

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

In the Matter of:

Digital Performance Right in Sound
Recordings and Ephemeral Recordings

Docket No. 2009-1
CRB Webcasting III

TESTIMONY OF

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Public Version

**STATEMENT OF W. TUCKER McCRADY
WARNER MUSIC GROUP**

Background and Qualifications

I am Associate Counsel, Digital Legal Affairs at Warner Music Group (WMG). In that role, I am responsible for handling a range of digital legal issues, a majority of which involve negotiating digital deals on behalf of WMG. I have negotiated deals for downloads, streaming (both audio and video, and both ad-supported and subscription-based), ringtones, custom radio and many others, with providers such as Apple, Amazon, Google, Rhapsody, MTV, Yahoo, Last.fm and Slacker. I have worked at WMG in this capacity since early 2006.

I am also a member of the Board of Directors and the Licensing Committee of SoundExchange. This committee, among other things, is directly responsible for negotiating and approving any settlements related to statutory licenses on behalf of SoundExchange.

I hold a bachelors degree from Harvard, a diploma in drama from The Juilliard School, and a JD from Columbia Law.

About Warner Music Group

Warner Music Group Corp. is the only stand-alone music company to be publicly traded in the United States. WMG is home to some of the best-known labels in the recorded music industry including: Asylum, Atlantic, Cordless, East West, Elektra, Nonesuch, Reprise, Rhino, Roadrunner, Rykodisc, Sire, Warner Bros. and Word. Collectively, these labels encompass a global roster of vibrant artists and a diverse catalog of some of the world's most celebrated and popular recordings. Warner Music International, a leading company in national and international recorded music repertoire,

operates through numerous affiliates and licensees in more than 50 countries. WMG also includes Warner/Chappell Music, one of the world's leading music publishers, with a catalog of more than one million songs from more than 65,000 songwriters.

Overview

My testimony seeks to explain WMG's strategy with respect to negotiations with digital service providers outside the limitations of the statutory licensing framework. These agreements are the best evidence of how we, as a willing seller of copyrighted sound recordings, approach such negotiations. Understanding that approach is essential to the proper determination of the statutory rate for non-interactive webcasting, and the Copyright Royalty Judges relied on similar testimony to set statutory webcasting rates in the prior proceeding known as Webcasting II.

The Digital Distribution of Music

The overarching strategy of WMG with respect to digital agreements is to seek out and exploit all potential avenues for monetizing the musical experience. As a general matter, WMG is not interested in allowing its sound recordings to be used for free in the name of "promotion," because the ubiquity and high quality of digital distribution have fundamentally transformed the concept of "substitution." In the past, our primary concern was to protect sales of our CDs or other physical products. Today, we examine each new business model or proposal, not just for its likely substitutional impact on sales of physical products, but for its likely substitutional impact on other revenue sources. As a result, we must now be increasingly vigilant to ensure that any particular digital exploitation of our sound recordings does not damage potentially more lucrative digital exploitations of our sound recordings.

As for promotion, as a general matter we cannot afford to enter into free or low-revenue digital agreements, with the hope of promoting sales of CDs, or any other type of digital or physical music product. As we continue to explore new avenues for monetization, each digital business model needs to provide a distinct revenue stream that either contributes meaningfully to our bottom line, or helps to develop a business model that may, over time.

Audio Streaming Agreements

A. Webcaster Settlement Act Settlements

In 2008, Congress passed legislation designed to encourage settlements of royalty disputes for statutory webcasting royalty rates. The Webcaster Settlement Act of 2008 (“WSA”), which was extended by Congress and President Obama in 2009, specifically permitted SoundExchange and webcasters to negotiate settlements of ongoing disputes arising out of the royalty rates that were set by the Copyright Royalty Judges (“CRJs”) in 2007 covering the time period from 2006-2010 and which were the subject of an ongoing appeal at the time. The WSA also permitted SoundExchange to negotiate royalty rates to be applied from 2011-2015, the time period at issue in this proceeding. The WSA permits the following WSA settlements to be considered in this proceeding.

1. Broadcasters

In February of 2009, SoundExchange and the National Association of Broadcasters (“NAB”) reached the first such settlement under the WSA. Exhibit 1, *Agreed Rates and Terms for Broadcasters*, available at 74 Fed Reg. 9293, 9299 (Mar. 3, 2009) (the “Broadcasters settlement”). This settlement governs the webcasting activities of traditional terrestrial commercial broadcasters. These activities overwhelmingly

consist of internet simulcasts of over-the-air radio broadcast transmissions, although they also may include internet-only programming. Any broadcaster, as the term is defined by the agreement, can opt in. The Broadcasters settlement features the following royalty rate structure:

Year	Rate per performance
2006	\$0.0008
2007	\$0.0011
2008	\$0.0014
2009	\$0.0015
2010	\$0.0016
2011	\$0.0017
2012	\$0.0020
2013	\$0.0022
2014	\$0.0023
2015	\$0.0025

WMG believes that these rates are below what the webcasting rate would be in the open market, but nevertheless see this agreement with the broadcasters as a positive development.

Another feature of the Broadcasters settlement is a minimum fee of \$500 for each individual channel/station, with a \$50,000 annual cap on minimum fees for any single broadcaster. A minimum payment, which is also included in the other WSA settlements, is an important element of these deals from WMG’s perspective because it ensures a minimum amount of compensation for the use of WMG’s copyrighted sound recordings. The minimum included within this and the other WSA settlements, however, is substantially smaller and less valuable than the type of minimum payments and revenue guarantees that are generally included within WMG’s digital deals, as discussed more fully below. It was obviously based on the statutory minimum, and is an example of how

negotiating in the context of a statutory licensing regime leads to below-market outcomes.

In addition to the per-play royalty rates and the minimum payment structure, the Broadcasters settlement also generally requires more comprehensive reporting than called for by the current regulations. Specifically, broadcasters that opt in to the Broadcasters settlement are usually required to provide reports of use to SoundExchange “on a census reporting basis (i.e., reports of use shall include every sound recording performed in the relevant month and the number of performances thereof).” Ex. 1, at § 5.2. However, small broadcasters have an option to avoid reporting.

a. Performance Complement Waivers

Separate and apart from the negotiated agreement between SoundExchange and the broadcasters, WMG negotiated with broadcasters on the issue of the sound recording performance complement (defined in 17 U.S.C. § 114(j)(13)), which limits the number and frequency of recordings by a given artist or from a given album that may be played within a specified time period. Terrestrial broadcasters have long maintained that the performance complement is, as a practical matter, incompatible with their traditional broadcasting practices, and operates as a strong motivating factor against a broadcaster entering into the webcasting business.

Although WMG was under no obligation to grant the waiver, we did so for the reasons set out below, which are unique to the business of terrestrial broadcasters, the only ones eligible to opt in to the Broadcasters settlement. Most importantly, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

For simulcasts, however, WMG was happy to offer the waiver, [REDACTED]
[REDACTED]

[REDACTED] Terrestrial radio has never been subjected to a statutory requirement similar to the performance complement, and it has been asserted that some medium and small broadcasters lack the resources to program in strict compliance with it. But the standard programming practices of broadcasters already reflect principles that are similar in some respects to the performance complement. Blocks of radio programming devoted to a single artist or album are the exception rather than the rule for terrestrial radio stations, and for good reason; rather than appealing to a geographically unlimited but extremely taste-specific audience, broadcasters' programming must appeal to as broad a range of listeners as possible, within a narrow geographic range. Thus, broadcasters tend to play a variety of music organized around a genre or format, such as Top 40, Hip-Hop, Oldies, Classic Rock, etc., that will appeal to a broad market segment.

To ensure that the waiver did not extend to unforeseen business practices, WMG included provisions in its complement waiver [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

2. Commercial Webcasters

In July of 2009, SoundExchange also reached a settlement with Sirius XM Satellite Radio that is applicable to commercial webcasters. Exhibit 2, Agreed Rates and Terms for Webcasts by Commercial Webcasters, *available at* 74 Fed Reg. 40614 (Aug. 12, 2009) (the “Commercial Webcasters settlement”). The Commercial Webcasters settlement features the following royalty rate structure:

Year	Rate per performance
2009	\$0.0016
2010	\$0.0017
2011	\$0.0018
2012	\$0.0020
2013	\$0.0021
2014	\$0.0022
2015	\$0.0024

The Webcasters settlement includes a \$500 per channel minimum payment, with a \$50,000 minimum payment cap for a commercial webcaster with more than 100 channels. Unlike the Broadcasters settlement, the Commercial Webcasters settlement does not change the reporting obligations of the webcasters.

3. Noncommercial Educational Webcasters.

Also in July of 2009, SoundExchange reached a settlement with College Broadcasters, Inc. (“CBI”) that is applicable to noncommercial educational webcasters. Exhibit 3, Agreed Rates and Terms for Noncommercial Educational Webcasters, *available at* 74 Fed Reg. 40614, 40616 (2009) (the “Noncommercial Educational settlement”). The Noncommercial Educational settlement features the following royalty rate structure:

Year	Rate per performance
2011	\$0.0017
2012	\$0.0020
2013	\$0.0022
2014	\$0.0023
2015	\$0.0025

This per-performance rate is only applicable when a noncommercial educational webcaster transmits more than 159,140 Aggregate Tuning Hours (“ATH”) in a month on any individual channel or station. This is another instance of a WSA agreement being based on the statutory rate structure. Any webcaster that must pay these additional usage fees, but is unable to calculate the total number of performances (and not required to do so, as discussed below), can opt to pay the fees on the basis of ATH, by converting total ATH to performances at the rate of 12 performances per hour. The Noncommercial Educational settlement also includes a \$500 annual minimum fee for each individual channel. There is no cap on the aggregate minimum payments, because of the usage restriction built into the minimum fee.

The reporting requirements contained within the Noncommercial Educational settlement are different than those in the Broadcasters settlement. Specifically, noncommercial educational webcasters who opt in to the settlement can choose one of three reporting mechanisms. First, like small broadcasters, a qualifying webcaster that does not exceed 55,000 total ATH per channel for more than one month in the previous year and does not anticipate exceeding that amount in a single month in the applicable calendar year can pay a \$100 fee and be exempt from any usage reporting. The intention of the \$100 fee is to help pay for proxy data on usage which SoundExchange will need to either develop internally or acquire from a third party.

Second, a noncommercial educational webcaster that does not exceed 159,140 total ATH per channel for more than one month in the previous year and does not anticipate exceeding that amount in a single month in the applicable calendar year can submit reports of use on a sample basis, which is defined as a two-week period per calendar quarter, as governed by 37 C.F.R. § 370.3. Webcasters that elect to report on this basis are not required to report ATH or actual total performances, but are encouraged to do so. Finally, a qualifying webcaster that exceeds 159,140 total ATH in more than one month in the previous calendar year, or anticipates exceeding that amount in more than one month in the applicable calendar year, or did not otherwise elect to report usage under one of the other two options must provide quarterly Reports of Use on a census basis.

B. WMG Agreements

Outside of the statutory webcasting framework, WMG has negotiated an increasing number of deals for the digital exploitation of WMG's extensive catalog of copyrighted sound recordings. The U.S. deals that we have executed for online streaming services seem particularly relevant to the CRJs' task of determining the proper rate for statutory webcasting. These services fall into one of three broad categories:

(1) subscription on-demand streaming, (2) ad-supported streaming, and (3) custom radio.

Each of these categories engenders unique concerns, and I will discuss each one below.

In these deals, there are a few important elements are of value to WMG, and important components of our negotiating strategy. The single most important aspect of negotiated marketplace agreements is that they feature a payment structure based on the greatest of three different amounts (or in some cases, the greater of two different

amounts). Specifically, WMG almost always requires audio streaming services to pay the greatest of [REDACTED]
[REDACTED]
[REDACTED] Our proportionate share is calculated as a percentage of the total streams that are WMG-owned or controlled sound recordings.

In the U.S., WMG does not have a single agreement with an audio streaming service where the payment amount is based solely on a per-play rate, as is the case with the statutory license. In all of our negotiated agreements we view the per-play minimum payment as the absolute floor for our revenue, a minimum protection for the value of the recordings we provide. The [REDACTED] represent the potential upside for our revenue. Although we negotiate the amounts of the per-play minimums, the [REDACTED]
[REDACTED] with each streaming service, our ultimate goal in these negotiations is to ensure that WMG and its recording artists are fairly compensated for providing the one essential element without which an audio streaming service simply could not function – the music.

Another important component of negotiated deals is the non-refundable advance payments that WMG typically receives. Even when these advance payments are recoupable against future royalty payments, they essentially serve as minimum revenue guarantees, which can be significantly higher than the minimum payment requirements under the statutory rate and the WSA settlements.

WMG is also able to obtain important protections with respect to other aspects of audio streaming in its negotiated deals. For example, WMG requires adherence to strict security measures, limits the types of devices that can be used with a given service, and

specifies the audio quality of streams offered by a service. WMG also negotiates extensive and uniform reporting requirements for these services, along with technical and financial auditing rights, thus allowing WMG broad oversight over the exploitation of its copyrighted works.

All of these deal components are designed to ensure that each digital audio streaming service functions as a distinct product, offering a distinct method of monetization, and limit the substitution risk for other revenue sources (such as permanent digital downloads).

In its negotiated deals, WMG also has much more control over the recordings that are made available. This control is partially mandated by restrictions that WMG has with its artists regarding the use of their music. But WMG also negotiates holdback rights so that it can create exclusive deals for certain content, enabling WMG to derive greater value, including by way of lucrative sponsorship opportunities.

Finally, our negotiated agreements are typically of short duration, especially for new services. Thus, with any given service, WMG is able to commit to a particular deal structure in the short term, knowing that it will be able to re-assess the structure's long-term financial viability when technology and consumer preferences inevitably change.

Importantly, none of these valuable negotiated deal components is found in the statutory license. In fact, in the last rate-setting proceeding for webcasting in 2007, the CRJs specifically rejected arguments that the statutory rate should feature a "greater of" structure. The long term of the statutory license – five years – also means that there is no opportunity to correct for any undervaluation until the next rate-setting proceeding.

1. Subscription On-demand Services

Among the more established and profitable negotiated streaming deals that WMG has executed are those entered into with subscription on-demand streaming services. These services offer the height of the interactive experience for a subscriber – the ability to hear exactly the song the subscriber wants to hear when he or she wants to hear it (hence, “on-demand”). Not only can subscribers hear requested songs via audio stream online, these services also typically permit subscribers to conditionally download the songs to their PC hard drive or in some cases, to a portable device (depending on the service and the subscription purchased). The songs that have been downloaded by a subscriber from one of these services can be played on-demand, and remain accessible on the subscriber’s hard drive or portable device for as long as the subscriber maintains his or her paid subscription.

An example of the type of on-demand subscription agreement that WMG has entered into is the Subscription Services Agreement that we executed with Napster, LLC (“Napster”) for its subscription service in November of 2005 (the “Napster Subscription Agreement”) (Attached as Exhibit 4). This agreement is still in effect and its material terms remain unchanged, with the exception of the recently introduced bundled offer discussed in detail below. The specific royalty terms of the Napster agreement are as follows: [

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Although WMG's agreements with other subscription services vary in details such as [REDACTED]

[REDACTED]

In addition to this rate structure, the Napster agreement also features a number of the deal components I outlined above as valuable considerations in WMG's strategy for agreements with services. For example, [REDACTED]

[REDACTED]

As I explained above, the "greatest of" rate structure and the additional valuable deal components in our subscription on-demand agreements allow WMG to maximize the revenue potential of providing our recordings to on-demand subscription services. I have attached the May 2009 Subscription Earnings Statement provided by Napster to WMG that emphasizes just how valuable the "greatest of" structure really is to WMG (Exhibit 5). As shown on the report, [REDACTED]

[REDACTED]

The most important aspect of those figures is that neither of them is calculated based on the "per-play" fee of [REDACTED], as the "per-play" fee was not the "greatest of". Rather, [REDACTED]

[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED] In other words, the agreement is functioning exactly the way WMG hoped it would when we negotiated the contract – we are receiving revenue in an amount that far exceeds the contractual floor of the per-play fee.

Recently we have negotiated agreements with two subscription on-demand services related to a new bundled offer they are making available to consumers. Specifically, this type of bundled offer, which both Napster and Microsoft (through its ZunePass service) have in some form, provides a subscriber a set number of monthly credits for permanent downloads along with the standard on-demand streaming and conditional download functionality of the service. These download credits are being offered essentially as a sales incentive, in an attempt to win over consumers who may continue to be uncomfortable with the idea of “renting” music that is associated with Napster and other such services, where access to music is dependent on continued membership, and users never possess the music on a permanent basis

I have attached as Exhibit 6, the Bundled Offer Agreement that WMG signed with Napster in May of 2009 for its bundled offer. I also have attached as Exhibit 7 the May 2009 Bundled Offer Royalty Statement provided to WMG by Napster. The statement shows that WMG [REDACTED]
[REDACTED]

[REDACTED] Because of the relative newness of these bundled offers it is difficult to gauge just how successful they will be in attracting subscribers and driving revenue to WMG. But we are enthusiastic about the possibility that these types of

services represent for revenue growth. These are examples of the opportunities presented by free-market negotiations.

2. Ad-supported Services

In recent years WMG has explored an experimental business model involving free-to-the-user, on-demand, limited streaming of WMG content. Unlike the subscription services discussed above, these experimental services derive their revenue entirely from advertising, including audio and video ads. In the United States, WMG primarily has agreements with these types of services for video (rather than audio) streaming, but we do have uniquely structured agreements with a few ad-supported audio streaming services. However, we tend to view the ad-supported audio business model with caution, because it has yet to generate stable revenue streams.

The primary examples of ad-supported services with which WMG has agreements are imeem and MySpace Music, two social networking sites with significant scale, but (so far) limited ability to generate significant per-user revenue. Both deals represent WMG's licensing approach at its most experimental, as we seek to develop an alternate business model that is very much in demand (as evidenced by the services' popularity), but which is not yet mature. WMG also works closely with both imeem and MySpace to drive purchases of digital downloads, another business model that we do not yet believe has reached its full potential (despite its success to date), and [REDACTED]

[REDACTED] We do not yet know whether these services will succeed in the long run, but as is always the case with

experimental negotiated agreements, we will be able to revisit terms should the services not succeed as hoped.

3. Custom Radio

Finally, WMG has agreements with services that are not on-demand, but are, to a degree, customized to the listener's preferences. We generally refer to these services as "custom radio," although there are differences in functionality across the category. Many of these agreements arose as part of larger relationships such as those with Rhapsody, MySpace and others; but of our currently active agreements, our deal with Slacker (a stand-alone custom radio service) is perhaps the purest example of the category.

The most noticeable feature about custom radio deals is that they have traditionally included a per-play rate expressed as a percentage of the statutory webcasting rate. WMG has always believed that custom radio services, with their varying degrees and types of customization, ought to pay more than the terms in the agreements tend to indicate because the user experience of some of these services is so good that they probably substitute for on-demand services that tend to pay us more. On the other hand, some custom radio services have adamantly maintained that they are, in fact, statutory webcasters. As a result, the existence of the statutory licensing option has depressed the market rates for the use of copyrighted music in customized audio streaming deals.

This issue has been further complicated recently by the decision of the United States Court of Appeals for the Second Circuit in *Arista Records, et al. v. Launch Media, Inc.*, Docket No. 07-2576-cv (August 21, 2009) (the "*Launch* decision"), wherein the court held that Launch, which essentially operated as a custom radio service, fell within

the statutory definition of a non-interactive webcasting service. In the wake of this decision, I believe that we are likely to see a proliferation of customized webcasting services in the coming years that will be able to offer listeners a highly personalized entertainment experience, while paying only the statutory royalties the CRJs have established for more traditional, non-interactive, non-customized webcasting.

Examination of WMG's deal with one of these service providers, Slacker, demonstrates just how much variation there can be within even this seemingly small band of services. WMG has authorized Slacker to use WMG recordings in a number of different services. In this agreement, [REDACTED]

The agreement sets forth the following rate structure for each of the services: [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Slacker's different service tiers all offer different user experiences. First, there is Slacker's Basic Radio Service which is free to consumers and allows users to create personalized stations based on a number of settings including a preference for newer versus older music, or popular versus relatively unknown music. Basic Radio features advertising and does not allow the user to play a specifically requested song. Moreover, Basic Radio stations must comply with the performance complement and users are limited to 6 forward skips per hour.

Second, Slacker offers a Premium Radio Service which is similar in most respects to the Basic Radio, but requires a subscription to use and allows for ad-free streaming. Premium Radio users are also allowed an unlimited number of forward skips. The other relevant feature of the Premium Radio is that users can save streams that they like to their cache and later access those streams on-demand.

Finally, the agreement includes rates for a non-portable on-demand service and a portable on-demand service. To my knowledge, Slacker does not actually offer either of these services.

As I mentioned above, the Second Circuit's *Launch* decision is likely to have far-reaching implications for deals like our agreement with Slacker, substantially weakening WMG's ability to negotiate fair rates for the use of our copyrighted sound recordings in these types of custom radio services. Under such circumstances, the importance of setting a reasonable statutory rate, designed to reflect the likely migration to customized webcasting services, is of paramount importance to WMG.

Role of the Collection Organization for Statutory Licensing

I offer one final note about the preferred mechanism for statutory royalty collection and distribution. WMG believes that in the interest of efficiency for both webcasters and those who receive revenue from the statutory license, there should be one unified licensing collective. SoundExchange, a nonprofit organization governed by an equally-weighted coalition of artists (and representatives of artist organizations) and representatives of recorded music organizations, has done an admirable job. It collects and distributes royalties from and to countless parties, persistently seeks out artists who may not be aware of monies being held for them, and has reached settlements covering the substantial majority of the industry, enabling multiple statutory business models to develop and thrive while protecting the economic value of the music on which these services are built. Based upon its track record, SoundExchange deserves to maintain its position as the only licensing collective. I see no benefit – and myriad potential drawbacks – to permitting multiple entries into the field of webcasting royalty collection, particularly when SoundExchange is embracing its challenging mission so fully.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: Sept. 23, 2009

W. Tucker McCrady
W. Tucker McCrady

Exhibits Sponsored by W. Tucker McCrady

Exhibit No.	Description
SX Ex. 101-DP	Webcaster Settlement Act Agreement for Broadcasters made between SoundExchange, Inc. and the National Association of Broadcasters, on behalf of its members
SX Ex. 102-DP	Webcaster Settlement Act Agreement for Commercial Webcasters made between SoundExchange, Inc. and Sirius XM Radio Inc.
SX Ex. 103-DP	Webcaster Settlement Act Agreement for Noncommercial Educational Webcasters made between SoundExchange, Inc. and College Broadcasters, Inc.
SX Ex. 104-DR	Subscription Services Agreement between Warner Music Inc. and Napster, LLC, Nov. 13, 2005 (RESTRICTED - not included in public version of direct case)
SX Ex. 105-DR	Napster Subscription Earnings Statement for Warner Music Inc., May 2009 (RESTRICTED - not included in public version of direct case)
SX Ex. 106-DR	Bundled Offer Agreement between Warner Music Inc. and Napster, LLC, May 18, 2009 (RESTRICTED - not included in public version of direct case)
SX Ex. 107-DR	Napster Bundled Offer Royalty Statement for Warner Music Inc., May 2009 (RESTRICTED - not included in public version of direct case)