is advertising-based (as opposed to subscription-based) listening. *E.g.*, Smallens CWRT at ¶¶33-34; 7/28/10 Tr. at 211:12-212:9 (Smallens) (“primarily non-interactive services are by nature going to be ad-supported.”); Salinger WRT at ¶¶26, 31; 4/20/10 Tr. at 312:7-11 (Pelcovits) (“Q: Now, Dr. Pelcovits, are you aware that the majority of listening to non-interactive webcasting is done by non-subscribers? A: Based on what I have seen, I believe that to be true.”) *see also* 4/20/10 Tr. at 313:2-5 (Pelcovits) (Q: And would you say the vast majority of listeners, as opposed to listening hours, are non-subscribers? A: Yes”); 4/26/10 Tr. at 895:3-896:2 (Floater) (Two percent of Live365’s audience are paid subscribers accounting for approximately 25% of the listening hours); 8/2/10 Tr. at 349:10-19 (Ordovery) (acknowledging that the business of noninteractive webcasting has “very little subscription based” listening).

49. For those statutory webcasters who have entered into the Pureplay deal – which represents well over 50% of the streaming in the statutory webcasting industry – SoundExchange’s data indicates that only 2.4% of the streaming is subscription-based; the other 97.6% is advertising-based (or, at least, non-subscription) listening. *See* Salinger WRT, Exhibit 2 (SoundExchange 2009 Budget); *id.*, ¶26.

50. NAB simulcasters have either no subscription-based streaming or, at best, a negligible amount. Smallens CWRT at ¶34, 4/20/10 Tr. at 354:6-9 (Pelcovits) (acknowledging the NAB companies are “ad-supported services.”).

51. It is anticipated that statutory webcasting will continue to be primarily advertising based. *See* 7/28/10 Tr. at 226:19-227:17 (Smallens).

52. The fact that the statutory webcasting industry is primarily an advertising-based model is important to take into account given Dr. Pelcovits’ assumption that comparing subscription figures in the interactive and statutory webcasting markets will provide a suitable framework for setting rates. Smallens CWRT at ¶34; Salinger WRT at ¶¶26, 31. The inherent flaw with this assumption is that the vast majority of the statutory webcasting listening – as described above – is *not* based on subscription listening, yet this fundamental distinction is not accounted for in Dr. Pelcovits’ analysis. Smallens CWRT at ¶34; Salinger WRT at ¶¶26, 31.

3. **The Decline In Advertising Rates And Its Impact On The Economic Health Of the Statutory Webcasting Market**

53. Given the fact that statutory webcasting industry is primarily based on advertising-supported listening, a proper analysis of the industry must consider CPM rates, inventory sell-outs, and the impact of each factor on the overall market. Smallens CWRT at ¶14, *see also* 7/28/10 Tr at 197:6-198:17 (Smallens). As discussed by Mr. Smallens, these are important factors for an advertising-supported industry. Smallens CWRT at ¶14.

54. Among the most relevant factors in assessing the health of the statutory webcasting market are advertising *rates* (in the form of CPMs) – not aggregate advertising *revenues* – and inventory sell-out rates. Smallens CWRT at ¶15; *see also* 7/28/10 Tr at 197:6-198:17 (Smallens).

55. Mr. Smallens testified that these metrics determine the revenue potential for ad-supported services and, implicitly, the royalty rate these services could afford to pay. Smallens CWRT at ¶15; *see also* 7/28/10 Tr. at 197:6-198:17 (Smallens).

56. Statutory webcasters assess their revenue potential in a variety of ways. One manner is to assess the total impressions served over the course of a given time period and then factor in average CPMs and sell-out percentage. Smallens CWRT at ¶15, *see also* 7/28/10 Tr. at 197:6-198:17 (Smallens). No such analysis, which could have illustrated webcasters' ad revenue capabilities, was provided by Dr. Pelcovits. *See* Smallens CWRT at ¶15; *see also* 7/28/10 Tr. at 197:6-198:17 (Smallens).

57. As testified by Mr. Smallens, CPMs for online audio ads have generally been stagnating or declining – especially for inventory sold via multi-market deals or ad networks (such as TargetSpot). Smallens CWRT at ¶16; *see also* 7/28/10 Tr. at 198:18-199:10. (Smallens); 4/26/10 Tr. at 884:3-886:16 (Floater) (“So one of the trends I am definitely seeing in my own data, and when talking to others, is the average price of CPM decreasing.”).

58. Multiple sources confirm this stagnation and/or reduction in average statutory webcasting industry CPMs. Smallens CWRT at ¶15; *see also* 7/28/10 Tr. at 198:18-199:10 (Smallens). For example, even Dr. Pelcovits acknowledged that there is no evidence of CPMs increasing:

Q. Sitting here today, you cannot say that CPMs have been rising, can you?

A. Are you talking about CPM in terrestrial broadcasting or in webcasting?

Q. Well, let's start with the webcasting market.

A. I have not seen evidence of CPM increasing.

4/19/10 Tr. at 177:15:20 (Pelcovits); *see also* Smallens CWRT at ¶16.

59. Further, Live365's General Manager of Media, Johnie Floater, cited internal data revealing a decline in CPMs since 2006 for streaming audio ads as well as CPMs for ad banners and video gateway ads (i.e., video-based ads that play automatically when a user clicks to listen to a stream). Floater CWDT at ¶10; 4/26/10 Tr. at 884:3-886:16 (Floater); *see also* Smallens CWRT at ¶17.

60. Similarly, Dr. Fratrick, who is a Vice President at BIA/Kelsey, confirms that CPMs for audio ads have fallen steadily since 2005, citing figures from AccuStream iMedia Research released in 2009. Fratrick CAWDT, Exhibit 3, Section Three; *see also* Smallens CWRT at ¶17

61. Even major streaming media destinations such as MySpace and YouTube are plagued by low CPMs and "low-value," excess ad inventory "that can only command weak CPMs, and they're not growing its value as quickly as content costs are growing." Smallens CWRT at ¶17 (citing Forrester Research report).

4. **Statutory Webcasters' Necessary Reliance On Ad Networks Results In Lower Yield And Higher Costs Of Sale**

62. A further factor impacting the revenues generated by most statutory webcasters – and, therefore, the royalty rate they could afford to pay – is their reliance on ad networks. Smallens CWRT at ¶¶18-23. Such reliance results in lower revenue yields and higher costs of sale. *Id.*; 4/26/10 Tr. at 892:13-894:4 (Floater).

63. As Mr. Smallens explained, statutory webcasters face a specific challenge in monetizing their audio ad inventory. Smallens CWRT at ¶18. Since there is theoretically no limit on a statutory webcasters' ad inventory – as opposed to the finite inventory of terrestrial radio stations, which can drive demand and command higher CPMs (as Mr. Smallens observed during his experience at two of the largest terrestrial radio companies in the U.S.) – adding listeners does not necessarily drive more value creation. Smallens CWRT at ¶18.

64. As one leading analyst in this space concludes, “many ad-supported content destinations are not growing ad revenue effectiveness as quickly as their audiences are growing in size and level of engagement.” Smallens CWRT at ¶18 (citing Mark Mulligan of Forrester Research).

65. As testified by Mr. Smallens, audience growth without complimentary growth in sell-out rate creates a “glut” of unsold inventory. Smallens CWRT at ¶19. To address this, non-interactive webcasters who do not have sufficiently-sized local audiences that can be targeted and who lack the robust, specially-trained sales forces of the NAB simulcasting entities, must rely on ad networks. Smallens CWRT at ¶19.

66. Ad networks aggregate unsold advertising inventory from a variety of online entities and make it available to marketers. Smallens CWRT at ¶19. This inventory is commonly referred to as “remnant” – i.e., left-over advertising spots which generate a small number of ad impressions. Smallens CWRT at ¶19. By collecting this disparate inventory from multiple websites, ad networks hope to amass enough impressions to be able to sell it. Smallens CWRT at ¶19. Marketers generally expect to pay lower CPMs for ad network inventory because it is an amalgamation of remnant impressions. Smallens CWRT at ¶19; 7/28/10 Tr. at 201:14-202:21 (Smallens).

67. Because remnant inventory is not premium content, the expectation is that it is less valuable inventory. 7/28/10 Tr. at 201:14-202:21 (Smallens).

68. Ad networks are unable to fill all the inventory from a webcaster. 7/28/10 Tr. at 208:3-12 (Smallens).

69. In addition, ad networks charge hefty commissions to sell this low-priced inventory. Smallens CWRT at ¶20; 7/28/10 Tr. at 201:14-202:21 (Smallens); 4/26/10 Tr. at

892:13-894:4 (Floater) (“[I]n order to stay in the TargetSpot networks, I had to agree to go from 25 to 40 percent.”). These commissions are generally higher than the commissions that would be paid to an in-house salesperson for selling the same inventory. Smallens CWRT at ¶20; 7/28/10 Tr. at 201:14-202:21 (Smallens).

70. Consequently, webcasters that are reliant on ad networks yield lower revenues from their ad inventory and realize a much smaller percentage of revenue for every dollar made. Smallens CWRT at ¶20. For this reason, media companies generally consider ad networks to be a last resort, backfill for the less desirable inventory that their sales team cannot monetize. Smallens CWRT at ¶20. In fact, in December 2009, CBS Interactive – whose online properties contain highly trafficked content (including CBS.com, CNET, Gamespot and TV.com) – declared they would almost completely eliminate their reliance on third-party ad networks. Smallens CWRT at ¶20 (citing Dec. 14, 2009 article from *AdvertisingAge*).

5. **Excess Inventory Is Further Driving Down CPM Rates And Reducing Revenue Generation**

71 There are not enough streaming media advertisers making big enough buys to fill even this lower-priced inventory. Smallens CWRT at ¶21. As Johnie Floater has testified, advertising orders consistently do not fill all of Live365’s advertising inventory; therefore, increasing the number of ad spots per hour would not generate more revenues since Live365 already cannot fill all of its commercial availabilities. Floater CWDT at 4-5; *see also* Smallens CWRT at ¶21.

72. This problem of excess inventory is exacerbated by the fact that many streaming network buys are “dayparted” – i.e., airing ads during specific hours of the broadcast day, which means that weekends and overnight hours are vastly undersold. Smallens CWRT at ¶21. The shortfall of paid ads results in webcasters over-delivering for their existing advertisers or rotating

“house” or promotional spots through the ad inventory, prompting a deterioration of the quality of the listening experience for the user. Smallens CWRT at ¶21.

73. This shortfall can also lead to lower average time spent listening and, therefore, reduce the number of ad impressions served per listening session, further reducing revenue generation. Smallens CWRT at ¶21. At the same time, the webcaster is incurring performance costs for the listenership during the undersold non-daypart hours. Smallens CWRT at ¶21.

74. There is a variety of reasons for this shortfall in advertising sales and resulting excess in ad inventory. Smallens CWRT at ¶22. Streaming audio advertising is still relatively new to marketers, and commands a low single-digit percentage of overall broadcast radio revenues. Smallens CWRT at ¶22.

75. In addition, producing quality streaming radio ads requires a different expertise than producing a compelling banner ad, for example, and many marketers are reluctant to delve into this area. Smallens CWRT at ¶22. In many cases, webcasters display synchronized ad banners when a streaming audio spot plays, but it is difficult to determine if the listener is looking at their streaming web player when these banners display or has either minimized the player or buried it beneath other browser windows. Smallens CWRT at ¶22. Synchronized banner ads for streaming audio spots have historically generated low click-through rates for this reason – which is another discouraging factor for media buyers. Smallens CWRT at ¶22.

76. Internet radio companies – which do not have mass audiences concentrated in a particular geographical market – have to rely on national advertisers as a source of revenue. Smallens CWRT at ¶23. These national advertisers are few, and have many other established outlets for their advertising (e.g., radio, television and cable networks; print, etc.) that offer larger

audiences than Internet radio. Smallens CWRT at ¶23. Thus, it is not easy to cause these advertisers to change their practices to dedicate money to Internet radio. Smallens CWRT at ¶23.

77. For all of the reasons set forth above, webcasters' low CPMs and low sell-out rates do not allow their revenues to keep pace with their audience growth. Smallens CWRT at ¶23.

6. Subscription Revenues In Webcasting Are Declining

78. Many statutory webcasters also rely, to a lesser extent, upon subscriptions to generate revenues; however, subscription revenues have been declining or stagnating over the past several years. *E.g.*, Smallens CWRT, ¶¶25, 33-35; Floater CWDT, ¶¶11-13, 23-26

79. Subscription levels for statutory webcasters are small and have not been growing. Live365 reports that fewer than 2% of its users are subscribers. Floater CWDT, ¶11. From August 2007 to June 2009, Live365's subscriptions declined by 24%. Floater CWDT, ¶12.

80. Live365's internet radio service depends on paying subscribers to cover costs directly related to their listening. Floater CWDT, ¶23. Although subscribers currently represent less than 2% of Live365's audience, they account for 23.5% of its streaming ATH. Floater CWDT, ¶11, 26.

81. Consequently, Live365 aggressively pursues subscriber acquisitions, to the point that every site visitor and/or listener receives multiple signup offers in unsold advertising inventory that highlight the benefits of a subscription. Floater CWDT, ¶24. In addition, Live365 includes VIP promotional messages and discount price offers in its quarterly newsletter sent to over one million listeners. Floater CWDT, ¶24. Live365 also pays its online marketing affiliates a 25% commission of the initial VIP sale if a listener signs up through an ad placed on the affiliates' site or stream. Floater CWDT, ¶25. Similarly, Live365 webcasters earn revenue by attracting VIP subscribers to their stations. Floater CWDT, ¶25.

82. Despite extensive efforts to attract subscribers by Live365, subscriber churn rates have increased and new subscriber acquisition rates have decreased since 2007, resulting in a net loss of subscribers month after month. Floater CWDT, ¶26. This trend is partly due to more free alternatives (i.e., ad or venture supported internet radio sites) available to consumers. Floater CWDT, ¶26.

83. This difficulty in attracting subscribers has affected much of the statutory webcasting industry. Smallens CWRT, ¶¶25, 33-35. For example, Last.FM – which is highlighted by Dr. Pelcovits as a “success” in the industry – has suffered an inability to attract subscribers. Smallens CWRT, ¶¶25, 34. The CBS Interactive VP overseeing Last.FM recently admitted that it has only “tens of thousands” of paying subscribers despite self-reported traffic of about 10 million unique visitors per month in the U.S. alone, and hopes to be profitable (finally) by 2010. Smallens CWRT, ¶¶25, 34 (citing March 18, 2010 *PaidContent* article).

84. Rhapsody’s self-reported shrinkage from 800,000 subscribers in Q1 2009 to 650,000 subscribers in Q1 2010 further bear out the difficulty of subscription-based models for online music companies. Smallens CWRT, ¶34 (citing May 10, 2010 *Billboard* article).

85. Adding subscribers (and thereby increasing revenues) in the statutory webcasting industry is particularly challenging due to the plethora of free sources, such as NAB simulcasters. Smallens CWRT, ¶33.

7. **Listenership Growth Has Flattened Over The Last Year**

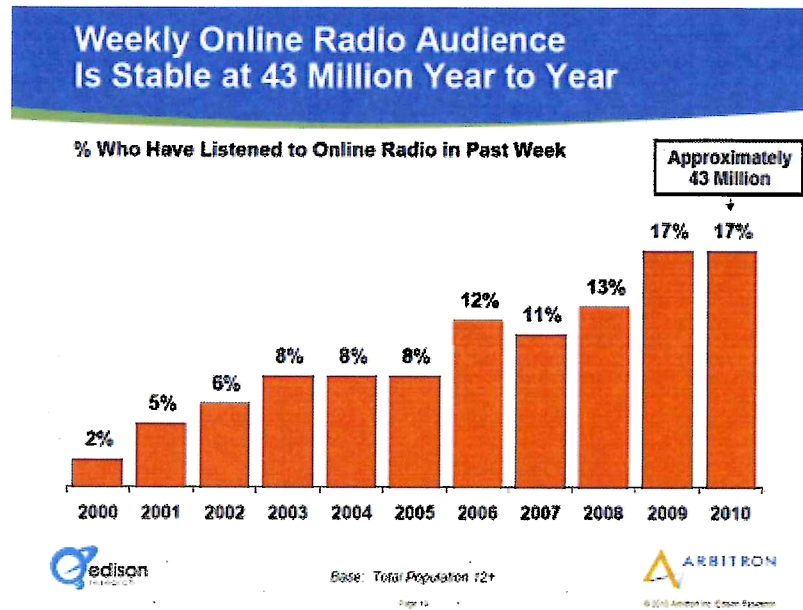
86. Relying almost exclusively on listenership levels, Dr. Pelcovits claims that “the webcasting industry continues to grow.” Pelcovits ACWDT at 7-11. However, Dr. Pelcovits concedes that according to the Arbitron/Edison report he relies on, from 2006 to 2008 “the percent of audience that’s listened to online radio has been relatively flat.” 4/19/10 Tr. at 173:12-

20 (Pelcovits). In addition, Dr. Pelcovits does not know whether increased performances lead to increased profits for webcasters. 4/19/10 Tr. at 176:15-18 (Pelcovits). Moreover, whatever Dr. Pelcovits' claims are regarding listenership, his analysis fails to take into account the difficulties in monetizing any growth. Smallens CWRT at ¶11.

87. One of the main sources to support Dr. Pelcovits' growth assertion is the 2008 and 2009 "Infinite Dial" reports by Arbitron and Edison Media Research. Pelcovits ACWDT at 8-10. The Infinite Dial reports combine both news/talk/sports and music formats, and does not provide a specific breakout among these formats. Smallens CWRT at ¶11.

88. For many terrestrial simulcasters, non-music formats – which do not have the same royalty obligations of Internet music services – dominate overall online listening and drive listenership growth. Smallens CWRT at ¶11. Therefore, Dr Pelcovits' failure to take into consideration the allocation of listenership attributable to news, talk and sports formats, with respect to the report he cites, is a considerable flaw Smallens CWRT at ¶11

89. In addition, as Internet penetration has leveled off, so too has online radio listenership. Smallens CWRT at ¶11. Since the time that Dr Pelcovits' testimony was originally submitted, the April 2010 Arbitron/Edison "Infinite Dial" study was released. Smallens CWRT at ¶11. The April 2010 "Infinite Dial" study shows that listenership growth flattened from 2009-2010, as shown in Table 1 of Mr. Smallens' CWDT (reproduced below). Smallens CWRT at 7.

Table 1 of Mr. Smallens' Written Testimony

90. As Mr. Smallens testified, based on recent data, the future growth of Internet radio listenership is uncertain and is unlikely to grow at the same rate it has in the past. Smallens CWRT at ¶11; 7/28/10 Tr. at 191:13-192:2 (Smallens).

8. Consolidation of Listenership

91. Another factor that is ignored in Dr. Pelcovits' discussion of the purported growth of the statutory webcasting market is the consolidation of listenership in the industry by Pandora and simulcasters (terrestrial and satellite). Smallens CWRT at ¶12; *see also* 7/28/10 Tr. at 192:3-193:2 (Smallens).

92. As Mr. Smallens testified, the increase in aggregate tuning hours and/or aggregate revenue of the statutory webcasting industry is heavily skewed by a few companies. Smallens CWRT at ¶12; *see also* 7/28/10 Tr. at 192:3-193:2 (Smallens).

93. According to Sound Exchange's 2009 usage reports, the top four entities in terms of aggregate performances are: Pandora (██████% market share by volume); CBS Radio and Clear

Channel ██████% market share by volume); and satellite radio companies Sirius-XM (█████% market share by volume). Live365 Trial Ex. 14 at 8; *see also* Smallens CWRT at ¶12.

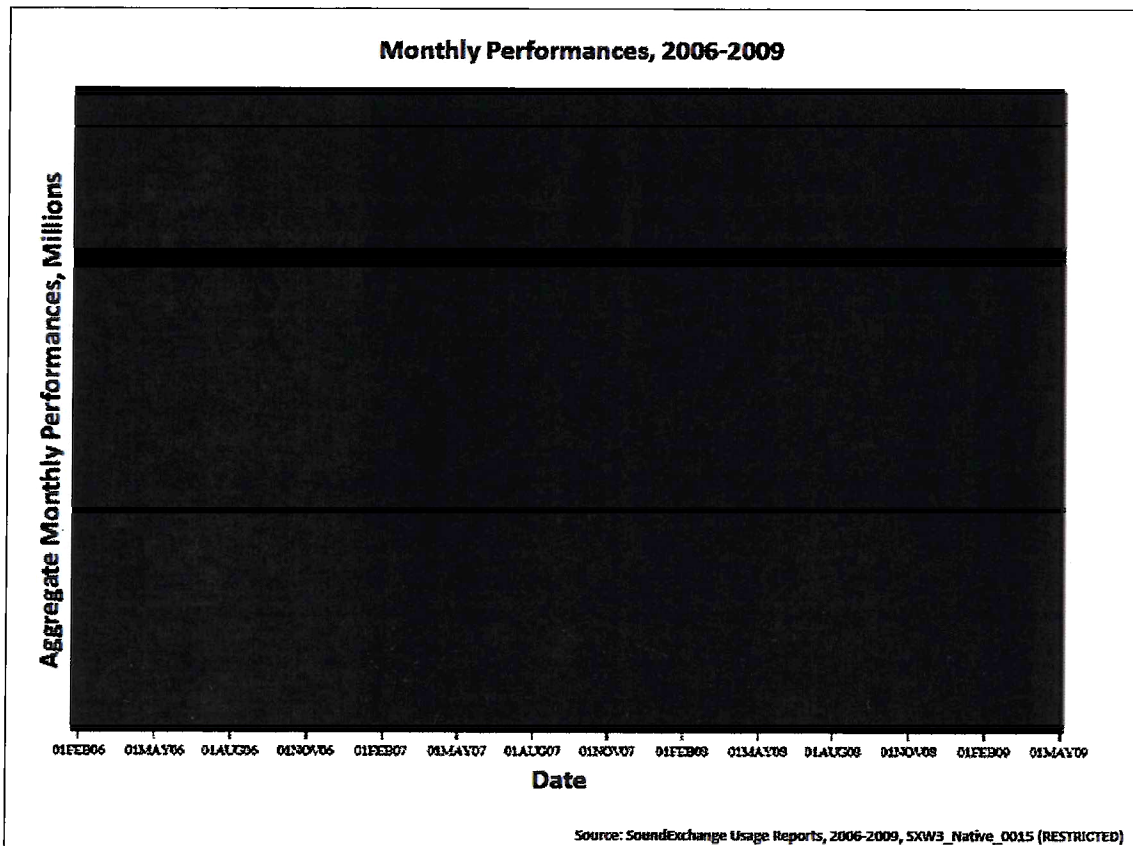
Combined, these four entities account for over 80% of 2009's aggregate yearly performances reported to SoundExchange. Live365 Trial Ex. 14 at 8; *see also* Smallens CWRT at ¶12.

94. As Mr. Smallens observed, the statutory webcasting market was not nearly as consolidated just a few years earlier, during which time the top four entities represented only ██████% and ██████% of the aggregate performances in 2006 and 2007, respectively. *See* Smallens CWRT, ¶12 (citing Live365 Trial Ex. 14 at 2, 4).

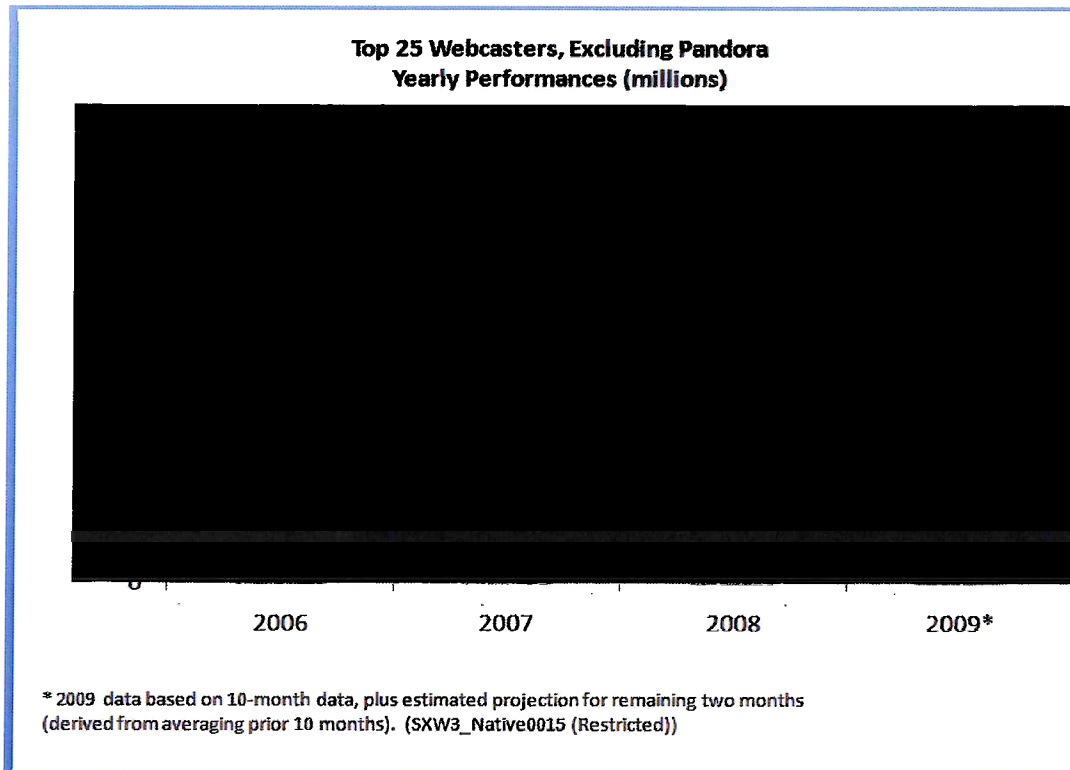
9. Any Growth In The Statutory Webcasting Market Is Heavily Skewed By One Entity: Pandora

95. The upward trend in aggregate performances – which Dr. Pelcovits cites to as evidence of a “robust and evolving market” (Pelcovits ACWDT at 11) – is almost completely a function of one service's growth: Pandora's. Smallens CWRT, ¶30. Dr. Pelcovits admitted that the growth of listening to statutory webcasters appeared to be entirely due to Pandora. 4/20/10 269:19-272:13 (Pelcovits).

96. The positive trajectory of the “Statutory Webcasters' Aggregate Monthly Performances 2006-2009” graph on page 8 of Dr. Pelcovits' Amended & Corrected Written Direct Testimony primarily reflects Pandora's growth. Smallens CWRT, ¶30. This is further illustrated in Table 2 of Mr. Smallens' CWDT (below), which derives from graphs prepared in connection with Dr. Pelcovits' report. Smallens CWRT, ¶30.

Table 2 of Mr. Smallens' Written Testimony

97. Moreover, over this same time period, the total aggregate performances by other statutory webcasting services have been flat or declining over the past few years, again undermining Dr. Pelcovits' conclusion of a robust market. Smallens CWRT, ¶30. Indeed, removing Pandora from this consideration reveals a very different trajectory in terms of aggregated performances, as shown in Table 3 of Mr. Smallens CWRT (below). Smallens CWRT, ¶30.

Table 3 of Mr. Smallens' Written Testimony

10. Audience Growth Does Not Equate To Increased Revenues

98. Even if listenership in the statutory webcasting market is growing, webcasting listenership growth does not, in and of itself, translate to financial success or even viability for a number of reasons. Smallens CWRT at ¶13.

99. The overwhelming majority of statutory listening is ad-based, hence heightening the importance of advertising revenues. However advertising revenues continue to decline on revenue-per-performance basis. Smallens CWRT at ¶13.

100. Every single song streamed triggers additional costs; however, ad-supported webcasters cannot recover these costs in the same per-song manner. Smallens CWRT at ¶13. Therefore, unless CPM and inventory sell-out rates (i.e., the percentage of the total advertising impressions sold) keep pace with the growth in listenership, statutory webcasters – which are

already saddled with increasing hosting, bandwidth and royalty costs due to this growth – are paradoxically penalized for the success of their increased listenership. Smallens CWRT at ¶13.

101. Given persistent industry trends, CPMs are subject to significant downward pressures. Smallens CWRT at ¶13. Consequently, the inverse relationship between costs associated with listenership growth and CPM revenues will likely continue. Smallens CWRT at ¶13; *see also* 7/28/10 Tr. at 197:6-198:17 (Smallens).

11. Demographic Targeting Has Not Materialized In An Impactful Way

102. Another factor that potentially could impact the economics of the statutory webcasting industry is the use of demographic targeting. Dr Pelcovits touts “the ability of advertisers to obtain detailed demographics on listeners” as a revenue-driver for webcasters. Pelcovits ACWDT at 11. However, beyond rudimentary IP-based geo-targeting, more detailed targeting is reliant on users voluntarily filling out registration forms. Smallens CWRT at ¶26.

103. But most terrestrial simulcasters do not require user registration, nor do many statutory webcasters. Smallens CWRT at ¶26. And for good reason: there is a plethora of “no registration required” options for listening to streaming music online; hence, requiring it makes a webcaster less competitive. Smallens CWRT at ¶26. Ultimately, in this competitive environment, requiring registration is still the exception, not the norm. Smallens CWRT at ¶26.

104. Moreover, while targeting might increase the CPM rate for a particular demographic, the net effect may still reduce overall per-performance revenue. Smallens CWRT at ¶27. By way of example, a service could obtain a CPM rate of \$12 for men in the 24-35 age bracket in select major markets during certain hours of the day. Smallens CWRT at ¶27. The problem, however, is that much smaller revenue – or even no revenue – may be obtained for

listeners who do not meet these restrictions, even though the per-performance royalty rate is the same for both. Smallens CWRT at ¶27

105. Consequently, demographic targeting can and does lead to further excess inventory and lower overall per-performance revenue. Smallens CWRT at ¶27. In sum, targeting has yet to have any material impact on overall online radio CPMs. Smallens CWRT at ¶27

12. New Platform Launches Does Not Necessarily Increase Revenues Per Play

106. Dr. Pelcovits also touts new features, such as song skipping and mobile access, provided by webcasters and asserts – without any authority – that such features should yield copyright holders greater royalty payments. Pelcovits ACWDT at 12-14.

107. While it may be true that mobility will increase listening and overall revenue, the same issue of excess inventory and low-bucket CPMs comes into play in the mobile space. Smallens CWRT, ¶28. Because the mobile audience is a fraction of the overall streaming audience, and because more expensive video pre-roll ads and display ads are even less relevant in the overall ad mix on a mobile device, webcasters face significant challenges in monetizing this mobile audience. Smallens CWRT, ¶28; 7/28/10 Tr. at 220:15-221:18.

108. Thus, merely increasing audience size through mobile application does not mean that there is any increase in revenue per listener. Smallens CWRT, ¶28. Again, this means that services are increasing their costs without any unique way to increase their per listener revenues. Smallens CWRT, ¶28.

109. Moreover, there are additional costs of developing and delivering these new features: Smallens CWRT, ¶29. For instance, Apple's successful new portable device, the iPad, requires many webcasters to develop a new, device-specific player. Smallens CWRT, ¶29.

110. Also, any of these new features are the result of web services' significant investments in creating and maintaining these players. Smallens CWRT, ¶29. Therefore, even if one assumes that new features (such as mobility) increase revenues, Dr. Pelcovits still fails to take into consideration the services' additional investments and costs. Smallens CWRT, ¶29.

111. Significantly, Dr. Pelcovits also fails to consider whether his identified new features would ultimately increase revenue *per play*, the key metric for a license that is paid on a per-performance basis. Smallens CWRT, ¶29.

B. AD-SUPPORTED SERVICES ARE STRUGGLING UNDER THE WEIGHT OF ROYALTY PAYMENTS AND CHALLENGING ECONOMIC CONDITIONS

112. The Internet music space is littered with examples of failed and shuttered ad-supported music services (e.g., SpiralFrog, Ruckus Network) as well as once-promising music start-ups forced to sell themselves for a fraction of their previous value. Smallens CWRT, ¶24.

113. For example, Imeem, an ad-supported service, “raised above \$50 million in funding over the last two years...with the valuation north of \$200 million.” Smallens CWRT, ¶24 (quoting *PaidContent* article dated Oct. 22, 2008). The company ended up selling to MySpace for \$1 million in December 2009. Smallens CWRT, ¶24. Prior to its sale, the service had been “reportedly running out of money, especially because of how much it has to pay for music licensing deals it has with record labels.” Smallens CWRT, ¶24 (quoting article).

114. Lala Media, Inc., another popular and primarily ad-supported music service, was recently acquired and then shuttered by Apple as of May 31, 2010. Smallens CWRT, ¶24. Warner Music Group, for example, recorded a charge of \$11 million to write-down its \$20 million investment in Lala to its estimated fair value of \$9 million. Smallens CWRT, ¶24 n.19 (citing Warner's SEC 10-Q Form, dated May 7, 2009).

115. Further, two of the largest companies subject to statutory rates and terms of *Webcasting II* – i.e., Yahoo! LAUNCHcast and AOL Radio – exited the webcasting business shortly after the *Webcasting II* determination by partnering with CBS Radio, who “powers” Yahoo! and AOL-branded offerings and provides all content licensing, programming and royalty payments. Smallens CWRT, ¶24.

116. Dr. Pelcovits points to the purported success of Last.FM, purchased for \$280 million in May 2007 by CBS Interactive. Pelcovits ACWRT at 10. Now, in 2010, Last.FM is a poster child for how difficult it is to create a successful, ad-supported streaming model – even with the backing of a major media company, such as CBS. Smallens CWRT, ¶25.

117. As a leading industry report stated: “Last.FM has struggled to find its new identity within CBS and its paymasters recently took the decision to turn off free-streaming outside of the major territories due to the inability to generate sufficient advertising revenue....further evidence of the challenges of making free pay.” Smallens CWRT, ¶25 (citing Forrester Research report, dated April 23, 2010). As Mr. Smallens testified, CBS is struggling to properly monetize its \$280 million investment.” Smallens CWRT, ¶25; 7/28/10 Tr. at 212:10-213:12 (Smallens).

118. Given the underperforming advertising market – as described above – Live365 is also experiencing difficulties in generating enough revenues from its Internet radio line of business to afford the royalty payments to SoundExchange. Floater CWDT, ¶¶14-22.

119. Through June 2009, SoundExchange royalties accounted for over 32% of Live365’s total internet radio revenues. Floater CWDT, ¶14. In other words, nearly one-third of Live365’s internet radio revenues are devoted solely to a single statutory royalty fee. Floater CWDT, ¶14. In addition, advertising agency/network deductions accounted for 30% of Live365’s gross advertising revenues, resulting in Live365 earning less than \$1 million out of the gross ad

revenue of \$1.32 million; meanwhile, Live365's accrued royalty fees due to SoundExchange was \$1.1 million. Floater CWDT, ¶14.

C. EVERY DOLLAR OF REVENUE EARNED BY PANDORA, THE MOST SUCCESSFUL STATUTORY WEBCASTER (AND LARGEST "WILLING BUYER"), WOULD HAVE BEEN PAID TO COVER THE SOUND RECORDING ROYALTY IN 2009

120. The difficulty for ad-supported service to monetize in the current economic conditions is exemplified by Pandora, which accounts for roughly 44-45% of total SoundExchange royalties for non-interactive streams. Smallens CWRT, ¶31. Pandora would not be able to sustain a viable business if it were subject to the full statutory rates. Smallens CWRT, ¶¶31-32; Salinger WRT, ¶25

121. From January 2009 through October 2009, Pandora reported [REDACTED] performances. Smallens CWRT, ¶31. Based on averaging the amount of monthly performances during those 10 months, one can conservatively estimate that the remaining two months of 2009 would amount to [REDACTED] performances. Smallens CWRT, ¶31. This is conservative because, historically, streaming hours rise significantly during the holiday season as people tune into holiday-themed channels and spend more time listening. Smallens CWRT, ¶31.

122. Conservatively, Pandora's total performances for 2009 were [REDACTED]. Multiplying that amount by the statutory royalty rate for 2009 – i.e., \$.0018 – Pandora would have owed \$ [REDACTED] for only the sound recording performance royalty. Smallens CWRT, ¶31

123. This means that just about *every* dollar in reported revenue that Pandora earned in 2009 – and it's widely reported to have been about \$50 million – would have gone to a single cost. Smallens CWRT, ¶31

124. A 10-year old company, Pandora represents one of the most successful, most listened-to, and most established statutory webcaster in this space. Smallens CWRT, ¶32; 4/19/10 Tr. at 204:2-6 (Pelcovits);

125. No willing buyer – much less the biggest buyer in the statutory webcasting industry – could realistically ever agree to a rate that ate up all of its revenues, leaving no money to meet other expenses or to provide a return to investors. Smallens CWRT, ¶32. Expecting willing buyers to pay rates through 2015 that are substantially higher than the 2009 rate – as SoundExchange proposes – is utterly unrealistic and unsustainable for the statutory webcasting industry. Smallens CWRT, ¶32. Salinger WRT, ¶25.

126. Therefore, this reality check refutes Dr. Pelcovits’ testimony that the proposed rates fall within a reasonable range that would be paid by a willing buyer since not even the biggest “buyer” could afford such rates. Smallens CWRT, ¶32.

D. THE MAJORITY OF THE STATUTORY WEBCASTING INDUSTRY PAYS UNDER A WSA AGREEMENT AND NOT THE PRESCRIBED STATUTORY RATES

127. No statutory webcasting service pays the sound recording performance royalty under any direct deal with a major label. 8/2/10 Tr. at 420:8-14 (Ordovery). In fact, there has never been a direct deal between a major label and a statutory webcasting service. 8/2/10 Tr. at 420:15-21 (Ordovery).

128. There are, however, agreements (such as the WSA Agreements) that allow webcasters to pay rates that are different – and lower – than the statutory royalty rates prescribed in *Webcasting II*. See, e.g., McCrady WDT, SX Ex. 101-DP (NAB deal) & SX Ex. 102-DP (Sirius XM deal).

129. In 2009, only █% of the total royalties collected for statutory webcasting were collected at the prescribed statutory rates while over █% of the royalties were paid pursuant to Webcasters Settlement Act agreements. See Live365 Ex. 25 (SXW3_Native_001 (Restricted)) at 24.

130. All of the foregoing strongly indicates that the current statutory rates are too high, especially given the economic challenges facing the statutory webcasting industry.

V. LIVE365'S RATE PROPOSAL

A. **DR. FRATRIK'S MODEL ANALYZES THE ACTUAL REVENUE AND COSTS OF A "REPRESENTATIVE" COMMERCIAL WEBCASTING SERVICE TO DERIVE THE VALUE OF THE COPYRIGHTED WORK ON A PER-PERFORMANCE BASIS, RATHER THAN RELYING ON UNPROVEN AND UNTESTED PROJECTIONS**

131. Dr. Fratrik's model provides an economic valuation of the digital sound recording performance royalty rate for the commercial webcasting industry. Fratrik CAWDT at 4; 4/27/10 Tr. at 1104:6-21 (Fratrik).

132. One of the most important underlying considerations in Dr. Fratrik's model was his examination of the recent history of the webcasting industry and his comparison to the projections made in *Webcasting II*. 4/27/10 Tr. at 1096:13-1097-1 (Fratrik).

133. Dr. Fratrik concluded that the evidence today shows that the financial projections made in *Webcasting II* for the periods 2006-2010 were not fulfilled. Fratrik CAWDT at 9; 4/27/10 Tr. at 1097:2-5 (Fratrik).

134. Therefore, Dr. Fratrik's model, unlike those created by the economists in *Webcasting II*, is based on historical data and not unsupported projections or estimates. This

consideration is particularly important given the lackluster performance of the commercial webcasting industry over the most recent royalty period (2006-2010). Fratrik CAWDT at 15.

135. As Dr. Ordover agrees, in doing an economic model one has to reflect the realities of the marketplace in which the modeling takes place. 8/2/10 Tr. at 367:5-11 (Ordover).

136. Dr. Fratrik's model performs a financial analysis of the actual revenues, costs and margins related to operating a commercial webcasting service. Fratrik CAWDT at 4-5; 4/27/10 Tr. at 1104:11-21 (Fratrik).

137. Further, Dr. Fratrik's data comes from analysis of industry reports, financial data from non-interactive webcasters, and data produced by SoundExchange. *See, e.g.*, Fratrik CAWDT 16, 19, 24-25; 4/27/10 Tr. at 1095:3-19, 1107:15-1108:15, 1290:21-1291:9 (Fratrik).

B. KEY ASSUMPTIONS TO DR. FRATRIK'S MODEL

138. Dr. Fratrik assumes that the commercial webcaster in his model will derive revenue from two sources: subscription revenue and advertising. Fratrik CAWDT at 16; 4/27/10 Tr. at 1104:22-1105:18 (Fratrik).

139. Dr. Fratrik's sources for advertising revenue come from two specific industry reports that serve as the lower and upper bounds on revenue estimates, the 2009 AccuStream Report and the ZenithOptimedia Report, respectively Fratrik CAWDT at 16, Exhibit 3 (AccuStream Report) & Exhibit 8 (ZenithOptimedia Report); 4/27/10 Tr. at 1104:22-1105:15 (Fratrik).

140. To confirm the reliability of these reports, Dr. Fratrik spoke to representatives of both sources. 4/27/10 Tr. at 1107:15-1108:5 (Fratrik).

141. Dr. Fratrik's subscription revenue is based on Live365 subscriber rates and monthly listening hours. *See* Fratrik CAWDT at 24. Both of these numbers are confirmed in data

provided by SoundExchange. See Fratrik CAWDT at 24 at n. 42, 43. Dr. Fratrik's operating cost estimates come from Live365. Given the fact that Live365 is a mature internet radio business (over ten years), and that it has taken significant cost-cutting and cost-saving measures, Live365's cost structure can serve as reasonable proxy for the industry Fratrik CAWDT at 16; 4/27/10 Tr at 1104:22-1105:11, 1111:3-12 (Fratrik).

142. Dr. Fratrik assumes that a commercial webcaster is entitled to a reasonable profit margin. Fratrik CAWDT at 17; 4/27/10 Tr. at 1104:22-1105:21 (Fratrik). This assumption has not been controverted by *any* expert in this proceeding. See, e.g., 4/19/10 Tr. at 214:21-215:3 (Pelcovits) ("over time, [a willing buyer] would need to cover cost[s] and operate a profitable business. . . ."); Salinger WRT, ¶24 ("A willing buyer would not buy at a rate that would not allow it to cover its costs and earn a reasonable rate of return,"); see also 8/2/10 Tr. at 381:15-21 (Ordoover).

143. As stated by the RIAA's expert in *Webcasting I*: "If a webcaster had to pay statutory license fees equivalent to the total economic value, the business would just break even and there would be no profit remaining for the owner of the business. Therefore, the fee for the statutory license should be based on portion of the value of the statutory licenses, which allows investors/owners to make a reasonable return on their investment." Salinger WRT, Exhibit 3 ("Estimation of Economic Value of Webcaster Statutory Licenses," by Dr. Thomas Nagle), at 15; *id.* at 12 n.12.

C. ECONOMICS OF DR. FRATRIK'S MODEL

144. Dr. Fratrik's rate proposal is based on the data listed in Table 5 of Dr. Fratrik's Amended and Corrected Written Direct Testimony. Fratrik CAWDT at 28; 4/27/10 Tr. at 1162:11-17 (Fratrik).

145. All of Dr. Fratrik's calculations are based on a per aggregated tuning hour (ATH) basis. This allows all data points to be compared under the same basic unit. 4/27/10 Tr. at 1109:14-22 (Fratrik).

146. In order to derive a recommended per-performance rate, Dr. Fratrik specifically excludes the royalty costs associated with the economics of streaming sound recordings and solves for the royalty input after examining market financial data for the other inputs of his model – i.e., the inputs related to the revenues and costs of operating a commercial webcasting service. Fratrik CAWDT at 5.

1. **Dr. Fratrik's Subscription Revenue Per ATH Calculation Is Based On Live365's Historical Numbers And Confirmed In Data Provided By SoundExchange's Expert, Dr. Pelcovits**

147. Subscription revenue was calculated by dividing the average monthly fee charged to subscribers at Live365, \$6.02/month in 2008, by the average number of hours a subscriber listened to Live365 per month, 40 hours. Dr. Fratrik's concludes that a typical webcaster can generate subscription revenue per ATH of \$0.1505. Fratrik CAWDT at 24; 4/27/10 Tr. at 1110:1-14 (Fratrik).

148. Dr. Fratrik has confirmed that this number is appropriate for his industry calculation. Based on data and research conducted by Dr. Pelcovits regarding non-interactive subscription rates in the industry and the number of performances per month for non-interactive subscription services, Dr. Fratrik concludes that his subscription revenue calculation is on target with the industry. *See* Fratrik CAWDT at 24 n.42 & 43; Pelcovits ACWDT at 25, 32.

149. In particular, Dr. Pelcovits concluded that the industry subscription average for non-interactive streaming is \$4.13 – almost two dollars *less* than the number Dr. Fratrik uses. *See* Pelcovits ACWDT at 25. In addition, Dr. Pelcovits confirmed Live365's internal data that

subscribers listen on average 40 hours per month. See Fratrik CAWDT at 24, n.42 & 43; Pelcovits ACWDT at 32.

150. Although Dr. Ordover criticizes Dr. Fratrik for his subscription numbers, Dr. Ordover had no counter-proposal for an industry subscription revenue number. Dr. Ordover was “not here to put in counterproposals.” 8/2/10 Tr. at 376:1-6 (Ordover).

2. Dr. Fratrik’s Advertising Revenue Per ATH Calculation Is Based On Reliable Industry Estimates

151. Dr. Fratrik’s advertising revenue was calculated by using ZenithOptimedia’s 2008 Internet Radio estimate and dividing by the estimated total hours streamed in 2008 from AccuStream. Dr. Fratrik concluded that advertising revenue per ATH based on these numbers was equal to \$0.0678 per ATH. Fratrik CAWDT at 26-27; 4/27/10 Tr. at 1110:1-7 (Fratrik).

152. Using a ratio of subscription to non-subscription performances based on hours streamed, Dr. Fratrik concluded that the total revenue per ATH generated by a commercial webcaster in 2008 was \$0.0872. Fratrik CAWDT at 27

153. Dr. Ordover had no alternative suggestion for advertising revenue as he has “no idea” what webcasting services are currently getting for CPM rates. 8/2/10 Tr. at 361:20-22 (Ordover).

3. Dr. Fratrik’s Total Revenue Per ATH Calculation Is Based On The Ratio Between Subscription And Non-Subscription Performances In The Non-Interactive Webcasting Market

154. The ratio used by Dr. Fratrik between subscription and non-subscription performances is based upon Live365’s data in 2008. See Fratrik CAWDT at 24-25. In 2008, Live365 subscription performances accounted for 23.5% of the total ATH. Floater CWDT, ¶26.

155. Discovery from SoundExchange revealed that this ratio was in fact high. SoundExchange has provided data that subscription performances are significantly lower,

dropping from 22.7% in 2008 to 10.13% in 2009. Fratrik CAWDT at 24-25. No SoundExchange witness has articulated a different ratio of performances for the industry.

156. In Dr. Ordover's criticisms of Dr. Fratrik, Dr. Ordover could not provide a different number for the ratio of subscription to nonsubscription performances, and he agreed that he had no knowledge as to the approximate percentage of subscription versus nonsubscription performances streamed in the statutory webcasting industry. 8/2/10 Tr. at 362:1-5 (Ordover).

4. Costs Calculation in Dr. Fratrik's Model

157 Because Live365 generates and records revenue from two independent business lines – i.e., its Webcaster Services (sometimes referred to at Live365 as “Broadcaster” Services), and its Internet Radio Business – but only records costs for the unified business, Dr. Fratrik had to allocate Live365's costs to approximate the costs for webcasting. Fratrik CAWDT at 18.

158. Table 1 of Dr. Fratrik's Amended and Corrected Written Direct Testimony shows the results of this allocation. Fratrik CAWDT at 19.

159. Dr. Fratrik calculates the Cost Per ATH in his model, based upon Live365 costs data and Live365 US royalty bearing ATH, is equal to \$0.0572 per ATH. Fratrik CAWDT at 18-19.

5. An Operating Margin of 20% Is Appropriate For The Statutory Webcasting Industry

160. Dr. Fratrik's rate proposal concludes that a 20% operating profit margin is appropriate. *See* Fratrik CAWDT at 28, Table 5.

161 Dr. Fratrik's use of a 20% operating margin is based on data from a comparable industry – i.e., terrestrial radio companies: Table 3 of Dr. Fratrik's Amended and Corrected Written Direct Testimony provides a listing of publicly traded comparable entities and the margins they generate. Fratrik CAWDT at 22.

162. The average operating margin for those terrestrial radio companies is 23.6% of their revenues, with a median of 25.6%. See Fratrick CAWDT at 22, Table 3.

163. A 20% operating margin is appropriate as it gives commercial webcasters a fair return in order for them to pay their depreciation, amortization and interest costs – expenses which were not included as part of Dr. Fratrick’s model. 4/27/10 Tr. at 1114:8-14 (Fratrick).

164. In addition, Dr Fratrick has provided a sensitivity analysis based on various operating margins as part of his calculations in Table 5. 4/27/10 Tr. at 1111: 13-19 (Fratrick).

165. In *Webcasting I*, the RIAA presented their economist, Dr. Thomas Nagle, who made a very similar argument with respect to operating margins. Salinger WRT, Exhibit 3, at 16. In fact Dr. Nagle provided a range of margins from 13.2% to 21.8% as appropriate for mature webcasters (those who had been in operation for over nine years). Salinger WRT, Exhibit 3, Appendix 2.

166. Although Dr Ordover criticized Dr. Fratrick for his use of a 20% operating margin, Dr. Ordover could not offer any guidance on what an appropriate margin should be. 8/2/10 Tr. at 383:8-15 (Ordover).

167 Further, Dr Ordover could not articulate a more representative comparable industry that should have been used by Dr. Fratrick in his margin analysis. See 8/2/10 Tr. at 380:13-381:3 (Ordover). In fact, Dr Ordover did “not spen[d] time investigating the issue.” 8/2/10 Tr. at 381:4-10 (Ordover).

D. AN APPROPRIATE RATE FOR THE INDUSTRY IS \$.0009 PER PERFORMANCE

168. Given the data above, Table 5 of Dr. Fratrick’s written direct testimony calculates a Value of Copyrighted Material per ATH \$0.0126. Fratrick CAWDT at 28 (Table 5); 4/27/10 Tr at 1112:13-1113:2 (Fratrick).

169. Assuming fourteen performances per hour, this translates into a royalty of \$0.0009. Fratrik CAWDT at 28 (Table 5); 4/27/10 Tr. at 1113:3-10 (Fratrik).

170. Dr. Fratrik concludes that a constant rate of **\$0.0009** per-performance is appropriate for the period 2011-2015 given that competition for advertising revenue will continue to keep advertising rates down and the ability to charge higher prices for subscription services is limited. Fratrik CAWDT at 5; 4/27/10 Tr. at 1113.11-1114:1 (Fratrik).

171. This recommended rate is not unrealistic as other entities on the willing seller side have entered into agreements with webcasters for the same right at rates close to Dr. Fratrik's recommended proposal. 4/27/10 Tr. at 1281:15-1282:9 (Fratrik).

172. Dr. Salinger also computed a rough estimate of an appropriate royalty in the range suggested by Dr. Fratrik, ██████████ per play using 2008 data and ██████████ using 2009 data. 7/28/10 Tr. at 55:8-22 (Salinger); Salinger WRT at ¶33; id., Exhibit 5.

E. DR. FRATRIK HAS PROVIDED THE COURT WITH UPDATED NUMBERS FOR 2009 IN HIS APPENDICES

173. Dr. Fratrik has also provided the Court with updated calculations of his model using 2009 data that was not available at the time of his filing of the direct statement. These appendices apply data from updated industry sources, Live365 2009 financial information and documentation provided by SoundExchange during the course of discovery. Fratrik CAWDT Appendix I-III, at 46-56; 4/27/10 Tr. at 1122:4-21 (Fratrik).

174. Dr. Fratrik's updated calculations conclude that, using the updated information, the proposed royalties should actually be lower. 4/27/10 Tr. at 1122:19-1123:4 (Fratrik).

175. Despite the evidence to suggest that rates should be lower given the state of the industry in 2009, Dr. Fratrik did not change his conclusion that the proposed rate for 2011-2015 should remain constant at \$0.0009. 4/27/10 Tr. at 1123:5-10 (Fratrik). Given that 2009 was a

tough year financially for many advertising based-media, Dr Fratrik felt that 2009 data should not be used as the basis for the upcoming rate term, thereby providing yet another benefit to the copyright owners. 4/27/10 Tr. at 1123:5-10 (Fratrik).

F. UNLIKE DR. PELCOVITS, DR. FRATRIK EMPLOYED PROPER ECONOMIC THEORY BY CONDUCTING A REALITY CHECK ON HIS CALCULATIONS.

176. Unlike Dr. Pelcovits, Dr. Fratrik did conduct a “reality check” to see if his calculations made sense in light of the performance of the industry. Specifically, Dr. Fratrik conducted two calculations to determine if his revenue estimates for the industry were correct. Using data provided by SoundExchange in discovery regarding Live365’s market share of non-interactive streaming performances in 2008 (i.e., 2.34%), Dr Fratrik concluded that advertising revenue generated by the industry in 2008 was approximately \$84.2 million. Fratrik CAWDT at 30; 4/27/10 Tr at 1108:6-15 (Fratrik).

177. Dr. Fratrik also estimated the size of the market by examining the market share of Pandora. Pandora reported revenues in 2009 of \$50 million. Given that Pandora represents approximately 50% of the performances in the non-interactive market according to SoundExchange, this suggests a total industry size of \$100 million. 4/27/10 Tr. at 1290:21-1291:9 (Fratrik).

178. Both of these methods confirmed that the advertising revenue estimates used by Dr Fratrik in his model were reasonable figures to use. 4/27/10 Tr. at 1108:6-18 (Fratrik).

VI. RATE PROPOSAL FOR AGGREGATION SERVICES

A. BENEFITS OF AGGREGATION SERVICES

179. The evidence demonstrates that aggregation services provide numerous benefits that flow to the owners of the copyrighted works and SoundExchange. *See* Floater CWDT, ¶¶27-36; Fratrik CAWDT at 38-40. These benefits should be recognized and reflected in an Aggregation Service rate, as set forth more fully below. *See* Fratrik CAWDT at 38-40. An aggregation service operates a streaming architecture that can aggregate hundreds or thousands of individual webcasters. *See* Floater CWDT, ¶27; 4/26/10 Tr 898:16-899:9 (Floater).

180. The aggregated webcasting stations are often setup and programmed by individual hobbyists, music fans, record labels, schools, faith-based organizations, and other distinct communities. *Id.* Since 2002, Live365 has enabled over 38,000 paying individual webcasters to broadcast according to their musical tastes and personal interests. *See* Floater CWDT, ¶27.

181. Live365, among other Internet radio aggregators (like Shoutcast), provides a webcasting aggregation service. 8/2/10 Tr. at 454:14-15 (Funn); SoundExchange Ex. 13 (1/28/10 Depo. Tr. at 36:25-37:21 (Lam)). In the past, other entities have also provided aggregation services. 8/2/10 Tr. at 454:12-13 (Funn). Moreover, new aggregation services can very well enter the webcasting market in the future. 8/2/10 Tr. at 454:16-18 and 455:4-17 (Funn).

182. Aggregation services provide a considerable amount of administrative savings to the owners of the copyrighted works, as these services collect, compile and consolidate all of the necessary reporting of the actual copyrighted works that are streamed from their aggregated stations. *See* Fratrik CAWDT at 38; 4/27/10 Tr. at 1117-7-13 (Fratrik); Floater CWDT, ¶¶35-36.

183. In addition to the recording and documentation of this listening, aggregators make consolidated royalty payments to the appropriate parties. *See* Fratrik CAWDT at 38; Floater

CWDT, ¶¶35-36. Also, some aggregation services, such as Live365, provide valuable webcasting tools to assist webcasters in becoming compliant with reporting and DMCA requirements. *See* 4/28/10 Tr. at 1319:20-1320:13 (Lockhart).

184. These administrative functions provided by aggregation services reduce the burden on the copyright owners and/or any collective formed to administer the collection of these royalties. *See* Fratrik CAWDT at 38-39; Floater CWDT, ¶¶35-36.

185. Barrie Kessler, the Chief Operating Officer of SoundExchange, testified that the administrative cost per licensee was approximately \$5,777 and that the average per channel or station cost for webcasters in 2008 was approximately \$825. Kessler CWDT at 23-24, 25; 4/20/10 Tr. 452:4-453:13 (Kessler). By providing consolidated reporting and payments on behalf of hundreds (if not thousands) of stations, aggregation services significantly reduce SoundExchange's per-station costs. 4/20/10 Tr. 470:5-471:6 (Kessler); 8/2/10 Tr. 461:3-20 (Funn). SoundExchange prefers consolidated reporting because of the administrative cost savings they yield. *See* 4/20/10 Tr. 471:8-19 (Kessler).

186. Another benefit provided to copyright owners through aggregation services is the support of actual webcasters. *See* Floater CWDT ¶¶27-29, 35-36; Fratrik CAWDT at 39. By providing an efficient mechanism to advertisers to reach the audiences of these smaller webcasters, aggregation services generate more revenues to the webcasters, and ultimately more royalty payments to the copyright owners. Floater CWDT, ¶¶35-36; Fratrik CAWDT at 39; 4/26/10 Tr. 899:10-901:16 and 901:17-903:18 (Floater). Many of these smaller webcasters operating at such a small scale could not generate enough advertising revenues to cover royalty payments, and as a result, would either leave the industry or refrain from paying royalties altogether. *See* Floater CWDT, ¶35; Fratrik CAWDT at 39; 4/27/10 Tr. at 1117:7-20. Moreover,

by creating more opportunities for individuals to webcast while keeping costs low, an aggregation service is able to play a wider breadth of content. 4/26/10 Tr. 899:10-901:16 and 901.17-903:18 (Floater).

B. EXAMPLES OF BENEFITS PROVIDED BY AGGREGATION SERVICES IN ROYALTY CONTRACTS

187. Evidence of the benefits provided to copyright owners by aggregation services are found in agreements with the Performance Rights Organizations (PROs) for musical works royalties. *See* Fratrik CAWDT at 39; SX Ex. 13, 1/28/10 Tr. 113:1-113.10 (Lam). The three collective licensing organizations – ASCAP, BMI, and SESAC – have negotiated various discounts on their royalty rates for Live365 and its webcasters. *See* Fratrik CAWDT at 39.

188. Dr. Fratrik examined the discount provided by the PROs. Fratrik CAWDT at 39-40. These discounts were provided to Live365 in recognition of the “centralized administration” that Live365 provides for the benefit of the PROs, including centralized collection, reporting, and compliance. Fratrik CAWDT at 40; 4/27/10 Tr. at 1117:21-1118:8 (Fratrik).

189. For BMI, Dr. Fratrik compared the royalty set forth in the Live365 Minicaster Web Site Music Performance Agreement with the royalty provided in the standard BMI Web Site Music Performance Agreement that was provided to other webcasters. Dr. Fratrik calculated the discount BMI provides to Live365’s webcasters to be 16.92%, as compared with the standard BMI agreement with other webcasters. Fratrik CAWDT at 40-41, 4/27/10 Tr. at 1118:9-13 (Fratrik).

190. Dr. Fratrik also examined the contracts with the other PROs – i.e., ASCAP and SESAC. *See* Fratrik CAWDT at 40. Dr. Fratrik determined the discount provided by the other PROs to be even greater (22% and 56%, respectively) than the discount provided by BMI. *See id*, 4/27/10 Tr. at 1118:14-18 (Fratrik).

C. DISCOUNT FOR AGGREGATION SERVICES

191. As Dr. Fratrick testified, aggregation services like Live365 provide the same services and benefits that the PROs recognize as valuable. *See* Fratrick CAWDT at 40. Accordingly, Dr. Fratrick concluded that a similar discount is warranted with respect to the royalties provided to SoundExchange. *Id.*

192. The evidence from market-based transactions with the PROs strongly suggests that aggregation services and the benefits they provide are substantial. *See* Fratrick CAWDT at 40. Further, given that two major music licensing organizations have arrived at around the same value provides strong evidence that aggregation services should receive a similar discount for the sound recording performance royalty. *Id.*

193. Dr. Fratrick averaged the discounts provided by the two major PROs – i.e., ASCAP and BMI – which results in an average savings of 19.5%. *See* Fratrick CAWDT at 40. Observing that SESAC provided a much higher savings, Dr. Fratrick concluded that an appropriate discount for an Aggregation Service should be 20% less than the industry rate for commercial webcasters. *Id.*; 4/27/10 Tr. at 1118:19-1119:5 (Fratrick).

VII. SOUNDEXCHANGE'S RATE PROPOSAL IS NOT BASED ON THE WILLING BUYER / WILLING SELLER STANDARD

A. SOUNDEXCHANGE HAS PUT FORTH NO SUPPORTABLE EVIDENCE FOR ITS RATE PROPOSAL

194. As explained below, there are numerous flaws that undermine SoundExchange's rate proposal. One of the most fundamental deficiencies in its rate proposal is that SoundExchange provides no supportable evidence regarding the derivation of its rate proposal.

195. The only SoundExchange witness who had any knowledge of the development of the SoundExchange rate proposal is Mr. Tucker McCrady, a lawyer at Warner Music Group and a member of SoundExchange's Licensing Committee. *See* 4/22/10 Tr. 726:3-13 (McCrady).

196. None of SoundExchange's other witnesses had any knowledge about the derivation of SoundExchange's rate proposal. *See* 4/19/10 Tr. 107:1-107:11 (Kooker); 4/20/10 Tr. 393:6-20 (Hedgpeth); 4/21/10 Tr. 498:10-499:7 (Kessler).

197. Furthermore, Dr. Pelcovits not only did not help in developing SoundExchange's rate proposal, he had no idea who created the rate proposal. *See* 4/19/10 Tr. at 169:15-170:2 (Pelcovits).

198. According to Mr. McCrady, SoundExchange's rate proposal was based on "litigation posture." 4/22/10 Tr. at 725:15-18 (McCrady); *id.* at 734:15-735 17 (McCrady). Mr. McCrady did not testify – or suggest – that SoundExchange's rate proposal was based on a willing buyer / willing seller analysis. *See id.*

199. Moreover, according to Mr. McCrady, SoundExchange's rate proposal "has a nice benefit of where it comes out is a little bit above where some of the settlements are and we thought it would be good to have encouraged retroactively the parties who are willing sit down at the table and actually settle out at rates we could live with." 4/22/10 Tr. at 735:1-17 (McCrady). As Mr. McCrady concluded, the rates in the proposal "seemed appropriate." 4/22/10 Tr. at 735:1-17 (McCrady).

200. Similarly, there is no supportable evidence for the \$.0002 annual increase in SoundExchange's rate proposal. Dr. Pelcovits testified that he did not know the reason that the rate proposal increased by .02 cents every year. *See* 4/19/10 Tr. at 170:3-5 (Pelcovits). Mr. McCrady, who was the only witness who had any knowledge of the derivation of

SoundExchange's rate proposal, testified that the \$.0002 rate increase was based on a "litigation posture." 4/22/10 Tr. at 734:15-735:17 (McCrary). The rate increase was, according to Mr McCrary, SoundExchange's attempt "to extend the logic of the Court" with respect to "the kind of trajectory" of the Court used in the past proceeding. 4/22/10 Tr. at 735:1-17 (McCrary).

201. However, in response to Judge Wisniewski's question about "the trajectory on the past proceeding," Mr. McCrary had no recollection of the Court's analysis in the past proceeding or what the Court based its "trajectory" on in *Webcasting II*. 4/22/10 Tr. at 735:18-22 (McCrary).

B. SOUNDEXCHANGE HAS MADE NO SHOWING THAT INCREASED RATES YEAR AFTER YEAR ARE JUSTIFIED

202. None of the interactive service agreements reviewed by Dr. Pelcovits and admitted as exhibits in this proceeding have provisions with annual rate increases. *See e.g.*, McCrary WDT at Ex. 104-DR (Napster-Warner Music Group Subscription Services Agreement), 106-DR (Best Buy Co.-Warner Music Group Bundled Offer Agreement), Live365 Exs. 17 (Last.fm-Warner Music Group Interactive Radio Agreement) & 18 (Slacker-Warner Music Group Interactive Radio Agreement).

203. Further, no SoundExchange witness was able to provide evidence that any copyright holder ever analyzed whether a *lower* royalty rate would yield *greater* revenues to copyright holders. *See e.g.*, 4/19/10 Tr. at 97:5-98:1 (Kooker) ("Q: Mr. Kooker, you've never considered whether a lower royalty rate, as set forth for the statutory market, would generate more revenues to Sony, correct? A: Never done modeling of that sort, no."); 4/20/10 Tr. at 390:10-20 (Hedgpeth) ("Q: Are you aware of whether anybody at SoundExchange has examined whether lower royalty rates may increase royalty revenues altogether? A. I have no recollection of that either.").

204. In fact, SoundExchange's own financial documentation projects a fixed performance rate of \$0.0019 for the upcoming statutory period (2011-2015). *See* Salinger WRT, Exhibit 2 (SoundExchange Budget).

VIII. DR. PELCOVITS' INTERACTIVE SERVICES BENCHMARK IS FRAUGHT WITH ERRORS

A. NATURE OF MODEL FOR BENCHMARK METHOD

205. Dr. Pelcovits computes two benchmarks in his analysis: one based on the only two precedential commercial Webcaster Settlement Act agreements; the other based on contracts between the four major record labels and a handful of interactive music services (which do not qualify for a compulsory license). *See* Pelcovits ACWDT at 2; *see also* Salinger WRT, ¶13.

206. Dr. Pelcovits opines that any rate that SoundExchange proposes within the range spanned by his two benchmark approaches would be reasonable. Salinger WRT, ¶14

207. Dr. Pelcovits has utilized a very similar model in this proceeding as he did in *Webcasting II*. *See* Live365 Ex. 5 (Dr. Pelcovits' *Webcasting II* Written Direct Testimony). However, underlying his model in Web II was an assumption that advertising supported businesses would generate revenue equal to (or greater) than subscription services. *See* Fratrick CAWDT at 9 (citing Rebuttal Testimony of Michael Pelcovits in *Webcasting II*).

208. Despite the fact that this assumption has never materialized, Dr. Pelcovits has nonetheless applied the exact same methodology in this proceeding to derive his recommended royalty rate. Dr. Pelcovits has not modified his methodology in any capacity to account for the fact that ad-supported businesses generate substantially less than subscription services. 4/19/10 Tr. at 138:8-17 (Pelcovits); 4/20/10 Tr. at 274:18-275:6 (Pelcovits).

B. DERIVATION OF INTERACTIVE SERVICES BENCHMARK

209. To derive a benchmark using contracts for interactive webcasting services, Dr. Pelcovits first examines the royalty paid in the interactive market and then attempts to create an adjustment factor to get to his target royalty rate for non-interactive webcasting. Salinger WRT, ¶13.

210. Dr. Pelcovits adjustment factor is a simple algebraic calculation. Dr. Pelcovits makes a fundamental (yet unproven) assumption that the ratio between the royalty paid in the interactive market and the subscription price for an interactive service should be the same as the ratio between the royalty paid in the non-interactive market and the subscription price for a non-interactive service. Salinger WRT, ¶13; 7/28/10 Tr. at 36:20-38:12 (Salinger); 4/20/10 Tr. at 277:13-278:9 (Pelcovits).

211. Dr. Pelcovits concludes that royalties in the interactive market are approximately 47.4% of the revenue generated by interactive subscription services, and therefore royalties in the non-interactive market should also be equal to 47.4% of the revenue generated by non-interactive subscription services. Salinger WRT, ¶13; *see also* Salinger WRT at 4 n.4; 7/28/10 Tr. at 36:20-38:12 (Salinger).

212. Using an untested theory and highly selective data, Dr. Pelcovits concludes that the target royalty rate for non-interactive services should be \$0.0036 per play. Salinger WRT, ¶13. Translating this royalty into revenue, Dr. Pelcovits' analysis dictates that non-interactive services need to generate revenue per play of \$0.0073 in order to maintain the same percentage of revenue ratio as interactive services. Salinger WRT, ¶13.

213. While this number may make mathematical sense – indeed, his “expert” analysis is nothing more than simple algebra using cross-multiplication – Dr. Pelcovits ignores the

fundamental business reality that non-interactive services cannot generate revenue anywhere close to \$0.0073 per play. Salinger WRT, ¶17. In fact, there is *no* evidence in the record that shows non-interactive services can even earn total revenues per play of \$0.0036 – which is Dr. Pelcovits’ recommended rate using his Interactive Services analysis. Salinger WRT, ¶¶ 13, 24; 7/28/10 Tr at 38:13-39:8 (Salinger).

214. As testified by SoundExchange’s rebuttal expert witness, Dr. Ordovery, “if you put the wrong data in, you’re going to get a wrong outcome even though the translation between the data and the outcome is flawless as a matter of algebra.” 8/2/10 Tr at 374:14-17 (Ordovery).

215. The realities of the market are such that no willing buyer would buy at the rate proposed by this benchmark since no willing buyer would be able to cover its costs and earn a reasonable rate of return if a rate were set at this level. Salinger WRT, ¶24.

C. DR. PELCOVITS FAILS TO EXAMINE THE IMPACT OF HIS RATES ON A WILLING BUYER

216. Dr. Pelcovits’s calculation of the interactive services benchmark performs no “reality check” to see if his conclusions make economic sense. A recommended royalty rate of \$0.0036 is clearly not grounded in the realities of the industry. Salinger WRT, ¶¶15, 24. This is because a royalty at that rate would not only exceed the percentage of revenue of a service that Dr. Pelcovits posits as appropriate, but it would significantly exceed the *total* revenue per play that a non-interactive webcasting service is even able to earn. Salinger WRT, ¶¶15, 24; 7/28/10 Tr. at 52:19-53:12 (Salinger).

217. A simple reality check would have shown that Dr. Pelcovits’ recommended royalty rate from his interactive services benchmark analysis utterly misses the mark. 7/28/10 Tr. at 53:13-18 (Salinger).

218. Dr. Salinger has taken steps to calculate the total revenue generated per play by the webcasting industry. Using data from Accustream, Dr. Salinger concluded that total advertising revenue per play was \$0.0023 in 2008. Salinger WRT ¶26. Using Dr. Pelcovits' conclusion that subscription revenue per play is \$0.0073, and applying SoundExchange performance data showing the mix of plays between subscription and non-subscription, Dr. Salinger concludes that the total revenue per play generated by the industry is [REDACTED] Salinger WRT ¶26. This is far less than the estimated royalty rate of \$0.0036 of Dr. Pelcovits. Salinger WRT, ¶26; 7/28/10 Tr. at 45:10-47:10 (Salinger).

219. Given this information, Dr. Salinger concludes that no willing buyer would buy at a rate that would not allow it to cover its cost and earn a reasonable rate of return. Salinger WRT, ¶24; 7/28/10 Tr. at 47:11-22 (Salinger).

220. Further proof that Dr. Pelcovits' calculations do not take into account the impact on a webcaster is revealed by the revenue per play generated by Pandora to the royalty rate. In his description of the industry, Dr. Pelcovits emphasizes Pandora as the fastest growing and largest webcasting service. Pelcovits ACWDT at 12. In fact, Pandora accounts for over [REDACTED]% of the reported performances to SoundExchange for non-interactive streaming in 2009. Live365 Ex. 14 at 8. However, not even Pandora would (or could) be a willing buyer at the recommended rate of \$0.0036.

221. Based on public reports of Pandora's revenues and data provided by SoundExchange related to the number of reported performances by Pandora, it is estimated that Pandora's total revenues per play were \$[REDACTED] in 2008 and \$[REDACTED] in 2009. Salinger WRT, ¶25, 7/28/10 Tr. at 48:1-49:5 (Salinger). Given that Pandora's yearly total revenue per play is

well below the royalty rate derived by Dr. Pelcovits, it defies logic that Pandora would be a willing buyer at the \$0.0036 proposed rate. Salinger WRT, ¶25; 7/28/10 Tr. at 49:6-10 (Salinger).

222. Dr. Pelcovits has provided no analysis of the economics facing a willing buyer and he has provided no analysis to suggest that a willing buyer could realistically afford the rate his methodology suggest. Salinger WRT, ¶15.

D. DR. PELCOVITS' BENCHMARK APPROACH IGNORES THE REALITY OF THE INDUSTRY – THE VAST MAJORITY OF THE LISTENING IS DONE THROUGH AD SUPPORTED SERVICES, NOT SUBSCRIPTION SERVICES

223. Dr. Pelcovits' benchmark analysis only considers the revenue generated for subscription services and does not consider revenue generated by any advertising supported service. 4/20/10 Tr. at 282:4-9 (Pelcovits); 7/28/10 Tr. at 54:17-22 (Salinger); Salinger WRT, ¶17.

224. What he ignores – i.e., the revenue for ad-supported services – is a fatal omission and is sufficient basis, by itself, to dismiss the benchmark as having no predictive value for what the typical non-interactive service would be willing to pay. Salinger WRT, ¶17; 7/28/10 Tr. at 39:9-40:15 (Salinger).

225. As asserted by Dr. Ordovery, in doing an economic model, “one has to reflect the realities of the marketplace in which the modeling takes place.” 8/2/2010 Tr. at 367:5-11 (Ordovery). Yet, Dr. Pelcovits ignores this fundamental principle in his analysis.

226. Dr. Pelcovits' entire analysis relies upon data from subscription services only. The subscription-services data applies to the calculations for his effective per play rate, adjustment factor for differences in plays, and his interactivity adjustment. Salinger WRT, ¶31.

227. However, Dr. Pelcovits admits the vast majority of listeners and listening hours derive from ad-supported services. 4/20/10 Tr. at 312:7-313:5 (Pelcovits).

228. In reality, services have a mix of subscribers and nonsubscribers, with the vast majority of listening coming from nonsubscribers. 4/20/10 Tr. at 312:7-11, 313:2-5 (Pelcovits); 7/28/10 Tr. at 55:1-7 (Salinger).

229. For example, in 2009, subscription listening accounts for 2.4 % of the reported performances by webcasters that have entered into the Pureplay agreement. Salinger WRT, ¶31.

230. More importantly, the subscription revenue per play is significantly greater than what a service can generate from advertising. Dr. Salinger has concluded that subscription revenue per play earns roughly *three times* more than advertising revenue per play. Salinger WRT, ¶32.

231. As a result, Dr. Pelcovits' calculations show an upward bias as his inputs are artificially inflated through his omission of ad-supported revenues. Salinger WRT, ¶17.

232. Given that data on total revenues and total plays (i.e. both subscription and advertising-based plays) was available to Dr. Pelcovits, he could have estimated the appropriate royalty rate using a more realistic assessment of the industry. He just chose not to. 7/28/10 Tr at 40:17-42:4, 43:7-9 (Salinger).

233. If Dr. Pelcovits had included ad-supported revenue, the non-interactive per-performance royalty would have been significantly less. As shown in Dr. Salinger's Exhibits 4 & 5, which applies Dr. Pelcovits' ratio and total plays, a more appropriate royalty rate would have been \$ [REDACTED] per play using 2008 data and \$ [REDACTED] using 2009 data. See Salinger WRT at Exhs. 4 & 5; 7/28/10 Tr. at 55:8-22 (Salinger).

234. Both of these calculations are far below the number calculated by Dr. Pelcovits and offer a more realistic estimate of the appropriate royalty rate for the industry.

E. DR. PELCOVITS EXACERBATES HIS ERRORS BY SELECTIVELY CHOOSING DATA TO INFLATE HIS RECOMMENDED ROYALTY RATE

235. Dr. Pelcovits only relies upon contracts with the four major record companies, assuming without foundation, that independent record labels would be able to command the same fees. Salinger WRT, ¶18; 7/28/10 Tr. at 56:1-20 (Salinger).

236. In addition, in calculating the effective per play rate for his model (the \$0.2194 number used in his calculations), Dr. Pelcovits ignores the downward trend in these rates over the recent years. Salinger WRT, ¶39.

1. Failure To Analyze Data From Independent Labels Results In An Inflated Royalty Rate

237. To calculate his Effective per Play rate of \$0.02194, Dr. Pelcovits examines the amount of royalties paid by six interactive subscription services (Altnet, Classical Archives, Imesh, Microsoft/ZunePass, Napster and Rhapsody) with the four major record companies and divides by the total number of plays. Pelcovits ACWDT at 25, 30; Salinger WRT, ¶¶35, 38 n.20.

238. Despite reviewing 214 agreements and amendments with the major labels in connection with his written statement, Dr. Pelcovits did not review a single contract with an independent record company. 4/20/10 Tr. at 299:9-11 (Pelcovits) (“Q: You did not include any data . . . from any independent label; is that correct? A: That is correct.”); *see also* Salinger WRT, ¶35.

239. His failure to review contracts with the independent labels is a significant flaw Salinger WRT, ¶35. Content from independent labels represents a substantial percentage of music streamed on non-interactive services. For example, A2IM (American Association of Independent Music), a SoundExchange Board member, has reported that approximately 40% of

all music streamed on non-interactive services comes from independent labels. Pandora has reported that over 50% of its streamed music comes from non-major labels. Salinger WRT, ¶35

240. SoundExchange has not provided any contracts with independent labels for interactive streaming, nor has Dr. Pelcovits explained why he excluded an entire category of copyright owners that represent a significant share of sound recording performances. Salinger WRT, ¶36.

241. Dr. Pelcovits easily could have obtained this data. Many independent labels are SoundExchange members, and in fact the SoundExchange Board has independent label representatives. As an expert, Dr. Pelcovits should have asked for this information for his model. 7/28/10 Tr. at 60:22-61:5 (Salinger). However Dr. Pelcovits not only did not ask for this information from SoundExchange, he did not bother to speak with any executives from any independent label. *See* 4/19/10 Tr. at 122:14-123:1 (Pelcovits) (Q: You mentioned that you talked with executives at some record companies. Do you recall which companies and who you talked to? A: I talked to the representatives of each of the four majors. . ."); *see also* Salinger WRT, ¶36; 7/28/10 Tr. at 60:22-61:5 (Salinger).

242. Given the lack of bargaining power and desire for promotion to increase market share, it is entirely plausible that the sound recording royalty charged by independent labels for interactive streaming is lower than the rates charged by the major labels. Salinger WRT, ¶36.

243. At trial, Dr. Pelcovits had no knowledge of the rates charged by independent labels. *See* 4/20/10 Tr. at 299:20-300:3 (Pelcovits).

244. If royalty rates charged by independent labels are less than the rates charged by the four major labels that Dr. Pelcovits includes in his sample, then Dr. Pelcovits has artificially inflated his rate upwards. Salinger WRT, ¶35.

245. Johnie Floater of Live365 presented agreements between Live365 and non-interactive services that showed independent labels were willing to waive the entire sound recording performance royalty in exchange for promotion. *See e.g.* Floater CWDT, at 13 & Exhibit 3 (Live365 License Agreement with Garageband) (“In consideration for inclusion of GB’s catalog into the Live365 Music Library and/or the promotion of GB’s catalog to Live365’s users, GB hereby grants a non-exclusive, worldwide, fully paid-up license.”); *see also* 7/28/10 Tr at 61:19-62:3 (Salinger).

246. Dr. Pelcovits has only examined the type of service that would generate the highest return for the content owner – i.e., a subscription service that plays content only from the major record labels. A more representative sample might have produced a significantly lower estimate of a reasonable rate. Salinger WRT, ¶37.

2. **Dr. Pelcovits’ Data Shows A Lower Effective Per Play Rate Over Time Than The Number Used In His Calculations**

247. Dr. Pelcovits examined performances and payments over an 18-month period between 2007 and 2009. 4/20/10 Tr at 309:16-310:21 (Pelcovits); Salinger WRT, ¶38.

248. During that time period, the effective per play rate decreased from \$0.02610 in 2007 to \$0.01917 in 2009. Yet Dr. Pelcovits uses a number of \$0.02194 in his calculations. Salinger WRT, ¶39; 7/28/10 Tr. at 62:10-22 (Salinger).

249. Dr. Pelcovits failed to take into consideration this downward trend in the data. Salinger WRT, ¶39. As a result, the benchmark rate overstates the *current* value that willing buyers and sellers place on a license in the interactive market, which causes the estimated non-interactive rate to be higher than it would be based on the actual rates *currently* paid in the interactive market. *Id.*; 7/28/10 Tr. at 63.1-7 (Salinger).

3. Selective Use Of Data In Dr. Pelcovits' Calculations

250. To make matters worse, the effective per play rate is calculated by reviewing data from *only* six interactive services (Altnet, Classical Archives, Imesh, Microsoft/ZunePass, Napster and Rhapsody). *See* Pelcovits ACWDT at 30 & Appendix IV; Salinger WRT at 17 n.20.

251. To calculate the per play adjustment, Dr. Pelcovits relies on just five interactive services and only one custom service used as a proxy for “non-interactive.” *See* Pelcovits ACWDT at 30 & Appendix IV; Salinger WRT at 17 n.20.

252. With respect to the calculation of the adjustment factor Dr. Pelcovits relies upon a total of 18 subscription services (7 non-interactive and 11 interactive) despite originally starting with over 40 services. *See* 4/20/10 Tr. at 291:18-292:6 (Pelcovits).

253. And yet, Dr. Pelcovits communicated to the Court that he reviewed over 214 agreements and amendments. Salinger WRT, ¶35.

254. Dr. Pelcovits use of subscription-only data, major label contracts, and ignorance of the current effective per play rate combine to inflate the proposed per-performance rate that Dr. Pelcovits calculated.

F. DR. PELCOVITS' USE OF A HEDONIC REGRESSION MODEL IS NOTHING MORE THAN SMOKE AND MIRRORS TO CONFIRM AN ANALYSIS THAT CLEARLY HAS PRODUCED AN UPWARDLY BIASED RESULT

255. Dr. Pelcovits uses hedonic regression analysis to confirm his methodology for developing the interactive benchmark. This method is nothing more than a diversion and has the effect of increasing Dr. Pelcovits' royalty calculation. 7/28/10 Tr. at 63:13-66:3 (Salinger).

256. The purpose of Dr. Pelcovits' hedonic regression analysis is to understand the features that affect interactive subscription rates. Like the other methods employed by Dr. Pelcovits to calculate the interactive services benchmark, this regression analysis similarly fails to

take into account the fact that non-interactive webcasting is primarily advertising-supported, not a subscription business. Salinger WRT, ¶41.

257. Further, the regression analysis conducted by Dr. Pelcovits has no relevance to calculating a royalty rate in the non-interactive market. Salinger WRT, ¶43. What the interactive services would charge if they were not interactive simply does not matter Salinger WRT, ¶46.

258. Examining the coefficients of his statistical output, Dr. Pelcovits concludes that the “value of interactivity” is \$8.52. He then subtracts this value from \$13.30, a value which Dr Pelcovits has calculated to represent the average subscription price in the interactive webcasting market (adjusted for downloads). Subtracting \$8.52 from \$13.30 results in a value of \$4.78. Dr. Pelcovits thus concludes that the value of subscription based webcasting without interactivity (i.e. the value of non-interactive webcasting subscription services), is \$4.78. Salinger WRT, ¶45.

259. Of course, Dr. Pelcovits already determined the *actual* monthly value that a subscriber would pay for non-interactive webcasting through his empirical market analysis; that value was \$4.13. Pelcovits ACWDT at 25; Salinger WRT at ¶ 43.

260. The reason for the difference between his empirical data and his regression analysis is that interactive services have features beside interactivity that consumers value. Salinger WRT, ¶45.

261. By using \$4.78 as the value of non-interactive webcasting instead of \$4.13, Dr. Pelcovits is able to increase the value of the royalty under his formula. This is a creative diversion that adds nothing of substance to his analysis. 7/28/10 Tr. at 63:13-66:3 (Salinger).

262. The whole purpose of Dr. Pelcovits’ hedonic regression is to compute the \$4.78 number. There is no value in this calculation for determining a royalty rate for non-interactive performances and should be deemed irrelevant by the Court. Salinger WRT, ¶¶46-47.

263. Further, Dr. Pelcovits regression analysis cannot model the value of interactivity for advertising based services. Dr. Pelcovits again ignores the realities of the non-interactive market by relying on a model that is incapable of accounting for the predominant source of revenue. Salinger WRT at 18 n.23.

G. EVEN IF THE COURT FINDS THE HEDONIC ANALYSIS RELEVANT, DR. PELCOVITS' REGRESSION TECHNIQUES ARE FRAUGHT WITH ERRORS RESULTING IN ENTIRELY UNRELIABLE CONCLUSIONS

1. Improper Use Of Fixed Effects

264. One of the most questionable techniques used by Dr. Pelcovits is his use of “fixed effect variables” in his calculations. Fixed effect variables are sometimes called dummy variables or indicator variables. 4/20/10 Tr. at 301:11-17 (Pelcovits); 7/28/10 Tr. at 66:10-21 (Salinger); Salinger WRT, ¶50.

265. Specifically, Dr. Pelcovits' regression analysis uses these indicator variables for five services out of his 18 observations: Kazaa, Digitally Imported, Classical Archives, Pasito Tunes and iMesh. *See* Pelcovits ACWDT at 27; Salinger WRT, ¶48.

266. Using “Fixed Effects” is relatively common in econometrics; however, it is generally used for large panel data sets, not for single cross-sections like what Dr. Pelcovits has employed. Salinger WRT, ¶50; *see also* Salinger WRT at 21 n.29 & 30.

267. Because some of Dr. Pelcovits “fixed effects” are simply indicator variables for single observations, treating these five services as fixed effects is econometrically equivalent to discarding these observations from his calculations. Salinger WRT, ¶50; 7/28/10 Tr. at 67:3-12 (Salinger).

268. As an econometrician, Dr. Salinger expressed great concern about this technique. Excluding observations needs to be done very carefully; otherwise, if given free rein to exclude observations, the results can be manipulated. 7/28/10 Tr. at 67:13-68:5 (Salinger).

269. Based on Dr. Salinger's expertise and experience, he believes that Dr. Pelcovits did not adhere to the compelling standard required to justify excluding observations. 7/28/10 Tr. at 68:6-9 (Salinger).

270. To prove this point, when Dr. Pelcovits runs the regression without these five "fixed effect" variables, the resulting estimated royalty rate drops substantially. In this scenario, the estimated value of interactivity increases from \$8.52 to \$10.55, causing the estimated royalty rate to decline almost 36% from \$0.0036 to \$0.0023. See Salinger WRT, ¶49, n.28; Live365 Ex. 15 at SXW3_00003734 (Regression Output); 4/20/10 Tr. at 372:9-373:5 (Pelcovits).

2. Failure To Provide A Confidence Interval

271. Dr. Salinger calculated the 95% Confidence Interval for Dr. Pelcovits' regression and found that the range of rates from Dr. Pelcovits analysis runs from \$0.00004 to \$0.008. See Salinger WRT at 21 n.31, 7/28/10 Tr. at 69:1-22 (Salinger). This would encompass rates almost *triple* what SoundExchange proposes to those that are a fraction of what Live365 proposes. *Id.*

272. Moreover, the small numbers of degrees of freedom (due to the small number of observations and large number of variables) means that the conventional method of computing confidence regions might understate this range. Salinger WRT at 21-22, n. 31

273. Dr. Pelcovits never provided a confidence interval in his written statement to the Court and "chose not to" to calculate the range of possible rates when asked to do so at trial. 4/20/10 Tr. at 320:7-321:3; 321:15-18.

IX. THE WSA AGREEMENTS ARE NOT APPROPRIATE BENCHMARKS

274. In deriving his WSA Agreement benchmark rate, Dr. Pelcovits merely averaged the rates that the NAB and Sirius XM agreed to in their corresponding WSA deals. He made *no* adjustments to those rates. *See* Pelcovits ACWDT at 4; Salinger WRT, ¶12.

275. As Dr. Pelcovits acknowledges, the WSA Agreements are not “free market agreements.” *See* 4/19/10 Tr at 150:15-151:9 (Pelcovits). The rates prescribed by these agreements are “colored” by what the parties expected this Court will do and are *not* based on what they expected the willing buyer/willing seller standard would yield. *See* 4/19/10 Tr. at 156:3-17 (Pelcovits).

276. Dr. Ordover confirms that the rates in the WSA Agreement with the NAB are merely a “predicted outcome” of what the parties (SoundExchange and the NAB) believed the Court would establish. Ordover WRT, ¶27.

277. The testimony from Tucker McCrady confirms this “predicting the outcome” approach. With respect to the WSA Agreement with Sirius XM, Mr. McCrady testified “that this was a litigation settlement . . . that was conducted in the context of what we thought the Judges might award and what they hoped the Judges would award.” 4/22/10 Tr at 733:10-734:10 (McCrady).

278. With respect to the NAB Agreement, Mr. McCrady as a member of the Licensing Committee of SoundExchange was “very much” involved in the “analysis and early strategizing, and ultimately approving of the final deal.” 4/22/10 Tr. at 643:12-21 (McCrady). However, Mr. McCrady provided no evidence as to how that rate was derived.

279. Furthermore, Dr. Ordovery, who opined that the NAB agreement is an appropriate benchmark failed to ask his own client (SoundExchange) about how those rates were derived. *See* 8/2/10 Tr. at 398:5-7 (Ordovery).

280. Nor did Dr. Pelcovits ever talk with any simulcasting entity or review any financial statements of any simulcaster before opining that the rates in the WSA Agreements serve as appropriate benchmarks for this proceeding. *See* 4/20/10 Tr at 324:18-325:2 (Pelcovits) (“Q: Have you talked to any other webcasters about whether they’re making profits in their current operations at the NAB rates? A. No.”)

A. SOUNDEXCHANGE IS NOT A WILLING SELLER

281. Among many other reasons, the precedential WSA Agreements relied upon by SoundExchange in this proceeding are not appropriate benchmarks because SoundExchange is *not* a “willing seller” under the governing standard. 8/2/10 Tr. at 390:1-4, 391.19-392:9 (Ordovery).

282. The willing sellers are the “record companies.” Pelcovits ACWDT at 6; 4/19/10 Tr. at 156:21-157:2 (Pelcovits); 8/2/10 Tr. at 391:19-392:9 (Ordovery).

283. As it has previously conceded, SoundExchange already has been determined *not* to be a “willing seller” under the governing standard due to “antitrust concerns” previously discussed by CARP. In summarizing CARP’s finding on this matter, SoundExchange stated the following:

SoundExchange had argued that the “willing seller” should be SoundExchange itself rather than the individual record companies. The CARP rejected this position, finding that “Congress clearly perceived antitrust concerns with such an arrangement. . . . Accordingly, in the hypothetical marketplace, where no compulsory license would exist to provide true protection, we do not perceive the hypothetical seller to be RIAA.”

Proposed Conclusions of Law of SoundExchange, Inc., Docket No. 2005-1 CRB DTRA (Dec. 12, 2006) at 16 n.4; *see also* Report of the Copyright Arbitration Royalty Panel, Docket No. 2000-9 CARP DTRA 1 & 2 (Feb. 20, 2002), at 23-24.

284. Because SoundExchange is *not* the “willing seller” under the willing buyer / willing seller standard, the Court should not rely on the rates in the WSA Agreements.

B. BECAUSE SOUNDEXCHANGE IS A COLLECTIVE OF COMPETING SELLERS – AND NOT A WILLING SELLER – IT CAN NEGOTIATE RATES THAT ARE HIGHER THAN WHAT RECORD COMPANIES COULD NEGOTIATE INDIVIDUALLY

285. The precedential WSA agreements were negotiated on behalf of competing sellers by a single entity (SoundExchange). *See* Salinger WRT at ¶¶ 61-63.

286. Economic and antitrust principles dictate that the rates charged by a collective of competing sellers, like SoundExchange, will be higher than the rates obtained by the individual sellers in a competitive marketplace. *See* Salinger WRT at ¶¶61-63; 7/28/10 Tr at 83:2-14 (Salinger).

287. Indeed, without an explicit antitrust exemption, such joint negotiations would be *per se* criminal violations of the antitrust laws because of the strong presumption that such coordination poses a risk of increased prices. *See* Salinger WRT at ¶¶61; 7/28/10 Tr. at 83:15-84:3 (Salinger).

288. These economic and antitrust principles are the reasons that ASCAP and BMI are subject to rate courts, and why Congress created a proceeding like the Copyright Royalty Board. *See* Salinger WRT at ¶¶61, 63.

C. THE NAB IS NOT A WILLING BUYER

289 Dr. Pelcovits incorrectly asserts that the NAB broadcasters “are identical to the buyers in the hypothetical market at issue in this case.” Pelcovits ACWDT at 15.

290. As Dr. Ordovery acknowledged, a willing buyer is defined as a DMCA-compliant service. *See* 8/2/10 Tr. at 392:10-12 (Ordovery).

291. The NAB entities, as a whole, are not DMCA-compliant, and must obtain waiver of the performance complement rules in order to legally simulcast their terrestrial programming. 4/2210 Tr. at 675:4-21 (McCrary); Fratrick CAWDT at 43.

D. THE PERFORMANCE COMPLEMENT WAIVERS ARE VALUABLE TO THE NAB SIMULCASTERS, AND THAT VALUE SHOULD BE CONSIDERED IN RELYING ON THE NAB DEAL AS A BENCHMARK

292. Another reason that the NAB deal is not an appropriate benchmark is that the NAB entities were granted waivers by the record labels of the “sound recording performance complement” rules specified in 17 U.S.C. §114(j)(13). *See* Fratrick CAWDT at 43-44. These waivers had significant value to the NAB entities. *See id.*

293. Among other things, Section 114(j)(13) restricts the playing of (1) no more than three different songs from the same *album* within three hours or no more than two such songs from the same album transmitted consecutively, or (2) no more than four different songs by the same *artist* within three hours or no more than three such songs by the same artist transmitted consecutively. Fratrick CAWDT at 43.

294. As SoundExchange’s witnesses have acknowledged, the performance complement waiver allows qualifying broadcasters to stream their terrestrial programming without altering the programming. *See, e.g.,* 4/2210 Tr. at 673:15-20 (McCrary); 8/2/10 Tr. at 395:2-18 (Ordovery) (“So the purpose of the waiver is to avoid unnecessary transactional costs and reprogramming costs, which may be substantial for some or it may be trivial for others.”).

295. If terrestrial radio broadcasters had to comply with these performance complement rules in order to stream their content online, these broadcasters likely would have stopped

simulcasting those broadcasts. *See* Fratrick CAWDT at 43; 4/22/10 Tr. at 673:21-674:10 (McCrary).

296. The performance complement rules would be a “roadblock” to the NAB entities “entering into the simulcast arena.” 4/22/10 Tr. at 673:21-675:3 (McCrary). As communicated by the NAB negotiators to Mr. McCrary, broad segments of NAB broadcasters would not have been able to comply with the statutory license because of the restrictive nature of the performance complement rules. 4/22/10 Tr. at 675:22-676:9 (McCrary).

297. As even SoundExchange’s witnesses admitted, the waiver of the performance complement rules was valuable to the NAB entities. For example, Mr. Tucker McCrary, who “was the lead and really the only negotiator for the performance complement waiver on Warner Music Group’s behalf” – 4/22/10 Tr. at 646:21-647:6 – testified that the NAB “said to us very strongly that they wanted [the performance complement waiver], that they need it, and at least as a negotiation posture they said they wouldn’t do a deal without it.” 4/22/10 Tr. at 676:10-19 (McCrary). Mr. McCrary had “no reason to dispute” that the performance complement waiver had value to the NAB. 4/22/10 Tr. at 676:20-677:4 (McCrary).

298. Dr. Pelcovits confirmed Mr. McCrary’s statements, saying that after his discussions with Mr. McCrary about the NAB negotiation, the “NAB needed waivers in order to sign the agreement with SoundExchange.” 4/19/10 Tr. at 229:22-230:12 (Pelcovits).

299. Similarly, Dr. Ordovery, SoundExchange’s economics expert, admitted that “in order to enable streaming without inducing or necessitating the revision or rewriting or redesigning of the programming, the waiver would be valuable.” 8/2/10 Tr. at 395:2-14 (Ordovery); *see also id.* at 414:18-21 (Ordovery) (The source of the value comes from simulcasters

not having to reprogram their streams of terrestrial broadcasts.) 4/20/10 Tr at 350:3-351:2 (Pelcovits).

300. Because it would be costlier for terrestrial broadcasters to establish a whole new programming stream to webcast in order to be DMCA-compliant, the NAB entities were willing to pay more for an agreement that relieved them of the DMCA's performance complement rules. *See* Fratrik CAWDT at 42-43.

E. SIRIUS XM IS A SUBSCRIPTION SERVICE, AND NOT COMPARABLE TO OTHER WEBCASTING SERVICES, WHICH ARE PRIMARILY ADVERTISING-SUPPORTED

301. The WSA Agreement negotiated by Sirius XM is not an appropriate benchmark because Sirius XM is the only statutory webcasting service that is subscription-based and is, therefore, not reflective of most "willing buyers" in the statutory webcasting marketplace. *See, e.g.,* 8/2/2010 Tr. at 396:7-9 (Ordover).

302. Dr. Ordover conceded that Sirius XM is primarily, if not exclusively, a subscription-only service. *See* 8/2/2010 Tr. at 396:7-9 (Ordover). Indeed, it is the *only* type of statutory webcasting service that is primarily subscription-based, as Dr. Ordover observed in his written testimony. Ordover WRT at ¶15 (providing a list of different types of webcasters).

303. Yet, as even Dr. Ordover acknowledged in response to questions by Judge Roberts, noninteractive webcasting has "very little subscription based" listening. *See* 8/2/2010 Tr. at 349:10-19 (Ordover).

304. In doing an economic model, as Dr. Ordover asserted, one has to reflect the realities of the marketplace in which the modeling takes place. *See* 8/2/2010 Tr. at 367:5-11 (Ordover).

305. However, in his benchmark analysis using the average rates of the Sirius-XM and NAB deals, Dr. Pelcovits again fails to take into account the realities of the marketplace by relying on an agreement with a subscription-based service (Sirius XM) for a market dominated by non-subscription listening. *See* Salinger WRT at ¶¶17, 26, 31. As discussed above, subscription revenue per play earns roughly three times more than advertising revenue per play. Salinger WRT at ¶ 32.

F. THE NAB AND SIRIUS XM HAVE SUBSTANTIALLY DIFFERENT ECONOMIC STRUCTURES

306. There are vastly different economics and advantages associated with terrestrial commercial radio broadcasters and Sirius XM, thereby affecting the amount that these buyers would be willing to pay compared with the rest of the “buyers” in statutory webcasting industry. *E.g.*, Fratrick CAWDT at 41-42; Smallens CWRT at ¶¶23, 36-39; 8/2/10 Tr. at 399:12-400:18 (Ordoover).

307. As Dr. Fratrick pointed out, based on his sixteen years of experience at the NAB serving as the Director and Vice President of Research and Planning, the operating structure of a simulcaster is not the same as a commercial webcaster. *See* 4/27/10 Tr. at 1119:6-1120:2, 1120:11-13 (Fratrick). This fact has been confirmed through his experience at BIA/Kelsey in which he studies both the cost structure of terrestrial broadcasters and the cost structure of terrestrial broadcasters who simulcast. *See* 4/27/10 Tr. at 1120:3-10 (Fratrick).

308. For simulcasters, years of marketing and developing audiences for their on-air personalities and programming present an instant competitive advantage in webcasting. Smallens CWRT at ¶36.

309. The major business of commercial terrestrial radio broadcasters is attracting listeners to their over-the-air transmissions and selling to advertisers access to those audiences. *See* Fratrik CAWDT at 41.

310. Also, many terrestrial radio broadcasters have begun simulcasting their over-the-air programming. *See* Fratrik CAWDT at 41. As such, they incur very little cost when they simulcast the same over-the-air programming. 7/28/10 Tr. at 228:6-231:20 (Smallens).

311 Simulcasters, therefore, have no additional programming costs, as those costs have already been paid in connection with their over-the-air operations. *See* Fratrik CAWDT at 41; 4/27/10 Tr. at 1120:11-22 (Fratrik). Their listener acquisition costs are very low, as they can use their own broadcast stations to promote their website listening. *See* Fratrik CAWDT at 41. Similarly, they have an existing sales force to sell commercials for their over-the-air stations who can also sell online advertising. *See* Fratrik CAWDT at 41; 4/27/10 Tr. at 1120:11-1121:5; *see also* 7/28/10 Tr. at 228:6-231:20 (Smallens).

312. At the same time, simulcasters have great advantages in selling advertisements on their webcasting programming to local advertisers. *See* Fratrik CAWDT at 41 &n.64. Part of the advantage in selling advertising is the greater amount of inventory that these simulcasted webcasts of terrestrial radio broadcasting have as compared to the commercial webcasters' programming, resulting in greater advertising revenues for those webcasts. *See* Fratrik CAWDT at 41-42. This inventory can also be better sold because of the nature of the audiences of simulcasts of terrestrial radio stations versus those of pure webcasters. *See* Fratrik CAWDT at 42.

313. Simulcasters have a substantial advantage over non-simulcasting webcasters in selling local advertising because of their existing team of seasoned experts who have sold audio advertising for years to local and national marketers. *See* Smallens CWRT at ¶37; Fratrik

CAWDT, Exhibit 3 (Online Music Spins and Media Spend 2003-2012, AccuStream iMedia Research, 2009, at Section Four); 4/27/10 Tr. at 1121:11-21 (Fratريك) (“local radio broadcasters have . . . a sales staff out there, and they can provide a more targeted geographic audience to potential advertisers, which many local advertisers want, as opposed to a national audience which a commercial webcaster is offering.”).

314. They also have a built-in source to market and cross-promote their simulcast streams on their over-the-air signals and station websites. *See* Smallens CWRT at ¶37.

315. As explained by Mr. Smallens and Dr. Fratريك, the audience for the webcasts of terrestrial radio stations tends to be concentrated in the same area as their terrestrial listening audience, so that these stations can sell advertising to local advertisers in that market. *See* Smallens CWRT at ¶¶23, 37; Fratريك CAWDT at 42.

316. In contrast, a webcaster with a similar sized audience (who would have a similar number of performances on which its royalty would be based) would have listeners scattered all over the country, and thus would not be able to have the concentrated local advertising market on which it could rely to induce local businesses to advertise on their streams. *See* Fratريك CAWDT at 42. This is a significant advantage, as in most major markets, terrestrial radio stations make 70-80% of their advertising revenue from local advertisers, a source not readily available to the webcasters. *See* Fratريك CAWDT at 42. Therefore, simulcasters are less reliant on webcasting ad networks, such as Target Spot, because their ad monetization abilities are better developed than their webcasting counterparts. Smallens CWRT at ¶39.

317. Unlike the statutory webcaster, who must pay all of its operating costs from the revenues derived from its operations, most of the costs of the simulcaster have already been paid by revenues generated by its terrestrial radio operations. Smallens CWRT at ¶38. These costs

include office space, computer systems, information technology infrastructure, and on and off air personnel. *Id.* Therefore, as these costs do not need to be spent on the streaming, simulcasters can afford royalties that its webcasting competitors cannot. *Id.*

318. Indeed, both of SoundExchange's economics experts have found the economics of simulcasters to be different from commercial webcasters. Dr. Pelcovits acknowledges that terrestrial radio broadcasters who simulcast are a "different business model" and have "different types of costs." *See* 4/19/10 Tr. at 216:17-217:3 (Pelcovits). Dr. Ordover agrees that "the economics of a simulcaster are quite different from an Internet-only webcaster." 8/2/10 Tr. at 399:12-15 (Ordover).

319. As Dr Ordover acknowledged, terrestrial broadcasters and Sirius XM are likely satisfied with running their simulcasting operation that would not be profitable on its own, so long as the simulcasting operation is bringing in more listeners to the radio stations. 8/2/10 Tr. at 400:1-11 (Ordover). Internet-only webcasters, however, have a different sort of platform. 8/2/10 Tr. at 400:12-18. (Ordover).

320. Given these differences in the economics between simulcasters and non-simulcasters, there are differences – as a matter of reality – in the actual rates being paid between simulcasters on one hand and non-simulcasters on the other hand, as Dr. Ordover testified. 8/2/10 Tr. at 403:13-17. (Ordover).

321. As a result of their lower costs and higher revenues generated from simulcasting streams, terrestrial broadcasters and Sirius XM are more willing to pay higher royalty fees for webcasting as they are able to generate greater profits from that industry. Fratrik CAWDT at 42.

G. THE WSA AGREEMENTS WERE ENTERED INTO UNDER THREAT OF PENDING LITIGATION IN THE CRB

322. The WSA Agreements were entered into under threat of pending litigation in the CRB, and further reflects why the WSA Agreements are not an appropriate benchmark. *See* Fratrik CAWDT at 40-44; *see also* Proposed Conclusions of Law of Live365, Inc., ¶¶53-57.

323. Even Dr. Pelcovits acknowledges, these rates are imperfect benchmarks because of their possible effect on this proceeding can distort them. Pelcovits ACWDT at 3, 15.

324. As the evidence demonstrates, the simulcasters were willing to enter into these WSA Agreements to avoid the significant costs that would be incurred in litigating in this CRB proceeding. *See* Fratrik CAWDT at 40-44.

325. Millions of dollars were spent by the broadcasters to litigate in each of the prior CRB and CARP proceedings. *See* Fratrik CAWDT at 43. As Dr. Fratrik testified, most of the costs were borne by a few companies, as most broadcasters do not see significant revenue from their streams and, thus, are unwilling to contribute to the litigation costs of a CRB proceeding. *Id.*

326. As Dr. Pelcovits confirms, there are substantial costs to participate in a CRB proceeding. *See* 4/19/10 Tr at 235:12-15 (Pelcovits). Such litigation costs are non-recoverable by the companies spending them, as those costs are paid on top of the royalties which the CRB ultimately sets (unlike the litigation costs of SoundExchange, which are funded out of the royalties that webcasters pay). *See* Fratrik CAWDT at 43. Thus, simulcasters would be willing to agree to an above-market royalty to avoid these litigation costs. *Id.*

H. THE NAB RECEIVED A DISCOUNT IN 2008 & 2009 AS A BENEFIT FOR HIGHER RATES IN 2011-2015

327. In the precedential WSA agreements, SoundExchange's accepted rates in 2009 and 2010 that are lower than the statutory rates to which it was entitled.³ McCrady WDT Ex.101-DP, WSA Agreement for Broadcasters made between SoundExchange, Inc. and the National Association of Broadcasters; McCrady WDT Ex.102-DP, WSA Agreement for Commercial Webcasters made between SoundExchange, Inc. and Sirius XM Radio Inc.; Salinger WRT at ¶55.

328. As a matter of economics, it is important to consider what SoundExchange got in return for this concession of lower rates in 2009 and 2010. *See* Salinger WRT at ¶55.

329. As Dr. Salinger testified, it is apparent that SoundExchange accepted higher rates for 2011-2015 than it otherwise could have in exchange for lower rates in 2009 and 2010. *See* Salinger WRT at ¶55; *see also* 7/28/10 Tr. at 81.14-82:17 (Salinger).

330. Though Dr. Pelcovits posits that SoundExchange might have accepted lower rates than it otherwise would have to induce early settlement, this argument is entirely speculative and fails to address why the inducement took the form of lower rates in 2009-2010 rather than later on. *See* Salinger WRT at ¶55.

331. SoundExchange had available to it a variety of contractual terms to induce early settlement. *See* Salinger WRT at ¶55. Moreover, since SoundExchange could have legally required the statutory rates to be paid for 2009 and 2010 and presumably would have preferred them all else equal, it must have insisted on something in return for the concession. *See* Salinger

³ Even the 2011 rates for both the NAB deal (\$0.0017) and the Sirius XM deal (\$0.0018) are lower than the statutory rate for 2010 (\$0.0019). *See* Salinger WRT, at 23 n.33 (citing Pelcovits ACWDT at 20).

WRT at ¶55. Obtaining higher rates for 2011-2015 is the most obvious rationale. *See* Salinger WRT at ¶55; *see also* 7/28/10 Tr. at 81:14-82.17 (Salinger).

332. It is also important to consider, as a matter of economics, why it was mutually beneficial for SoundExchange, NAB and Sirius XM to structure their deals with relatively low rates for the first years and higher rates thereafter. *See* Salinger WRT at ¶56.

333. A natural rationale to consider is that these parties recognized that the rates they set might then become a benchmark that the Copyright Royalty Judges would set for companies that compete with the terrestrial broadcasters represented by NAB and with the satellite radio service provided by Sirius XM. *See* Salinger WRT at ¶56. The fact that the parties consented to letting the rates be precedential is consistent with this explanation. *See* Salinger WRT at ¶56.

334. Accordingly, the WSA Agreements are not appropriate benchmarks for 2011-2015 rates since they reflect higher than marketplace rates given the discount provided to the NAB and Sirius XM for 2009 and 2010.

I. THE NAB AND SIRIUS XM HAVE SUBSTANTIAL INCENTIVES TO RAISE THEIR RIVALS' COSTS

335. One other consideration that militates against relying on the WSA Agreements as appropriate marketplace benchmarks is the significant incentive that NAB and Sirius XM had to raise their rivals' costs by entering into these agreements. *See* Salinger WRT at ¶¶56-60.

336. As a matter of economics, an increase in the price of an input generally lowers a company's profitability and is, therefore, harmful to its interest. *See* Salinger WRT at ¶57. There is, however, an exception to this principle: a company can benefit from an increase in the price of an input if its rivals use the input more intensively than it does. The broad theory underlying this principle is called "Raising Rivals' Costs." *See* Salinger WRT at ¶57 (citing relevant articles); 7/28/10 Tr. at 72:4-15 (Salinger).

337 The 10-K reports submitted by Sirius XM, Clear Channel and a number of major radio broadcasters all cite Internet radio as a competitive threat to their business. *See Salinger WRT at ¶58 (citing 10-K reports); 7/28/10 Tr. at 72:16-74:5 (Salinger).* Dr. Pelcovits confirms from his analysis that Sirius XM sees webcasting as a competitive threat. *See 4/19/10 Tr. at 236:12-237:14 (Pelcovits).*

338. Terrestrial radio stations currently do not pay royalties for over-the-air broadcasts, and Sirius XM's royalties in 2010 are only 7% of revenue (and increasing to 8% of revenue in 2012). *See Salinger WRT ¶58 (citing 37 C.F.R. § 382.12).*

339. Performance royalties account for a far larger share of the total costs for non-simulcasting webcasting services, which rely on revenues from non-interactive streaming for the bulk of their revenues. *See Salinger WRT ¶58 and n.37 (noting, for example, that Pandora has reported royalties accounting for between 56% and 70% of its total revenues).*

340. The substantial cost that performance royalties represent for non-simulcasting webcasting services – as compared with the simulcasting entities – provides significant incentives for the simulcasters to engage in raising their rivals' cost to disadvantage their Internet radio competitors. *See Salinger WRT ¶58.*

341 As shown in Dr Salinger's testimony, Pandora can be used as an example to demonstrate that raising rivals' costs is a viable strategy. *See Salinger WRT ¶59.* Pandora's revenue per play in 2009, [REDACTED] is approximately equal to the 2011 WSA rate, \$0.00175, on which Pelcovits relies. *See Salinger WRT ¶59.* At the WSA royalty rate, Pandora would only have [REDACTED] per play, or [REDACTED]% of its total revenue, to cover all of its remaining costs and earn a reasonable profit. *See Salinger WRT ¶59.*

342. As it would be highly unlikely for Pandora to be able to afford the WSA rates, it may well be eliminated as a competitor to the companies (i.e., NAB and Sirius XM) that agreed to these rates. *See* Salinger WRT ¶59.

343. The above example makes clear the ability and incentives of NAB and Sirius XM to raise their rivals' costs through the negotiations of above-market royalty rates. *See* Salinger WRT ¶60. In addition, it demonstrates that even the lower WSA benchmark relied upon by Pelcovits would be rejected by Pandora and other non-interactive services because of their likely unprofitability at these rates. *See* Salinger WRT ¶60.

X. NON-INTERACTIVE WEBCASTING HAS SIGNIFICANT PROMOTIONAL VALUE

A. NON-INTERACTIVE WEBCASTING POSITIVELY IMPACTS MUSIC SALES

344. Statutory webcasting provides promotional benefits to copyright holders. *E.g.*, Smallens CWRT ¶¶40-42; Floater CWDT ¶¶29-32; Lockhart WDT ¶16; 4/28/10 Tr. 1316:20-1317:15 (Lockhart).

345. Numerous studies have confirmed the positive sales impact and other promotional benefits of statutory webcasting for recording artists. *See* Smallens CWRT ¶40-41 (summarizing music sales data from statutory webcasting services).

346. For example, as Mr. Smallens testified, a report by the NPD Group from February 2010 indicated that “online radio services lead to a 41% increase in paid downloads.” Smallens CWRT ¶40 (citing articles from *CNet News* and *Wired Magazine*). That same analysis by the NPD Group revealed that on-demand services like Napster and Spotify drives digital download sales *lower* by 13%. *Id.* ¶41

347 As admitted by SoundExchange's record label witness, Mr. Dennis Kooker, reports from the NPD Group are routinely reviewed upon by him and are regarded as "useful and insightful" in the music industry. 4/19/10 Tr. at 103:15-104:2 (Kooker).

348. Mr. Smallens also testified about other data from Pandora and Rhapsody regarding an increase in music sales associated with non-interactive listening. For example, the Chief Technology Officer of Pandora, Tom Conrad, had publicly stated in May 2010 that Pandora was driving sales of 1 million songs a month, and that "for every song purchase Pandora drives, users are likely to buy 3 to 5 more songs on top of the one they found." Smallens CWRT ¶40 (citing article from *The Washington Post*). Similarly, relying upon Rhapsody's internal data, Timothy Quirk (the Vice President of Programming for Rhapsody) stated: "More non-interactive plays of a particular track correlate clearly and directly with more MP3 sales of that track." Smallens CWRT ¶40 (quoting sworn testimony submitted by Mr. Quirk).

349. Live365's data regarding the amount of "click-through" buying of recorded materials (either through physical CDs or legal downloads) also point toward the promotional value to copyright owners from statutory webcasting. See Fratrick CAWDT at 34; Floater CWDT ¶30. Live365 offers click-through buying through links to both Amazon.com and Apple's iTunes. See Floater CWDT ¶30 and Ex. 2 (Screenshots of Live365's Internet Radio Players); Fratrick CAWDT at 34. Between 2004 and 2009, Amazon.com and iTunes generated close to \$1.3 million in sales from music and MP3 downloads by Live365's webcasting listeners. See Floater CWDT ¶30; Fratrick CAWDT at 34; 4/27/10 Tr. at 1115:19-1116:14 (Fratrick).

350. As Dr. Fratrick observed, even other courts have noted how non-interactive webcasting services, including "custom radio" services, promote the sales of music. Fratrick CAWDT at 34-35 (citing *Arista Records, LLC v. Launch Media, Inc.*, 578 F.3d 148, 161 n.19 (2d

Cir. 2009)). For example, in the *Launch Media* case from August 2009, the Second Circuit stated the following in its decision:

Recently webcasting services have been credited with “becom[ing] a massive driver in digital [music] sales” by exposing users to new music and providing an easy link to sites where users can purchase this music.

Id.

351. In sum, all of the empirical evidence in the record demonstrates that statutory webcasting promotes the sales of music. SoundExchange has provided *no* empirical evidence to the contrary.

B. OTHER EVIDENCE OF THE PROMOTIONAL VALUE OF STATUTORY WEBCASTING

352. The two songwriter witnesses that testified during this proceeding – i.e., Mr. Smallens and Ms. Lockhart – confirmed the promotional value of statutory webcasting. *See* Smallens CWRT ¶42; Lockhart WDT ¶16. As observed by Mr. Smallens – who was a senior executive at two of the largest terrestrial broadcasters (CBS Radio and Entercom Communications) – most terrestrial radio stations have been reduced to playlists of 250 or fewer songs in established musical formats because terrestrial radio’s appetite for new music outside of the established formats has dwindled. *See* Smallens CWRT ¶42. For the most part, the only stations that still play bands like Mr. Smallens’ band (Too Much Joy) and more obscure alternative bands are on Internet radio. *Id.*

353. Similarly, Ms. Lockhart, who holds copyrights to several of her works, testified that she would much rather have airplay and exposure than the small amount of revenue she sees in performance royalties. Lockhart WDT ¶16. This promotional exposure from Internet radio is more valuable to her since it opens doors for additional revenue streams that outweigh the small amount of performance royalty fees she obtains. *See id.*, 4/28/10 Tr. at 1323:16-1324:5

(Lockhart). As observed by Ms. Lockhart, there are more opportunities for songwriters, such as her, to gain exposure on Internet radio than on terrestrial radio, which should be weighed in favor of setting a lower royalty rate on webcasting. *Id.*

354. There is yet additional evidence in the record of promotional value that statutory webcasting provides. For example, Live365 and its webcasters routinely receive letters and CDs from artists requesting as much exposure (i.e., playing of their songs) as possible on Live365 webcasts. *See* Floater CWDT ¶32; 4/26/10 Tr. at 1039:12-1040:17 (Floater); Fratrik CAWDT at 34.

355. In addition, Live365 has agreements with several independent labels, which have expressly *waived* the sound recording performance royalty in exchange for promotion of their artists. *See* Floater CWDT ¶32 & and Ex. 3 at p. A-1 (Live365 License Agreement with Garageband), Ex. 4 at p. A-1 (Live365 License Agreement with INgrooves), Ex. 5 at p. A-1 (Live365 License Agreement with DMI), Ex. 6 at p.A-1 (Live365 License Agreement with Soleilmoon); 4/26/10 Tr. 867:8-868:3 (Floater); Fratrik CAWDT at 34; 4/27/10 Tr. at 1115:19-1116:14 (Fratrik). As Dr. Fratrik observed, this waiver of the royalty indicates that some copyright owners see a financial benefit at least equal to the value of the royalty rate for the promotional value of these webcasters. *See* Fratrik CAWDT at 34.

C. WEBCASTING IS NOT A SUBSTITUTE FOR MUSIC SALES

356. There is *no* evidence showing that webcasting has displaced a single sale of a single sound recording (or that such displacement is likely to occur in the foreseeable future). *E.g.*, Smallens CWRT ¶40; 4/19/10 Tr. 106:9-106:18 (Kooker). This is not surprising given the fact that statutory webcasters (except for the NAB entities) must comply with DMCA requirements limiting the number of times any particular artist can be played within a specified

time period, as well as limiting the similarity of these broadcasts with the actual recorded materials of a particular artist. *See* Fratrick CAWDT at 35.

357. As Mr. Smallens testified, the empirical data showing an increase in music purchases from non-interactive services directly contradict Dr. Pelcovits' unverified, bald supposition that "there is even more reason to believe that non-interactive (i.e., statutory) services would be as much of a substitute for purchasing music as interactive services." Smallens CWRT ¶41 (quoting from Pelcovits ACWDT at 35).

358. While Mr. Tucker McCrady at Warner Music Group also expressed concerns of the substitutional impact of digital distribution models – McCrady WDT at 2 – Mr. McCrady is unable to point to any evidence that statutory webcasting has such an impact. 4/22/10 Tr. 714:3-17, 715:11-18 (McCrady).

D. IMPACT ON ROYALTY RATE

359. Listeners are exposed to a more diverse range of artists on statutory webcasting, thereby generating greater revenues (i.e., click-through purchases of recorded materials) for many more copyright owners. Fratrick CAWDT at 36. Moreover, given the un rebutted evidence of an increase in music sales from statutory webcasting, a reduced royalty rate is appropriate.

XI. CREATIVE CONTRIBUTION, TECHNICAL CONTRIBUTION, CAPITAL INVESTMENTS, COSTS AND RISKS BY LIVE365 AND OTHER WEBCASTERS

360. The contributions, costs and risks incurred by webcasters in providing the service have been substantial over time while the record companies have spent little if anything on developing this new service. *See* Fratrick CAWDT at 36; Floater CWDT at ¶14; 4/19/10 Tr. 84:6-12, 88:19-89:14, 90:7-91:10, 93:18-94.1 (Kooker). Statutory webcasters like Live365 spend considerable amounts in technological development, operations and bandwidth to provide their

services, as well as marketing and sales expenditures to generate the revenues necessary to fund these operations. *See* Floater CWDT at ¶14; Fratrick CAWDT at 36.

361. There are still significant risks and uncertainties that plague the webcasting industry. For example, increasing and fluctuating statutory royalty rates – which represent the largest single cost for statutory webcasters – make it very difficult impossible for statutory webcasters to plan for the future, creating a significant risk for webcasters. SX Ex. 13 (Lam Depo Tr.) at 125:21-126:25.

362. Another significant risk faced by webcasters is from the increasing diversity of online media outlets, which represent competitive risks to webcasters. SX Ex. 13 (Lam Depo Tr.) at 127:1-129:2.

363. On the other hand, the contributions, costs and risks by the record labels would have been incurred even if a webcasting industry did not exist. *See* 4/19/10 Tr. 84:6-12, 88:19-89:14, 90:7-91:10, 93:18-94:1 (Kooker). As Mr. Kooker from Sony Music testified, statutory webcasting has not caused the record labels to incur additional talent acquisition and A&R costs. *See id.* at 84:6-12. Statutory webcasting has also not imposed additional manufacturing costs on record labels. *See id.* at 88:19-89:14. In addition, statutory webcasting has not generated physical content distribution costs for record labels. *See id.* at 90:17-91:10. Further, statutory webcasting has not and cannot cause cut out costs for record labels. *See id.* at 93:18-94:1

364. In addition, digital distribution provides a new source of revenue for labels through digital content delivery fees, which are charged by record labels to digital services for delivery of their digital content. 4/19/10 Tr. 99:10-99:18 (Kooker).

365. As Mr. Kooker testified, statutory webcasting has not prevented record labels, such as Sony Music, from being profitable. 4/19/10 Tr. 101:4-101:9 (Kooker).

366. In other words, record companies have already spent their money producing and marketing the digital tracks, and thus have no additional costs in connection with the webcast. *See* Fratrik CAWDT at 37. So, while webcasters have everything to risk in connection with its webcasting operations (especially if the royalty rates are too high), the record companies face no real risk from the webcasting of their works, or in having a royalty rate too low. *See* Fratrik CAWDT at 37-38.

XII. PROGRAMMING FACTORS NECESSITATE A DOWNWARD REDUCTION OF THE CURRENT STATUTORY RATES

367. Statutory webcasting plays a rich diversity of programming and genres of music. *See* Fratrik CAWDT at 33, Floater CWDT at ¶¶28-29 and Ex. 1 (Live365 Station Genre Selection); 4/21/10 Tr. 514:7-13 (Kessler). For example, according to Live365's playlist data, there were over 300,000 different artists' works played in a recent quarter by Live365 stations. *See* Floater CWDT at ¶28. This exposure to new artists is one of the hallmarks of commercial webcasting. *See* Fratrik CAWDT at 33; Floater CWDT at ¶¶28-29.

368. The diversity of content played by statutory webcasters is more wide-ranging than terrestrial radio programming. 4/21/10 Tr. 514:7-20 (Kessler).

369. According to Arbitron/Edison Research of online audiences published in April 2009, the largest response to the question, "Of the following reasons you might listen to Internet radio, what is the ONE main reason you listen?" was the response "To listen to audio you cannot get elsewhere." *See* Fratrik CAWDT Ex. 6 (*The Infinite Dial 2009*), p. 12.

370. Listeners expect, and statutory webcasters deliver, access to a wide variety of artists and genres of music. *See* Fratrik CAWDT at 33.

371. Through statutory webcasting, listeners are exposed to a more diverse range of artists, thereby generating greater revenues for many more copyright owners (i.e., click-through purchases of recorded materials). *See* Fratrik CAWDT at 36. Given the wide array of music and artists that are played on statutory webcasting services and the resulting promotional value such streaming provides for copyright owners, a reduced royalty rate (as compared with the 2006-2010 rates) is appropriate. *See id.*

XIII. COMPETITIVE FACTORS NECESSITATE A DOWNWARD REDUCTION OF THE CURRENT STATUTORY RATES

372. The evidence demonstrates that competitive factors affecting the webcasting industry necessitate a downward reduction from the current statutory rates. The supply of all different types of advertising inventory, including internet advertising, has continued to increase substantially, thereby affecting the demand for advertising on commercial webcasts. *See* Fratrik CAWDT at 31. Also, as Dr. Fratrik observed, terrestrial radio broadcasters have felt the impact of this increased competition in view of their negative growth over the last three full years. *See* Fratrik CAWDT at 31-32 (citing *Investing in Radio. 2009*, 1st edition, 2009, BIA Advisory Services [attached as Exhibit 2 of Dr. Fratrik's CAWDT]).

373. Moreover, the market power is concentrated in the hands of only a few willing sellers. Dr. Fratrik cited evidence from Dr. Adam Jaffe, an expert witness in the *Webcasting II* proceeding, that the four major record companies “collectively represented over 85% of the physical product (mainly CDs).” *See* Fratrik CAWDT at 32.

374. Relying on data used by Dr. Jaffe, Dr. Fratrik noted that the “Herfindahl-Hirschmann Index” (a commonly used measure of concentration and competition in industries) for the record industry is 2150, which exceeds the threshold of 1,800 that the U.S. Department of

Justice and the Federal Trade Commission use to describe “highly concentrated” markets. *See* Fratrick CAWDT at 32 (citing U.S. Department of Justice Horizontal Merger Guidelines, April 8, 1997).

375. As Dr. Fratrick stated, this high concentration indicates that the record industry has excess negotiating power and can extract rates that do not reflect what a willing buyer and willing seller would enter into in a hypothetical competitive market. *See* Fratrick CAWDT at 32-33.

376. As a result of the increased competition facing webcasters, and the market power afforded by the record companies, a downward reduction of the royalty rate for the next 5 years (as compared with the 2006-2010 rates) is warranted. *See* Fratrick CAWDT at 33.

XIV. MINIMUM FEE UNDER SECTION 114(f)

377. During the direct case phase, SoundExchange and Live365 submitted nearly identical proposals for a minimum fee applicable to commercial webcasters in their respective direct cases. *Compare* “Rate Proposal for Live365, Inc.,” *with* “Proposed Rates and Terms of SoundExchange, Inc.”

378. Subsequently, on May 14, 2010, SoundExchange and Live365 entered into a stipulation regarding the minimum fee, as follows:

Pursuant to 17 U.S.C. §§ 112(e)(3) and (4) and 114(f)(2)(A) and (B), all commercial webcasters (as defined in 37 C.F.R. § 380.2(d)) shall pay an annual, nonrefundable minimum fee of \$500.00 for each calendar year or part of a calendar year of the license period during which they are licensees (as defined in 37 C.F.R. § 380.2(g)), for each individual channel and each individual station (including any side channel maintained by a broadcaster that is a licensee, if not covered by SoundExchange’s proposed settlement with NAB), subject to an annual cap of \$50,000.00 for a licensee with 100 or more channels or stations. For each such licensee, the annual minimum fee described in this paragraph shall constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B). Upon payment of the minimum fee, a licensee would receive a credit in the amount of the minimum

fee against any additional royalty fees payable in the same calendar year.

“Stipulation of SoundExchange, Inc. And Live 365, Inc. Regarding The Minimum Fee For Commercial Webcasters And The Royalty Payable For The Making Of Ephemeral Recordings,” submitted on May 14, 2010.

XV. ROYALTY RATE FOR EPHEMERAL RECORDINGS UNDER SECTION 112(e)

379. SoundExchange and Live365 submitted royalty rate proposals for the making of ephemeral recordings under 17 U.S.C. § 112(e) in connection with their respective direct cases. Both parties proposed a single bundled rate with a percentage attributable to the Section 112 license and a percentage attributable to the Section 114 license. *See* “Rate Proposal for Live365, Inc.” & “Proposed Rates and Terms of SoundExchange, Inc.”

380. Subsequently, on May 14, 2010, SoundExchange and Live365 entered into a stipulation regarding a bundling of the Section 112 and Section 114 licenses and attributing 5% of the bundled royalties to the Section 112 license. *See* “Stipulation of SoundExchange, Inc. And Live 365, Inc. Regarding The Minimum Fee For Commercial Webcasters And The Royalty Payable For The Making Of Ephemeral Recordings,” submitted on May 14, 2010

381. SoundExchange and Live365 stipulated as follows:

The royalty payable under 17 U.S.C. § 112(e) for the making of all ephemeral recordings used by the licensee solely to facilitate transmissions for which it pays royalties shall be included within and constitute 5% of the total royalties payable under §§ 112 and 114.

See id.

XVI. PROPOSED REGULATIONS AND TERMS

382. SoundExchange and Live365 entered into a partial stipulation regarding certain proposed regulations and terms set forth in 37 C.F.R. Part 380. Live365 submits that the

stipulated regulations and terms should be adopted by the CRJs. Live365 objects to – or has no opinion on – the adoption of SoundExchange’s proposed regulations and terms that are not stipulated to.

383. Four Interactive Services Agreements have been admitted as trial exhibits in this proceeding. *See* Live365 Ex. 17 (Last.fm-Warner Music Group Interactive Radio Agreement), Live365 Ex. 18 (Slacker Inc.-Warner Music Group Interactive Radio and Music Services Agreement), McCrady WDT Ex. 104-DR (Napster-Warner Music Group Subscription Services Agreement) (Restricted), and McCrady WDT Ex. 106-DR (Napster LLC-Warner Music Group Bundled Offer Agreement).

384. All four of these agreements were reviewed by Dr. Pelcovits for his retention in this matter. *See* Pelcovits ACWDT, Appendix IV.

385. Each agreement requires that a per-performance royalty is paid when a performance (or play) is streamed for more than thirty (30) consecutive seconds. For example, in Live365 Trial Exhibit 17 (Last.fm-Warner Music Group Interactive Radio Agreement), a “Play” is defined as “a Stream of a Sound Recording of more than thirty (30) consecutive seconds. . . .”

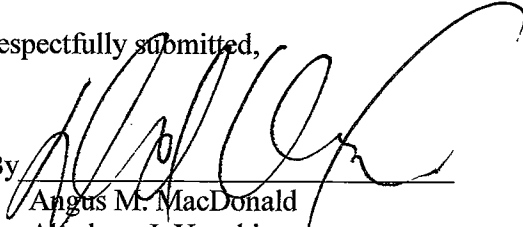
386. The remaining agreements all specify that the “Per Play Fees” are triggered only after a performance is streamed for after thirty consecutive seconds. *See* Live365 Ex. 18 (Slacker Inc.-Warner Music Group Interactive Radio and Music Services Agreement); McCrady WDT, Ex. 104-DR (Napster-Warner Music Group Subscription Services Agreement); McCrady WDT, Ex. 106-DR (Napster LLC-Warner Music Group Bundled Offer Agreement).

387. Live365 proposes that the definition of “Performance” under 37 C.F.R. § 380.2(i) be modified so that it excludes any performances of sound recording that are not more than thirty (30) consecutive seconds. This definition would be consistent with the definition of a

“performance” or “play” set forth in each of the four interactive services agreements that were reviewed by Dr. Pelcovits and submitted as evidence in this proceeding.

Respectfully submitted,

By



Angus M. MacDonald
Abraham J. Yacobian
HOVANESIAN & HOVANESIAN
301 Colorado Blvd., Suite 514
Pasadena, CA 91101
Fax: (626) 795-8900
angusm@hovlaw.com
abrahamy@hovlaw.com

David D. Oxenford
DAVIS WRIGHT TREMAINE, LLP
1919 Pennsylvania Ave., NW, Suite 800
Washington, DC 20006
Fax: (202) 973-4499
davidoxenford@dwt.com

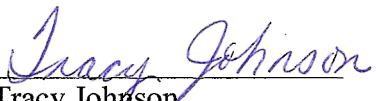
Counsel for Live365, Inc.

September 10, 2010

CERTIFICATE OF SERVICE

I, Tracy Johnson, do hereby certify that copies of the foregoing "Proposed Findings of Fact of Live365, Inc." were sent via overnight mail and email on this 10th day of September, 2010 to the following:

<p>David A. Handzo Michael B. DeSanctis Jared O. Freedman JENNER & BLOCK LLP 1099 New York Ave., N.W. Washington, D.C. 20001 Fax: (202) 639-6066 dhandzo@jenner.com mdesanctis@jenner.com jfreedman@jenner.com</p> <p><i>Counsel for SoundExchange, Inc.</i></p>	<p>William Malone MILLER & VAN EATON, P.L.L.C. 1155 Connecticut Avenue, N.W Suite 1000 Washington, D.C. 20036-4320 Fax: (202)785-1234 wmalone@millervaneaton.com mschettenhelm@millervaneaton.com</p> <p><i>Counsel for Intercollegiate Broadcasting System, Inc. and Harvard Radio Broadcasting Co. Inc.</i></p>
<p>William B. Colitre ROYALTY LOGIC, LLC 21122 Erwin Street Woodland Hills, CA 91367 Fax: (818) 558-3474 BColitre@RoyaltyLogic.com</p> <p><i>Counsel for RoyaltyLogic, LLC</i></p>	<p>Catherine R. Gellis PO Box 2477 Sausalito, CA 94966 Phone: (202) 642-2849 cbi@cathygellis.com</p> <p>Mitchell L. Stoltz Constantine Cannon LLP 1301 K Street N.W., Ste. 1050 East Washington, DC 20005 mstoltz@constantinecannon.com</p> <p><i>Counsel for College Broadcasters, Inc.</i></p>


Tracy Johnson
DAVIS WRIGHT TREMAINE, LLP
1919 Pennsylvania Ave., NW
Suite 800
Washington, DC 20006

Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In the Matter of:

Digital Performance Right in Sound
Recordings and Ephemeral Recordings

Docket No. 2009-1
CRB Webcasting III

PROPOSED CONCLUSIONS OF LAW
OF LIVE 365, INC.

Angus M. MacDonald
Abraham J. Yacobian
HOVANESIAN & HOVANESIAN
301 Colorado Blvd., Suite 514
Pasadena, CA 91101
Fax: (626) 795-8900
angusm@hovlaw.com
abrahamy@hovlaw.com

David D. Oxenford
DAVIS WRIGHT TREMAINE, LLP
1919 Pennsylvania Ave., NW, Suite 800
Washington, DC 20006
Fax: (202) 973-4499
davidoxenford@dwt.com

Counsel for Live365, Inc.

September 10, 2010

TABLE OF CONTENTS

I.	THE STATUTORY CRITERIA FOR SETTING RATES AND TERMS	1
II.	THE WILLING BUYER AND WILLING SELLER STANDARD	3
	A. Willing Buyer.....	3
	B. Willing Seller.....	4
	C. Hypothetical Marketplace.....	5
III.	BASED ON THE MANDATORY STATUTORY FACTORS, A PER-PERFORMANCE RATE OF \$.0009 MOST CLEARLY REPRESENTS THE RATE THAT WOULD HAVE BEEN NEGOTIATED IN THE MARKETPLACE BETWEEN A WILLING BUYER AND A WILLING SELLER.....	6
IV.	A DISCOUNT FOR QUALIFIED AGGREGATION SERVICES IS APPROPRIATE.	11
V.	SOUNDEXCHANGE’S RATE PROPOSAL IS NOT BASED ON A WILLING BUYER / WILLING SELLER STANDARD	12
VI.	DR. PELCOVITS’ INTERACTIVE SERVICES “BENCHMARK” IS FUNDAMENTALLY FLAWED	14
VII.	THE WSA AGREEMENTS ARE NOT APPROPRIATE BENCHMARKS	17
VIII.	NON-INTERACTIVE WEBCASTING HAS SIGNIFICANT PROMOTIONAL VALUE	21
	A. Mandatory Factor.....	21
	B. Non-Interactive Webcasting Positively Impacts Music Sales	21
	C. Impact On Royalty Rate.....	22
IX.	CREATIVE CONTRIBUTION, TECHNICAL CONTRIBUTION, CAPITAL INVESTMENTS, COSTS AND RISKS BY LIVE365 AND OTHER WEBCASTERS	23
X.	PROGRAMMING FACTORS NECESSITATE A DOWNWARD REDUCTION OF THE CURRENT STATUTORY RATES.....	23
XI.	COMPETITIVE FACTORS NECESSITATE A DOWNWARD REDUCTION OF THE CURRENT STATUTORY RATES	23
XII.	ROYALTY RATE FOR EPHEMERAL RECORDINGS UNDER SECTION 112(E).....	24

XIII.	MINIMUM FEES UNDER SECTIONS 114(F) AND 112(E).....	25
XIV.	PROPOSED REGULATIONS AND TERMS	25
A.	Definition Of “Performance”	25
B.	Definition Of “Aggregate Tuning Hours”	26
XV.	CONCLUSION.....	27

CONCLUSIONS OF LAW¹

1. The purpose of this proceeding is to set rates and terms for two complementary statutory licenses created by the Digital Millennium Copyright Act (“DMCA”) for eligible nonsubscription transmission services and new subscription services: (1) the performance license, 17 U.S.C. § 114(d)(2), which permits eligible webcasters to perform sound recordings over the Internet; and (2) the ephemeral reproduction license, 17 U.S.C. § 112(e), which permits webcasters to make multiple temporary copies of sound recording to facilitate such performances via the Internet. *See* 17 U.S.C. § 114(d)(2); *id.* § 112(e).

2. The Copyright Royalty Judges (“Judges” or “CRJs”) must set the rates and terms that will apply from January 1, 2011 through December 31, 2015. *See* 17 U.S.C. § 804(b)(3)(A).

3. In addition, “[t]he Copyright Royalty Judges shall act in accordance with regulations issued by the Copyright Royalty Judges and the Librarian of Congress, and on the basis of a written record, prior determinations and interpretations of the Copyright Royalty Tribunal, Librarian of Congress, the Register of Copyrights, and the Copyright Royalty Judges . . . , and decisions of the court of appeals under this chapter before, on, or after the effective date of the Copyright Royalty and Distribution Reform Act of 2004.” 17 U.S.C. § 803(a)(1).

I. THE STATUTORY CRITERIA FOR SETTING RATES AND TERMS

4. The Judges are required to “establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.” 17 U.S.C. § 114(f)(2)(B); *id.* § 112(e)(4).

¹ Live365 respectfully requests that any proposed conclusion of law that is determined by the Court to be a factual finding be regarded as a proposed finding of fact; likewise, Live365 requests that any proposed finding of fact determined by the Court to be a legal conclusion be regarded as a proposed conclusion of law to the extent appropriate.

5. “In determining such rates and terms,” the Judges must “base [their] decision on economic, competitive and programming information presented by the parties.” 17 U.S.C. § 114(f)(2)(B); *id.* § 112(e)(4); *see also Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 571 F.3d 69, 73 (D.C. Cir. 2009).

6. Specifically, the Judges must consider:

- (i) “whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner’s other streams of revenue from its sound recordings;”
- and
- (ii) “the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.”

17 U.S.C. § 114(f)(2)(B)(i)-(ii); *id.* § 112(e)(4)(A)-(B); *Intercollegiate*, 571 F.3d at 73.

7. Whereas the Judges *must* base their decision on the “economic, competitive and programming information presented by the parties,” the Judges simply “*may* consider the rates and terms for comparable types of digital audio transmission services and comparable circumstances under voluntary license agreements.” *Intercollegiate*, 571 F.3d at 79 (emphasis in original); *see also* 17 U.S.C. § 114(f)(2)(B); *id.* § 112(e)(4).

8. As the D.C. Circuit made clear in the appeal of the *Webcasting II* proceeding, “[n]othing in the statute *requires* the Judges to consider any comparable agreements, let alone particular agreements.” *Intercollegiate*, 571 F.3d at 79 (emphasis in original).

9. In addition, Sections 114(f) and 112(e) direct the CRJs to include “a minimum fee for each type of service.” 17 U.S.C. § 114(f)(2)(B); *id.* § 112(e)(4); *see also Intercollegiate*, 571 F.3d at 81.

II. THE WILLING BUYER AND WILLING SELLER STANDARD

A. WILLING BUYER

10. It is well-established that the willing buyers “are DMCA-eligible (also referred to as ‘DMCA-compliant’) services.” Report of the Copyright Arbitration Royalty Panel, Docket No. 2000-9 CARP DTRA 1 & 2, at 24 (Feb. 20, 2002); *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, Librarian of Congress, 67 Fed. Reg. 45240, 45244 (July 8, 2002) (willing buyers are “the services which may operate under the webcasting license (DMCA-compliant services)”).

11. In order to legally operate under the statutory license and, therefore, be DMCA-compliant, a webcasting service must comply with the sound recording performance complement, which prohibits a service from transmitting within any given three-hour period:

- more than three different songs from the same album if more than two such songs are transmitted consecutively, or
- four different songs by the same artist (or four different songs from the same compilation) if more than three such songs are transmitted consecutively.

17 U.S.C. §§ 112, 114(j)(13) (codifying Digital Millennium Copyright Act of 1998, Pub. L. No. 105-304, 112 Stat. 2860).

12. Because the terrestrial broadcasting entities represented by the National Association of Broadcasters (“NAB”) could not, as a whole, simulcast their terrestrial broadcasting and be DMCA-compliant without obtaining waivers of the DMCA’s performance complements rules, the NAB entities do not represent “willing buyers” under the statutory standard. *See* Live365 Proposed Findings of Fact (hereinafter, “Live365 PFF”), ¶¶291-299.

B. WILLING SELLER

13. It is equally well-settled that the willing sellers are the “record companies,” as determined by this Court in *Webcasting II*, the Copyright Arbitration Royalty Panel in *Webcasting I*, and the Librarian of Congress. See Final Rule and Order, *Digital Performance Right in Sound Recordings And Ephemeral Recordings*, Docket No. 2005-1 CRB DTRA, 72 Fed. Reg. 24084, 24087 (May 1, 2007) (“The ‘sellers’ in this hypothetical marketplace are record companies”); Report of the Copyright Arbitration Royalty Panel, Docket No. 2000-9 CARP DTRA 1 & 2, at 24 (Feb. 20, 2002) (“The appropriate sellers would be the individual record companies.”); *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, Librarian of Congress, 67 Fed. Reg. 45240, 45244 (July 8, 2002) (“the willing sellers are record companies”).

14. A single collective representing the sound recording copyright owners – such as the RIAA or SoundExchange – already has been determined *not* to be a willing seller under the statutory standard. See Report of the Copyright Arbitration Royalty Panel, Docket No. 2000-9 CARP DTRA 1 & 2, at 23-24 (Feb. 20, 2002).

15. As CARP stated, one reason that “a single collective designated by the record companies” should not be considered the willing seller is that “Congress clearly perceived antitrust concerns with such an arrangement.” *Id.* at 23. CARP further stated that allowing a collective “to negotiate for all copyright owners had the effect of strengthening the seller’s bargaining power.” *Id.* at 46; see also *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, Librarian of Congress, 67 Fed. Reg. at 45245 (“RIAA is clearly an established market force with extensive resources and sophistication.”).

16. Even SoundExchange has conceded that it is not a willing seller under the governing standard due to “antitrust concerns” previously discussed by CARP. In summarizing CARP’s finding on this matter, SoundExchange stated the following during the *Webcasting II* proceeding:

SoundExchange had argued that the “willing seller” should be SoundExchange itself rather than the individual record companies. The CARP rejected this position, finding that “Congress clearly perceived antitrust concerns with such an arrangement.... Accordingly, in the hypothetical marketplace, where no compulsory license would exist to provide true protection, we do not perceive the hypothetical seller to be RIAA.”

Proposed Conclusions of Law of SoundExchange, Inc., Docket No. 2005-1 CRB DTRA, at 16 n.4 (Dec. 12, 2006) (citing CARP Report in *Webcasting I*). SoundExchange has accepted that “the record companies and not SoundExchange itself [are] the willing sellers.” *Id.*

17. SoundExchange’s economics expert in this proceeding, Dr. Janusz Ordoover, also conceded that SoundExchange is *not* the willing seller under the governing standard. Live365 PFF”), ¶281 (8/2/10 Tr. at 390:1-4; 390:14-19; 391:19-392:9 (Ordoover)).

C. HYPOTHETICAL MARKETPLACE

18. The hypothetical marketplace is the market “that would exist in the absence of a statutory license constraint.” Final Rule and Order, *Digital Performance Right in Sound Recordings And Ephemeral Recordings*, Docket No. 2005-1 CRB DTRA, 72 Fed. Reg. 24084, 24091 (May 1, 2007); *see also id.* at 24087 (“this marketplace is one in which no statutory license exists”).

19. Royalty rates in license agreements that arose under the threat of litigation have little or no relevance in determining an appropriate royalty rate in the hypothetical marketplace. *See Report of the Copyright Arbitration Royalty Panel* at 48, 60 (finding that 25 of the 26

agreements between RIAA and music services were “unreliable benchmarks” partly because “RIAA developed a strategy to negotiate [these] deals for the purpose of establishing a high benchmark for later use as precedent”); *see also Panduit Corp. v. Stahl Bros Fibre Works*, 575 F.2d 1152, 1164 n.11 (6th Cir. 1978) (A royalty rate agreed to in the face of a threat of litigation “should not be considered evidence of an ‘established’ royalty”); *Fenner Invs., LTD. v. Hewlett-Packard Co.*, 2010 WL 1727916 *3 (E.D. Tex. 2010) (finding an agreement that “arises under the threat of litigation ... has little relevance to the hypothetical reasonable royalty situation”).

III. BASED ON THE MANDATORY STATUTORY FACTORS, A PER-PERFORMANCE RATE OF \$.0009 MOST CLEARLY REPRESENTS THE RATE THAT WOULD HAVE BEEN NEGOTIATED IN THE MARKETPLACE BETWEEN A WILLING BUYER AND A WILLING SELLER

20. As discussed above, the Judges *must* base their decision on the “economic, competitive and programming information presented by the parties.” *Intercollegiate*, 571 F.3d at 79 (emphasis in original); *see also* 17 U.S.C. § 114(f)(2)(B); *id.* § 112(e)(4).

21. Live365 presented ample uncontroverted evidence of the economic conditions impacting the statutory webcasting industry. The evidence conclusively demonstrates the following:

- The statutory webcasting is dominated by advertising-based listening, which garners significantly less revenue (on a per-performance basis) than subscription listening. Live365 PFF, ¶¶48-52, 230.
- There has been a decline in advertising rates (i.e., CPMs or cost-per-thousand impressions), and such decline has been noticeably felt in the predominantly ad-supported statutory webcasting industry. Live365 PFF, ¶¶53-61.

- Advertising inventory sell-out rates have been flat or are decreasing, and excess inventory is further driving down CPM rates and reducing revenue generation. Live365 PFF, ¶¶53-61, 71-77.
- Because of the abundant excess ad inventory, webcasters must rely on ad networks, whose commissions have steadily grown, thereby further decreasing net revenues to webcasters. Live365 PFF, ¶¶62-70.
- Subscription revenues, which generate much higher revenues than ad-based listening, are not growing in the statutory webcasting industry. Live365 PFF, ¶¶78-85.
- Listenership growth has flattened recently, and whatever growth has occurred over the past several years is heavily skewed by one service, Pandora, which accounts for over 50% of the market. Live365 PFF, ¶¶86-97.
- Growth in listenership or performances does not equate to an increase in per-performance revenues to the webcasters. Live365 PFF, ¶¶98-101.
- Recent technological trends in the industry – such as mobile listening and demographic targeting – have not increased revenues per listener (or per play). Live365 PFF, ¶¶102-111.
- Given these conditions, ad-supported webcasting services are struggling to earn sufficient revenues to afford the weight of per-performance royalty payments. Live365 PFF, ¶¶112-119.

22. Dr. Fratrick's analysis took into account the foregoing *actual* economic conditions of the statutory webcasting industry – as opposed to (mostly unfulfilled) predictions, as presented

in *Webcasting II* – in deriving his recommended rate of what would have been negotiated in the marketplace between a willing buyer and a willing seller. Live365 PFF, ¶¶131-137.

23. SoundExchange has produced nothing (or, at least, very little) to refute the evidence regarding the economic difficulties of the statutory webcasting industry. SoundExchange's *only* evidence on the purported growth and health of the industry was presented through Dr. Pelcovits, who readily conceded that he was *not* a webcasting industry expert. Live365 PFF, ¶40. Moreover, Dr. Pelcovits relied primarily on outdated secondary sources, and even those sources often did not support Dr. Pelcovits' characterization. Live365 PFF, ¶¶42-43. As Chief Judge Sledge stated:

And you're not an expert in the industry, so the only thing you know is what you have read and studied, and what you've cited to us doesn't support what you've said about these services.

Live365 PFF, ¶42 (4/19/10 Tr. at 212:21-213:2 (Pelcovits)).

24. Moreover, instead of speaking to webcasting companies about the industry or relying upon actual financial statements of webcasters, Dr. Pelcovits relied on listenership growth, anecdotal stories of "success" of webcasters, and forecasted increases in industry advertising revenues (though those forecasts were adjusted downward twice, and both adjustments were ignored by Dr. Pelcovits). Live365 PFF, ¶¶41-47. Yet the most important metric for the statutory webcasting industry, particularly for the Judge's consideration in setting a per performance royalty – i.e., revenue-per-performance – was not considered by Dr. Pelcovits. Live365 PFF, ¶¶41-47, 111. In sum, given the dearth of probative evidence provided by SoundExchange regarding the economics of the industry and given the largely uncontroverted nature of Live365's evidence on this topic, the economic conditions of the industry as presented by Live365 should be accepted by the Court.

25. In deriving its proposed rate for this proceeding, Live365 also presented evidence about the competitive and programming conditions affecting the industry – which Dr. Fratrik’s analysis also took into account. *See* Sections X-XI *infra*.

26. The model and calculations presented by Dr. Fratrik provide every benefit of the doubt to SoundExchange. For example:

- Dr. Fratrik selected the higher industry-wide estimate of advertising revenues from the sources that were available. Live365 PFF, ¶139.
- Dr. Fratrik’s subscription revenue figure was significantly higher than Dr. Pelcovits’ subscription figure – i.e., \$6.02 per month per average subscriber vs. \$4.13 calculated by Dr. Pelcovits. Live365 PFF, ¶¶147-149.
- The ratio of subscription and non-subscription listening (as calculated by Dr. Fratrik) is higher than what the SoundExchange data revealed through discovery, thereby giving an additional benefit. Live365 PFF, ¶¶154-155.

27. Meanwhile, SoundExchange’s witnesses did nothing to rebut Dr. Fratrik’s conclusions other than their bald assertions that he was wrong – whether or not the perceived error provided a higher or lower recommended rate. Moreover, their critiques provided no indication of what the "right" answer would be. For example:

- For the advertising revenue figure, Dr. Ordover had no alternative suggestion for advertising revenue as he has “no idea” what webcasting services are currently getting for CPM rates. Live365 PFF, ¶153.
- For the subscription revenue figure, Dr. Ordover criticized Dr. Fratrik’s calculation, but had no counter-proposal for an industry subscription revenue number. Live365 PFF, ¶150.

- For the ratio of subscription and non-subscription listening, Dr. Ordover again criticized Dr. Fratrick but could not provide a different number for the ratio, and in fact, Dr. Ordover agreed that he had no knowledge as to the approximate percentage of subscription versus nonsubscription performances streamed in the statutory webcasting industry. Live365 PFF, ¶156.
- Though both Dr. Pelcovits and Dr. Ordover believed that commercial webcasters are generally entitled to a reasonable profit, they were unable to articulate to the Court what that profit margin should be. Live365 PFF, ¶¶142, 166.
- Further, though Dr. Ordover criticized Dr. Fratrick's use of the terrestrial broadcasting industry to derive an appropriate profit margin, Dr. Ordover could not articulate a more representative comparable industry that should have been used by Dr. Fratrick. Live365 PFF, ¶¶166-167.

28. Applying the mandatory factors and based on his model, Dr. Fratrick concluded the royalty rate that “most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller” for commercial statutory webcasting for 2011-2015 should be \$.0009 per performance. *See* Live365 PFF, Section V. As the criticisms of Dr. Fratrick's proposals do not undermine his conclusions, they should be accepted by this Court.

29. The applicable terms for commercial statutory webcasting for 2011-2015 should be those embodied in the stipulation between SoundExchange and Live365 regarding proposed regulations (filed on September 10, 2010) as well as Live365's separately proposed regulations, as attached hereto as Appendix A.

IV. A DISCOUNT FOR QUALIFIED AGGREGATION SERVICES IS APPROPRIATE

30. Section 114(f)(2)(B) requires that “rates and terms *shall* distinguish among the different types of eligible nonsubscription transmission services then in operation.” 17 U.S.C. § 114(f)(2)(B) (emphasis added). In other words, the statute sets forth an affirmative obligation (as opposed to permissive request) that different rates and terms must be set to account for the different types of services in the industry. *See id.*

31. As CARP explained, “a range of negotiated rates reflecting the particular circumstance of each negotiation” – and “not a uniform rate” – is expected “between diverse buyers and sellers.” Report of the Copyright Arbitration Royalty Panel, at 24.

32. A webcast aggregation service is a streaming service that operates a network of at least one hundred (100) independently-operated, aggregated webcasters. *See* Rate Proposal of Live365, Inc. (filed on September 29, 2009); *see also* Report of the Copyright Arbitration Royalty Panel at 61, 84 (describing Yahoo!’s “aggregator” streaming service and noting that “third-party aggregators like Yahoo! aggregate hundreds of radio stations on their portal sites”); *Determination of Reasonable Rates and Terms for Digital Performance of Sound Recordings and Ephemeral Recordings*, Librarian of Congress, 67 Fed. Reg. 45240, 45248-45249 (describing the webcasting service of Yahoo! as a “third-party aggregator” whose main business was the retransmission of radio re-broadcasts).

33. A webcast aggregation service provides numerous benefits to the copyright holder, primarily in the form of administrative savings through reduced transactional costs and compliance monitoring. *See* Live365 PFF, ¶¶179-186, 188.

34. Webcast aggregation services represent a different type of eligible nonsubscription service from other services; consequently, different rates and terms should be established for qualified aggregation services. *See* 17 U.S.C. § 114(f)(2)(B).

35. For qualified aggregation services (as defined in the Live365's Rate Proposal), a 20% discount of the commercial webcasting rate is appropriate. *See* Live365 PFF, ¶193. This discount is similar to the average discount provided by Performance Rights Organizations (PROs) to Live365 for the same type of benefits that Live365 provides to the PROs in the form of "centralized administration." *See* Live365 PFF, ¶¶187-193. SoundExchange's only witness on this issue conceded the fact that it would receive an administrative benefit from an aggregation service that accurately filed reports and royalties for many small services. *See* Live365 PFF ¶185. Thus, the Court should adopt this aggregation discount.

V. **SOUNDEXCHANGE'S RATE PROPOSAL IS NOT BASED ON A WILLING BUYER / WILLING SELLER STANDARD**

36. The governing standard mandates the setting of "rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B); *id.* § 112(e)(4).

37. The hypothetical marketplace is the market "that would exist in the absence of a statutory license constraint." Final Rule and Order, *Digital Performance Right in Sound Recordings And Ephemeral Recordings*, Docket No. 2005-1 CRB DTRA, 72 Fed. Reg. 24084, 24091 (May 1, 2007); *see also id.* at 24087 ("this marketplace is one in which no statutory license exists").

38. "The willing buyer/willing seller standard is the *only* standard to be applied." Report of the Copyright Arbitration Royalty Panel, at 21 (emphasis in original).

39. There is *no* evidence that any willing buyer for statutory webcasting actually is or will be paying the rates proposed by SoundExchange in this proceeding. Live365 PFF, Section VII. On this basis alone, SoundExchange’s rate proposal does *not* “most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.” 17 U.S.C. § 114(f)(2)(B).²

40. Moreover, SoundExchange’s rate proposal is not based on the governing standard and, therefore, SX’s rate proposal should be disregarded. Tucker McCrady, the only SoundExchange witness who had any knowledge of the derivation of SoundExchange rate’s proposal, testified that SX’s rate proposal was based on “litigation posture” and “seemed appropriate” since it “has a nice benefit of where it comes out is a little bit above where some of the settlements are and we thought it would be good to have encouraged retroactively the parties who are willing sit down at the table and actually settle out at rates we could live with.” Live365 PFF, ¶199 (4/22/10 Tr. at 734:15-735:17 (McCrady)).

41. None of Mr. McCrady’s testimony – the only evidence in the record regarding the derivation of SoundExchange’s rate proposal – indicates that this rate proposal was based on the willing buyer / willing seller analysis. Therefore, SoundExchange’s proposed rates should be rejected.

42. Indeed, this Court has already recognized – in the context of setting an appropriate rate for the ephemeral license in *Webcasting II* – that “an effort to preserve a *litigation position* for future negotiations” is not an appropriate consideration in determining what a willing buyer and willing seller would have negotiated. *See* Final Rule and Order, Docket

² At most, broadcasters are paying a rate substantially below that proposed by SoundExchange and, for the reasons set forth below, even these rates do not represent the rates that a willing buyer (i.e., a DMCA-compliant service) and a willing seller would agree to in a hypothetical marketplace.

No. 2005-1 CRB DTRA, 72 Fed. Reg. at 24101 (declining to accept “SoundExchange’s valuation of 8.8%” as the appropriate rate for ephemeral license) (emphasis added). By the same logic, SoundExchange’s rate proposal in this proceeding – which also “is nothing more than an effort to preserve a litigation position for future negotiations,” based on Mr. McCrady’s admission – should similarly be disregarded. *Id.*

43. None of SoundExchange’s other witnesses had any knowledge about the derivation of SoundExchange’s rate proposal. Live365 PFF, ¶196. Indeed, Dr. Pelcovits not only did *not* help in developing SoundExchange’s rate proposal, he had *no* idea who created the rate proposal. Live365 PFF, ¶197.

44. Similarly, Dr. Pelcovits testified that he did not know the reason that the rates in SoundExchange’s proposal uniformly increased by \$.0002 cents every year. Live365 PFF, ¶200.

45. Mr. McCrady, who was the only witness who had any knowledge of the derivation of SoundExchange’s rate proposal, again testified that this uniform rate increase of \$.0002 was based on a “litigation posture.” Live365 PFF, ¶200 (4/22/10 Tr. at 734:15-735:17 (McCrady)). The rate increase was, according to Mr. McCrady, SoundExchange’s attempt “to extend the logic of the ... Court” with respect to “the kind of trajectory” of the Court used in the past proceeding. *Id.* Again, nothing about Mr. McCrady’s testimony is grounded on the governing willing buyer / willing seller analysis. Thus, the Court must conclude that the SoundExchange rate proposal is not one based on the willing buyer/willing seller standard.

VI. DR. PELCOVITS’ INTERACTIVE SERVICES “BENCHMARK” IS FUNDAMENTALLY FLAWED

46. A benchmark model which does not reflect the economic realities of the target marketplace is unsound and has little to no probative value. *Crystal Semiconductor Corp. v.*

TriTech Microelects. Intern'l, Inc., 246 F.3d 1336, 1358 (Fed. Cir. 2001) (the benchmark market “did not resemble” the target market and “was like comparing apples and oranges”); 8/2/2010 Tr. at 367:5-11 (Ordoover) (in doing an economic model, “one has to reflect the realities of the marketplace in which the modeling takes place”).

47. Dr. Pelcovits’ Interactive Services benchmark analysis is fundamentally flawed and unreliable primarily because it fails to take into account the substantial evidence reflecting the economic realities of the statutory webcasting industry, including:

- The vast majority of the listening in the statutory webcasting market is done through ad supported services, yet Dr. Pelcovits’ model only examines subscription services, which can afford much higher rates. Live365 PFF, ¶¶223-234. Using a benchmark based on a subscription-only market as the basis for the setting rates in a primarily advertising-based market is “like comparing apples and oranges.” *Crystal Semiconductor*, 246 F.3d at 1358.
- A significant amount (40%-50%) of streamed content in the statutory webcasting market comes from independent labels, yet Dr. Pelcovits’ benchmark model only examines content from the four major labels, which can command higher rates than most independent labels. Live365 PFF, ¶¶237-246.
- The effective per-play rates among the agreements that Dr. Pelcovits relied upon for his model have been decreasing over the past two years. Live365 PFF, ¶¶247-249.

48. Dr. Pelcovits compounds the flaws in his approach by relying on assumptions of the market that are clearly erroneous, such as:

- The webcasting industry is “robust and evolving” despite evidence that clearly is to the contrary. Live365 PFF, ¶42 (Pelcovits ACWDT at 11).
- That statutory webcasting (which is primarily ad-supported) can afford to pay what subscription services could pay, despite the fact that ad-supported businesses generate substantially less revenue-per-performance than subscription services do. Live365 PFF, ¶230. This is a fatally incorrect assumption, and the absence to take into account ad-supported services is sufficient alone to dismiss Dr. Pelcovits’ benchmark analysis as having no predictive value for what the typical non-interactive services would be willing to pay. Live365 PFF, ¶224.

49. One of the most critical errors in Dr. Pelcovits’ Interactive Services benchmark approach was his failure to conduct a “reality check” to verify that his conclusions made economic sense. Live365 PFF, ¶216. Given the industry estimates of revenue per play and using Dr. Pelcovits’ calculation of subscription revenue per play, the total revenue per play generated by statutory webcasting services averages to be about \$0.0024. Live365 PFF, ¶218. This figure, however, is far less than the estimated royalty rate of \$0.0036 in Dr. Pelcovits’ analysis. Live365 PFF, ¶218. No willing buyer would buy at a rate that would not allow it to cover its costs and earn a reasonable rate of return. Live365 PFF, ¶219.

50. Further compelling evidence of the failings of Dr. Pelcovits’ analysis is a comparison of Pandora’s revenue per play with his \$0.0036 recommended rate. Live365 PFF, ¶220. Pandora, which accounted for over 50% of the reported performances to SoundExchange for statutory webcasting in 2009, had estimated total revenues per play in 2008 and 2009 that were a fraction of the \$0.0036 recommended per play rate. Live365 PFF, ¶221. Given that Pandora’s yearly total revenue per play is well below the royalty rate derived by Dr. Pelcovits, it

defies logic that Pandora could be a “willing buyer” at the \$0.0036 proposed rate. Live365 PFF, ¶221. Thus, the Court should reject Dr. Pelcovits’ proposed rates.³

VII. THE WSA AGREEMENTS ARE NOT APPROPRIATE BENCHMARKS

51. The WSA Agreements submitted into evidence by SoundExchange are not appropriate benchmarks because, among other reasons, each of these agreements has been entered into by SoundExchange as the “seller.” However, as discussed above, SoundExchange is *not* a “willing seller” under the governing standard. *See* Section II.B *supra*.

52. The SoundExchange-NAB agreement is additionally not an appropriate benchmark since the NAB is *not* a “willing buyer” under the standard, as most of its members would not qualify for the statutory rate without the performance complement waivers that were negotiated simultaneously with this WSA Agreement. *See* Section II.A *supra*. Thus, as the NAB members would not qualify for the statutory rate, they are not buying the same right as the one at issue in this case, but instead are buying a right to stream on terms different than those set out in Section 114.⁴

53. Further, the WSA Agreements are not reliable benchmarks given they represent – in the words of Mr. McCrady, a member of SoundExchange’s Licensing Committee – “a

³ In addition to the infirmities cited above, there are numerous methodological problems with Dr. Pelcovits analysis that renders it unworthy of consideration, from questions of shifting and shrinking data sets, unexplained exclusions of variables, a standard deviation that is so wide as to encompass almost any possible royalty rate, and other techniques that almost always seemed to err on the side of a higher royalty. *See* Live365 PFF, ¶¶250-273. These flaws provide yet another reason to reject Dr. Pelcovits’ analysis.

⁴ *See Determination of Reasonable Rates and Terms for Digital Performance of Sound Recordings and Ephemeral Recordings*, Librarian of Congress, 67 Fed. Reg. at 45248 (accepting the RIAA-Yahoo! agreement as a benchmark since it was a negotiation simply about the rates and terms for webcasting, contrasting it to an agreement in the Digital Cable Radio proceeding which was rejected as a benchmark because the sound recording performance terms were just one component of a larger deal).

litigation settlement ... conducted in the context of what we thought the Judges might award and what they hoped the Judges would award.” 4/22/10 Tr. at 733:10-734:10 (McCrary) (emphasis added).

54. Given Mr. McCrary’s admission of a “litigation settlement,” the Judges should not give any weight to the WSA Agreements as reliable benchmarks. It is well-established that royalty rates negotiated as a litigation settlement have little to no probative value in determining the rate that would be established in the hypothetical marketplace. *Panduit Corp. v. Stahlin Bros Fibre Works*, 575 F.2d 1152, 1164 n.11 (6th Cir. 1978) (A royalty rate agreed to in the face of a threat of litigation “should not be considered evidence of an ‘established’ royalty”); *Wang Labs., Inc. v. Mitsubishi Elecs. Am., Inc.*, 860 F. Supp. 1448, 1452 (C.D. Cal. 1993) (finding agreements made “in anticipation of litigation cannot be relied upon to prove a reasonable royalty rate”); *Kowalski v. Mommy Gina Tuna Res.*, 574 F. Supp. 2d 1160 (D. Haw. 2008) (“Royalty rates that are set through settlement ... should not be considered evidence of an established royalty.”); *Fenner Invs., LTD. v. Hewlett-Packard Co.*, 2010 WL 1727916 *3 (E.D. Tex. 2010) (finding an agreement that “arises under the threat of litigation ... has little relevance to the hypothetical reasonable royalty situation”).

55. Indeed, in a very recent decision from the ASCAP rate-setting court, the court determined that a litigation settlement agreement between MobiTV and SESAC for the same public performance rights that were at issue in the ASCAP litigation was *not* an appropriate benchmark. *In re Application of MobiTV, Inc.*, 2010 WL 1875706 *42 (S.D.N.Y. May 11, 2010). The court noted that the license agreement was entered into under the threat of litigation, and ASCAP “failed to offer any analysis of the size of the discount that must be applied to the SESAC license.” *Id.* As the court concluded, “[t]his alone is sufficient to undermine the use of

the SESAC settlement agreement as a reliable measure of the reasonableness of the fee adopted here.” *Id.* A similar determination is warranted here with respect to the unreliability of the rates in the WSA Agreements since they represent “litigation settlements.”

56. There are many reasons that parties enter into settlement agreements with royalty rates that do not reflect the fair market value of the license. As the Supreme Court observed, “[t]he avoidance of the risk and expense of litigation will always be a potential motive for a settlement.” *Rude v. Westcott*, 130 U.S. 152, 164 (1889).

57. Similarly, in finding that the 25 of the 26 agreements submitted into evidence by the RIAA were “unreliable benchmarks” in *Webcasting I*, CARP observed that the “RIAA developed a strategy to negotiate [these] deals for the purpose of establishing a high benchmark for later use as precedent.” *See* Report of the Copyright Arbitration Royalty Panel at 48, 60.

58. In addition to all of the foregoing legal reasons – e.g., no willing buyer, no willing seller, and the “litigation settlement” context – the WSA Agreements are not reliable benchmarks for webcasters (as a whole) for a host of factual and economic reasons set forth in the Live365’s Proposed Findings of Fact, including:

- The performance complement waivers – which allowed the NAB simulcasters to simulcast their content – were valuable to the NAB simulcasters, and that value is reflected with higher than fair-market rates. Live365 PFF, ¶¶292-300.
- Sirius XM is a subscription service, and not comparable to other webcasting services, which are primarily advertising-supported. Live365 PFF, ¶¶301-305.
- The NAB and Sirius XM received discounts in 2008 and 2009 as a benefit for higher rates in 2011-2015. Live365 PFF, ¶¶327-334.

- The NAB and Sirius XM have substantial incentives to raise their rivals' costs by entering into the WSA Agreements. Live365 PFF, ¶¶335-343.
- The simulcasters (i.e., the NAB and Sirius XM) have substantially different economic structures and other real-world differences from the majority of webcasters which have no supporting business, and therefore, simulcasters can afford much higher royalty rates for their simulcasting operations.⁵ For example:
 - i. Simulcasters generally have a sales team that sells ads locally, and thus, these entities do not have to rely upon national ad networks and their hefty sales commissions. Live365 PFF, ¶¶312-313.
 - ii. Simulcasters have low programming production costs associated with their streaming, as they already have their programming paid for by their over-the-air broadcasts. Live365 PFF, ¶¶308-311.
 - iii. The simulcasting operations do not have to incur additional costs of buildings, staff, and other infrastructure since those are largely, if not entirely, incurred through their main business (i.e., terrestrial broadcasting). Live365 PFF, ¶317.
 - iv. Simulcasters have a built-in source to market and cross-promote their simulcast streams on their over-the-air signals and station websites, thereby garnering higher ad rates. Live365 PFF, ¶¶314-315.

⁵ Section 114(f)(2)(B) requires that the rates and terms distinguish between “the different types of eligible nonsubscription transmission services and new subscription services then in operation.” 17 U.S.C. § 114(f)(2)(B). Thus, even if the simulcasters are considered to be willing buyers, the facts demonstrate that they are of a different type of webcaster that should be paying at a different rate than pure webcasters.

59. Given all of the foregoing evidence and since “[n]othing in the statute *requires* the Judges to consider any comparable agreements” – *Intercollegiate*, 571 F.3d at 79 (emphasis in original) – the WSA Agreements should not be viewed as appropriate benchmarks for this proceeding.

VIII. NON-INTERACTIVE WEBCASTING HAS SIGNIFICANT PROMOTIONAL VALUE

A. MANDATORY FACTOR

60. The CRJs must consider whether webcasting “may substitute for or may promote the sales of phonorecords” or otherwise affect the “copyright owner’s other streams of revenue.” 17 U.S.C. § 114(f)(2)(B); *Intercollegiate*, 571 F.3d at 73.

B. NON-INTERACTIVE WEBCASTING POSITIVELY IMPACTS MUSIC SALES

61. All of the empirical evidence in the record demonstrates that statutory webcasting has substantial promotional benefits to the sales of music. SoundExchange has provided *no* empirical evidence to the contrary. *See* Live365 PFF, Section X. The evidence includes:

- A recent report from the NPD Group – whose reports are routinely relied upon by music industry executives – showing a substantial increase in paid downloads from statutory webcasting services (and a decrease in downloads from interactive services). Live365 PFF, ¶¶346-347.
- Other data from Pandora, Rhapsody and Live365 showing a significant increase in music sales associated with non-interactive listening. Live365 PFF, ¶¶348-349.

- Testimony from Mr. Smallens and Ms. Lockhart – the only two songwriter witnesses that testified during this proceeding – confirming the promotional value of statutory webcasting. Live365 PFF, ¶¶352-353.
- The agreements between Live365 and several independent labels, wherein the labels have waived the sound recording performance royalty for performances streamed through Live365. Live365 PFF, ¶355.

62. In addition, other courts have observed how non-interactive webcasting services, including “custom radio” services, promote the sales of music. *Arista Records, LLC v. Launch Media, Inc.*, 578 F.3d 148, 161 n.19 (2d Cir. 2009)). For example, in this decision, the Second Circuit stated the following:

Recently webcasting services have been credited with “becom[ing] a massive driver in digital [music] sales” by exposing users to new music and providing an easy link to sites where users can purchase this music.

Id.

63. Moreover, in contrast to the evidence of positive promotional impact of statutory webcasting, there is *no* evidence showing that statutory webcasting has displaced a single sale of a single sound recording (or that such displacement is likely to occur in the foreseeable future). *See* Live365 PFF, ¶¶356-358.

C. IMPACT ON ROYALTY RATE

64. Given the unrebutted evidence of an increase in music sales from statutory webcasting, a downward adjustment of the current royalty rate is appropriate.

IX. CREATIVE CONTRIBUTION, TECHNICAL CONTRIBUTION, CAPITAL INVESTMENTS, COSTS AND RISKS BY LIVE365 AND OTHER WEBCASTERS

65. The CRJs are required to consider “the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.” 17 U.S.C. § 114(f)(2)(B); *Intercollegiate*, 571 F.3d at 73.

66. The evidence demonstrates that the contributions, costs and risks incurred by statutory webcasters in providing the service have been substantial over time while the record companies have spent little, if anything, on developing this new service. *See* Live365 PFF, ¶¶360-363, 366.

67. When all of the elements of contribution, risk and cost are evaluated together, the evidence demonstrates that current royalty rates should be adjusted downward.

X. PROGRAMMING FACTORS NECESSITATE A DOWNWARD REDUCTION OF THE CURRENT STATUTORY RATES

68. The CRJs are required to consider, among other things, the “programming information presented by the parties.” 17 U.S.C. § 114(f)(2)(B); *Intercollegiate*, 571 F.3d at 73.

69. The evidence demonstrates that statutory webcasting plays a rich diversity of programming and genres of music. *See* Live365 PFF, ¶¶367-371. This evidence weighs in favor of the webcasting services; consequently, current royalty rates should be adjusted downward.

XI. COMPETITIVE FACTORS NECESSITATE A DOWNWARD REDUCTION OF THE CURRENT STATUTORY RATES

70. The CRJs are also required to consider the “competitive” information presented by the parties. 17 U.S.C. § 114(f)(2)(B); *Intercollegiate*, 571 F.3d at 73.

71. As a result of the increased competition facing webcasters, and the market power afforded by the record companies, a downward reduction from the current statutory royalty rates for the next five years is appropriate. *See* Live365 PFF, ¶¶372-376.

XII. ROYALTY RATE FOR EPHEMERAL RECORDINGS UNDER SECTION 112(e)

72. In connection with this proceeding, the Court must “establish rates that most clearly represent the fees that would have been negotiated in the marketplace between a willing buyer and a willing seller” for ephemeral recordings, which are “the temporary copies necessary to facilitate the transmission of sound recording during internet broadcasting.” *See* 17 U.S.C. § 112(e)(4); *Intercollegiate*, 571 F.3d at 73.

73. Based on the May 14, 2010 stipulation submitted jointly by SoundExchange and Live365 in this proceeding – *see* Live365 PFF, ¶¶379-381 – and given no other evidence submitted by the parties about an appropriate royalty rate under 17 U.S.C. § 112(e), the following should be adopted:

The royalty payable under 17 U.S.C. § 112(e) for the making of all ephemeral recordings used by the licensee solely to facilitate transmissions for which it pays royalties shall be included within and constitute 5% of the total royalties payable under §§ 112 and 114.

See “Stipulation of SoundExchange, Inc. And Live 365, Inc. Regarding The Minimum Fee For Commercial Webcasters And The Royalty Payable For The Making Of Ephemeral Recordings,” submitted on May 14, 2010.

XIII. MINIMUM FEES UNDER SECTIONS 114(f) AND 112(e)

74. As part of this proceeding, the Judges “shall include a minimum fee for each such type of service.” 17 U.S.C. § 114(f)(2)(B) & 17 U.S.C. § 112(e)(4); *see also Intercollegiate*, 571 F.3d at 73.

75. Based on the May 14, 2010 stipulation submitted jointly by SoundExchange and Live365 in this proceeding – *see* Live365 PFF, ¶¶377-378 – and given no other evidence about an appropriate minimum fee, a \$500 per channel or station fee, subject to a \$50,000 annual cap, should be adopted as the bundled minimum fee under Section 114(f)(2)(B) and Section 112(e)(4) for commercial webcasters for 2011-2015. *See* “Stipulation of SoundExchange, Inc. And Live 365, Inc. Regarding The Minimum Fee For Commercial Webcasters And The Royalty Payable For The Making Of Ephemeral Recordings,” submitted on May 14, 2010.

XIV. PROPOSED REGULATIONS AND TERMS

76. SoundExchange and Live365 entered into a partial stipulation regarding certain proposed regulations and terms set forth in 37 C.F.R. Part 380. Live365 also separately submits its own proposed regulations as to certain provisions on which no stipulation has been reached, as attached hereto as Appendix A.

A. DEFINITION OF “PERFORMANCE”

77. Live365 proposes that the definition of “Performance” under 37 C.F.R. § 380.2(i) be modified so that it excludes any performances of sound recording that are not more than thirty (30) consecutive seconds. *See* Appendix A. This definition would be consistent with the definition of a “performance” or “play” set forth in each of the four interactive services agreements that were reviewed by Dr. Pelcovits and submitted as evidence in this proceeding.

See Live365 PFF, ¶¶383-387. For example, in Warner Music Group's agreement with Last.fm (Live365 Trial Ex. 17), a royalty obligation is triggered for each "play," which is defined as "a stream of a Sound Recording of more than thirty (30) consecutive seconds, other than Sponsored Plays." See Live365 PFF, ¶385.

78. In addition, excluding partial performances from the royalty-bearing performances is consistent with past precedent. For example, in the May 2003 settlement agreement adopted by the Librarian and negotiated by SoundExchange, the American Federation of Television and Radio Artists, the American Federation of Musicians of the United States and Canada, and the Digital Media Association, 4% of all performances were not subject to any royalty "due to, for example, technical interruptions, the closing down of a media player or channel switching." *Digital Performance Right in Sound Recordings And Ephemeral Recordings*, Docket Nos. 2002-1 CARP DTRA3 & 2001-2 CARP DTNSRA, 68 Fed. Reg. 27506, 27509 (May 20, 2003).

B. DEFINITION OF "AGGREGATE TUNING HOURS"

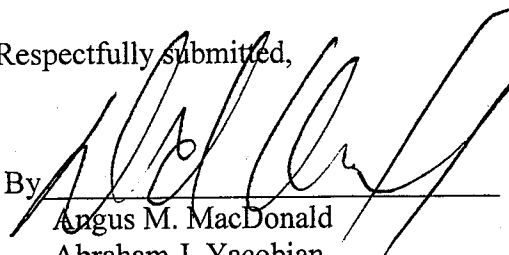
79. In Live365's Proposed Terms (Appendix A), Live365 proposes that the definition of "Aggregate Tuning Hours" under 37 C.F.R. § 380.2(a) be modified so that it excludes programming that does not contain sound recordings – e.g., talk, sports, and advertising not containing sound recordings), as programming without sound recordings should not be subject to consideration in regulations dealing with a royalty to be paid for the use of sound recordings.

XV. CONCLUSION

80. For the reasons set forth above, Live365 respectfully requests that the Copyright Royalty Judges adopt the rates and terms for commercial webcasters that it has proposed, as attached as Appendix A hereto.

Respectfully submitted,

By



Angus M. MacDonald
Abraham J. Yacobian
HOVANESIAN & HOVANESIAN
301 Colorado Blvd., Suite 514
Pasadena, CA 91101
Fax: (626) 795-8900
angusm@hovlaw.com
abrahamy@hovlaw.com

David D. Oxenford
DAVIS WRIGHT TREMAINE, LLP
1919 Pennsylvania Ave., NW, Suite 800
Washington, DC 20006
Fax: (202) 973-4499
davidoxenford@dwt.com

Counsel for Live365, Inc.

September 10, 2010

APPENDIX A

Attachment
Proposed Regulations

PART 380. RATES AND TERMS FOR CERTAIN ELIGIBLE NONSUBSCRIPTION TRANSMISSIONS, NEW SUBSCRIPTION SERVICES AND THE MAKING OF EPHEMERAL REPRODUCTIONS

SUBPART A—COMMERCIAL WEBCASTERS AND NONCOMMERCIAL WEBCASTERS

Sec.

380.1 General.

380.2 Definitions.

380.3 Royalty fees for the public performance of sound recordings and for ephemeral recordings.

380.4 Terms for making payment of royalty fees and statements of account.

380.5 Confidential information.

380.6 Verification of royalty payments.

380.7 Verification of royalty distributions.

380.8 Unclaimed funds.

Authority: 17 U.S.C. 112(e), 114(f), 804(b)(3).

§ 380.1 General.

(a) Scope. This subpart establishes rates and terms of royalty payments for the public performance of sound recordings in certain digital transmissions by Licensees as set forth herein in accordance with the provisions of 17 U.S.C. 114, and the making of Ephemeral Recordings by Licensees in accordance with the provisions of 17 U.S.C. 112(e), during the period January 1, 2011, through December 31, 2015.

(b) Legal compliance. Licensees relying upon the statutory licenses set forth in 17 U.S.C. 112(e) and 114 shall comply with the requirements of those sections, the rates and terms of this part, and any other applicable regulations.

(c) Relationship to voluntary agreements. Notwithstanding the royalty rates and terms established in this part, the rates and terms of any license agreements entered into by Copyright Owners and Licensees shall apply in lieu of the rates and terms of this part to transmission within the scope of such agreements.

§ 380.2 Definitions.

For purposes of this part, the following definitions shall apply:

(a) *Aggregate Tuning Hours* (ATH) means the total hours of programming that the Licensee has transmitted during the relevant period to all listeners within the United States from

all channels and stations that provide audio programming consisting of eligible nonsubscription transmissions or noninteractive digital audio transmissions as part of a new subscription service, less (i) the actual running time of any sound recordings for which the Licensee has obtained direct licenses apart from 17 U.S.C. 114(d)(2) (ii) sound recordings which do not require a license under United States copyright law, (iii) news, talk and sports segments that do not contain sound recordings, and (iv) commercial and promotional announcements that do not contain sound recordings. By way of example, if a service transmitted one hour of programming to 10 simultaneous listeners, the service's Aggregate Tuning Hours would equal 10. If 3 minutes of that hour consisted of transmission of a directly licensed recording, the service's Aggregate Tuning Hours would equal 9 hours and 30 minutes. As an additional example, if one listener listened to a service for 10 hours (and none of the recordings transmitted during that time was directly licensed), the service's Aggregate Tuning Hours would equal 10.

(b) *Aggregated webcasters* means an individual, business organization or other legal entity that individually streams less than 100,000 ATH per month of royalty-bearing performances and utilizes a webcast aggregation service.

(c) *Broadcaster* is a type of Licensee that owns and operates a terrestrial AM or FM radio station that is licensed by the Federal Communications Commission.

(d) *Collective* is the collection and distribution organization that is designated by the Copyright Royalty Judges.

(e) *Commercial Webcaster* is a Licensee, other than a Noncommercial Webcaster, that makes eligible digital audio transmissions.

(f) *Copyright Owners* are sound recording copyright owners who are entitled to royalty payments made under this part pursuant to the statutory licenses under 17 U.S.C. 112(e) and 114.

(g) *Ephemeral Recording* is a phonorecord created for the purpose of facilitating a transmission of a public performance of a sound recording under a statutory license in accordance with 17 U.S.C. 114, and subject to the limitations specified in 17 U.S.C. 112(e).

(h) *Licensee* is a person that has obtained a statutory license under 17 U.S.C. 114, and the implementing regulations, to make eligible nonsubscription transmissions, or noninteractive digital audio transmissions as part of a new subscription service (as defined in 17 U.S.C. 114(j)(8)) other than a Service as defined in § 383.2(h), or that has obtained a statutory license under 17 U.S.C. 112(e), and the implementing regulations, to make Ephemeral Recordings for use in facilitating such transmissions, but that is not.

(1) a Broadcaster as defined in § 380.11; or

(2) a Noncommercial Educational Webcaster as defined in § 380.21.

(i) *Noncommercial Webcaster* is a Licensee that makes eligible digital audio transmissions and:

(1) Is exempt from taxation under section 501 of the Internal Revenue Code of 1986 (26 U.S.C. 501),

(2) Has applied in good faith to the Internal Revenue Service for exemption from taxation under section 501 of the Internal Revenue Code and has a commercially reasonable expectation that such exemption shall be granted, or

(3) Is operated by a State or possession or any governmental entity or subordinate thereof, or by the United States or District of Columbia, for exclusively public purposes.

(j) *Performance* is each instance in which any portion of a sound recording is publicly performed to a listener by means of a digital audio transmission (e.g., the delivery of any portion of a single track from a compact disc to one listener) but excluding the following:

(1) A performance of a sound recording that does not require a license (e.g., a sound recording that is not copyrighted);

(2) A performance of a sound recording for which the service has previously obtained a license from the Copyright Owner of such sound recording;

(3) Any transmission of a sound recording that is less than thirty (30) consecutive seconds in duration; and

(4) An incidental performance that both:

(i) Makes no more than incidental use of sound recordings including, but not limited to, brief musical transitions in and out of commercials or program segments, brief performances during news, talk and sports programming, brief background performances during disk jockey announcements, brief performances during commercials of sixty seconds or less in duration, or brief performances during sporting or other public events and

(ii) Other than ambient music that is background at a public event, does not contain an entire sound recording and does not feature a particular sound recording of more than thirty seconds (as in the case of a sound recording used as a theme song).

(k) *Performers* means the independent administrators identified in 17 U.S.C. 114(g)(2)(B) and (C) and the parties identified in 17 U.S.C. 114(g)(2)(D).

(l) *Qualified Auditor* is a Certified Public Accountant.

(m) *Qualified Webcast Aggregation Service* means a Webcast Aggregation Service that registers with the Collective as such and agrees to provide the following services to the Collective:

- (1) Monitor and enforce Performance Complement rules for each Aggregated webcaster; and
- (2) Provide monthly aggregated full-census statutory performance reports.

(n) *Side Channel* is a channel on the website of a Broadcaster which channel transmits eligible transmissions that are not simultaneously transmitted over the air by the Broadcaster.

(o) *Webcast Aggregation Service* is a streaming service that operates a network of at least one hundred (100) independently-operated "aggregated webcasters."

§ 380.3 Royalty fees for the public performance of sound recordings and for ephemeral recordings.

(a) *Royalty rates.* Royalty rates and fees for eligible digital transmissions of sound recordings made pursuant to 17 U.S.C. 114, and the making of ephemeral recordings pursuant to 17 U.S.C. 112(e) are as follows:

(1) *Commercial Webcasters:* For all digital audio transmissions, including simultaneous digital audio retransmissions of over-the-air AM or FM radio broadcasts, and related Ephemeral Recordings, a Commercial Webcaster will pay a royalty of: \$.0009 per performance for 2011 through 2015.

(2) *Aggregator discount:* Qualified Webcast Aggregation Services shall receive a 20% discount from the commercial webcaster royalty rate specified in 380.3(a)(1) above.

(3) *Noncommercial Webcasters:*

Live365 offers no rate proposal for Noncommercial Webcasters, as it is not eligible for such royalties!

(b) *Minimum fee*—(1) *Commercial Webcasters.* Each Commercial Webcaster will pay an annual, nonrefundable minimum fee of \$500 for each calendar year or part of a calendar year of the period 2011-2015 during which it is a Licensee pursuant to 17 U.S.C. 112(e) or 114. This annual minimum fee is payable for each individual channel and each individual station maintained by Commercial Webcasters, and is also payable for each individual Side Channel maintained by Broadcasters who are Commercial Webcasters, provided that a Commercial Webcaster shall not be required to pay more than \$50,000 per calendar year in minimum fees in the aggregate (for 100 or more channels or stations). For each such Commercial Webcaster, the annual minimum fee described in this paragraph shall constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B). Upon payment of the minimum fee, the Commercial Webcaster will receive a credit in the amount of the minimum fee against any additional royalty fees payable in the same calendar year.

(2) Noncommercial Webcasters.. [Live365 offers no proposal as to minimum fees for Noncommercial Webcasters as it is not eligible for such fees]

(c) *Ephemeral recordings.* The royalty payable under 17 U.S.C. 112(e) for the making of all Ephemeral Recordings used by the Licensee solely to facilitate transmissions for which it pays royalties shall be included within, and constitute 5% of, the total royalties payable under §§ 112(e) and 114.

§ 380.4 Terms for making payment of royalty fees and statements of account.

(a) *Payment to the Collective.* A Licensee shall make the royalty payments due under § 380.3 to the Collective.

(b) *Designation of the Collective.*

[Live365 recognizes that the designation of the collective may be a matter of dispute between Royalty Logic and SoundExchange, and Live365 has taken no position in such dispute, thus it does not offer a proposal on the designation of the Collective]

(c) *Monthly payments.* A Licensee shall make any payments due under § 380.3 on a monthly basis on or before the 45th day after the end of each month for that month. All monthly payments shall be rounded to the nearest cent.

(d) *Minimum payments.* A Licensee shall make any minimum payment due under § 380.3(b) by January 31 of the applicable calendar year, except that payment for a Licensee that has not previously made eligible nonsubscription transmissions, noninteractive digital audio transmissions as part of a new subscription service or Ephemeral Recordings pursuant to the licenses in 17 U.S.C. 114 and/or 17 U.S.C. 112(e) shall be due by the 45th day after the end of the month in which the Licensee commences to do so.

(e) *Late payments and statements of account.* A Licensee shall pay a late fee of 1.5% per month, or the highest lawful rate, whichever is lower, for any payment, and/or statement of account received by the Collective after the due date. Late fees shall accrue from the due date until payment is received by the Collective.

(f) *Statements of account.* Any payment due under § 380.3 shall be accompanied by a corresponding statement of account. A statement of account shall contain the following information:

(1) Such information as is necessary to calculate the accompanying royalty payment;

(2) The name, address, business title, telephone number, facsimile number (if any), electronic mail address and other contact information of the person to be contacted for information or questions concerning the content of the statement of account;

(3) The signature of:

(i) The owner of the Licensee or a duly authorized agent of the owner, if the Licensee is not a partnership or corporation;

(ii) A partner or delegee, if the Licensee is a partnership; or

(iii) An officer of the corporation, if the Licensee is a corporation.

(4) The printed or typewritten name of the person signing the statement of account;

(5) The date of signature;

(6) If the Licensee is a partnership or corporation, the title or official position held in the partnership or corporation by the person signing the statement of account;

(7) A certification of the capacity of the person signing; and

(8) A statement to the following effect:

I, the undersigned owner or agent of the Licensee, or officer or partner, have examined this statement of account and hereby state that it is true, accurate, and complete to my knowledge after reasonable due diligence.

(g) *Distribution of royalties.*

As the distribution of royalties does not involve Live365, it offers no proposal on this regulation.

(h) *Retention of records.* Books and records of a Licensee and of the Collective relating to payments of and distributions of royalties shall be kept for a period of not less than the prior 3 calendar years. Such books and records of the Licensee must be made available to the Collective's Qualified Auditor in the event of an audit pursuant to § 380.6.

§ 380.5 Confidential information.

(a) *Definition.* For purposes of this part, "Confidential Information" shall include the statements of account and any information contained therein, including the amount of royalty payments, and any information pertaining to the statements of account reasonably designated as confidential by the Licensee submitting the statement.

(b) *Exclusion.* Confidential Information shall not include documents or information that at the time of delivery to the Collective are public knowledge. The party claiming the benefit of this provision shall have the burden of proving that the disclosed information was public knowledge.

(c) *Use of Confidential Information.* In no event shall the Collective use any Confidential Information for any purpose other than royalty collection and distribution and activities related directly thereto.

(d) *Disclosure of Confidential Information.* Access to Confidential Information shall be limited to:

(1) Those employees, agents, attorneys, consultants and independent contractors of the Collective, subject to an appropriate confidentiality agreement, who are engaged in the collection and distribution of royalty payments hereunder and activities related thereto, for the purpose of performing such duties during the ordinary course of their work and who require access to the Confidential Information;

(2) An independent and Qualified Auditor, subject to an appropriate confidentiality agreement, who is authorized to act on behalf of the Collective with respect to verification of a Licensee's statement of account pursuant to § 380.6 or on behalf of a Copyright Owner or Performer with respect to the verification of royalty distributions pursuant to § 380.7;

(3) Copyright Owners and Performers, including their designated agents, whose works have been used under the statutory licenses set forth in 17 U.S.C. 112(e) and 114 by the Licensee whose Confidential Information is being supplied, subject to an appropriate confidentiality agreement, and including those employees, agents, attorneys, consultants and independent contractors of such Copyright Owners and Performers and their designated agents, subject to an appropriate confidentiality agreement, for the purpose of performing their duties during the ordinary course of their work and who require access to the Confidential Information; and

(4) In connection with future proceedings under 17 U.S.C. 112(e) and 114 before the Copyright Royalty Judges, and under an appropriate protective order, attorneys, consultants and other authorized agents of the parties to the proceedings or the courts.

(e) *Safeguarding of Confidential Information.* The Collective and any person identified in paragraph (d) of this section shall implement procedures to safeguard against unauthorized access to or dissemination of any Confidential Information using a reasonable standard of care, but no less than the same degree of security used to protect Confidential Information or similarly sensitive information belonging to the Collective or person.

§ 380.6 Verification of royalty payments.

(a) *General.* This section prescribes procedures by which the Collective may verify the royalty payments made by a Licensee.

(b) *Frequency of verification.* The Collective may conduct a single audit of a Licensee, upon reasonable notice and during reasonable business hours, during any given calendar year, for

any or all of the prior 3 calendar years, but no calendar year shall be subject to audit more than once.

(c) *Notice of intent to audit.* The Collective must file with the Copyright Royalty Judges a notice of intent to audit a particular Licensee, which shall, within 30 days of the filing of the notice, publish in the Federal Register a notice announcing such filing. The notification of intent to audit shall be served at the same time on the Licensee to be audited. Any such audit shall be conducted by an independent and Qualified Auditor identified in the notice, and shall be binding on all parties.

(d) *Acquisition and retention of report.* The Licensee shall use commercially reasonable efforts to obtain or to provide access to any relevant books and records maintained by third parties for the purpose of the audit. The Collective shall retain the report of the verification for a period of not less than 3 years.

(e) *Acceptable verification procedure.* An audit, including underlying paperwork, which was performed in the ordinary course of business according to generally accepted auditing standards by an independent and 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.

(f) *Consultation.* Before rendering a written report to the Collective, except where the auditor has a reasonable basis to suspect fraud and disclosure would, in the reasonable opinion of the auditor, prejudice the investigation of such suspected fraud, the auditor shall review the tentative written findings of the audit with the appropriate agent or employee of the Licensee being audited in order to remedy any factual errors and clarify any issues relating to the audit; Provided that an appropriate agent or employee of the Licensee reasonably cooperates with the auditor to remedy promptly any factual errors or clarify any issues raised by the audit.

(g) *Time for Completion of Audit.* Absent unreasonable delays on the part of the Licensee, the audit shall be complete and the report issued within one (1) year of the publication of the Notice of Intent to Audit in the Federal Register.

(h) *Costs of the verification procedure.* The Collective shall pay the cost of the verification procedure, unless it is finally determined that there was an underpayment of 10% or more, in which case the Licensee shall, in addition to paying the amount of any underpayment, bear the reasonable costs of the verification procedure.

§ 380.7 Verification of royalty distributions.

[As these provisions involve the Collective and the parties entitled to distributions, Live365 offers no proposal on this regulation]

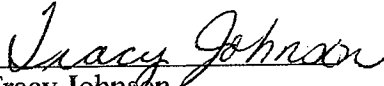
§ 380.8 Unclaimed funds.

[As this section deals with the relations of the Collective to its members, and Live365 has no involvement in such a relationship, it offers no proposal on this regulation]

CERTIFICATE OF SERVICE

I, Tracy Johnson, do hereby certify that copies of the foregoing "Proposed Conclusions of Law of Live365, Inc." were sent via overnight mail and email on this 10th day of September, 2010 to the following:

<p>David A. Handzo Michael B. DeSanctis Jared O. Freedman JENNER & BLOCK LLP 1099 New York Ave., N.W. Washington, D.C. 20001 Fax: (202) 639-6066 dhandzo@jenner.com mdesanctis@jenner.com jfreedman@jenner.com</p> <p><i>Counsel for SoundExchange, Inc.</i></p>	<p>William Malone MILLER & VAN EATON, P.L.L.C. 1155 Connecticut Avenue, N.W. Suite 1000 Washington, D.C. 20036-4320 Fax: (202)785-1234 wmalone@millervaneaton.com mschettenhelm@millervaneaton.com</p> <p><i>Counsel for Intercollegiate Broadcasting System, Inc. and Harvard Radio Broadcasting Co. Inc.</i></p>
<p>William B. Colitre ROYALTY LOGIC, LLC 21122 Erwin Street Woodland Hills, CA 91367 Fax: (818) 558-3474 BColitre@RoyaltyLogic.com</p> <p><i>Counsel for RoyaltyLogic, LLC</i></p>	<p>Catherine R. Gellis PO Box 2477 Sausalito, CA 94966 Phone: (202) 642-2849 cbi@cathygellis.com</p> <p>Mitchell L. Stoltz Constantine Cannon LLP 1301 K Street N.W., Ste. 1050 East Washington, DC 20005 mstoltz@constantinecannon.com</p> <p><i>Counsel for College Broadcasters, Inc.</i></p>


Tracy Johnson
DAVIS WRIGHT TREMAINE, LLP
1919 Pennsylvania Ave., NW
Suite 800
Washington, DC 20006