Before the
UNITED STATE COPYRIGHT ROYALTY JUDGES
Washington, D.C.

In the Matter of: Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services	Docket No. 2011-1 CRB PSS/Satellite II

REBUTTAL TESTIMONY OF DAVID J. DEL BECCARO

My name is David J. Del Beccaro and I am the President and CEO of Music Choice. I have overseen all aspects of Music Choice since the company's inception in 1987. I submit this testimony in connection with the above-captioned proceeding, in which the Copyright Royalty Judges ("CRJ") will adjust the rates for the statutory license used by Music Choice for the public performance of sound recordings as a preexisting subscription service pursuant to 17 U.S.C. § 114(f)(1).

My Background

I have been involved in the digital music business for twenty-five years, having founded and run one of the first and longest operating digital music services—Digital Cable Radio Associates, which is now Music Choice—continuously since 1987. As a long-time participant in the digital music industry, I have become intimately familiar with various facets of the music industry, including the many forms of broadcasting and digital music services available in the marketplace. I have attended and spoken at many digital music industry conferences alongside the management of various other digital music services, at which various financial, licensing, and other business aspects of a broad range of digital music services have been discussed. A list of my speaking engagements was attached to my direct testimony as Exhibit MC 1. I regularly read trade publications covering the various digital music businesses and the music industry in general. Because of my long participation in the digital music industry and my role as President and CEO of Music Choice, I am generally familiar with the history and offerings of other participants in the broader digital music marketplace, as well as the general profitability (or more accurately lack thereof) of these participants.

The Benchmark Markets Proposed By SoundExchange Are Not Meaningfully Comparable To The PSS Market

In support of its rate proposal, SoundExchange seeks to use three disparate categories of digital music services as benchmarks: (1) permanent downloads, (2) cell phone ringtones, and (3) interactive webcasting. None of these unrelated services are suitable comparables for the residential cable radio service offered by Music Choice. None of the services and markets relied upon by SoundExchange are meaningfully comparable to the residential cable radio market in which Music Choice operates. In each of SoundExchange's benchmark markets, the product or service licensed, and the market demand characteristics for the product or service, are fundamentally different from those Music Choice operates, other than at the most facile level that all of the services use digital music in some way. In fact, Stephen Bryan and Dr. George S. Ford, the only SoundExchange witnesses who address the PSS rate at all, acknowledge that Music Choice's service and market are fundamentally different from those of any other digital music service. (Bryan WDT, p. 15; Ford WDT, p. 13.) They are both correct on that point, if nothing else.

Having identified these three categories of digital music services that are directly licensed by the record labels, SoundExchange argues that the PSS rate should be set within the range of the rates obtained in these other markets. In each of SoundExchange's proposed benchmark markets, as compared to Music Choice, the digital recordings are (1) used differently by the service and by the end users; (2) sold to different types of customers and in different ways; (3) valued very differently by consumers; (4) in two out of the three markets licensed for totally different rights under copyright. In sum, there are no material similarities between Music Choice's PSS service and market and those of any of SoundExchange's three proposed benchmarks.

a. <u>Permanent download stores are fundamentally different than Music Choice</u>

Permanent download stores, such as iTunes, allow a consumer to download permanent digital copies of sound recordings for her own unlimited personal use. Record labels license the download store to make and publicly distribute (i.e., sell) copies of the digital sound recordings. The license to the download store does not include a performance right for the full sound recording, because the resellers are not publicly performing the recordings (other than perhaps short samples of the recordings, used to induce consumers to purchase the full tracks). Consumers choose specific recordings they want to purchase, pay the reseller, and download the digital music file from the reseller's website or through the reseller's software. The consumers then own the copies that they downloaded and can listen to them whenever they like, much like consumers own the compact disc that they buy at a record store or Internet CD retailer. The music file is permanently theirs to play at will, and transfer between computers or other listening devices, like an iPod or smartphone. The transaction between the record label and the download store reflects a wholesaler-retailer relationship. Indeed, the permanent download sale is a sale of goods that completely substitutes for the sale of physical product such as compact discs.

Music Choice's pre-programmed residential cable radio service is not comparable, in any way, to digital music stores such as iTunes, which re-sell permanent digital downloads as a substitute for compact discs. Music Choice does not obtain or require a public distribution license for the sound recordings or underlying musical compositions used in its service because it does not distribute copies of the recordings. Instead, it publicly performs, i.e. plays, sound recordings as part of a set of pre-programmed music channels. Music Choice provides these channels to cable companies, which in turn bundle the Music Choice channels with a wide array of other programming and sell the entire channel lineup of cable television service to the ultimate consumer. The consumers of Music Choice's service do not choose the song they want to hear; they can only choose a genre to listen to. Nor do Music Choice listeners own the recordings they hear; they cannot record the music, much less transfer recordings between devices or take the recordings with them outside the home. Thus, the Music Choice service cannot possibly substitute for compact disc (or digital download) sales. To the contrary, Music Choice's service promotes and complements those sales.

b. <u>Ringtone re-sellers are fundamentally different than Music Choice</u>

Like permanent downloads, ringtones are a fundamentally different (distribution and ownership-based) product than the pre-programmed performance-based service provided by Music Choice. With ringtones, a consumer downloads a digital music recording to her phone for the phone to play when receiving an incoming call. Also similar to permanent downloads, with ringtones the consumer chooses the specific song and owns the copy. The ringtone reseller does not obtain a public performance license, only a license to make and distribute copies. As with permanent downloads, consumers' transactions with ringtone services are sales of goods, which are wholly non-comparable to Music Choice's cable radio service. Again, Music Choice's residential service does not and cannot substitute for ringtone sales, and to the contrary is promotional of and complementary to those sales.

Moreover, consumers use ringtones in a fundamentally different way than they use either permanent downloads or the Music Choice service. Ringtones are lifestyle products, purchased to personalize one's phone. Users do not buy them to listen to the songs. As such, the user experience and value to the consumer of a ringtone is not remotely comparable to that of the Music Choice service.

c. Interactive webcasting services are <u>fundamentally different than Music Choice</u>

Interactive webcasting is also a fundamentally different service than Music Choice. With interactive webcasting, users are able to select the specific recordings that they want to hear, but do not own them and cannot transfer them between devices, though users can typically access interactive webcasting services on multiple devices and from any location. The ability to listen to any particular song whenever and wherever the user wishes is very much like owning a song, and the on-demand nature of the service to a large degree replaces the need to buy recordings. Interactive webcasting therefore substitutes for the record labels' primary revenue stream (sales of copies) in a way that Music Choice's pre-programmed music service does not. With Music Choice, users cannot select a specific song, only a genre of music over a specific channel. Music Choice's service is available only as part of a consumer's cable television service and not on a variety of internetconnected devices outside the home. The Music Choice service exposes the user to music such that if the user wants to hear a particular recording again, he must purchase it (or subscribe to a licensed interactive webcasting service as a substitute for that purchase). Music Choice therefore promotes and complements the sale of music and stimulates the record label's primary revenue stream, rather than substitutes for it.

The value of an interactive webcasting service to the user is also very different from the value of Music Choice's residential music service. For the reasons noted above, interactive webcasting is like having millions of CDs in a subscriber's personal collection, limited only by the size of the catalog of the particular interactive webcasting service. The value of a particular interactive service to the user comes almost exclusively from the size of the webcaster's catalog, which in turn is dependant solely upon the number of record labels from which the interactive service obtains a direct license. Subscribers do not listen to Music Choice when they want to hear specific songs. The user only selects a genre of music and wants Music Choice to choose the specific songs played. The value to the user, and that which differentiates Music Choice from its competitors in the cable radio market, is the creative decisions Music Choice programmers make to select which songs the user hears and the order in which those songs are heard. Music Choice's competitive value is thus derived primarily from Music Choice's programming efforts, not the record labels' catalogs, which are equally available to all cable music services.

There is another important reason why the rates paid by interactive webcasters cannot be relied upon as a fair, market-based benchmark. Those rates are the product of an immature and unstable market (even after ten years), where the licensing deals struck with the record companies are not based (neither on the buyer nor seller side) upon traditional long-term business concerns. Rather, the deals are driven, on both sides, by entirely ancillary goals that do not reflect a typical willing buyer / willing seller business deal and certainly do not incorporate any of the Section 801(b) policy objectives.

As evidence of this, in the more than ten years that interactive webcasting services have existed and been in the market, not a single one has ever turned a profit on an annual basis, much less on a cumulative basis. In fact, over ten years after launching one of the earliest interactive webcasting services, Rhapsody is still losing money every quarter.[1] This inability to turn a profit is driven largely by the license fees extracted by the record labels. The interactive webcasters have to agree to these rates to launch and maintain their entry into the market, because, as noted above, the services compete for users (and perhaps more importantly investors) based upon the size of their music catalogs. Therefore, an interactive webcaster must have licenses with all the major labels and as many of the independents as possible. Moreover, interactive webcasters have to obtain licenses with at least all of the major labels to secure venture capital financing to keep their businesses going.

Almost all of the original, and many of the more recent, interactive webcasters have gone out of business entirely. Examples include Pressplay, Ruckus, MusicMatch On Demand, MusicGremlin, Lala Media, Yahoo! Music Unlimited, iMeem, and Spiral Frog. Those that remain in business can only do so by obtaining repeated infusions of additional capital. One might wonder why venture capital firms would put money into and continue to

[1] Rhapsody's continued failure to produce any profit even after ten years is disclosed in the public filings of Real Networks, which is a part owner of Rhapsody. Copies of those recent public filings are attached as Exhibits MC 67 and MC 68. Page seven of MC 67 (Real Networks' most recent 10-Q) separately reports Rhapsody's losses from 2011 and the first quarter of 2012. Page 13 of MC 68 (Real Networks' 2011 10-K) describes the history of Rhapsody's failure to generate a profit and the risk that Rhapsody may never be able to generate a profit.

fund webcasting services with no hope of long-term profitability. The answer is that these firms are not primarily concerned with the long-term prospects of the companies, either. Instead, they hope to make money by building up the perceived value of a company and then selling it at a higher price. Thus, as long as they can maintain the perception that these webcasters will someday be profitable, they believe they can flip the companies at a profit. That said, according to accounts in music industry trade publications it seems that even the venture capital firms are finally starting to lose their appetites for these investments and those funding sources are starting to dry up.

On the seller side, the record labels do not particularly care whether the licensed webcasters ever turn a profit or even stay in business. At least up to this point, as webcasters have gone out of business, new services have entered the market with new venture capital funding, as described above. Moreover, I understand that the record labels typically demand very large advance payments and minimum guarantees from licensed interactive webcasters. Because of these large advances and guarantees, the record labels wind up getting paid, irrespective of the health or survival of the licensed webcaster. As long as venture capital keeps flowing into the market, the record labels can continue to siphon off that money in the form of these advances and guarantees, without regard to whether any of the licensed services can stay in business. Indeed, the very fact that the record companies demand such large advances and guarantees indicates that they know that the services will not stay in business for very long.

The record companies have repeatedly and publicly acknowledged this dynamic. For example, David Ring, one of the heads of UMG's global digital business division, spoke on this point earlier this year at the San Francisco MusicTech industry conference. He was appearing on a panel with Larry Marcus, who specializes in venture capital deals in the digital music market for Walden Venture Capital. In response to Mr. Marcus's noting that, from his experience in funding digital music services, the record company up-front payment and royalty demands created an "insurmountable" obstacle to profitability for the services, Mr. Ring countered that it was not the record industry's problem that venture capital firms were choosing to fund digital music services that did not have a sufficient revenue model to make them profitable. For one industry news source's reporting on this exchange, see http://www.digitalmusicnews.com/permalink/2012/120214huge.

This article prompted a former record company employee, who had worked in the industry for almost seventeen years at various labels and had been directly involved in early digital music service licensing, to write his own response. In that response, he described the record company licensing model for interactive webcasters as one of "extortion," and contrasted it with the ways in which the record companies used to work cooperatively with physical retailers to help them maintain healthy long-term businesses. In the ensuing comments section associated with his article, he explained:

> You know why the labels require huge advances? Because they can, because the law allows them to, especially with interactive streaming services, which are not covered under statutory licensing. And also because, and I know this because I sat in the meetings and heard it dozens of times, "get the advance, cash the check, get it on the books for this year, we need to show digital revenue, if these guys go out of business next year because they made a bad deal, f*** them, we chased the check already."
>
> That mentality still prevails, it is not about working together to build a sustainable business that works for everyone in the chain. . . .

> The labels are not "funding companies that have no revenue model," that's a completely bulls*** spin on what actually happens. They're collecting a stiff toll on a bridge that an optimist wants to cross, and when he gets to the other side, he's broke and starves to death.

http://www.digitalmusicnews.com/permalink/2012/120216retailers

Notably, less than one month after Mr. Ring made his statements at San Francisco MusicTech, essentially blaming the venture capital firms for investing in digital music services that cannot make a profit under the royalty terms extracted by the record companies, Francis Keeling, another UMG global digital business executive, published an opinion-editorial in the Financial Times, urging venture capitalists to continue investing in these same digital music services and noting that "a key part of [UMG's] growth will come from external investment in new digital services."

Because of these unusual dynamics, interactive webcasting deals cannot reasonably be considered the product of a healthy, functioning business market and the rates obtained in that market should not serve as a comparable for the rate to be paid by Music Choice for the sound performance license. Moreover, the parties that negotiated these license agreements clearly do not, in any way, set the rates and terms in a way meant to satisfy the Section 801(b) policy objectives, nor is there any indication those policy objectives are even considered in these negotiations.

d. Additional reasons why Music Choice's PSS service is fundamentally different from SoundExchange's proposed benchmark services

Music Choice's cable radio service is fundamentally different from these other digital music services in several other significant ways as well. Music Choice sells its programming to cable companies and other multi-channel video programming distributors

("MVPDs"), not directly to consumers. Consumers in turn receive Music Choice as part of a basic digital tier of cable service, but consumers do not pay a separate fee to receive Music Choice. The service seems "free" to cable subscribers. This dynamic evolved over time after Music Choice was unsuccessful in getting cable subscribers to pay a separate fee for its service. In sharp contrast, digital download re-sellers, ringtone re-sellers and interactive webcasters are all able to sell their products or services directly to consumers.

Additionally, Music Choice's music channels are packaged as ancillary to the video channels (television networks, ESPN, Comedy Central, etc.) provided by the MVPDs. In its negotiations with the MVPDs, Music Choice competes primarily with these other cable channels for its share of the basic cable subscriber fee. The typical Music Choice listener uses Music Choice as background music in the living room or bedroom (the places most likely to have cable television). Moreover, many subscribers who get Music Choice as part of their basic cable service do not actually use Music Choice. Music Choice obtains its revenue from all cable subscribers regardless of whether they view or listen to any particular channel, and in some cases regardless of whether they receive Music Choice at all because Music Choice is typically paid on a "per basic" basis (*i.e.*, for all cable subscribers), whereas Music Choice is delivered only to homes with digital service. By extension, the record labels and recording artists, who are paid a percentage of Music Choice's revenues, obtain their royalties from all subscribers to Music Choice's MVPDs, including subscribers who do not listen to any of the music or even receive the Music Choice channels.

All of these factors, which the cable companies view as evidence of a relatively low monetary value ascribed to Music Choice's service by cable subscribers, is reflected in the continued downward pressure on the rates Music Choice can negotiate in the market as described in my direct testimony. None of these factors are present in any of the markets for SoundExchange's proposed benchmark services, all of which command vastly higher rates from consumers.

An Increased Rate For the PSS License Would Not Add Anything To The Record Companies' Incentive To Produce And Release Recordings

Dr. Ford claims that increased royalty payments for the PSS license would inherently cause the record labels to produce and release more recordings. (Ford WDT, p. 19) This claim is demonstrably false.

The amount of money received by each record label from the PSS is so small in the context of a record label's budget as to be irrelevant. Even if the rate were ten times higher, this would still be the case. Such an increase would not even be noticed by record label management, much less used to fund incrementally additional recordings.

Even if the additional revenue were significant, there is no reason to think that a record label would have any incentive to use that additional revenue to release additional recordings. According to the record labels, the vast majority of their releases lose money. Thus, they are far more likely to simply take more profits from any additional revenue, without releasing any incrementally additional recordings that are likely to lose money.

Moreover, releasing more recordings will not lead to any additional revenue from Music Choice. SoundExchange distributes the PSS royalties to record labels based upon the relative percentage of plays each label receives on Music Choice's channels, not the number of different recordings played. Music Choice only plays a tiny percentage of any record label's total catalog, however, and makes its programming decisions based upon the creative judgment of its programming staff. Thus, merely adding new recordings to a record label's catalog in no way assures that Music Choice will actually play that recording. Even if it did, however, Dr. Ford's false assumption implies that all of the record labels would release additional recordings (because they all would be receiving higher PSS royalty payments) and thus there would not necessarily be any net incremental increase in royalties to any of the record companies from those additional releases.

SoundExchange's Proposed Rate of 45% Would Put Music Choice Out Of Business

SoundExchange's proposed rate of 45% of gross revenue would have a devastating effect on Music Choice. As set out in our direct case, even under the existing 7.25-7.5% rate, Music Choice has struggled, and in some years failed, to generate even a small annual profit and is nowhere near generating a reasonable return on its partners' investments. Increasing that already-too-high rate to 45% would prevent Music Choice from ever earning a profit and would simply drive Music Choice out of business.

In my earlier testimony, I included an exhibit showing Music Choice's historical financial performance, and projecting Music Choice's results out to 2017 using the current royalty rates, under three different sets of assumptions with respect to Music Choice's ability to maintain its market share. The following similar charts will help demonstrate the impact of SoundExchange's proposed rate.

a. Historical Performance at Actual Rates vs. Proposed Rate

Attached as Exhibit MC 69 are two tables, demonstrating Music Choice's historical financial performance. Table 1 shows the actual historical financial performance of Music Choice's residential music service through 2011. Table 1.A shows how that actual performance would have been impacted if the sound recording royalty rate had been set at 45% of revenue during the current rate period. As these charts indicate, had the PSS royalty been set during the current rate period at 45%, the rate SoundExchange claims is the current "market rate" for the PSS, Music Choice would have incurred unsustainable losses.

b. Projections at Current Rate

Attached as Exhibit MC 70 are three tables, similar to the tables I submitted with my direct testimony, showing historical financial performance and Music Choice's current projections of future performance if the PSS rate stays at its current rate, under three different potential scenarios regarding Music Choice's ability to maintain its current affiliate relationships. Table 2 shows Music Choice's projected financial performance if the sound recording royalty rate stays at 7.5%, assuming the best case scenario in which Music Choice does not lose any market share. Table 2.A shows Music Choice's projected financial performance if the sound recording royalty rate stays at 7.5%, assuming a likely downside scenario in which [redacted]. Finally, Table 2.B shows Music Choice's projected financial performance if the sound recording royalty rate stays at 7.5%, [redacted].

These tables differ slightly from the tables submitted with my direct testimony due to one error correction[2], recent changes in Music Choice's internal revenue projections driven by business developments that occurred after the filing of my direct testimony, and the use of actual figures for 2011 that were not available at the time of my written direct testimony. However, these new versions similarly show the precarious nature of Music Choice's projected financial performance if the current PSS rate were carried forward, and how that rate will continue to prevent Music Choice from realizing any return, much less a reasonable rate of return, on its partners' investments.

c. Projections Using SoundExchange's Proposed <u>Phase-In of Alleged "Market" Rate</u>

Attached as Exhibit 71 are three tables demonstrating Music Choice's projected financial performance if SoundExchange's alleged "market rate" were phased in from 15% to 45% during the next rate period as set forth in SoundExchange's rate proposal. As with the other projections, Table 3 shows Music Choice's projected financial performance assuming the best case scenario in which Music Choice does not lose any market share. Table 3.A shows Music Choice's projected financial performance assuming a likely downside scenario in which [redacted]. Finally, Table 3.B shows Music Choice's projected financial performance [redacted].

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[2] During the direct phase hearing, it was brought to my attention that the projections of the "rights and other" cost line were incorrect. Upon investigation, we realized this error was due to an error in the spreadsheet formula, and for these tables we have fixed that error.

d. Conclusion on effect of SoundExchange's rate proposal

The results speak for themselves. If Music Choice's rate had been set at 45% of revenue in the past, our losses would have been so much greater that we could not have made it to this point. If our rate were to be increased to 45% as a result of this proceeding, even if phased in over five years, the effect would be no less dire. Even under our most optimistic assumptions, SoundExchange's rate proposal would cause Music Choice to incur significant losses every year during the next rate period, and our accumulated losses from almost 25 years of operation would almost double during that five-year period. There is simply no way that Music Choice could continue operations if it were forced to endure such losses.

It is important to note that Music Choice is not arguing that the rate must always be set at a rate that keeps Music Choice from going out of business under any circumstances. However, the very reason Congress chose to create the compulsory license when it granted sound recording copyright owners an entirely new revenue stream in 1995 and furthermore chose (and later grandfathered) a policy-based rate-setting standard instead of a market rate standard, was to ensure that the sound recording royalty rate itself would not cause an otherwise well run PSS to fail. As I demonstrated in my direct testimony, Music Choice has continuously offered (and constantly improved) a viable music service, which is well received by consumers, priced above its competitors, and widely distributed by a well-managed and cost efficient business. Under these circumstances, and where setting a fair rate will in fact make the difference between Music Choice's long-term survival and failure, SoundExchange's proposed increase to 45% of revenue must be a non-starter.

If Music Choice Were To Cease Operations, Both The PSS Market And The Broader Market For Cable Radio Services Would Suffer Severe Disruption

Dr. Ford claims that even if Music Choice went out of business from a raise in rates, that vacuum would quickly be filled by various "competitors." Dr. Ford's speculation on this point does not reflect market realities. As a preliminary matter, both the legislative histories of the DPRA and DMCA as well as the prior appellate decision by the Librarian of Congress make clear that when setting rates for the PSS (unlike when setting rates for services that entered the market after the passage of the DPRA and DMCA), the fourth policy factor relates to disruption of the PSS services' businesses and not any broader digital music service market. As I testified during the direct phase of this proceeding, the PSS market has already been disrupted by the existing rate. The original DMX no longer exists, and Muzak has never attempted to expand beyond its one affiliate, Dish Network. Driving Music Choice out of business would effectively eliminate over three-quarters of the PSS market.

Even if the Judges were to consider the broader cable radio market, Music Choice has no direct or even indirect competitors that would be able to quickly fill the void that would be created by Music Choice's exit from the market.

With respect to interactive and customized webcasters like Rhapsody and Pandora, those services are very different from a programming and user experience perspective than Music Choice's curated music channels. The MVPDs do not view them as substitutes for Music Choice because the user experience is so very different, and no MVPD has replaced Music Choice with any of these services. The near-term competitive threat to Music Choice from these types of services is not one of displacement of, or substitution for, Music Choice.

Instead, the immediate threat from interactive or customized music services, whether provided over-the-top ("OTT") or as an app on the cable box, is that our cable affiliates will use their presence on the television to argue that Music Choice's channels are worth less. In any event, given that they have not entered Music Choice's market to this point, it is highly unlikely that they would be able suddenly or quickly to do so simply because Music Choice exited the market. And even if they did, their services are so different that they could not actually be considered a replacement for Music Choice's curated cable radio channels.

With respect to Music Choice's direct competition, by which I mean services that actually provide pre-programmed music channels as part of a residential cable or satellite television package, none of those competitors could quickly or easily take Music Choice's place if we exited the market. The only services in this category over the past ten years have been the so-called CABSAT services: MTV's Urge service, Sirius XM, the new DMX, and a new Canadian service called Galaxie.

With respect to Urge, MTV entered the CABSAT market for only a short time, beginning in 2007. Although Urge was able to take away some of Music Choice's affiliates by undercutting our price and/or bundling the service along with MTV's popular video channels, the Urge cable radio channels were not as popular with subscribers as Music Choice's channels and MTV discontinued the Urge cable radio service in 2010. We have since regained many of the affiliates we had lost to Urge, and in all such instances listening intensity increased substantially after Music Choice replaced Urge. Having left the market this way, it is doubtful that MTV would want or be able to re-enter, even if Music Choice went out of business.

Turning to Sirius XM, it has only one affiliate, Dish Network. Sirius XM provides a subset of the music channels from its satellite radio service to Dish Network at a very low rate in order to entice Dish Network subscribers to pay for Sirius XM in their cars. Because Sirius XM cannot command more than a nominal fee for its CABSAT service and provides the service solely for promotional purposes, Sirius XM has not tried to expand its CABSAT service beyond Dish Network, does not attempt to sell against us in the broader cable market, and would certainly have no business reason to replace Music Choice throughout the cable market if Music Choice were driven out of the market by SoundExchange's proposed rates.

With respect to the DMX CABSAT service, like Sirius XM it only has one affiliate in the residential space, DirectTV, and does not attempt to sell against us in the broader cable market. Also like Sirius XM, DMX agreed to provide its music channels to DirecTV practically for free as a means to support its primary line of business. In DMX's case, that primary business is commercial background music. In order to provide its commercial service through DirecTV, DMX had to agree to give DirecTV the residential music channels at a very low rate. [redacted] A Canadian background music company that purchased Muzak in 2011, Mood Media, also recently acquired DMX. Thus, even if DMX does not exit the CABSAT market completely, it has absolutely no business incentive to expand beyond its deal with DirecTV.

The only other direct competitor to Music Choice in the cable radio market is a music service called Galaxie, offered by Canadian company Stingray Digital. Galaxie is a very recent entrant into the U.S. cable radio market. It is the dominant cable radio service in Canada. As noted in my direct testimony, the Canadian cable radio market is much more profitable than the U.S. market, and Galaxie's Canadian service is by far its primary business. Galaxie entered the U.S. market by taking a subset of the channels from its Canadian service and offering them to U.S. cable companies at a substantially lower rate than Music Choice. So far, Galaxie has only been able to take a small amount of market share away from Music Choice, and only with smaller affiliates. I do not believe Galaxie could replace Music Choice with our larger affiliates for a number of reasons. Most importantly, and as I have previously explained in my direct testimony, the larger cable companies (which service the vast majority of cable subscribers nationwide) pay far lower rates for cable radio than do the smaller affiliates because of their size. If Galaxie were to attempt to replace Music Choice on any of these larger cable systems, its higher rights costs would likely lead to significant losses. Indeed, to replace Music Choice on the larger affiliates, those affiliates would require that Galaxie bundle at least a video on demand service[3] with the audio channels at no additional cost, like Music Choice does. [redacted]

[3] Notably, if Galaxie (or any other market entrant) were to attempt to provide any music video offerings as part of its service, the development and licensing of such video channels would take substantial effort and time. The licensing alone would take years, as it did for Music Choice.

SoundExchange's Proposed Changes To The PSS Regulations Are Unjustified And Unsupported And Would Adversely Impact Music Choice To The Sole Benefit of SoundExchange

SoundExchange has given no adequate justification for the changes it seeks to the PSS regulations, many of which are substantive changes that would adversely impact Music Choice. The parties have been operating under the existing regulations, without substantive change for fifteen years, without any evidence of a problem. Any changes after fifteen years will cause at the very least extreme inconvenience to Music Choice and would introduce new uncertainties by changing so much of the existing language. Moreover, many of the changes are substantive changes that take away rights and protections Music Choice presently has. After fifteen years, any changes to the regulations should require a showing of need. SoundExchange has failed to do this. Instead, SoundExchange has clearly selected its proposed changes to benefit itself without any regard for objectivity or fairness.

Even though SoundExchange claims it merely wants to conform the PSS regulations with the SDARS regulations, it notably wants to keep the regulations different with respect to at least one provision, the audit fee shifting threshold, because the PSS regulations are more favorable to SoundExchange than the SDARS regulations on this point. This alone shows that SoundExchange is cherry picking its changes and its primary interest is gaining advantage rather than conforming the regulations.

The specific substantive changes proposed by SoundExchange that will most adversely impact Music Choice include:

i. Proposal p. 28, Section 382.5(c) – Use of confidential information.

SoundExchange removed the reference to employees and agents of the

Collective as being subject to the limitations on use of the PSS's confidential information. This effectively nullifies the confidentiality protections because it would seemingly allow SoundExchange's employees and agents to use Music Choice's confidential information in ways that are meant to be prohibited.

ii. Proposal p. 28-29, Section 382.5(d)(1) – SoundExchange seeks to eliminate the existing prohibition on sharing Music Choice's confidential information with employees, agents, etc. of SoundExchange who are also employees of record companies or artists. This change would undermine the primary purpose of the existing confidentiality restrictions, which is to keep Music Choice's confidential information out of the hands of the record labels. Music Choice regularly negotiates licenses and other agreements with the record labels and individual artists, and if the employees or representatives of record labels and artists were allowed to obtain Music Choice's confidential business information that information could be used to Music Choice's disadvantage in business deals unrelated to the PSS license. Moreover, this would create an uneven playing field, where Music Choice would not have reciprocal access to the record companies' confidential business and financial information.

iii. Proposal p. 29, Section 382.5(d)(2) – SoundExchange seeks to eliminate the existing restriction on using an auditor that is an employee or officer of a record company or artist. The one time that

SoundExchange audited Music Choice, they asked us to waive this provision so they could use an auditor that was partially owned by or otherwise affiliated with a sound recording copyright owner, and we naively agreed in a gesture of good faith. We were "rewarded" with an audit wherein the auditor was anything but independent and took outrageous positions on alleged underpayments that were based upon aggressive misreadings of the regulations. [redacted] It was quite obvious that the auditor's conduct was driven largely by its affiliation with a record label, and we would never agree to waive this provision again in the future. Indeed, the very concept of a fair, objective audit necessitates the use of an independent auditor.

iv. Proposal p. 29, Section 382.5(d)(3) – SoundExchange is seeking to eliminate the existing provision that limits the confidential information that may be shared with record companies and artists to the statements of account. Again, this eliminates protection of Music Choice's other confidential information for no discernible reason.

v. Proposal p. 30, Section 382.6(c) – SoundExchange is seeking to add entirely new language that, for the first time, provides that only the auditor specified in SoundExchange's notice of intent can conduct an audit and that the audit shall be binding on all parties. First of all, this is inconsistent with Section 382.6(e), which provides that any independent audit conducted in the ordinary course of business can constitute an acceptable verification. Second of all, this change would seem to eliminate Music Choice's existing right to dispute the audit, and as well as its right to litigate the audit dispute if the dispute cannot be settled by agreement. This change removes any protection Music Choice has against an unfair audit. In the example of our prior audit noted above, we apparently would not have had any ability to challenge SoundExchange's audit report and would have been compelled to pay any amount the auditor claimed was underpaid, irrespective of how improper the findings were.

This change is also inconsistent with SoundExchange's own proposed changes to the provisions of Section 382.7(c), which apply to copyright owners' and performers' audits of SoundExchange. In that section, SoundExchange seeks to make an audit of it by copyright owners or performers binding not on all parties (thus not binding on SoundExchange), but only on the auditing parties (the copyright owners and performers). This is yet another example of how SoundExchange is seeking changes that unevenly benefit SoundExchange while burdening the PSS, and even the copyright owners and performers.

vi. Proposal p. 30, Section 382.6(d) – SoundExchange seeks to impose a new requirement that Music Choice provide access to third-party records. Such a requirement would be incredibly burdensome, with a serious potential to adversely impact Music Choice's business relationships with affiliates and any other third parties from whom Music Choice would be required to obtain non-Music Choice records. Indeed, Music Choice has faced strong resistance from affiliates in the past when we have tried to obtain any commitment to provide us with access to their business records. Notably, this sensitivity is different for Music Choice than it is for Sirius XM or webcasters, which do not provide their services to consumers through third-party affiliates. As with the other proposed changes, SoundExchange has not even hinted at any justification or need for imposing this new burden on Music Choice.

vii. Proposal p. 30, Section 382.6(g) – Although SoundExchange seeks to "conform" most of this audit provision with the analogous SDARS provision, SoundExchange seeks to keep the existing 5% underpayment threshold for shifting the audit fees to Music Choice. In the SDARS decision, the Copyright Royalty Judges rejected SoundExchange's attempt to impose a 5% threshold on the SDARS, noting it was too low and inconsistent with marketplace audit provisions in the record labels' own contracts. There is no reason, and Sound Exchange gives no reason, why the PSS should be treated any differently than the SDARS with respect to this threshold. If the Copyright Royalty Judges were to change any of the regulations, and they should not, they certainly should raise the audit fee-shifting threshold to 10% for the same reasons the Judges set that threshold at 10% in the SDARS decision.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

Executed in Horsham, Pennsylvania on the 27th day of June, 2012

David J. Del Beccaro

CERTIFICATE OF SERVICE

I, Martin Cunniff, do hereby certify that copies of the public version of ***Rebuttal Testimony of David J. Del Beccaro*** was sent on July 2, 2012 by both Federal Express (with exhibits) and electronic mail (without exhibits), to the following:

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