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United States Court of Appeals for the District of Columbia Circuit

No. 19-1028

Consolidated with 19-1058, 19-1059, 19-1060, 19-1061 and 19-1062

GEORGE JOHNSON,

Appellant,

v.

COPYRIGHT ROYALTY BOARD and LIBRARIAN OF CONGRESS,

Appellees.

NASHVILLE SONGWRITERS ASSOCIATION INTERNATIONAL; PANDORA MEDIA, LLC; GOOGLE LLC; NASHVILLE SONGWRITERS ASSOCIATION INTERNATIONAL; SPOTIFY USA INC.; NATIONAL MUSIC PUBLISHERS' ASSOCIATION; and AMAZON DIGITAL SERVICES LLC,

Appellants/Intervenors.

On Appeal from a Final Determination of the Library of Congress, Copyright Royalty Board in 37 CFR 385 (Docket No. 16-CRB-0003-PR (2018-2022))

PUBLIC INITIAL BRIEF FOR APPELLANTS/INTERVENORS PANDORA MEDIA, LLC, GOOGLE LLC, SPOTIFY USA INC. AND AMAZON DIGITAL SERVICES LLC

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to D.C. Circuit Rule 28(a)(1), Appellants Google LLC, Spotify USA Inc., Pandora Media, LLC, and Amazon Digital Services LLC (collectively, the "Services") certify as follows:

(A) Parties and Amici. The following parties appeared before the Copyright Royalty Judges (the "Judges") in the proceedings below: Amazon Digital Services LLC; Apple, Inc.; American Society of Composers, Authors and Publishers; Broadcast Music, Inc.; Church Music Publishers Association; David Powell; Deezer S.A.; Digital Media Association; The Harry Fox Agency; Gear Publishing Company; George Johnson d/b/a/ GEO Music Group; Google, Inc.; Music Reports, Inc.; Nashville Songwriters Association International; National Music Publishers' Association; Omnifone Group Limited; Pandora Media, Inc.*; Recording Industry Association of America, Inc.; Rhapsody International Inc.; Songwriters of North America; Sony Music Entertainment; SoundCloud Limited; Spotify USA Inc.; Universal Music Group; and Warner Music Group.

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* Pandora Media, LLC is the successor to Pandora Media, Inc.

In addition, American Association of Independent Music filed comments on a partial settlement that the Judges ultimately approved.

No amici appeared before the Judges in the proceedings below.

The following are the parties before this Court in these consolidated cases:

In No. 19-1028, the appellant is George Johnson, the appellees are the Copyright Royalty Board** and the Librarian of Congress, and the intervenors are Amazon Digital Services LLC, Apple Inc., Google LLC, Nashville Songwriters Association International, National Music Publishers' Association, Pandora Media, LLC, and Spotify USA Inc.

In No. 19-1058, the appellant is Google LLC, and the appellees are the Copyright Royalty Board and the Librarian of Congress.

In No. 19-1059, the appellant is Spotify USA Inc., and the appellees are the Copyright Royalty Board and the Librarian of Congress.

** The Copyright Royalty Board is "the regulatory name for the collective entity composed of the [Copyright Royalty Judges] and their staff." *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 684 F.3d 1332, 1335 (D.C. Cir. 2012).

In No. 19-1060, the appellant is Pandora Media, LLC, and the appellees are the Copyright Royalty Board and the Librarian of Congress.

In No. 19-1061, the appellant is Amazon Digital Services LLC, and the appellees are the Copyright Royalty Board and the Librarian of Congress.

In No. 19-1062, the appellants are the National Music Publishers' Association, Inc. and the Nashville Songwriters Association International, and the appellees are the Copyright Royalty Board and the Librarian of Congress.

No amici filed briefs in these consolidated cases.

(B) Ruling Under Review. The ruling under review is Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (*Phonorecords III*), 84 Fed. Reg. 1918 (Feb. 5, 2019) (the "Final Determination"). Because the Final Determination published in the *Federal Register* redacts certain confidential and competitively sensitive information, and because it is necessary for this Court to consider that information in deciding certain issues in this appeal, this brief cites the unredacted version of the Final Determination (JA___).

The Final Determination published in the *Federal Register* also incorporates the reasoning and rulings from the Judges' January 4, 2019 Amended Order Granting in Part and Denying in Part Motions for Rehearing.

(C) Related Cases. This case has not been reviewed previously by this Court or any other court. Apart from the consolidated cases listed above, counsel is not aware of any other related cases currently pending in this Court or in any other court.

CORPORATE DISCLOSURE STATEMENTS

Pursuant to Federal Rule of Appellate Procedure 26.1 and D.C. Circuit Rule 26.1, the Services respectfully submit these corporate disclosure statements:

Google LLC provides many products and services. Among other things, Google LLC owns and operates Google Play Music, a music and podcast streaming service and online music locker. Google LLC is a subsidiary of XXVI Holdings Inc., which is a subsidiary of Alphabet Inc., a publicly traded company; no publicly traded company holds more than 10% of Alphabet Inc.'s stock.

Spotify USA Inc. is a provider of digital streaming services and is a wholly-owned subsidiary of Spotify AB. Spotify AB is a wholly-owned subsidiary of Spotify Technology S.A. Spotify Technology S.A. does not have any parent corporation. No publicly-held company holds a 10% or greater interest in Spotify Technology S.A.

Pandora Media, LLC is a wholly-owned subsidiary of Sirius XM Radio Inc. and an indirect subsidiary of Sirius XM Holdings Inc. and of Liberty Media Corporation.

Amazon Digital Services LLC is principally engaged in the business of providing products and services to consumers. Amazon Digital Services LLC is a wholly owned, indirect subsidiary of Amazon.com, Inc. Amazon.com, Inc. has no parent company, and based on a review of statements filed with the U.S. Securities and Exchange Commission pursuant to Sections 13(d) and 13(g) of the Securities Exchange Act of 1934, as of August 14, 2019, we are not aware of any publicly held company owning 10% or more of its stock.

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GLOSSARY OF ABBREVIATIONS

The following abbreviated terms are used in this brief:

Amazon	Amazon Digital Services LLC
APA	The Administrative Procedure Act
Board	Copyright Royalty Board
Copyright Owners	Collectively, Nashville Songwriters Association International and National Music Publishers' Association, representing songwriters and publisher copyright owners
Dissent	Dissenting Opinion of Judge David R. Strickler to Final Determination (JA___-___)
EX	Hearing Exhibit in this proceeding
Final Determination	Final Determination of the Copyright Royalty Judges in this proceeding (JA___-___)
Google	Google LLC
Initial Determination	Initial Determination of the Copyright Royalty Judges in this proceeding (JA___-___)
Initial Dissent	Dissenting Opinion of Judge David R. Strickler to Initial Determination (JA___-___).
Judges	Copyright Royalty Judges

Majority	Then-Chief Judge Barnett and Judge Feder
NMPA	National Music Publishers Association
Pandora	Pandora Media, LLC, together with its predecessor Pandora Media, Inc.
Phonorecords I	Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding, 74 Fed. Reg. 4510 (Jan. 26, 2009)
Phonorecords II	Adjustment of Determination of Compulsory License Rates for Mechanical and Digital Phonorecords, 78 Fed. Reg. 67,938 (Nov. 13, 2013)
Phonorecords III	Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III), 84 Fed. Reg. 1918 (Feb. 5, 2019) (JA___-___)
Rehearing Order	Amended Order Granting in Part and Denying in Part Motions for Rehearing, No. 16-CRB-0003-PR (2018-2022) (Jan. 4, 2019) (JA___-___)

SDARS III	Determination of Royalty Rates and Terms for Transmission of Sound Recordings by Satellite Radio and "Preexisting" Subscription Services (SDARS III), 83 Fed. Reg. 65210 (Dec. 19, 2018)
Services	Collectively, Amazon Digital Services LLC, Google LLC, Pandora Media, LLC, and Spotify USA Inc.
Subpart A Ruling	Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III); Subpart A Configurations of the Mechanical License, 82 Fed. Reg. 15,297 (Mar. 28, 2017) (JA___-___)
Spotify	Spotify USA Inc.
TCC	Total Cost of Content
TR	Hearing Transcript in this proceeding (JA___-___)

PRELIMINARY STATEMENT

Appellants provide interactive music streaming services, which enable listeners to select and play songs on demand. To offer these services, Appellants obtain several different licenses from the owners of various copyrights. One of these licenses—the "mechanical" license for musical works—is compulsory, with rates and terms set by agreement or through an administrative rate-setting process before the Copyright Royalty Board ("Board").

The decision below is the first time the Board actually adjudicated those rates. Previously, the rates and terms for the mechanical license for interactive streaming were set through voluntary, industry-wide agreements between services and copyright owners. And while those settlements were in effect, streaming services brought more music to more paying listeners, generating more royalties for the songwriters and publishers who hold the copyrights to musical works.

In adopting new rates and terms, a two-person majority concluded that mechanical rates should increase by at least 44%. The Board's third member issued a meticulous, more-than-150-page dissent detailing the Majority's numerous legal errors.

As the dissenting judge explained, the Majority adopted a combination of rate structure (how the rate is determined) and rate levels (the numbers at each step of the calculation) that no party had a chance to address or rebut because the Majority invented them after the record closed. This Court has reversed the Board and other agencies for similar errors. Here, moreover, the Majority set rates based on royalties paid to record labels, which the Board has previously recognized exercise significant market power, on the express assumption that they would simply decline to exploit it.

In addition, the Majority selected rate levels based on an approach that mixed and matched incompatible elements from three experts' theoretical economic models, resulting in what the dissenting judge correctly labeled an economically incoherent "mash-up" analysis. Dissent at 2 (JA___). This Court previously vacated a Board decision that used the same mix-and-match approach. The same outcome is warranted here.

After issuing its Initial Determination, the Majority made additional legal errors. First, acting outside the narrow rehearing authority Congress has granted, the Majority substantively revised its

Initial Determination to change rates for bundled service offerings, adopting by "default" a rule the Copyright Owners did not propose during the hearing. Rehearing Order at 18 (JA___). Second, the Majority made its new rates and terms effective retroactive to January 1, 2018. No statutory provision authorized retroactive rate-making.

This Court should vacate the Majority's determination and remand for the Board to establish a rate structure and rate levels that are based on the record, are consistent with the Board's statutory mandate, and will work to benefit consumers, copyright owners, and service providers alike.

JURISDICTIONAL STATEMENT

The Board had jurisdiction under 17 U.S.C. §§ 115(c) and 801(b)(1). This Court has jurisdiction under 17 U.S.C. § 803(d)(1). The Final Determination was published on February 5, 2019. 84 Fed. Reg. 1918. The Services' March 7, 2019 notices of appeal were timely under 17 U.S.C. § 803(d)(1).

STATUTES AND REGULATIONS

Pertinent statutes and regulations are reproduced in an addendum.

STATEMENT OF ISSUES

1. Whether the Majority erred in adopting a rate structure that was not proposed during the hearing and, therefore, deprived the parties of their right to adduce rebutting evidence; is not justified by a reasoned explanation; and is not supported by substantial evidence.

2. Whether the Majority erred by failing to give a reasoned explanation for the rates it selected and by applying the statutory rate-setting factors in an arbitrary and capricious manner that was not supported by substantial evidence.

3. Whether the Majority's revision of the "Service Revenue" definition for bundled offerings is invalid because the Judges lacked authority to revise the definition adopted in the Initial Determination and because the revision is not supported by substantial record evidence.

4. Whether the Majority erred in giving the new rates and terms a retroactive effective date despite lacking statutory authority to do so.[1]

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[1] Spotify does not join this argument.

STATEMENT OF THE CASE

A. The Emergence and Growth of Interactive Music Streaming Services

At the turn of the century, piracy was devastating the music industry. Final Determination at 83 (JA___). That devastation was exacerbated by a shift in legal distribution from album sales to individual song downloads. Consumers were able to purchase only the specific songs they wanted, rather than entire albums, which meant a loss of revenue from albums' less popular songs. *Id.*

The emergence of interactive streaming services reversed the fortunes of the music industry. By the mid-2000s, it was already clear that interactive streaming would become a highly important form of music delivery. TR3693:14-3694:12 (JA___) (NMPA President/CEO David Israelite testimony); EX697 ¶ 6 (JA___) (Google's Zahavah Levine testimony).

Interactive streaming services offer consumers unlimited, on-demand access to a vast library of recordings in exchange for a fixed, monthly fee. Dissent at 111 (JA___). More recently, services have introduced offerings at varying price points, including "limited offerings" with a smaller catalog or reduced functionality, advertisingsupported tiers, and bundles that combine music streaming with other valuable products or services. Final Determination at 3, 8, 10 (JA___, ___, ___). These diverse offerings attract consumers with varying willingness to pay for music and thereby "grow the pie" of both industry revenues and royalties paid to rightsholders.

The growth of streaming has stabilized the music industry and caused rightsowners' revenues to start increasing again. EX1070 ¶¶ 12-17 (Services' expert Dr. Zmijewski testimony) (JA___-___). Moreover, the number of songwriters and the number and rate of growth of new musical works are all increasing. TR1120:2-1121:23 (JA___) (Google's expert Dr. Leonard testimony). The supply of music available for public consumption has never been greater. Final Determination at 7 (JA___).

Despite all this, no interactive streaming service has ever achieved sustained profitability. EX692 ¶ 16 (JA___) (Levine testimony); EX885 ¶ 64 (JA___) (Pandora's expert Dr. Katz testimony). Instead, the businesses that offer these services have reported losses in the hundreds of millions of dollars, and most entities that have entered the marketplace have failed. EX692 ¶ 16 (JA___) (Levine testimony);

EX696 ¶ 27 (JA___) (Services' expert David Pakman testimony); EX885 ¶ 65 (JA___) (Katz testimony). The biggest obstacle to achieving profitability has been the combined royalties that services must pay for the rights to stream music—payments that exceed 70% of their revenues. Final Determination at 73 (JA___); *see also* EX692 ¶ 16 & n.1 (JA___) (Levine testimony). These royalties include not just the compulsory mechanical license fees at issue here, but also fees to Copyright Owners for the rights to publicly perform the same musical works and fees to record labels that own the sound recordings of those works. Final Determination at 9 (JA___).

B. Statutory and Regulatory Background

1. The Compulsory License for Mechanical Rights and Other Licenses Obtained by Interactive Streaming Services

The Copyright Act provides owners of musical works and sound recordings the exclusive rights to reproduce, distribute, and publicly perform their works. 17 U.S.C. § 106. The rights to reproduce and distribute copyrighted musical works on phonorecords (which include CDs, digital downloads, and other audio-only material objects in which sounds are fixed), known as "mechanical" rights, are subject to a compulsory license—the license at issue here. *Id.* § 115. The separate right to publicly perform musical works is not subject to a statutory license and is typically obtained through licenses with performing rights organizations that license those rights collectively on behalf of affiliated publishers and songwriters. *See, e.g.*, EX885 ¶ 49 (JA___) (Katz testimony).

The copyrights relating to sound recordings are typically held by record labels. The rights to reproduce, distribute and publicly perform sound recordings are not subject to a compulsory license for interactive streaming services. The Services acquire those licenses from labels through individual negotiations. Dissent at 3 (JA___).

2. The Board's Rate-Setting Function

Congress assigned the task of setting statutory rates for mechanical rights to the Board, a three-judge administrative body within the Library of Congress. 17 U.S.C. §§ 115(c)(1)(E), 801. The Board commences a rate-setting proceeding every fifth year. *Id.* § 804(b)(4). Absent a settlement, the Board must determine rates and terms using a statutory standard.[2] Specifically, the Judges are to

[2] The Section 801(b)(1) standard was recently amended by the Music Modernization Act, Pub. L. No. 115-264, 132 Stat. 3676 (2018). That amendment is not applicable here.

determine "reasonable terms and rates of royalty payments" that achieve the following objectives: (A) "maximize the availability of creative works to the public"; (B) afford both "the copyright owner a fair return" and "the copyright user a fair income"; (C) "reflect the relative roles of the copyright owner and the copyright user in the product made available to the public"; and (D) "minimize any disruptive impact on the structure of the industries involved." *Id.* § 801(b)(1) (2006).

C. The Evolution of the Prevailing Mechanical License Rate Levels and Structure

1. The Phonorecords I Settlement

In 2006, the Board commenced *Phonorecords I*. Following years of negotiations, copyright owners and streaming services reached a settlement on applicable rates and terms. EX692 ¶ 33 (JA___) (Levine testimony); EX875 ¶ 7 (Parness testimony); EX3030 ¶ 5 (JA___) (Israelite testimony); EX6013 (JA___) (*Phonorecords I* settlement). The Board adopted the *Phonorecords I* settlement as Subpart B of 37 C.F.R. § 385, which took effect on March 1, 2009. *Phonorecords I*, 74 Fed. Reg. at 4510, 4514-15.

A key aspect of the settlement was that the "headline" mechanical royalty rates would be "all-in" from the services' point of view—that is, services would be able to deduct the amounts paid for the right to perform musical works from the amount they would otherwise owe for mechanical royalties. EX692 ¶ 35 (JA___) (Levine testimony). The new rates were structured as a percentage of revenue and set at a level—10.5%—that all parties deemed acceptable for the combination of mechanical and performance rights. EX875 ¶ 7 (JA___) (Parness testimony).

To protect copyright owners, the settlement also included a second rate prong with minimum payment thresholds. Those minimums included a capped percentage of a service's total royalty payments to record labels for the rights to perform the associated sound recordings, referred to as "total content cost" or "TCC." If the specified percentage of TCC was greater than 10.5% of revenue, that greater amount would apply up to a fixed, per-subscriber, per-month cap. *Id.* ¶ 8 (JA___); EX3030 ¶ 20 (JA___) (Israelite testimony). Lower minimums applied to service offerings with less interactivity or a limited catalog. EX875 ¶ 8 (JA___) (Parness testimony); *see also* 37 C.F.R. § 385.13 (2009) (reflecting minimums). The settlement also included a "floor" for mechanical rights royalties even after deducting performance rights payments. EX875 ¶ 9 (JA___) (Parness testimony).

While interactive streaming services reached a settlement for Subpart B, the recorded music industry and the Copyright Owners proceeded to trial to establish rates for the rights to reproduce and distribute musical works embodied in physical phonorecords and digital downloads. The Judges set this rate at the greater of $0.091 per track or $0.0175 per minute of playing time, *Phonorecords I*, 74 Fed. Reg. at 4510, and it was embodied in Subpart A of 37 C.F.R. § 385.

2. The Phonorecords II Settlement

In 2011, the Board commenced *Phonorecords II*, which settled after a year of negotiations. TR172:7-12 (JA___) (Levine testimony); TR3756:25-3757:23, 3760:8-3761:6 (JA___) (Israelite testimony). That settlement extended the existing *Phonorecords I* royalty rates and structure for interactive streaming services covered by Subpart B with only minor changes and also set rates for additional new types of services that had emerged. EX875 ¶¶ 13-14 (JA___) (Parness testimony); EX692 ¶¶ 38-39 (JA___) (Levine testimony). With respect to Subpart A rates for CDs and digital downloads, the record industry and the Copyright Owners agreed to continue the *Phonorecords I* rates without change. The Board adopted the parties' settlements, effective January 1, 2014, and with no fixed termination date. *Phonorecords II*, 78 Fed. Reg. at 67,938-39.

D. The Agreement to Continue Mechanical License Rates for CDs and Digital Downloads Until 2022

Shortly after *Phonorecords III* commenced, the record industry and the Copyright Owners reached a settlement to maintain the existing Subpart A rates and terms pertaining to mechanical rights in digital downloads of sound recordings for another five years. The agreement reflects the Copyright Owners' and record industry's view of the appropriate compensation to Copyright Owners for their contributions to sound recordings of musical works relative to the contributions of the labels and performing artists. EX698 ¶ 27 (JA___) (Leonard testimony); EX3014 ¶¶ 20-26 (JA___-___) (Israelite testimony). The Board adopted the settlement. Subpart A Ruling at 15,297-99 (JA___).

E. The Copyright Royalty Judges' Determination

1. The Majority's Initial Determination

On January 26, 2018, the Judges issued their Initial Determination: a majority opinion signed by then-Chief Judge Barnett and Judge Feder, and a more-than-150-page dissenting opinion and alternative rate determination by Judge Strickler. The Majority adopted a new rate structure and a rate increase of at least 44% as compared to the *Phonorecords II* rates. Initial Determination at 1, 34-35, 88 (JA___, ___-___, ___).

Under the new rate structure, services pay an "all-in" rate for mechanical and performance rights for musical works determined by the greater of: (i) a percentage of service revenue and (ii) a percentage of services' payments to record labels for the right to stream the associated sound recordings (as explained above, TCC). *Id.* at 1 (JA___).[3] The Majority phased the increase in over the five-year period:

[3] Both prongs are subject to per-subscriber floors for certain offerings carried over from the *Phonorecords II* settlement.

	2018	2019	2020	2021	2022
Percent of Revenue	11.4%	12.3%	13.3%	14.2%	15.1%
Percent of TCC	22.0%	23.1%	24.1%	25.2%	26.2%

Id.

Unlike the structure agreed to in the prior settlements, the new structure eliminated the caps on the TCC rate prong. When that prong controls, the mechanical royalty rate will increase whenever record labels demand and obtain a higher royalty rate for sound recording rights.

No party proposed this rate structure during the proceeding, and no party had an opportunity to rebut it. The Majority ascribed the rate structure to a proposal made by Google in a post-hearing filing but admitted that it "modif[ied]" Google's proposal in significant respects, including by setting substantially different rates. *Id.* at 36-37 (JA___-___).

Nor did any participant propose the rate levels adopted. The Majority rejected using the *Phonorecords II* settlement or the recent Subpart A settlement as benchmarks. *Id.* at 55-62 (JA___-___). The Majority instead looked to "Shapley value" analyses offered by three expert economists. *Id.* at 62-75 (JA___).[4] But the Majority did not adopt any one of the analyses the expert economists offered. Rather, it criticized each of the three analyses but nonetheless combined discrete aspects from each to derive its own range of reasonable rates and then arbitrarily selected the midpoint within that range. *Id.* at 70-75 (JA___-___).

The Majority dismissed the dissenting judge's concern that removing the cap on TCC-prong rates would "leave the services exposed to the labels' market power." *Id.* at 35 n.74 (JA___). It reasoned that the record labels already can put the services out of business if they choose to do so, so "[u]ncapping the TCC rate prong does not change that." *Id.* The Majority assumed that record labels—which are not subject to compulsory licensing or other rate regulation with respect to interactive streaming—would voluntarily lower their rates to accommodate the increased mechanical royalties, to "ensure the

[4] A Shapley value analysis is a game-theory model that attempts to value the contribution of each "player" in a joint enterprise to fairly allocate the profits among the players (here, services, the music publishers, and the record labels). Initial Determination at 62 (JA___).

continued survival and growth of the music streaming industry." *Id.* at 73 (JA___).

The Initial Determination retained the existing rule defining "Service Revenue" for bundles in which customers pay a single price for both a subscription streaming service and other products or services. *See* Initial Determination Attach. A at 7-8 (§ 385.2 ("Service Revenue" definition, subpart 5)) (JA___-___); *compare* 37 C.F.R. § 385.11 (2009). The Services had proposed retaining this definition and offered testimony that bundles result in higher revenues—and, therefore, higher royalties—because the discounted price entices customers who otherwise would not subscribe. *See* Initial Determination at 20-21 & n.49 (JA___-___). The Copyright Owners had not proposed revising this "Service Revenue" definition. *See id.* at 92 (JA___).

2. The Dissent

In his dissent, Judge Strickler—who occupies the Board position reserved by statute for an individual with "significant knowledge of economics," 17 U.S.C. § 802(a)—explained why he would have maintained the *Phonorecords II* rates and rate structure. Initial Dissent at 12-13 (JA___-___). Judge Strickler objected to adopting a "rate structure [that] was never proposed by any party *during* the proceeding," and observed that, by creating and adopting its own rate structure, the Majority "created a real risk of economic harm that the parties were not able to address." *Id.* at 1, 3 (JA___, ___). He explained that, "[b]ecause it is the *combination of rates* that is crucial, the majority erred by plucking two rates from the record, combining them post-hearing, and then wrongly declaring that this 'mash-up' was actually based on the record." *Id.* at 2 (JA ___).

Judge Strickler further criticized the Majority for uncapping the TCC rate prong, because record labels "exercise their economic power to demand rates that embody their 'complementary oligopoly' status." *Id.* at 3 (JA___). He recognized that eliminating this cap means that, whenever record labels use this power to obtain higher rates, the mechanical royalty rate "*must increase as well*." *Id.* Judge Strickler also concluded that, by eliminating the TCC cap, the Majority had not determined the statutory rates but rather had improperly ceded rate-setting authority to private record companies. *Id.* at 10 (JA___).

With respect to the rate levels, Judge Strickler concluded that the evidence did not support the Majority's rate increase. *Id.* at 10-12

(JA___-___). He described the Majority's assumption that sound recording royalties would eventually decrease to accommodate the increased payments to Copyright Owners as "a combination of naiveté and wishful thinking." *Id.* at 4 (JA___). And Judge Strickler found that the rate increase would be disruptive. *Id.* at 146-48 & nn.199-200 (JA___-___). Noting that the Majority had acknowledged the increase was "so draconian that it cannot be implemented immediately," Judge Strickler also found there was no evidence that phasing in the increase over five years would ameliorate the disruption. *Id.* at 152 (JA___).

3. The Rehearing Order

Following the Initial Determination, the Copyright Owners filed a motion seeking for the first time to revise the "Service Revenue" definition for bundled offerings. *See* Copyright Owners' Mot. at 13 (JA___). The Majority, in another decision that Judge Strickler did not join, granted that motion, even though the Majority found that the Copyright Owners had "not me[t] th[e] exceptional standard for granting rehearing motions" under 17 U.S.C. § 803(c)(2). Rehearing Order at 2 & n.3 (JA___).

To justify changing the rule, the Majority stated that "neither party presented evidence adequate to support the approach it advocates" for bundles. *Id.* at 17 (JA___). The Majority then asserted that the Services bore the burden of justifying the existing rule. *Id.* at 17-18 (JA___-___). Finding the Services had failed to carry that burden, the Majority concluded that, "[b]y default," it "must adopt an approach to valuing bundled revenue that is in line with" the Copyright Owners' proposal. *Id.* at 18 (JA___).

4. The Final Determination

On November 5, 2018, the Judges issued their Final Determination, which included both a Majority opinion and Judge Strickler's lengthy dissent. The Final Determination incorporated by reference the reasoning and rulings from the Rehearing Order and also included portions of that order. Final Determination at 2 (JA___).

The Final Determination made the new rates and terms effective retroactive to January 1, 2018. *Id.* at 1 (JA___). When the Board released the Initial Determination, its website stated that the *Phonorecords III* rates and terms "will apply from the date the determination becomes final." JA___; *see* 17 U.S.C. § 803(d)(2)(B). In the Final Determination, the Majority asserted that all parties had "designat[ed] . . . the rate period as January 1, 2018 through December 31, 2022," and described those dates as the "agreed rate period." Final Determination at 1 (JA___). But in fact the Services had stated that "January 1, 2018 . . . will actually be the effective date only if the Judges publish their determination in the Federal Register in November of 2017." Services' Joint Reply at 487 (JA___). The Final Determination was published in the Federal Register in February 2019. *Phonorecords III*, 84 Fed. Reg. at 1918 (JA___).

SUMMARY OF ARGUMENT

The Copyright Act directs the Board to "make determinations and adjustments of reasonable terms and rates of royalty payments." 17 U.S.C. § 801(b)(1). The Majority failed to do so in four key ways.

First, the Majority adopted a rate structure and rate levels no party proposed during the hearing. The parties had no opportunity to present or rebut evidence concerning the structure and rates selected. The Majority thus violated the Copyright Act and the APA. This Court has vacated similar Board actions. Moreover, the Majority compounded this error by structuring the rate as an uncapped percentage of the amount that record labels with significant market power are able to extract from interactive streaming services in private transactions—an impermissible abdication of the Board's rate-setting authority.

Second, the Majority arbitrarily mixed and matched rates from experts' economic models to derive new rates proposed by no party, supported by no expert, and acknowledged by the Majority itself to be disruptive to the industry. In evaluating these rates under the statutory objectives, the Majority misapplied the relevant factors and inadequately addressed the disruptive impact of the rate increase. And the Majority failed to consider available benchmarks. The result was arbitrary and capricious and not supported by the record.

Third, despite concluding that the Copyright Owners had not met the high statutory bar for rehearing, the Majority nevertheless made substantive changes to the Initial Determination's "Service Revenue" definition for bundled offerings. The Majority exceeded its limited statutory rehearing authority.

Fourth, the Majority exceeded its statutory authority by giving retroactive effect to the rates and terms. The Copyright Act provides that where, as here, rates and terms currently in effect "do not expire on a specified date," new rates "shall take effect on the first day of the second month that begins after the publication of the determination . . . in the Federal Register." 17 U.S.C. § 803(d)(2)(B). Retroactive rate-setting violated this clear statute.

STANDARD OF REVIEW

This Court "review[s] determinations of the [Board] under the familiar standard of the Administrative Procedure Act." *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 574 F.3d 748, 755 (D.C. Cir. 2009). The Court must vacate agency action that is "arbitrary, capricious, contrary to law, or not supported by substantial evidence." *Id.* The agency must explain its decision "sufficient to enable [the Court] to conclude that [it] was the product of reasoned decisionmaking." *Jicarilla Apache Nation v. U.S. Dep't of Interior*, 613 F.3d 1112, 1118 (D.C. Cir. 2010) (second alteration in original). And the agency's decision must be supported by record evidence that a "reasonable mind might accept . . . as adequate to support a conclusion." *Dickinson v. Zurko*, 527 U.S. 150, 162 (1999).

Furthermore, the APA applies to the Board's hearings. Each party must be given a fair opportunity "to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts." 5 U.S.C. § 556(d). When a party is "afforded no opportunity during the hearing to test [or] examine the methodology the [agency] ultimately adopted," the agency decision must be vacated. *Mail Order Ass'n of Am. v. U.S. Postal Serv.*, 2 F.3d 408, 429-30 (D.C. Cir. 1993).

STANDING

Each Service has standing because it participated in the proceedings below or is the successor to a participant, is bound by the Final Determination, and is a licensee of copyrights in musical works distributed by interactive streaming.

ARGUMENT

I. THE MAJORITY ADOPTED A RATE STRUCTURE THAT IS PROCEDURALLY AND SUBSTANTIVELY UNLAWFUL

The Majority's two-pronged rate structure requires services to pay the greater of (a) a percentage of the service's revenues, or (b) a percentage of the service's TCC, defined as the total royalties paid to record labels for the use of sound recordings.

But this structure has a critical difference from the *Phonorecords I* and *II* settlements: those agreements capped the TCC prong rates—for example, $0.80 per subscriber per month. Dissent at 27 (JA___). The Majority eliminated the cap, which makes the TCC-calculated rate entirely dependent on royalty payments demanded by record labels.

The adoption of an uncapped TCC rate was unlawful for three basic reasons. *First*, the uncapped TCC structure was not proposed before or during the hearing, and the parties had no opportunity to present evidence demonstrating the flaws in that approach. That straightforward violation of the Services' procedural rights, 5 U.S.C. § 556(d), alone warrants vacatur.

Second, the Board must determine "reasonable terms and rates of royalty payments." 17 U.S.C. § 801(b). A rate structure cannot qualify as "reasonable" if rate levels are uncapped and are pegged solely to transactions with private parties that exercise market power. Here, the TCC rate prong depends on terms record labels obtain as a result of their "economic power to demand rates that embody their 'complementary oligopoly' status." Dissent at 3 (JA___). The Majority thus ceded its "reasonable terms and rates" decision "to a market actor" with "market power" that is "economically adverse" to the Services. *Id.* at 4-5 (JA___-___).

Third, the Majority's justifications for uncapping the TCC prong fall far short of the reasoned explanations that the APA requires.

A. The Majority Unlawfully Adopted a Rate Structure on Which the Parties Had No Opportunity To Be Heard

The Dissent cogently explained that "[t]he Majority does not deny that [its chosen] rate structure was never proposed by any party during the proceeding." Dissent at 1 (JA___). The APA, however, guarantees each party a fair opportunity "to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts." 5 U.S.C. § 556(d); *see* 17 U.S.C. § 803(a)(1) (APA procedural requirements apply to Board hearings). When a party is "afforded no opportunity during the hearing to test, or even examine, the methodology the [agency] ultimately adopted," the agency decision must be vacated. *Mail Order Ass'n*, 2 F.3d at 430; *see Settling Devotional Claimants v. Copyright Royalty Bd.*, 797 F.3d 1106, 1121 (D.C. Cir. 2015); *Intercollegiate Broad. Sys.*, 574 F.3d at 767. Because no such opportunity was afforded here, the Board's decision should be vacated.

This Court has twice vacated Board decisions for failing to provide parties with an opportunity to respond to propositions or methodologies embraced by the Board. In *Intercollegiate Broadcast System*, the Court vacated the Board's decision to set at $500 a minimum annual fee intended to cover SoundExchange's administrative costs. 574 F.3d at 767. The Court criticized the Board for, among other things, justifying that fee based on "a theory first presented in the Judges' determination and not advanced by any participant." *Id.* at 87. In *Settling Devotional Claimants*, the Court found that the Board had repeated that error, this time while allocating royalties for transmissions on cable television. Unwilling to utilize any methodology offered during the hearing, the Board invented its own methodology. The Court found that Board again acted unlawfully because its methodology was "first presented in the Judges' determination and not advanced by any participant" during or before the hearing. 797 F.3d at 1121.

This Court has also reversed other agencies for failing to abide by the basic APA rule that an agency cannot reach a result of which the parties to a hearing had no notice or opportunity to present evidence. *See Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004, 1012 (D.C. Cir.

2005) ("FERC's power to [add a premium to rates] does not carry with it the authority to exercise such power without adequate notice of the basis for doing so," which would afford the parties the opportunity "to present evidence on the issue"); *Williston Basin Interstate Pipeline Co. v FERC*, 165 F.3d 54, 64 (D.C. Cir. 1999) (due process violated by selecting a rate using FERC staff's estimates of GDP growth, where "[n]o party at the hearing had presented, advocated, or even mentioned" the use of GDP data).

Here, as in the cases cited above, the Majority adopted a rate structure that no party advocated during or before the hearing. The Majority claimed it was "adopt[ing] Google's proposed rate structure" but that proposal first appeared after the hearing record had closed—and therefore no party had the opportunity to adduce fact or expert evidence regarding that structure. Final Determination at 36 & n.79 (JA___). Moreover, the Majority "modif[ied]" Google's proposal in significant respects, including by establishing rates far higher than Google's proposal. Final Determination at 36 (JA___). But Google warned of serious adverse consequences if its proposed structure were paired with higher rate values—and expressly stated that its proposal was presented as a package and should be disregarded if the Judges decided not to adopt the full proposal. Google's Proposed Findings of Fact ¶¶ 8, 73 (JA___, ___); TR6158:4-25 (JA___).

Judge Strickler recognized the Majority's error, stating that the Board "must choose among the rates and structures proposed by the parties, or reasonably ascertainable from the evidence through an evidentiary process that the parties were permitted to consider, challenge and rebut at the hearing." Dissent at 116-17 (JA___-___). It "subvert[s] the entire adversarial process" to "insert[] a new proposal after the record ha[s] closed." *Id.* at 2 n.4 (JA___). The Majority's violation of the Services' rights under the APA requires vacatur.

B. The Majority's Uncapped Rate Structure Violates Its Statutory Obligation To Set Reasonable Rates

1. An Uncapped Rate That Is Not Constrained by a Competitive Market Is Not "Reasonable"

Congress directed the Board "[t]o make determinations . . . of reasonable terms and rates of royalty payments." 17 U.S.C. § 801(b). A rate structure violates this standard if rate levels are uncapped and depend entirely on decisions by private actors not constrained by sufficient market competition.

When Congress "subject[s] producers to regulation because of anticompetitive conditions in the industry," the "prevailing price in the marketplace cannot be the final measure of 'just and reasonable' rates." *Fed. Power Comm'n v. Texaco Inc.*, 417 U.S. 380, 397, 399 (1974).[5] Setting an uncapped rate tethered to a non-competitive market and "rely[ing] solely on [those] market forces to evaluate rates" is plainly inconsistent with Congress's purpose of lessening the impact of anticompetitive forces. *Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cty., Wash.*, 554 U.S. 527, 546 (2008).

This Court, accordingly, has held it unreasonable for an agency to set rates based on the premise that entities with market power will simply refrain from using it. In *Air Transport Association of America v. Department of Transportation*, this Court vacated a rate standard that allowed airports to use "any reasonable methodology" in setting rates

[5] Congress established the compulsory license for mechanical rights specifically to prevent the emergence of a "great music monopoly." H.R. Rep. No. 60 2222, at 6 (1909); *see also Nimmer on Copyright* § 8.04(E)(1) ("[T]he Congress that enacted the current [1976] Act concluded that 'a compulsory licensing system is still warranted as a condition for the rights of reproducing and distributing phonorecords of copyrighted music.'" (citing H.R. Rep. No. 94-1476, at 107 (1976))).

for non-airfield fees. 119 F.3d 38, 41 (D.C. Cir.), *amended on rehearing on other grounds*, 129 F.3d 625 (D.C. Cir. 1997). The challengers argued that the standard allowed "airports to use their market power to charge airlines excessive amounts." *Id.* at 41. The agency asserted that if any airports had market power, they "will not use it." *Id.* at 42. This Court found that the agency had not "adequately explained how those generally unspecified restraints" on airports with market power "will ensure, in the absence of meaningful guidelines, that non-airfield fees are reasonable." *Id.* at 43. In other words, the agency had to demonstrate that market forces would actually constrain rate levels before the Court could uphold the rates as reasonable. *See Consumers Energy Co. v. FERC*, 367 F.3d 915, 922-23 (D.C. Cir. 2004) (explaining that market-based rates for energy prices are "just and reasonable" "only if the seller and its affiliates do not have, or adequately have mitigated, market power").

Here, the record labels operate as a "complementary oligopoly" and charge supra-competitive rates. Dissent at 3 (JA___); EX886 ¶¶ 56, 93 (JA___, ___) (Katz testimony); EX1069 ¶¶ 137-41 (JA___-___) (Spotify Director of Economics Will Page testimony); EX132 ¶¶ 6.26-

6.27 (JA___-___) (Amazon's expert Dr. Hubbard testimony); EX698 ¶¶ 24, 44 (JA___, ___) (Leonard testimony). As Judge Strickler observed, the Board in a recent proceeding unanimously "explained at length . . . th[e] complementary oligopoly" power held by record labels. Dissent at 100 (JA___). There, the Board found that the supra-competitive rates obtained by record labels "through the exercise of overwhelming market power" in unregulated transactions should not be allowed to infect statutory rate setting and so made "an adjustment . . . to eliminate the complementary oligopoly effect," which this Court affirmed. *SoundExchange, Inc. v. Copyright Royalty Bd.*, 904 F.3d 41, 53, 56-57 (D.C. Cir. 2018); *see also Air Transp. Ass'n of Am.*, 119 F.3d at 43 (vacating decision because it was "internally inconsistent" to rely on premise "that public airports are not profit maximizers" when the agency had itself recognized the opposite in different context).

By adopting a rate structure with an uncapped TCC prong, the Majority "ceded control over the statutory rates" to "the record companies." Dissent at 9-10 (JA___-___). "[W]henever the record companies demand and obtain a higher sound recording royalty rate"—which they can through their "economic power to demand rates that embody their 'complementary oligopoly' status"—the "mechanical royalty rate *must increase as well*." *Id.* at 3 (JA___). The "injury to the services" from turning rate-setting over to "record companies with 'must have' repertoires" is "easily demonstrated." *Id.* at 4, 10 (JA___, ___); *see id.* at 4 (demonstrating that ability) (JA___).[6]

Neither the Copyright Act nor the APA allows the Board to discharge its statutory responsibility to set reasonable rates by making them entirely dependent on supra-competitive prices obtained by third-party private companies exercising substantial market power. Dissent at 10-12 (JA___-___); *cf. U.S. Telecom Ass'n v. FCC*, 359 F.3d 554, 565 (D.C. Cir. 2004) (explaining that unlike "subdelegation to a *subordinate*" federal officer or agency—which is presumptively permissible—"subdelegation to an *outside party*" is "assumed to be improper absent an affirmative showing of congressional authorization").

[6] In contrast, the capped TCC prong in the *Phonorecords II* settlement—which Judge Strickler would have continued—"place[s] a limit on the . . . effect of the record companies' market power." Dissent at 4 (JA___).

2. *The Linchpin for the Majority's Justification of the Uncapped Rate Structure—Its Reliance on the "See-Saw" Effect—Is Fatally Flawed*

The Majority was "sanguine as to the impact of the uncapped TCC prong," Dissent at 7 (JA___), because it concluded that "sound recording royalty rates in the unregulated market will decline in response to an increase in the [mechanical] license rate," Final Determination at 73-74 (JA___-___). The decision to adopt an uncapped TCC prong was therefore entirely dependent on the "heroic assumption that the major record companies will docilely accept millions of dollars in lost revenue" by voluntarily agreeing to "lower sound recording royalties"—the "see-saw" effect. Dissent at 7 (JA___). The Dissent rightly called this "a combination of naiveté and wishful thinking." *Id.* at 4 (JA___).

The Majority's embrace of that fanciful theory requires vacatur, for two reasons.

First, the Majority provided no "satisfactory explanation," *Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983), for its facially implausible assumption. The Majority reasoned that, as "must-have suppliers in an unregulated market, record companies are [already] in a position to walk away from negotiations with the Services and, effectively, put them out of business," and the fact that "they have not [yet] done so demonstrates that it is not in their economic interest to do so." Final Determination at 74 (JA___).

As the Dissent explained, with an uncapped TCC prong, "the record companies may decide to keep their rates high despite the increase in mechanical rates, or decide it is in their interest to [create] a completely different paradigm for streaming" by creating "in-house" streaming services "and effectively destroy[ing] the existing services." Dissent at 4 (JA___). The Majority's failure to even acknowledge this "important aspect of the problem before it" renders its reasoning fatally deficient. *Jicarilla Apache Nation*, 613 F.3d at 1118. And its "lack of any coherent explanation countering the concerns" its ruling obviously raises is yet another basis for reversal. *Clark County v. FAA*, 522 F.3d 437, 443 (D.C. Cir. 2008).

Second, there is no factual evidence in the record to sustain the Majority's hypothesis that record labels would voluntarily lower their rates. As the Dissent explained, "no witness could state whether this see-saw effect would occur, and there were no witnesses from the record companies who testified that the record companies would impotently acquiesce to a significant loss in royalties to accommodate the diversion of a huge economic surplus . . . to the Copyright Owners." Dissent at 8 (JA___).

Indeed, the record shows that "the record companies' strategy has been to extract all of the services' surplus," even though the Services have not been able to return a profit even at the existing, substantially lower, mechanical rate levels. Dissent at 149 n.198 (JA___); EX693 ¶ 20 (Google Play Music Director of Product Management Paul Joyce acknowledging that rates are "too high" for Services to be profitable in current market conditions). And even one of the Copyright Owners' own experts refused to agree that the "see-saw" effect would happen, "underscor[ing] the tenuous nature of the see-saw hypothesis." Dissent at 7 (JA___).

Because there was no evidence—let alone "substantial evidence"—supporting the Majority's core premise for why its chosen rate structure is "reasonable," its decision must be vacated. *Pasternack v. Nat'l Transp. Safety Bd.*, 596 F.3d 836, 839 (D.C. Cir. 2010) (explaining that "the Board having entertained" a counter-argument against its ruling, "and having rejected it on a ground not supported by substantial evidence, we are constrained to vacate the Board's decision").

3. *The Majority's Other Justifications for an Uncapped TCC Prong Lack Merit*

Even if the Majority's uncapped TCC prong could qualify as reasonable because there were some constraint on the record labels' ability to exercise market power, its adoption should be set aside because the Majority failed to provide a reasoned explanation for its decision to eliminate that cap.

First, the Majority asserted that an uncapped TCC prong is the "most direct means" of reducing "the ratio of sound recording royalties to musical works royalties." Final Determination at 35 (JA___). But the agency failed to balance any benefits from "directness" against the harms of its chosen approach, and explain why it adopted that approach over "reasonably obvious alternatives." *Pub. Citizen v. Steed*, 733 F.2d 93, 99 (D.C. Cir. 1984). As shown above, the Majority's "most direct means" "leaves the services exposed to the labels' market power." Final Determination at 35 n.75 (JA___). The Majority's only response to this concern was to assert that "the services are already exposed to the labels' market power"—but as also shown above, that fails to grapple with the ways in which the new rate structure may cause the labels to use that "market power" differently. *Id.*[7]

Second, the Majority stated that an uncapped TCC prong discourages "revenue deferral": the pursuit of "scale over current revenue." *Id.* at 35 (JA___). But, as Judge Strickler observed, a rate structure with a capped TCC prong, like the *Phonorecords II* settlement, achieved the same goal, through a "structure that provide[d] alternate rate prongs and floors, below which the royalty revenue cannot fall." Dissent at 61 (JA___). The Majority had no response.

Third, the Majority asserted that its approach would "reduce the Rube-Goldberg-esque complexity and impenetrability" of the *Phonorecords II* settlement. Final Determination at 35-36 (JA___-___). But the Majority's simplification came from "merg[ing] ten separate rates for different service offerings into a single rate," not from uncapping the TCC prong. *Id.* at 36 (JA___). Moreover, the fact that

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[7] The Majority also stated that it "cannot allow" the "concern" regarding the labels' market power "to grow into a form of paralysis, where any change from the status quo is deemed too dangerous to contemplate." Final Determination at 35 n.75 (JA___). But the fear of "paralysis" does not constitute a "reasoned explanation" for the inadequacy of a rate with a cap.

the parties twice voluntarily negotiated—and for ten years operated under—a capped TCC rate prong refutes any contention that it was "impenetrable."

Fourth, the Majority asserted that an uncapped TCC prong "is supported by voluntary agreements that were reached outside the context of litigation." *Id.* Yet "many other . . . [voluntary] agreements contain different rate structures, including the [capped TCC prong] consistent with the 2012 [settlement]." Dissent at 6 (JA___). Judge Strickler correctly characterized as "bewildering" "[t]he majority's reliance" on the few agreements lacking a capped TCC prong, which were negotiated against the background of the *Phonorecords II* settlement. *Id.* at 6-7 (JA___-___).

II. THE ROYALTY RATES ARE ARBITRARY AND CAPRICIOUS, UNEXPLAINED, AND UNSUPPORTED BY SUBSTANTIAL EVIDENCE

The Majority's headline royalty rates fail to conform to the APA's requirements for three reasons.

First, the Majority adopted a mix-and-match methodology that this Court previously has described as "quintessentially arbitrary and capricious." *Settling Devotional Claimants*, 797 F.3d at 1120. Judge

Strickler rejected the Majority's unexplained "mash-up" of incompatible economic models. Dissent at 2 (JA___). This Court should do the same.

Second, the Majority failed to adequately explain how the rates it adopted were based on a proper consideration of each of the four statutory factors it was obligated to assess under Section 801(b)(1).

Third, the Majority provided no reasoned explanation for failing to incorporate any relevant, real-world benchmarks. The Majority's decision to jettison these important indicia of a reasonable rate in favor of a methodology this Court has already rejected is the height of arbitrary and capricious decisionmaking.

Moreover, the Majority's failures with respect to the rates must be considered in combination with its impermissible adoption of the uncapped TCC rate prong. The impermissible rates, together with the insupportable elimination of the cap, combine to create an overall rate methodology that that the Majority could not support with a rational explanation or with substantial record evidence.

A. Picking Elements from Incompatible, Rejected Economic Models Is Foreclosed by Precedent

The Majority adopted a rate-setting methodology that is virtually identical to the one this Court has rejected. As in *Settling Devotional*

Claimants, the Majority here examined multiple expert models, rejected critical elements of each, and then nonetheless used certain inputs and outputs of those models to set the "bounds" of a "zone of reasonableness." Then, without explanation, it simply took the midpoint between the two "bounds."

That methodology, "despite its Solomonic pedigree . . . [is] quintessentially arbitrary and capricious." *Settling Devotional Claimants*, 797 F.3d at 1120. The Board must carefully examine the relevant expert methodologies, resolve competing arguments about their validity and coherently explain its ultimate rate-setting decision. Simply averaging the difference between proposals the Majority found deficient is a clear violation of the rate-setting process.

Moreover, even within that faulty framework, the Majority's choice of the "bounds" for its "zone of reasonableness" reflected a fundamental misunderstanding of the economic tools it was attempting to use. The Majority offered no explanation validating its approach, nor was that approach supported by any evidence, let alone substantial evidence. The Majority's arbitrary rates must be vacated.

1. Settling Devotional Claimants *Prohibits Mixing and Matching Rejected Models*

In *Settling Devotional Claimants*, this Court considered a challenge to the Board's allocation of royalties from retransmissions of copyrighted material on cable television. There, "having rejected every proposed methodology" for distributing royalties, the Board decided that because one party's "proposed allocations were almost equal to the lower bound of the range proposed by the [other party] . . . it would be within the 'zone of reasonableness' to give effect to [that] number." 797 F.3d at 1114, 1120 (citation omitted).

This Court rejected that approach, describing it as a "two wrongs make a right methodology," which combined "percentages that were derived from [an otherwise] discredited methodology" and "allocations derived from a methodology that the [Board] had refused to consider." *Id.* at 1120. By simply "picking a number out" of one proposal "because it happened to roughly coincide with the lowest bound proposed by [another party]," the Board adopted a methodology that fell "beyond the bounds of reasoned decisionmaking." *Id.*

Despite this Court's admonition, the Majority used a virtually identical approach here. The Majority set the bounds of its "zone of reasonableness" by relying upon inconsistent analyses constructed by Professors Marx, Watt, and Gans, each of whom attempted to model a hypothetical negotiation between music services, on the one hand, and Copyright Owners and record labels, on the other. The Majority took issue with each model.

The Majority first found "Professor Marx's model understate[s] what would be a fair allocation of surplus" to Copyright Owners and record labels. Final Determination at 75 (JA___). But instead of either rejecting Professor Marx's model or attempting to quantify the magnitude of her "understatement," the Majority simply considered her "top value for total royalties . . . to constitute a lower bound for total royalties." *Id.*

For the upper bound, the Majority used Professor Watt's total royalty figure. *Id.* Yet the Majority concluded that other aspects of Professor Watt's model could not be relied on because (i) Professor Watt's analysis was "presented as rebuttal testimony, [which] Professor Marx . . . did not have an opportunity to rebut"; and (ii) his analysis was "not adequately explored or explained." *Id.* (giving "no weight" to an aspect of Professor Watt's model for these reasons).

But, again, instead of rejecting Professor Watt's model, the Majority relied on it to set the "upper bound for total royalties." *Id.* Then, to convert Professor Watt's total royalty into a headline rate, the Majority used an input from Professor Gans' model—a model the Majority explicitly *rejected* as unreliable. *Id.* at 70 (JA___).

Settling Devotional Claimants prohibits the Majority's construction of a "zone of reasonableness" by taking some numbers from "discredited methodolog[ies]" and others from "methodolog[ies] . . . [the Judges otherwise] refused to consider." 797 F.3d at 1114, 1120.

Worse still, once the Majority established its "zone of reasonableness," it set the rate by simply choosing the midpoint of the zone. The Final Determination contains no explanation whatsoever for that choice or even an acknowledgment that it made such a facile split, other than a cryptic statement that the Majority took into account "the totality of the evidence presented in th[e] proceeding." Final Determination at 75 (JA___). *Settling Devotional Claimants* also rejected that sort of arbitrary averaging. There, the Board allocated certain royalties in certain years by "simply split[ting] the difference." 797 F.3d at 1121. This Court held that the decision "cannot be sustained," because the Board cannot satisfy the requirement of reasoned decisionmaking by arbitrarily splitting the difference between competing figures in order to "bridg[e] over a lacuna in the record." *Id.*

2. *The Majority Erred in Setting the Bounds of the Zone of Reasonableness*

The fatal flaws in the Majority's mixing-and-matching approach are further demonstrated by the Majority's adoption of arbitrary bounds to its "zone of reasonableness" that were not supported by any expert model or any other evidence.

The Majority determined the lower bound of the zone ([redacted]%) by purporting to adopt the high end of the rates generated by Professor Marx's "alternative analysis." Final Determination at 75 (JA___). Specifically, the Majority took the highest total sound recording and musical works rate generated by the Marx model; split that total royalty between musical works and sound recordings using a ratio it claims was also taken from the same Marx model; and then used that resulting musical works rate as the lower bound of its zone.

But there was no need for the Majority to jump through these hoops. The Marx model already provided a musical works rate. *Id.* at 68 (JA___). Yet without explanation, the Majority arbitrarily replaced the actual sound recording to musical works ratio found in the Marx model with a [redacted]:[redacted] ratio of its own invention, thereby fundamentally distorting the model it was purporting to apply and generating a headline rate of [redacted]% that is significantly higher than the [redacted]%-[redacted]% range of musical works rates determined by the Marx model.[8]

Moreover, the Majority's decision to use an arbitrarily inflated *upper* bound of the Marx model as the *lower* bound of its zone of reasonable rates was similarly unsupported. The Majority asserted that the Marx model understated the "fair allocation of surplus to the upstream content providers" because it used financials from 2015 rather than 2016 and took into account certain "downstream costs" that Professor Watt asserted should have been excluded. *Id.* at 75 (JA___). But the Majority never assessed whether addressing these concerns would materially affect the results. Accordingly, the Majority could not

[8] To derive its ratio, the Majority inexplicably took the highest of all of the musical works rates output by the Marx model ([redacted]%) and compared that to the lowest total royalty rate ([redacted]%). Final Determination 68. Had it instead compared the highest headline rate ([redacted]%) to the highest total royalty ([redacted]%), it would have gotten a very different ratio of [redacted]:1. The Majority did not, and could not, provide a reasoned justification for utilizing the lower ratio.

provide a reasoned basis for using its adjustments to Professor Marx's upper bound as the lower bound for its zone of reasonableness. Doing so was entirely arbitrary.

The Majority likewise erred in constructing the upper bound by taking the total royalty output of Professor Watt's model, and applying a ratio derived by Professor Gans. *Id.* at 70, 75 (JA___, ___). The Majority did not explain why it was appropriate to combine a key element of one expert's model with the result of a different expert's model, particularly when the two models contained incompatible structures, made different assumptions, and used entirely different data inputs.[9]

[9] Professor Watt attempted to model a hypothetical negotiation in a world with three different interactive music services, no other music distribution channels, and a combined publisher/record label entity. EX3034 (JA___). Professor Gans' analysis was entirely different—he simply adopted a per-play rate for sound recording rights calculated by a different expert—Dr. Eisenach—that the Majority explicitly rejected, and made certain adjustments to arrive at a musical works rate. Final Determination at 63 (JA___). Nor did these analyses use the same input data. Professor Gans used a single Goldman Sachs report for his data (that no other expert employed), while Professor Watt started with Professor Marx's data and then modified it in ways that increased the profits allocated to the rightsholders. *Id.* at 69 (JA___); EX3034 (JA___).

Nor was there any evidence that supported the notion that the Majority could perform such mixing and matching and get credible results. The absurdity of the approach used by the Majority to set the bounds of its zone of reasonableness is perhaps most easily demonstrated by its results, which do not overlap with the outputs of any of the models the Majority claimed to embrace.

In sum, it is difficult to imagine a rate-setting decision more riven with confusion, inconsistency, and under-explanation.

B. The Majority Violated Its Obligation To Properly Consider Each of the Section 801(b)(1) Factors

The Board must perform a careful analysis of four statutory factors, and must adequately explain why its chosen rate accounts for each factor. 17 U.S.C. § 801(b)(1). Whatever deference the Board is accorded in its evaluation of the Section 801(b) factors, its decision must be vacated if it "has failed to provide a reasoned explanation" for how it accounted for each factor, or "where the record belies the agency's conclusion." *Petroleum Commc'ns, Inc. v. FCC*, 22 F.3d 1164, 1172 (D.C. Cir. 1994). The Majority failed to satisfy these requirements as to each factor.

1. *The Majority Failed To Properly Consider the Highly Disruptive Effects of the New Rates*

Section 801(b)(1) requires the Judges to "minimize any disruptive impact on the structure of the industries involved." 17 U.S.C. § 801(b)(1)(D) (2006). Here, the Majority recognized the reality of disruption but held that the disruption would be mitigated by a phase-in period or, in the alternative, that the sort of disruption that would occur was irrelevant under the statute. Both lack merit.

Nothing in the record supports the Majority's conclusory and arbitrary assertion that implementing the rate increase over five years will prevent disruption. Final Determination at 88-89 (JA___). These rates could cause a significant disruption to the market, including that record labels could adapt by "mov[ing] the streaming service in-house." Dissent at 4 (JA___). A five-year phase-in does nothing to minimize that disruption, because the source of disruption is the overall cost the Services will have to bear, not *when* that cost is imposed. Because it failed to establish a "rational connection" between the problem it identified (dissolution of the existing Services) and its purported solution (the five year phase-in), the Majority failed to engage in reasoned decisionmaking. *State Farm*, 463 U.S. at 43.

The Majority also opined that this kind of "market fluidity is not the sort of disruption the Judges consider under the fourth 801(b)(1) factor." Final Determination at 74 n.137 (JA___). But the Majority provided no explanation for why certain kinds of disruption are beyond its permissible consideration. Eliminating all existing providers of interactive streaming services, and their substitution with vertically-integrated providers, would "disrupt" the market under a plain reading of that statutory term. Because the Majority wrongly believed that it was *required* to ignore whether its decision may force all existing streaming services from the market, its decision should be vacated.

2. The Majority Failed To Properly Consider Fair Income to and the Relative Roles of the Services

The second statutory factor requires the Board to consider whether the rates "afford the copyright owner a fair return for his or her creative work *and* the copyright user a fair income" while the third factor requires the Board to consider whether the rates "reflect the relative roles of the copyright owner *and the copyright user* in the product made available to the public." 17 U.S.C. § 801(b)(1)(B)-(C) (2006) (emphasis added). Taken together, these factors require the Board to ensure that rates account appropriately for the interests of both copyright owners *and* copyright users. The Majority failed to adequately explain how its rate complied with that statutory mandate. It also improperly focused only on the relative roles and returns of the Copyright Owners and record labels.

The Majority concluded that for the Copyright Owners to receive a fair return on their investment and to be sufficiently compensated for their relative roles they should receive a total royalty of [redacted]% of service revenue. Final Determination at 75, 86-87 (JA___, ___-___). The same models from which the Majority derived this rate showed that the services should keep between [redacted]% and [redacted]% of their revenues after paying out all royalties for both musical works and sound recordings. *Id.* at 75 (JA___).

The Majority's decision, however, ensures that the Services will *not* keep anything close to [redacted]% to [redacted]% of their revenues. That is because, as the Majority recognized, the decision here does not govern the Services' payments to record labels and, while "current observed market rates [paid to record labels] . . . are approximately 60% of revenue," the Majority's models all "yield *lower* royalties for sound recordings." *Id.* at 66, 72 (JA___, ___).

While the Majority addressed what it perceived to be an imbalance between Copyright Owners' revenues earned and record labels' revenues, it did so by ignoring what the very models it drew from had to say about the income and roles of the services. The Majority thus failed to articulate a "rational connection" between "the relevant data . . . and the choice made." *State Farm*, 463 U.S. at 43. Its analysis of these two factors was therefore arbitrary and capricious.

3. The Majority's Determination that the New Rates and Rate Structure Are Necessary To Maximize the Availability of Creative Works Is Not Supported by Substantial Evidence

Section 801(b)(1) also required the Board to set rates that would "maximize the availability of creative works to the public." 17 U.S.C. § 801(b)(1)(A) (2006). The Majority claimed that its rate increase was necessary "to ensure the continued viability of songwriting as a profession." Final Determination at 85 (JA___).

But the Majority acknowledged that its conclusion rested on evidence that was "largely anecdotal and unsupported by sophisticated surveys, studies, or economic theories." *Id.* It found "no evidence in the record that songwriters as a group have diminished their supply of musical works to the public" and that "[n]o participant performed . . . an empirical study" that would provide a basis for a conclusion as to the causal relationship, if any, between mechanical royalty rates and the supply of musical works to the public. *Id.* at 81 (JA___). That evidence is nowhere close to the required "substantial evidence." *Safe Extensions, Inc. v. FAA*, 509 F.3d 593, 604 (D.C. Cir. 2007).

The Majority described its anecdotal evidence as "uncontroverted testimony." Final Determination at 81 (JA___). But the testimony was "controverted." A trial witness for the Copyright Owners, NSAI Executive Director Bart Herbison, admitted that streaming was not the cause of any reduction in the number of professional songwriters. TR2941:5-16 (JA___); *see* TR2955:25-2956:1 (JA___) ("I'm not blaming the loss of songwriters on streaming."); TR2949:5-9 (JA___) ("[M]ost of the decline in professional songwriters occurred well before the rise in popularity of interactive music services.").

The record also contained evidence that the number of songwriters and musical works has been increasing, even at the prevailing rate levels. The number of songwriters (as measured by membership in performing rights organizations such as ASCAP and BMI) has been increasing dramatically in recent years: ASCAP membership grew from

460,000 in 2012 to 570,000 in 2015, while BMI membership has grew from 500,000 in 2012 to 700,000 in 2015. EX885 ¶ 60 (JA___). At the same time, the number of musical works in the repertories of those organizations has grown at a rapid clip, with ASCAP's increasing from 8.5 million works in 2011 to 10 million in 2015 and BMI's increasing by *60%* over the same period, to 10.5 million works in 2015. *Id.* ¶ 61 (JA___).

These upward swings all occurred between 2012 and 2015, when the *Phonorecords II* settlement applied, belying any notion that the anecdotal evidence relied on by the Majority provides insight as to what rates will "maximize the availability of creative works to the public."

C. The Majority's Rejection of Benchmarks Was Arbitrary and Capricious

In rate-setting cases, courts and agencies normally look to benchmark agreements, which provide helpful indicia of how parties in the marketplace value particular rights. *See, e.g.*, *Music Choice v. Copyright Royalty Bd.*, 774 F.3d 1000, 1008-09 (D.C. Cir. 2014). The Board may reject or adapt a benchmark, but it must give a coherent explanation for doing so. *See Intercollegiate Broad. Sys.*, 574 F.3d at 764 (reviewing Board's rejection of benchmark for arbitrariness). Here, the Majority rejected two apt benchmarks without providing the necessary adequate explanation: the *Phonorecords II* settlement and the recent "Subpart A" settlement.

1. The Phonorecords II Settlement

The Majority rejected the prevailing rates as a benchmark for two reasons—neither of which can survive scrutiny.

First, the Majority claimed that the Services failed to justify the use of the prevailing rates as a benchmark because the Services did not "examine in detail the particular rates within the existing rate structure" or "consider the subjective understandings of the parties who negotiated [those rates]." Final Determination at 55 (JA___). But the very purpose of a benchmark is that its existence provides *objective* information regarding the valuation of rights that similar or the same parties have agreed to—there is no reason to look to subjective intent. *See, e.g.*, *SoundExchange, Inc. v. Librarian of Cong.*, 571 F.3d 1220, 1222 (D.C. Cir. 2009) (noting that the Judges had relied on benchmarks as "indicative of the prices that prevail for . . . similar music inputs").

Judge Strickler criticized the Majority on this point, explaining that a bargain struck by the same parties in arm's length negotiations in analogous circumstances satisfies the traditional, objective criteria for a benchmark *regardless* of whether there is evidence of the subjective intentions of the parties. Dissent at 84, 87 (JA___, ___).

Second, the Majority rejected a straw man, asserting, incorrectly, that the Services supported the prevailing rates because they had "relied on the continuation of the existing rates in developing their business models." Final Determination at 56 (JA___). The Services made no such claim.

As Judge Strickler recognized, the Services and their economic experts offered the prevailing rates as a benchmark because those rates are probative of "the economics of the interactive streaming market." Dissent at 49 (JA___). Indeed, he noted that the Services and their experts specifically *disclaimed* the argument that prevailing rates should be adopted simply because they represented the status quo. *Id.*

2. The Subpart A Settlement

The Majority also failed to adequately explain its rejection of the Copyright Owners' recent Subpart A settlement, which sets mechanical rates for digital downloads of music. Under that settlement, the Copyright Owners agreed that their contribution to the creation of a sound recording ready for digital downloading was worth approximately [redacted]% of record label revenue and approximately [redacted]% of retail revenues. EX695 ¶¶ 42-46 (JA___) (Leonard testimony). The relative contributions of the Copyright Owners (and the record labels) to the creation of a sound recording are the same whether the recording is ultimately downloaded or streamed. The Majority failed to explain why the Copyright Owners, who agreed to receive [redacted]% of record label revenues in the first scenario, should receive up to 26% in the second.

Importantly, the Majority promised to "incorporate" the rates derived from the Subpart A benchmark "into the development of a zone of reasonableness of royalty rates within the rate structure adopted by the Judges in this proceeding," Final Determination at 61 (JA___), but it never did. In fact, the Majority did not even mention the Subpart A rates when it developed its zone of reasonableness. The Majority's conspicuous failure to consider these rates for the purpose it said it would is further evidence that its decision was unreasoned.

III. THE COURT SHOULD REINSTATE THE INITIAL DETERMINATION'S "SERVICE REVENUE" DEFINITION FOR BUNDLES

A. The Judges Lacked Authority To Revise the Initial Determination's "Service Revenue" Definition

Congress has constrained the Board's authority to revise Initial Determinations. Congress allowed the Board to "order a rehearing" only "in exceptional cases" and "upon motion of a participant." 17 U.S.C. § 803(c)(2)(A). Congress also allowed the Board to correct "technical or clerical errors" and, "in response to unforeseen circumstances that would frustrate the proper implementation of such determination," "to modify the terms, but not the rates." *Id.* § 803(c)(4). The Board's rehearing authority is far narrower than Congress has given other agencies, which may grant rehearing on a lesser showing[10] or on their own motion.[11] Congress has thus "spoken directly to" the Judges' authority to revise an initial determination—and its

[10] *See* 47 U.S.C. § 405(a) (FCC may grant reconsideration "if sufficient reason therefor be made to appear").

[11] *See* 16 U.S.C. § 825*l*(a) (FERC may, "upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order").

restrictions are binding. *Air All. Houston v. EPA*, 906 F.3d 1049, 1060 (D.C. Cir. 2018) (per curiam).

The Majority acted outside that limited authority—and, therefore, acted unlawfully—in revising the Service Revenue definition between the Initial and Final Determinations.

First, the Majority recognized that its limited rehearing authority did not apply here. The Majority held that the Copyright Owners had "not me[t] th[e] exceptional standard for granting rehearing motions" in Section 803(c)(2). Rehearing Order at 2 (JA___). And the Majority later confirmed that it "did not treat" the Copyright Owner's "motion[] as [one] for rehearing under 17 U.S.C. 803(c)(2)." Final Determination at 2 n.2 (JA___).

Second, neither of the regulations the Majority cited grants authority to revise an initial determination. Rehearing Order at 1 (citing § 350.3 and § 350.4) (JA___); Final Determination at 2 (citing § 350.4) (JA___). Section 350.3 governs the format and length of motions and other filings. Section 350.4 specifies the requirements for the "content" of motions. Both are mere procedural regulations. Moreover, an agency cannot grant itself, by rule, authority "that is inconsistent with the administrative structure that Congress enacted into law." *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125-26 (2000).

Third, the Majority did not rely on its limited authority in Section 803(c)(4)—and for good reason. The Majority's change to the "Service Revenue" definition was neither "technical [n]or clerical," nor was it "in response to unforeseen circumstances that would frustrate the proper implementation of such determination." 17 U.S.C. § 803(c)(4).

Rather, the Majority's change was substantive, not technical or clerical. Under the rule continued in the Initial Determination, Service Revenue was calculated by subtracting from the price of the bundle "the stand-alone published price . . . for each of the . . . component(s) of the Bundle" *other than* the licensed subscription streaming music service. Initial Determination Attach. A at 7-8 (JA___-___). The Rehearing Order rejected that rule and adopted a substantively different rule for calculating Service Revenue for bundled services. Rehearing Order at 18 (JA___); Final Determination Attach. A at 8 (JA___).[12]

Nor was the change made "in response to unforeseen circumstances that would frustrate the proper implementation of such determination." 17 U.S.C. § 803(c)(4). The Services timely sought the continuation of the existing rule. The Copyright Owners could have timely offered an alternative proposal. They did not. Their decision to wait until after the Initial Determination to do so is not an "unforeseen circumstance," much less one that "would frustrate the proper implementation" of the Initial Determination.

B. The Majority Acted Unlawfully in Adopting a Revised Definition "By Default"

Even where the Board has authority to make substantive changes to an initial determination, those decisions still must be "supported by the written record." 17 U.S.C. § 803(c)(3). Here, the Majority made no attempt to satisfy that standard, instead adopting the new rule "[b]y

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[12] Elsewhere in the Rehearing Order, the Majority made technical and clerical corrections. Rehearing Order at 8 (correcting "inadvertent inclusion") (JA___); *id.* at 9 (fixing "typographical error") (JA___); *cf. Am. Petroleum Inc. v. SEC*, 714 F.3d 1329, 1336-37 (D.C. Cir. 2013) (describing Congress's failure to update a statutory cross-reference as a "scrivener's" or "clerical" error).

default" because it believed that "[n]either party presented evidence adequate" to support its proposed rule. Rehearing Order at 17, 18 (JA___, ___).

This Court has twice reversed similar decisions made in an evidentiary vacuum. In a 2007 order, the Board assessed a $500 minimum annual fee to cover administrative costs, even though "there [wa]s no record evidence that $500 represented [those] administrative cost[s]." *Intercollegiate Broad. Sys.*, 574 F.3d at 767. The Board found that it could act despite that "lack of evidence" because it was the royalty payors' "fault" for "not obtain[ing] discovery and introduc[ing] evidence." *Id.* This Court reversed, finding the Board's "approach [wa]s inconsistent with rational decisionmaking, which requires more than an absence of contrary evidence; it requires substantial evidence to support a decision." *Id.*

Six years later, this Court again faulted the Board for setting a "split the difference" royalty rate against "a blank slate of an evidentiary record," reiterating that a reasoned justification "requires more than an absence of contrary evidence." *Settling Devotional Claimants*, 797 F.3d at 1121. In both cases, the Court also faulted the

Board for blaming the royalty payors for the lack of record evidence, noting that those parties "could hardly challenge a theory first presented in the Judges' determination and not advanced by any participant." *Intercollegiate Broad. Sys.*, 574 F.3d at 767; *accord Settling Devotional Claimants*, 797 F.3d at 1121.

Intercollegiate Broadcast System and *Settling Devotional Claimants* are on all fours with this case. The Majority acted against a record that, it asserted, lacked "evidence adequate to support" any result. Rehearing Order at 17 (JA___). Making matters worse, the Majority faulted the Services—which had timely proposed to keep the existing rule—for purportedly not coming forward with sufficient evidence despite the Copyright Owners' decision not to contest that position until *after* the record closed. *Id.*[13]

The Majority was also wrong in asserting that the Services did not present evidence to support the existing rule. Indeed, the Initial

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[13] Placing the burden of production on the Services was not consistent with the *SDARS III* ruling, as the Majority claimed. Rehearing Order at 17 (JA___). There, the Board held that a party proposing a *new* rule bore the burden of justifying it. *SDARS III*, 83 Fed. Reg. at 65264. Consistency with *SDARS III* would have placed the burden of production on the Copyright Owners, the proponents of the new rule.

Determination expressly acknowledged evidence that the bundling that had occurred under the *Phonorecords II* rule increases revenues for Services and Copyright Owners alike. Initial Determination at 20-22 (JA___-___).

In sum, even assuming the Majority had the authority to alter this aspect of its Initial Determination, its change to the bundles rule "[b]y default" was inconsistent with rational decisionmaking and must be reversed.

IV. THE MAJORITY LACKED AUTHORITY TO APPLY THE *PHONORECORDS III* RATES AND TERMS RETROACTIVELY[14]

The Majority exceeded its authority by making the rates and terms in the Final Determination—published in the Federal Register on February 5, 2019—effective retroactive to January 1, 2018. It is "axiomatic" that "a statutory grant of legislative rulemaking authority will not . . . be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms." *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988). Only "clear, strong, and imperative [statutory] language

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[14] Spotify does not join this argument.

requiring retroactive application" will suffice. *Landgraf v. USI Film Prods.*, 511 U.S. 244, 270 (1994); *see also Owens v. Republic of Sudan*, 864 F.3d 751, 814-15, 817 (D.C. Cir. 2017) (requiring "a clear statement of congressional intent to give it retroactive effect," finding no such statement, and vacating district court decision in pertinent part), *cert. granted*, No. 17-1236 (U.S. June 28, 2019).

The Copyright Act authorizes the Board to set retroactive rates and terms in two narrow circumstances, neither of which exists here. First, when *no* prior rates and terms exist, new rates "shall be retroactive to the inception of [the new] activity." 17 U.S.C. § 803(d)(2)(B). Second, when old rates and terms "expire on a specified date," the new rates take effect on "the day following the date of expiration" even if the new rates are finalized later. *Id.* § 803(d)(2)(A). Here, there were existing rates and terms: those set through *Phonorecords II*. And those rates and terms did not contain a specific expiration date. Therefore, the Board was not operating here under either provision expressly allowing for retroactivity.

Instead, because the existing "rates and terms d[id] not expire on a specified date," the second sentence of Section 803(d)(2)(B) governs and provides that new rates and terms "shall take effect on the first day of the second month that begins after the publication of the determination of the Copyright Royalty Judges in the Federal Register." *Id.* § 803(d)(2)(B). Because *Phonorecords III* was published in the Federal Register on February 5, 2019, the earliest the new rates and terms could take effect—and replace the *Phonorecords II* rates and terms—was April 1, 2019.

Although the second sentence of Section 803(d)(2)(B) goes on to say that the effective date for such rates and terms may be "as otherwise provided . . . by the Copyright Royalty Judges," that general language does not provide the clear statement necessary to overcome the presumption against retroactivity. *Landgraf*, 511 U.S. at 260-62 (rejecting argument for retroactive application based on similar "otherwise . . . provided" language"). This is made plain when comparing the first two sentences of Section 803(d)(2)(B). The first states that, when the Judges adopt the first set of rates and terms for an activity, those "rates and terms *shall be retroactive* to the inception of activity." 17 U.S.C. § 803(d)(2)(B) (emphasis added). The inclusion of express retroactivity language in this first sentence confirms that

Congress deliberately omitted such language from the second sentence. *Orton Motor, Inc. v. U.S. Dep't of Health & Human Servs.*, 884 F.3d 1205, 1214 (D.C. Cir. 2018). The second sentence applies here.

The Register of Copyrights has reached the same conclusion, finding that "[n]either the [Judges] nor the participants have the power to engage in retroactive rate setting" with respect to successor rates and terms. Review of Copyright Royalty Judges Determination, 74 Fed. Reg. 4537, 4542 (Jan. 26, 2009). The Register applied Section 803(d)(2)(B) in holding "erroneous" the Judges' "retroactive application of . . . royalty rates" for an "activity where rates applicable to the activity were set for the previous rate period." *Id.* The Register explained that a "previous rate-setting proceeding established royalty fees that clearly applied to limited downloads." *Id.* Therefore, the Register "corrected" the Board's decision by holding that the new "rates do not apply retroactively to limited downloads." *Id.*

The Judges are bound by statute to follow "prior determinations and interpretations of . . . the Register of Copyrights." 17 U.S.C. § 803(a)(1); *see Indep. Producers Grp. v. Librarian of Congress*, 792 F.3d 132, 137 & n.3 (D.C. Cir. 2015) (noting Judges' "statutory mandate to follow precedent established by" the Register). The Majority's failure to follow the Register's precedent thus constitutes an independent legal error.

In making the *Phonorecords III* rates and terms retroactive, the Majority did not cite Section 803(d)(2). Instead, the Majority noted only that Section 115 provides that the rates and terms the Board establishes "shall end 'on the effective date of successor rates and terms, or such other period as the parties may agree.'" Final Determination at 1 (quoting 17 U.S.C. § 115(c)(3)(C) (2010)) (JA___).[15] The Majority asserted that, in the parties' post-hearing filings, they "agreed [to a] rate period" that began on January 1, 2018, which the Majority "adopt[ed]." *Id.* The Majority erred in both its reading of Section 115 and its finding of an agreement.

First, the provision the Majority cited does not contain the clear statement necessary to authorize retroactivity. *Landgraf*, 511 U.S. at 260-62. The provision reads:

> Proceedings under chapter 8 shall determine reasonable rates and terms of royalty payments for the activities

[15] The text the Majority quotes was moved to Section 115(c)(1)(E) on October 11, 2018; it previously appeared in Section 115(c)(3)(C).

> specified by this section during the period beginning with the effective date of such rates and terms, but not earlier than January 1 of the second year following the year in which the petition requesting the proceeding is filed, and ending on the effective date of successor rates and terms, or such other period as the parties may agree.

17 U.S.C. § 115(c)(1)(E). The general reference to "such other period as the parties may agree" is best read, in light of the presumption against retroactivity, to allow the parties to agree to a later start date or an earlier end date. As shown above, the Register reached the same conclusion, finding that "[n]either the [Judges] *nor the participants* have the power to engage in retroactive rate setting other than that which is expressly authorized by the statute." 74 Fed. Reg. at 4542 (emphasis added).

Second, there was no agreement to retroactivity. In a May 2017 filing, the Services expressly rejected the proposition that the *Phonorecords III* rates and terms would take effect on January 1, 2018, regardless of when the Board published its Final Determination:

> [T]he Services note that while January 1, 2018 would be a proper effective date for rates to be determined in this proceeding, it will actually be the effective date *only if the Judges publish their determination in the Federal Register in November of 2017*. *See* 17 U.S.C. § 803(d)(2)(B) (noting that "successor rates and terms shall take effect on the first day of the second month that begins after the publication of the

> determination of the Copyright Royalty Judges in the Federal Register" and that "the rates and terms, to the extent applicable, shall remain in effect until such successor rates and terms become effective").

Services Joint Reply at 487 (JA___) (emphasis added). Thus, far from agreeing to retroactivity, the Services argued then—as we argue now—that *Phonorecords III* established successor rates, the effective date of which is governed by the second sentence of Section 803(d)(2)(B).

Because the Board lacked authority to make the *Phonorecords III* rates and terms effective retroactively, the Court should vacate that aspect of the Final Determination and hold that the earliest that *Phonorecords III* rates and terms could take effect was April 1, 2019.

CONCLUSION

For the foregoing reasons, the Court should vacate the Final Determination and remand for further proceedings as to the royalty rates and rate structure. The Court should also order the reinstatement of the "Service Revenue" definition for bundled subscription offerings from the Initial Determination and order that the earliest date the post-remand *Phonorecords III* rates and terms can take effect is April 1, 2019.

August 14, 2019

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CIRCUIT RULE 32(a)(2) ATTESTATION

In accordance with D.C. Circuit Rule 32(a)(2), I hereby attest that all other parties on whose behalf this joint brief is submitted consent to the filing of this brief.

/s/ Gregory Silbert
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CERTIFICATE OF COMPLIANCE

This brief complies with the word limit set forth in this Court's Order of June 25, 2019, because it contains 12,922 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(f) and D.C. Circuit Rule 32(e)(1), according to the count of Microsoft Word.

This brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type style requirements of Federal Rule of Appellate Procedure 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word in Century Schoolbook 14-point font.

August 14, 2019

/s/ Gregory Silbert
Gregory Silbert

CERTIFICATE OF SERVICE

I hereby certify that, on August 14, 2019, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the District of Columbia Circuit using the appellate CM/ECF System. I further certify that all parties are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF System.

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