[Edited. You can read the full opinion here.]

In re Pandora Media, Inc.

6 F. Supp. 3d 317(SDNY 2014), *aff'd* 785 F.3d 73 (2d Cir. 2015)

DENISE COTE, UNITED STATES DISTRICT JUDGE.

OPINION & ORDER

INTRODUCTION

Pandora Media Inc. ("Pandora") has applied for a through-to-the-audience blanket license to perform the musical compositions in the repertoire of the American Society of Composers, Authors and Publishers ("ASCAP") for the period of January 1, 2011 through December 31, 2015. The parties having been unable to reach agreement on an appropriate licensing fee, pursuant to Article IX of the consent decree under which ASCAP operates -- known as the Second Amended Final Judgment ("AFJ2"), see United States v. ASCAP, Civ. No. 41-Civ-1395, 2001 U.S. Dist. LEXIS 23707, 2001 WL 1589999 (S.D.N.Y. June 11, 2001) -- Pandora requested on November 5, 2012 that this Court set a rate for that licensing fee.

The parties disagree as to which are the most appropriate benchmarks for the license rate here. Pandora asserts principally that it is similarly situated to radio stations licensed through a 2012 agreement between the Radio Music License Committee ("RMLC"), which represents commercial radio stations, and ASCAP, and is therefore entitled to the rate in that license. Pandora also points to a direct license agreement between Pandora and EMI Music Publishing Ltd. ("EMI") that was entered into after EMI purported to withdraw its new media[1] licensing rights from ASCAP in 2011.

ASCAP proposes a variety of benchmarks, including the direct licensing agreement into which Pandora entered with EMI, as well as Pandora's direct licenses with Sony/ATV Music Publishing LLC ("Sony") and Universal Music Publishing Group ("UMPG") in the wake of those publishers' putative withdrawals of new media licensing rights from ASCAP. ASCAP also puts forward other agreements between music rights holders and music users as secondary benchmarks.

The parties have proposed the following rates, expressed as a percentage of revenue: ASCAP proposes a rate of 1.85% for the years 2011 and 2012, 2.50% for 2013, and 3.00% for the years 2014 and 2015. Pandora proposes a rate of 1.70% for all five years. This Opinion sets the rate for all five years at 1.85%.

The task at hand is to determine the fair market value of a blanket license for the public performance of music. As this Court explained in a prior rate court proceeding:

1. New media is defined below, but the term refers generally to internet transmissions.

> The challenges of [determining a fair market rate for a blanket music license] include discerning a rate that will give composers an economic incentive to keep enriching our lives with music, that avoids compensating composers for contributions made by others either to the creative work or to the delivery of that work to the public, and that does not create distorting incentives in the marketplace that will improperly affect the choices made by composers, inventors, investors, consumers and other economic players.

In re Application of MobiTV, Inc., 712 F. Supp. 2d 206, 209 (S.D.N.Y. 2010), aff'd sub nom. ASCAP v. MobiTV, Inc., 681 F.3d 76 (2d Cir. 2012).

A bench trial was held from January 21 through February 10, 2014. Without objection from the parties, the trial was conducted in accordance with the Court's customary practices for non-jury proceedings, which includes taking direct testimony from witnesses under a party's control through affidavits submitted with the Joint Pretrial Order. The parties also served with the Joint Pretrial Order copies of all exhibits and deposition testimony that they intended to offer as evidence in chief at trial.

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This Opinion constitutes the Court's findings of fact and conclusions of law following that trial. The factual findings are principally set forth in the first section of this Opinion, but appear as well in the second section.

FINDINGS OF FACT

I. The American Society of Composers, Authors and Publishers

A. ASCAP Background

ASCAP is an unincorporated membership organization of music copyright holders created and controlled by music writers and publishers.[6] Its function is to coordinate the licensing of copyrighted musical works, and the distribution of royalties, on behalf of its nearly 500,000 members. ASCAP members grant ASCAP the non-exclusive right to license non-dramatic public performances of their music. ASCAP licenses these works on behalf of the copyright holders to a broad array of music users, including television networks, radio stations, digital music services, colleges, restaurants, and many other venues in which music is performed.

Employing ASCAP to perform these functions is efficient for both music users and copyright holders. A music user can license an enormous portfolio of copyrighted music through the execution of a single license without having to contact each copyright holder. Copyright holders benefit from ASCAP's expertise and resources in policing the market, negotiating licenses, and distributing the revenue from a vast array of licenses promptly and reliably among the multiple owners of the public performance copyrights in each work. The ability of ASCAP and other performing rights organizations ("PROs")

6 A music publisher is an entity which coordinates licensing and other logistics pertaining to copyrighted compositions. Music publishers are distinguished from record labels, which coordinate licensing of the sound recordings of performances of copyrighted compositions.

to grant licenses covering a large number of compositions creates significant economies of scale in the market for music licensing.

ASCAP offers the option of blanket licenses to users. A blanket license is a license that gives the music user the right to perform all of the works in ASCAP's repertoire, the fee for which does not vary depending on how much of the music the user actually uses. These blanket licenses

> reduce the costs of licensing copyrighted musical compositions. They eliminate costly, multiple negotiations of the various rights and provide an efficient means of monitoring the use of musical compositions. They also allow users of copyrighted music to avoid exposure to liability for copyright infringement.

Buffalo Broadcasting Co. v. ASCAP, 744 F.2d 917, 934 (2d Cir. 1984) (Winter, J., concurring).

ASCAP's board of directors is comprised of an equal number of composers and music publishers. The head of the ASCAP board is typically a songwriter. The present head of ASCAP is composer Paul Williams.

ASCAP competes with two other United States PROs: Broadcast Music, Inc. ("BMI") and SESAC, LLC. ("SESAC"), each of whom also offers blanket licenses. BMI, which is slightly smaller than ASCAP, operates under a consent decree that is similar to the one that governs ASCAP's licenses. SESAC is a PRO that is not currently bound by any consent decree.

B. The ASCAP Consent Decree

Since 1941, ASCAP has operated under a consent decree stemming from a Department of Justice antitrust lawsuit. This consent decree has been modified from time to time. The most recent version of the consent decree was issued in 2001 and is known as "AFJ2." AFJ2 governs here.[8]

In an attempt to ameliorate the anti-competitive concerns raised by ASCAP's consolidation of music licenses, AFJ2 restricts how ASCAP may issue licenses in a variety of ways. First, AFJ2 provides a mechanism whereby a court, known as the rate court, will determine a reasonable fee for ASCAP licenses when ASCAP and an applicant for a license cannot reach an agreement. AFJ2 § IX. This Court is presently the ASCAP rate court. Second, AFJ2 requires ASCAP to grant a license to perform all of the musical compositions in ASCAP's repertoire to any entity that requests such a license. AFJ2 §§ VI, IX(E). And third, AFJ2 prevents ASCAP from discriminating in pricing or with respect to other terms or conditions between "similarly situated" licensees. AFJ2 § IV(C). ASCAP members agree to be bound in the exercise of their copyright rights by the terms of AFJ2. For example, the 1996 Agreement Between Sony and ASCAP provides that "[t]he grant [of rights to ASCAP] . . . is modified by and subject to the provisions of [AFJ2]."

In addition to operating under a consent decree, ASCAP is governed by a series of internal rules and contracts. The most important internal rule set for purposes of this

8 For background discussion of AFJ2, see generally Meredith Co. v. SESAC LLC, 09 Civ. 9177 (PAE), 1 F. Supp. 3d 180, 2014 U.S. Dist. LEXIS 26992, 2014 WL 812795, at *11-12 (S.D.N.Y. Mar. 3, 2014).

litigation is the ASCAP Compendium. The ASCAP Compendium can be modified by the ASCAP Board and reflects many of the important rules that govern ASCAP's obligations to its copyright holder members and vice versa.

II. The Evolution of the Radio Industry

Much of the focus at trial was on the question of whether Pandora can be properly classified as "radio." A description of the evolution of the radio industry will provide context in understanding Pandora's features and its place within the music business.

Radio is a form of media in which a provider transmits audio programming to a listener, where the programming is not directly selected by the listener but is programmed by the provider. As a result, in the context of a music station, the listener does not choose the songs and does not know what composition will be played next. This radio experience has remained constant through the years, regardless of whether radio programming is transmitted by broadcasting, through a cable, from a satellite, or over the internet.

Radio made its debut approximately a century ago and has been a dominant force in the music industry ever since. The first commercial radio station in the United States was located in Pittsburgh, Pennsylvania and was licensed in 1920. The original technological means for delivering radio programming was by broadcasting an "amplitude modulation," or "AM" signal. By the 1930s, "frequency modulation" or "FM" signal technology was developed. FM broadcasting offered better audio quality but over a smaller range.

Another important moment in the history of radio occurred with the passage of the Telecommunications Act of 1996. Pub. L. No. 104-104, 110 Stat. 56 (1996). Empowered by that legislation, the FCC eliminated most caps on the number of stations that a single company could own. Following that change in the law, there was a large-scale expansion of group ownership of stations. Many terrestrial radio stations are now owned by large conglomerates, such as Clear Channel Communications, Inc. ("Clear Channel"), which owns over 800 stations.

In the 1990s, the first successful national cable radio network was launched, using cable TV transmission lines. Over time, what came to be known as digital TV radio was transmitted through means of cable, satellite,[9] and telephone-company lines. Some of the major competitors in this market are Music Choice, SiriusXM Satellite Radio, Muzak, and DMX.[10]

Also in the 1990s, the nascent internet provided a new means of radio transmission. The introduction in the early 1990s of MP3 digital audio encoding and compression format permitted music to be compressed in way that facilitated

9 Satellite radio permits coast-to-coast nationwide programming. It is primarily directed at the automotive market.

10 High Definition radio -- a digital radio technology which piggybacks on existing AM/FM signals but cannot be received by traditional radios -- was approved by the FCC in 2002.

distribution over the internet.[11] In 1994, the first simulcast of an AM/FM broadcast occurred over the internet. As of today, over 10,000 AM and FM stations stream online. Internet radio includes not just the simulcasting of signals broadcast by AM and FM stations, but also the creation of internet-only radio stations. Over time, some independent companies built directories of internet radio stations. These directories can contain tens of thousands of radio stations. Thus, the internet has enabled providers to present listeners with a vast library of radio programming, the likes of which has never been available before.

Clear Channel and CBS Radio, two major commercial radio companies, launched their own internet radio services in 2008 and 2010, respectively. Clear Channel's internet radio service is called iHeartRadio, and began as a vehicle to simulcast Clear Channel's own stations.

The arrival of the internet as a radio delivery platform has also permitted radio providers to introduce a level of instantaneous user interactivity for the first time. With the internet, each listener's device gets its own data stream, in contrast to the broadcasting of a common signal across a geographic area. As will be explained in greater detail below, this permits internet radio services to offer customized music programming based on user feedback. Thus, while a listener to a customized radio service cannot select and does not know what song will be played next, that listener can often give feedback to the customized station to shape the nature of the music that will be played.

As of today, Pandora is the most successful customized radio service. But it was not the first. Prior to Pandora's launch in 2005, LAUNCHcast and Last.fm, two customized radio services, began in 1999 and 2002, respectively.[12] Recently, three major competitors have emerged as challengers to Pandora's dominance. In 2011, Clear Channel launched a customized radio offering within its iHeartRadio service, called "Create Station." Spotify launched a customized radio feature called Spotify Radio in late 2011. And in September 2013, Apple launched its customized radio service called "iTunes Radio."

In addition to programmed and customized radio, the presence of digital technology and the internet have allowed for the emergence of a third means of delivering music: "on-demand" streaming services. These services provide users with access to large libraries of songs, from which they can select exactly which song to play at any time. A leading on-demand service is Spotify, which had 24 million active users globally as of March 2013. Launched in 2008 in Europe and in the United States in 2011, Spotify has a library of over 20 million songs. Other popular services with on-demand offerings include Rhapsody and Grooveshark. The most popular on-demand services offer both advertising supported and subscription options, but seek to persuade consumers to elect the subscription model.

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11 With the digital age, the music world has transitioned from one in which music must be purchased in physical form, whether a vinyl LP or CD, to a digital world in which digital downloads and digital music streaming are major forces. Apple's iTunes Store was launched in 2003 and established a mainstream market for the purchase of digital music files.

12 These services have been acquired, respectively, by MTV, Yahoo! and by CBS.

Through its century of existence, radio's popularity has remained robust. The radio industry is a $15 billion industry. It is understood by those in the music business to account for roughly 80% of the music listening experience in the United States. This percentage has remained roughly constant despite the rapid evolution in technology. Thus, while the 80% figure was once confined to listening to music over AM/FM radios, that figure now includes music delivered over radio stations playing through TV cable systems and over the internet. Almost half of radio listening occurs while the listener is in an automobile. The other 20% or so of music listening in the United States is experienced by listeners who seek more control over the music that they hear, whether through the purchase and playing of a record album or a CD, or the subscription to an on-demand digital music service such as Spotify.

III. The RMLC-ASCAP License Agreement for the Period 2010-2016

Much of the radio industry obtains its license for the public performance of ASCAP music through the RMLC, which is a trade association that represents the commercial radio industry. Between 2003 and 2009, the RMLC paid ASCAP for public performance licensing rights in the form of a "fixed fee" agreement.[15] As a result of the deep recession that hit the country in 2008, the RMLC's members' revenues contracted and the fixed fee license began to constitute an increasingly high percentage of RMLC member revenue. Consequently, in 2009, the RMLC began to negotiate new licensing terms to apply to commercial radio stations effective January 1, 2010 through December 31, 2016. The RMLC wanted a return to the 1.615% rate at which it had paid ASCAP before the fixed-fee arrangement was adopted. It also wanted a license not only for new media transmissions by RMLC member stations, but also new media transmissions by Clear Channel which aggregates many stations for delivery over the internet and mobile devices.

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ASCAP and the RMLC ultimately reached an agreement on terms for a license that established separate rates for radio stations depending on their intensity of music use. The rate for Music Format Stations[16] was set at 1.70% of all revenue, including revenue derived from new media uses. The RMLC and ASCAP memorialized their agreement in a binding letter of December 21, 2011. And on January 27, 2012, this Court approved the agreement and its terms became public.

It is of significance to the issues litigated in this trial, that the 1.70% rate applies both to revenue derived from terrestrial broadcasting and from internet transmissions by RMLC members. In addition, the 1.70% rate applies not only to simulcast radio

15 The RMLC allocated the fees among individual radio stations according to a formula that it developed.

16 The category "Music Format Station" is broad. A station is defined as a Music Format Station if it has a featured performance of ASCAP music in more than 90 of its "Weighted Program Periods" in a given week. A Weighted Program Period is of 15 minutes duration, and there are 318 Weighted Program Periods in a week. So, a station is a Music Format Station whether it plays ASCAP music anywhere between approximately 28% to 100% of the Weighted Program Periods. A station that does not fall within the Music Format Station definition because it uses ASCAP music less frequently pays at a rate starting at . 0296% of revenue, plus a supplemental fee.

stations that are streamed over the internet by terrestrial broadcasting RMLC members but also to programmed and customized internet radio stations owned by RMLC members. One RMLC member, Clear Channel, is licensed at this rate under a "Group License" form, which covers new media royalty payments for revenues not associated with an individual station. Thus, iHeartRadio's customized radio Create Station feature, which competes head on with Pandora, is licensed at the 1.70% rate. Until July of 2012, however, there was no revenue generated by the Create Station service.

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IV. Pandora

Pandora is the most successful internet radio service operating in the United States today. It is estimated to have approximately 200 million registered users worldwide and an approximately 70% share of the internet radio market in the United States. Pandora launched its internet radio service in 2005. Roughly eight years later, it had achieved great popularity, streaming an average of 17.7 billion songs per month in the fiscal year 2013.

A. Pandora's Music Genome Project

Pandora's exponential growth and popularity can be directly attributed to its substantial investment in its proprietary Music Genome Project ("MGP") database and associated algorithms. Pandora uses the MGP database to create customized internet radio stations for each of its customers. A Pandora customer creates a station by "seeding" it with a song, artist, genre, or composer. That seed serves as a starting point to which Pandora then applies the information in its MGP database to match that seed with other songs that Pandora's algorithms predict that the listener is likely to enjoy. The listener continues to give feedback by giving a thumbs-up or thumbs-down when a composition is played, or by signaling that a song should be skipped.

The MGP contains a wealth of data for every composition in its database. Trained music analysts, many of whom have music related degrees or are musicians, listen to the compositions selected for inclusion in the database and register the composition in reference to as many as 450 characteristics.[19] For pop and rock songs, for example, Pandora analyzes between 150 to 200 musical traits. Rap has about 350 "genes," and classical works have between 300 to 500 MGP-defined attributes. As Pandora's Conrad testified, "[b]ecause Pandora utilizes trained musicologists to analyze songs, the MGP is able to differentiate not only between an alto and tenor saxophone, but also between various styles of playing a tenor saxophone." When a Pandora listener seeds a station or registers a thumbs-up reaction, Pandora records that feedback and draws upon the MGP to locate other compositions that the listener is likely to enjoy. Conversely, when the feedback is a "thumbs down," the song will not reoccur in the user's playlist, and songs sharing its attributes will appear less frequently.

19 The use of human beings to classify each composition is unique to Pandora and has the advantage of ameliorating what the industry recognizes as the "cold start" problem. A cold start problem exists when the recommendation system cannot draw on adequate inferences for a composition because the item is new or obscure. Because of this limitation, the service may play the composition for listeners who do not like it or fail to play it for those who might.

Besides listening to as many as 100 of their own customized stations, Pandora users can opt to listen to programmed "genre" stations. The most popular Pandora genre stations include "Today's Hits," "Today's Country," and "Today's Hip Hop and Pop Hits." These genre stations are populated by songs which are hand selected by Pandora curators.

Pandora has a catalog of between approximately 1,000,000 to 2,000,000 songs, somewhat less than half of which are licensed through ASCAP. This number is considerably lower than the catalog size of an on-demand service like Spotify, which must have the ability to play virtually any composition any customer might select. Successful on-demand services have catalogs in the range of 20 million songs.

B. Pandora Premieres

Pandora has a small on-demand music service, but it is not part of this license application. The Pandora on-demand service is called Pandora Premieres. It features at any one point in time a few dozen songs, each available for listening on-demand for a limited period of time. This is music that artists and music publishers provide to Pandora for promotional purposes, typically before the commercial release of an album. This on-demand component of Pandora's service is not a significant part of Pandora; it constitutes a "barely measurable portion of Pandora listening." Pandora secures the rights to play the songs on Pandora Premiers by negotiating direct licenses with the copyright holders.

C. Pandora's Comedy Programming

While Pandora is overwhelmingly a service that plays music, in 2011 it introduced comedy offerings. The comedy content constitutes a very small percentage of Pandora's played content.

D. Pandora's Revenue

Pandora derives revenue from two principal sources: advertising and subscription fees. As of today, Pandora derives approximately 80% of its revenue from the sale of display, audio and visual advertising, and the remaining 20% or so from a paid subscription service without advertising called "Pandora One."

Pandora's revenue has grown exponentially since its inception. For fiscal year 2009, Pandora reported revenue of approximately $19 million. By fiscal year 2013, Pandora's revenue had risen to over $400 million. As of today, however, Pandora has yet to demonstrate sustained profitability.

Pandora's payment of licensing fees for the use of music consumes a very significant portion of its revenue. In 2013, Pandora's content acquisition costs were close to $260 million, or over 60% of its revenue for that fiscal year. A very substantial portion of these costs are for the fees paid to record companies for licenses for sound recordings, as described in more detail below.

E. Pandora's Competitive Environment

Pandora's competitive environment is dictated by the nature of its service. Pandora is a radio service, albeit a customized radio service. Unlike traditional broadcast AM/FM radio, in which one program is played for many listeners, Pandora's digital radio service provides the opportunity to have a unique program created for the enjoyment of each listener. This distinction between programmed and customized radio has been referred to as the one to many, versus the one to one distinction. But, despite that differentiation, made possible by digital technology, Pandora is radio. The listener does not control what song will next be played and doesn't know what that next song will be. As with other forms of radio, the listener may be introduced to new music she has not heard before. There is an industry term for distinguishing among types of listening experiences: lean-back versus lean-forward. Like radio, Pandora is a lean-back service, in contrast to the on-demand lean-forward services like Spotify.

Not surprisingly, therefore, Pandora competes aggressively with other radio stations for listeners. It competes directly with internet radio stations, whether they are programmed music streaming services or customized radio stations. But, because the internet radio market is comparatively small and because Pandora already holds a significant share of that market, Pandora expects its increased audience, listening hours, and advertising revenue to come largely at the expense of terrestrial radio. While Pandora has a 71% share of the internet radio market, it has less than an 8% share of the overall radio market.

Pandora is attempting to make itself ubiquitous, so that its listeners have Pandora available to them throughout their day, whether they are at home, at work, in the car, or somewhere else. As Pandora explained in a 2013 SEC 10-Q filing, "[o]ne key element of our strategy is to make the Pandora service available everywhere that there is internet connectivity." Pandora has consequently expanded its service to smartphones, tablets, and television streaming devices. And because almost half of radio listening takes place in cars, Pandora has negotiated agreements to integrate its service into new cars built by a number of auto companies.

Besides competing with traditional radio for listeners, Pandora also competes with traditional radio for advertising dollars. Most terrestrial radio advertising revenue comes from local advertising. To compete for these advertising dollars, Pandora has hired a large in-house local advertising sales force. And to improve its ability to compete for advertising dollars with terrestrial radio stations, Pandora contracts with third party Triton Digital, a firm that collects radio audience data on both a local and national level, in order for radio advertising buyers to better understand the reach of advertisements run on Pandora.

Despite this intensive effort to build advertising revenue, Pandora is still unable to play as many minutes of advertising per hour as its broadcasting competitors. Therefore, as of today, Pandora plays on average approximately 15 songs per hour as compared to terrestrial radio's roughly 11 songs per hour. While Pandora's free radio service now runs less audio advertising per hour than do terrestrial radio stations, this gap may lessen as Pandora's business matures.

In accordance with the above, in its public filings with the SEC Pandora identifies its principal competitors as broadcast radio providers, including terrestrial radio providers such as Clear Channel and CBS, satellite radio providers such as Sirius XM, and online radio providers such as CBS's Last.fm and Clear Channel's iHeartRadio. But, while programmed radio and customized radio are Pandora's primary competition, Pandora also competes with interactive,[21] on-demand internet music services.[22] Its identified competitors in this market include Apple's iTunes Store, RDIO, Rhapsody, Spotify, and Amazon.

V. Pandora's Licensing History with ASCAP

On July 11, 2005, Pandora first entered into an agreement with ASCAP for a blanket license to publicly perform the compositions in the ASCAP repertoire. This license was in effect from 2005 to 2010, when Pandora exercised its option to cancel it. The license which ASCAP issued to Pandora during this span of years was a form license.

Pandora was licensed by ASCAP from 2005 to 2010 under the ASCAP Experimental License Agreement for Internet Sites & Services — Release 5.0 ("5.0 License"). ASCAP first adopted the 5.0 License in 2004.[23] As of 2004, internet radio had been in existence for roughly ten years, customized internet radio had been in existence for approximately five years, and on-demand services had been in existence at least three years.[24] With its adoption of this form license, ASCAP made two important distinctions. First, it raised the rate for new media licenses, reflecting a judgment that those services made more intensive use of music than broadcast radio. Second, it made a distinction between interactive and non-interactive new media services. It did not, however, make any distinction between programmed and customized internet music services.

The 5.0 License allowed non-interactive users to choose between three rate schedules.[25] Schedule A of the 5.0 License, which Pandora chose, required it to pay the higher of 1.85% of revenue or a per-session rate. The 1.85% rate represented an increase in ASCAP's form license rate from the previous rate. The predecessor to the 5.0 License had an equivalent rate for this schedule of 1.615%.[26] ASCAP's form license for

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21 The music industry's use of the term "interactive" is explained below.

22 Pandora points out a cost advantage that broadcast and satellite radio have over Pandora. Broadcast radio pays no royalties for terrestrial broadcasts of sound recordings; satellite radio pays 9% of revenue for satellite transmission of sound recordings; and Pandora paid 55.9% of its revenue for internet transmission of sound recordings in 2012.

23 ASCAP created a "New Media" department in 1995 to address the licensing of music over the internet. Although the meaning of the term new media may depend on the context, ASCAP generally considers new media to include any music user that operates "primarily over the Internet, through wireless devices, or through other emerging digital technologies."

24 The Rhapsody on-demand service was inaugurated in 2001.

25 The 5.0 License defined non-interactive services as "site[s] . . . from which 'Users' may not download or otherwise select particular musical compositions, unless such compositions are sixty (60) seconds or less in duration."

interactive services provided for a substantially higher license rate of 3.0%.[27]

The interactive/non-interactive distinction in the ASCAP form license agreements is borrowed from 17 U.S.C. § 114's ("Section 114") use of the term interactive in the context of the licensing of sound recording rights (Section 114 and sound recording rights are discussed below). Because ASCAP considers its music to be more valuable to the services it classifies as interactive, it has licensed them at a higher rate than non-interactive services.

As noted, under the 5.0 License Pandora was required to pay the greater of either the percentage of revenue corresponding to its applicable rate, or a fee based on a concept known as "sessions." A "session" is defined in the license as "an individual visit and/or access to [the] Internet Site or Service by a User." Any visit that exceeded one hour in length began a new session.[28] At some point in 2010, Pandora recognized that it had been calculating sessions incorrectly, and that it had substantially underpaid ASCAP. It paid ASCAP over $1 million to account for that error. If the payments Pandora was required to make to ASCAP, when measured by the per session rate, are converted into a flat percentage of Pandora's annual revenue, the effective rate for the years 2005 through 2010 ranged from a high of 3.63% in 2006 to a low [**34] of 1.91% in 2007. But there is no evidence that any party believed that Pandora was obligated to pay above the 1.85% rate until 2010.

Pandora's systems do not track its customers' use of its services with any measure that corresponds to the 5.0 License definition of a session, and it was a complex undertaking for Pandora to calculate the amount it owed to ASCAP using that measure.[29] As a result of its dissatisfaction with this sessions component of its license, on October 28, 2010, Pandora sent a letter to ASCAP terminating its license and applying for a new license, pursuant to the terms of AFJ2, to run from January 1, 2011 through December 31, 2015.

Upon making a written request to ASCAP, Pandora obtained, pursuant to AFJ2 § V's requirement that "ASCAP is hereby ordered and directed to issue, upon request, a through-to-the-audience license to . . . [*inter alia*] an on-line user," the right to perform all of the compositions in ASCAP's repertoire for that period, with only the proper payment rates to be determined, either through negotiation or by the rate court. Having been unable to agree with ASCAP on the proper price for the license after roughly two years of negotiation, and spurred by Sony's impending withdrawal from ASCAP (as discussed below), on November 5, 2012, Pandora filed with this Court a petition for

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26 The 1.615% rate that ASCAP had applied to internet radio before its adoption of the 5.0 License was ASCAP's rate for a terrestrial radio license in the era before the RMLC license adopted a flat rate.

27 Interactive services are defined as those which "transmit[] and/or provide[] access to transmissions of content comprising or containing music to 'Users' at their request or direction."

28 For example, if a customer used a licensed service once for forty minutes and once for fifteen minutes, that was measured as two sessions. Similarly, if a customer used the service for 61 minutes, that was counted as two sessions.

29 As a consequence, Pandora and ASCAP agreed that Pandora could use a sample of usage to arrive at a reasonable estimate of the amount it owed.

determination of reasonable licensing fees pursuant to AFJ2. *See* AFJ2 § IX.

VI. The April 2011 ASCAP Compendium Modification

A. Overview and Context

In 2011, ASCAP modified its Compendium to permit its members to selectively withdraw from ASCAP the right to license works to new media entities. This was an unprecedented event. Never before had ASCAP granted partial withdrawal rights to its members. As this Court would hold in 2013, the modification violated the terms of AFJ2. AFJ2 requires that ASCAP license to any applicant all of the works in its repertoire, and consequently if a publisher leaves a composition in ASCAP's repertoire for some licensing purposes ASCAP is required to license that work to any applicant. *See* In re Pandora Media, Inc., 12 Civ. 8035 (DLC), 2013 U.S. Dist. LEXIS 133133, 2013 WL 5211927, at *1 (S.D.N.Y. Sept. 17, 2013). In the year and a half that followed the adoption of the modification of the Compendium, three of the four largest music publishers withdrew their new media rights from ASCAP. EMI's withdrawal was followed by the withdrawal of Sony and then UMPG. Each of these publishers thereafter negotiated direct licenses with Pandora. Those negotiations and licenses have been a central feature of this litigation, and are discussed in detail below.

To place the Compendium modification in broader context, it was simply one of the many ripple effects that have followed the onset of the digital age in the music business, and the industry's attempt to recover from the concomitant decline in some types of music sales. The modification of the Compendium came in response to pressure from ASCAP's largest music publishers. These publishers were focused principally on the disparity between the enormous fees paid by Pandora to record companies for sound recording rights and the significantly lower amount it paid to the PROs for public performance rights to compositions. The modification was enacted despite significant concern about the impact of this change on ASCAP, its writers and its independent publishers.

B. Public Performance Rights for Compositions versus Sound Recordings

A brief overview of the distinction between public performance rights in sound recordings and public performance rights in compositions is necessary to provide context for the discussion of the motivations of the largest publishers in effectuating the Compendium modification. A right to the public performance of a sound recording is the right to control the performance of one recording of a performance of a song. By contrast, a right of public performance in a composition is the right to control the use of the underlying musical composition itself. The latter right has been long recognized; but the right of public performance of a sound recording is a relatively new phenomenon and is restricted to digital services. The licensing fees for sound recordings are paid to an entity called SoundExchange, which collects and distributes these fees to the holders of sound recording copyrights.

In 1995, Congress passed the Digital Performance in Sound Recordings Act ("DPSRA"), which provided for the first time a public performance copyright in sound

recordings. *See* 17 U.S.C. §§ 106, 114 ("Section 114"). Section 114 did not require all music users to obtain a license to perform a sound recording, but only services that "perform the [sound recording] publicly by means of a *digital audio transmission*." 17 U.S.C. § 106(6) (emphasis added). Section 114 differentiates among services that are, in the meaning of the statute, "interactive" and "non-interactive." An interactive service is defined as a service "that enables a member of the public to receive a transmission of a program specially created for the recipient, or on request, a transmission of a particular sound recording . . . which is selected by or on behalf of the recipient." 17 U.S.C. § 114(j)(7). If a digital service does not provide users with this level of control it is non-interactive. The distinction between interactive and non-interactive services is meaningful because "non-interactive" digital music services are eligible for "a compulsory or statutory licensing fee set by the Copyright Royalty Board ["CRB"] made up of Copyright Royalty Judges appointed by the Library of Congress," *see* Arista Records, LLC v. Launch Media, Inc., 578 F.3d 148, 151 (2d Cir. 2009), whereas interactive services must independently negotiate rates for sound recording licenses. Pandora is a non-interactive service within the meaning of Section 114.

Importantly for purposes of this proceeding, Congress also provided that this rate court (and the BMI rate court) may not take into account sound recording licensing fees in setting a rate for the licensing of the compositions themselves. The DPSRA provides that "[l]icense fees payable for the public performance of sound recordings . . . shall not be taken into account in any . . . proceeding to set or adjust the royalties payable to copyright owners of musical works for the public performance of their works."[30] 17 U.S.C. § 114(i).

Ultimately, the CRB decided that the market for sound recording rights was materially different from the market for the public performance rights to musical compositions, and set rates for compulsory license fees for sound recordings at rates many times higher than the prevailing rates for the licensing of the public performance of the compositions. Consequently, Pandora pays over half of its revenue to record companies for their sound recording rights, and only approximately four percent to the PROs for the public performance rights to their songs.

The disparity between rates for the public performance of compositions versus sound recordings does not exist for most of ASCAP's revenue streams since, as just explained, the need to acquire sound recording licenses only applies to services who conduct digital audio transmissions. Thus, there is no disparity at all when it comes to most of ASCAP's business, including its general licensing program and its licensing of cable TV, broadcast TV, and terrestrial radio. Because only new media music services must acquire sound recording licenses, the PROs end up receiving far more money from public performance rights license fees for compositions than do the record companies from public performance license fees for sound recordings.

C. ASCAP-Publisher Negotiations Prior to the Compendium Modification

Against this backdrop, music publishers assessed their options. In September

30 Publishers lobbied for this provision in Congress because they were concerned that the sound recording rates would be set below the public performance rates for compositions and drag down the latter. ASCAP also supported the enactment of the provision, for the same reason.

2010, music publisher EMI advised ASCAP that it was contemplating withdrawing entirely from ASCAP. EMI Chief Executive Roger Faxon has explained that EMI wanted to withdraw because it believed that it was inefficient to license each right in the musical works and recordings it administered through different institutions. Faxon wanted EMI to be able to "unify the rights in the compositions that we represented so that a single negotiation with . . . a customer who wanted the rights could encompass all rights . . . necessary to empower their business." Faxon also said that EMI was dissatisfied with the "delays" in ASCAP's procedures and ASCAP's high operational costs.

Spurred by the potential loss of one of the four largest music publishers, ASCAP began in 2010 to explore a proposal to amend its Compendium to allow members to withdraw from ASCAP only the right to license works to new media users. It was, after all, only new media users who needed to acquire both a public performance and sound recording license. Not all of the ASCAP board was in agreement on this proposal. Large publishers were in general enthusiastic about such a change, but the songwriters and independent publishers were less so.

As noted, the largest publishers were fixated on the higher rates that record companies -- often their corporate affiliates -- were receiving from internet music providers, of which Pandora was the most prominent, for sound recording rights under Section 114's compulsory license regime when compared to the rates that Pandora and others were paying for public performance rights under AFJ2. The major publishers viewed AFJ2 as preventing them from closing the gap between the composition rates and the sound recording rates. In the words of Sony's Brodsky:

> We were struck by the vast disparity between what record companies received from digital music services for the sound recording rights that they conveyed and what was paid for the performance right.

This concern over the discrepancy between the revenues generated for record labels and those generated for music publishers is repeated in many of the communications related to the adoption of the Compendium modification and the subsequent withdrawals by the publishers of new media rights from ASCAP. In many of those exchanges they focus their attention directly on Pandora. For example, an email from ASCAP General Counsel Joan McGivern to LoFrumento of July 30, 2010, brought up the possibility of permitting partial withdrawals from ASCAP as a means to attempt to close the gap in Pandora's payments:

> I spoke to Peter Brodsky at Sony late yesterday. He would like to meet with us . . . to discuss — why publishers are not receiving as much as their record labels from Pandora and what options Sony might have, such as trying to license Pandora directly, withdrawing its rights, etc. . . .
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> . . . .

The publishers believed that AFJ2 stood in the way of their closing this gap. They believed that because the two PROs were required under their consent decrees to issue a license to any music user who requested one, they could not adequately leverage their market power to negotiate a significantly higher rate for a license to publically perform a composition.

. . . .

Against the backdrop of the urgency felt by the largest music publishers to close the gap between payments for composition rights and sound recording rights, other ASCAP members had their own separate concerns. Songwriters, and at least some independent music publishers, were concerned about the damage that might be wrought from the Compendium modification and the partial withdrawal of rights from ASCAP. Songwriters trusted ASCAP to account reliably and fairly for the revenues ASCAP collected and to distribute the portion of revenues owed to writers promptly and fully. Songwriters were concerned about the loss of transparency in these functions if publishers took over the tasks of collection and distribution of licensing fees. They were concerned as well that the publishers would not manage with as much care the difficult task of properly accounting for the distribution of fees to multiple rights holders, and might even retain for themselves certain monies, such as advances, in which writers believed they were entitled to share. Overall, they were concerned about the increasing concentration of the publishing industry and the willingness by some, particularly Sony, to engage in direct licensing outside the framework of the PROs. These concerns ripened as the writers learned that Sony intended to follow EMI's lead and take advantage of the Compendium modification to partially withdraw from ASCAP.

. . . .

Tension between the major publishers and the writers of ASCAP is not surprising given that the two groups' interests are not perfectly aligned. To balance their competing interests, ASCAP's internal rules are premised on equality in decision-making between writers and publishers. . . . As significantly, ASCAP provides writers with transparency. [I]n the words of LoFrumento:

> Major, major driving issue is [that] with ASCAP [the writers] get transparency . . . . [They] know our rules and we take the money that we collect, take off our overhead and split it fifty-fifty. Our writers get that part of the fifty percent, the publishers get the other parts. It's an equal division . . . . The writer's greatest fear is that in the world of publishers collecting the money the splits will not be reflective of how ASCAP splits the money.

Finally, the writers were concerned that to the extent that the major publishers pulled their significant resources out of ASCAP, the writers would have to shoulder a larger burden in paying for activities like licensing, advocacy, and litigation. . . .

The large publishers were well aware of the discomfort that at least some writers felt with the new media withdrawals and made the following argument to convince them to come on board: if the major publishers could get higher license rates by direct negotiations with new media companies outside of ASCAP then those rates could be used in rate court litigation to raise the ASCAP license fees. The publishers found an ally on this issue in writer and ASCAP chairman Williams, who agreed with the new media rights withdrawal strategy. His email illustrates the strategy he pursued to get writers to support the publishers' partial withdrawal of rights from ASCAP:

> My job is to make this transition as smoothly as possible in the board room . . . to assuage the fears of the writers who may see this as an ASCAP death

> knoll . . . . [W]e are in fact giving [the major publishers] the right to negotiate. The end result being that they will set a higher market price which will give us bargaining power in rate court.

As an internal debate swirled, the ASCAP Board authorized management on September 16, 2010 to "examine alternative means of licensing digital media and to engage antitrust counsel." In March 2011, ASCAP notified the Department of Justice of its consideration of a proposal to allow the withdrawals of new media licensing rights from ASCAP.

D. The Compendium Modification Allowing New Media Withdrawals is Enacted.

On April 27, 2011, the ASCAP Board adopted a resolution to amend its Compendium to allow a member to withdraw from ASCAP its rights to license music to new media outlets, while allowing ASCAP to retain the right to license those works to other outlets. Six songwriter members of the Board abstained from the vote, but there was no vote in opposition.

The Compendium modification was executed by creation of Compendium Rule 1.12. It allowed any ASCAP member, on six months notice, to "modify the grant of rights made to ASCAP . . . by withdrawing from ASCAP the right to license the right of public performance of certain New [M]edia Transmissions." The modified Compendium defines "New Media Services" -- i.e., entities which make "New Media Transmissions" and which would be purportedly subject to a decrease in their ASCAP rights as the result of publisher withdrawals -- as

> any standalone offering by a 'Music User' . . . by which a New Media Transmission of musical compositions is made available or accessible (i) exclusively by means of the Internet, a wireless mobile telecommunications network, and/or a computer network and (ii) to the public, whether or not, in exchange for a subscription fee, other fee or charge.
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> . . . .

One effect of the Compendium modification was that major publishers could pull a writer's works out of the PRO that the writer had decided to join. Although publishers had in the past considered a work to belong to the repertoire of the PRO to which the writer of the work belonged, in fact, it was a publisher that generally had contractual control over the licensing decisions for the work. With the withdrawal of rights from the PRO, the withdrawing publisher unilaterally removed the work from the PRO insofar as new media licensing rights were concerned.

The Compendium modification also allowed the withdrawing publishers to re-join ASCAP at any point, eliminating any risk to the publisher if a withdrawal proved to be a bad idea. . . .

To manage the withdrawal process, the Compendium modification mandated, in Section 1.12.4, ASCAP's creation of a list of works subject to any publisher's withdrawal by "[n]o later than ninety days before the Effective Date" of the withdrawal. The publisher was required to notify ASCAP of any errors or omissions "within ten days of

receipt of the List of Works." Thus, ASCAP and the publisher would both have a list of works that would be affected by the withdrawal well in advance of the effective date of the withdrawal.

E. ASCAP Provides Administrative Services for Withdrawing Publishers.

EMI publicly announced in early May of 2011, within days of the adoption of the Compendium modification, that it would be withdrawing new media rights from ASCAP. The turmoil caused by EMI's decision was widespread. Confronted with the reality of losing this major publisher, on May 5, ASCAP's LoFrumento made a proposal to EMI. He offered ASCAP's services in distributing the EMI revenues to ASCAP members and to other songwriters and publishers who would be entitled to share in the revenues. LoFrumento argued at the time that

> ASCAP is uniquely positioned to handle the distribution of these rights because it already distributes royalties from the online licensees; its operating ratio remains one of the lowest in the world and certainly the lowest in the US; its technology is leading edge and its databases are authoritative; and finally, its staff is truly professional.

LoFrumento also advised EMI's Faxon that ASCAP had been flooded with inquiries since EMI's announcement from both foreign and domestic rights holders and organizations. As he explained, many writers were concerned that EMI would not distribute royalties as carefully, accurately, and promptly as they had relied upon ASCAP to do.

Ultimately, EMI and other withdrawing publishers agreed to let ASCAP handle the distribution of royalties collected for the new media direct licenses that they negotiated. They executed "Administration Agreements" for this purpose. ASCAP charged a fee . . . for this service, which represented a very substantial discount from its ordinary charge to members. . . . ASCAP was concerned that without a low rate, the withdrawing publishers would be tempted to use competing PROs to perform the administration services.

As a result of the publishers' partial withdrawals from ASCAP, the burden on remaining ASCAP members to pay for all of the other functions that ASCAP performs for its members, including in LoFrumento's words at trial, "membership, legislative, legal, senior management, [and] international costs," increased. On the other hand, because ASCAP continued to administer the distribution of licensing revenues, the writers could continue to have confidence that they would actually receive the monies owed them by the withdrawing publishers. Finally, the Administration Agreements meant that the withdrawing publishers faced little downside in withdrawing new media rights. They could continue to enjoy the benefits of having ASCAP perform burdensome back-office tasks while licensing internet music entities directly.

VII. A Second Compendium Modification in December 2012: the "Standard Services" Agreement

At the urging of Sony, another change to the Compendium, executed in December 2012, further reduced the burdens on withdrawing publishers. The modification allowed the publishers to target large new media entities for direct licensing negotiations and to effect withdrawals of rights from ASCAP solely with respect to those large licensees.

The December 2012 amendment permitted a member that was withdrawing under Section 1.12 of the Compendium to indicate that it wished to leave to ASCAP the right to license certain new media services that paid to ASCAP license fees of less than $5,000 per year. Where the withdrawing member indicated that it was only withdrawing new media rights "in part," ASCAP continued to license new media services for the member that were defined in the Compendium as "Standard Services." As a consequence, smaller new media entities could avail themselves of an ASCAP license so long as they accepted ASCAP's 5.0 License (or its successor licenses) without negotiation.

ASCAP's DeFilippis offered the following explanation for the adoption of the Standard Services exception for the withdrawal of new media licensing authority:

> Given the rapidly changing marketplace and the low barriers to entry, new digital music services launch quite frequently. Many will never gain traction with listeners or generate substantial revenue. From the perspective of the withdrawing music publishers, they lacked the necessary staff and infrastructure to track the thousands of small music users that wished to license their music.

Sony's Brodsky stated that Sony wanted this revision to the Compendium so that Sony's withdrawal could be limited "to just the music services that we wanted to enter into direct deals with."

VIII. Pandora Negotiates Direct Licenses with EMI, Sony, and UMPG and Fails to Negotiate an Agreement with ASCAP.

A. The Pandora-EMI License Negotiations

Upon learning in May 2011 of EMI's withdrawal of its new media licensing rights from ASCAP, Pandora immediately began to negotiate with EMI for a license to its catalog. The negotiations were not contentious and the contours of the license were quickly settled. Indeed, in their very first substantive discussion, which occurred on June 6, EMI confirmed that it would be using 1.85% as the headline rate, and hoped to have the agreement effective as of January 1, 2012. The collegial tone is reflected in handwritten notes by Pandora's Rosenbloum. Rosenbloum colorfully recorded that EMI was "not looking to screw anyone."

. . . .

The 1.85% rate in the Pandora-EMI agreement was the same rate that was available to Pandora under ASCAP's 5.0 License for a non-interactive service. A July term sheet with EMI reflected this rate and an expectation that the agreement would have a two year term. It also reflected calculations premised on EMI's estimate that it had

approximately a 20% market share at the time.

During the ensuing months, the parties discussed the size of an advance that Pandora would pay to EMI, among other things. Meanwhile, Pandora continued to pay its licensing fees to ASCAP.

The licensing agreement, although not executed until March 16, 2012, covered the two-year period January 1, 2012 to December 31, 2013. Pandora agreed to a license that provided EMI with a pro-rata share of 1.85% of Pandora's revenues. . . .

Finally, the agreement included a most-favored-nation clause, or "MFN," for the benefit of Pandora. The agreement contemplated a prospective decrease in the headline rate from 1.85% to as low as 1.70% if Pandora succeeded in obtaining a lower rate for licensing a repertoire as large or larger than EMI's catalog. . . .

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B. The Pandora-ASCAP License Negotiations

As noted above, Pandora had terminated its license with ASCAP on October 28, 2010 because of its concern over the calculation of the per-session rate in the 5.0 License, and had applied at that time for a new license for the calendar years 2011 through 2015. It remained an applicant for such a license throughout 2011 and 2012, as ASCAP adopted its modification to the Compendium and as EMI withdrew new media rights from ASCAP.

On September 16, 2011, Pandora executed an interim license agreement with ASCAP effective as of January 1, 2011. It adopted the 5.0 License rate of 1.85% without any per session fee. The agreement noted the parties' competing positions on several issues, including Pandora's position that the adjustment for advertising expenses should apply to its internal advertising expenses.

Roughly a year later, on September 28, 2012, Pandora learned that Sony was also withdrawing its new media rights from ASCAP. With its discussions with ASCAP "languish[ing]", and with Sony's withdrawal from ASCAP due to take effect at year end, which was just weeks away, Pandora filed this rate court petition on November 5.

Pandora's filing in rate court angered some in the ASCAP community, particularly the major publishers. . . .

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Not surprisingly, given the fallout from Pandora's filing of the rate court petition, and with the deadline for Sony's withdrawal from ASCAP approaching, the negotiations between Pandora and ASCAP intensified. Had those negotiations succeeded, of course, this rate court action would have become moot.

By the end of November, Pandora believed that it had reached an agreement on terms with ASCAP, although it understood that the agreement needed final approval from ASCAP. . . . ASCAP had assured Pandora that if they finalized their agreement before the end of 2012, the license would cover the Sony repertoire since the Sony withdrawal

from ASCAP was only effective as of January 1, 2013.

LoFrumento decided to reject the license that his team had negotiated with Pandora. He knew that either way he faced litigation. He knew that if he executed the license, Sony would sue ASCAP. Sony had threatened to sue ASCAP in the event any license agreement with Pandora that encompassed the Sony repertoire was executed before the end of 2012. Sony had also notified ASCAP that it might not use ASCAP for administration services if ASCAP issued a license to Pandora. LoFrumento was already facing rate court litigation with Pandora. Given the pressure being exerted on him by both Sony and UMPG, LoFrumento was only willing to execute a license with Pandora that included a headline rate of at least 2.5%, and he knew Pandora was not willing to pay that much.

LoFrumento advised the Law and Licensing Committee of ASCAP's Board of Directors on December 12 that he intended to reject the terms Pandora and ASCAP had negotiated. Everyone understood that that meant that the rate court proceeding would go forward. None of the Committee members asked for a description of terms Pandora and ASCAP had negotiated or to discuss LoFrumento's decision.

Thus, in mid-December 2012, ASCAP set itself on a course to have its rate for licensing Pandora set in this rate court proceeding, despite the cost associated with that litigation. The decision was made in the midst of great turmoil, uncertainty and pressure. The partial withdrawals of new media rights by major publishers, who collectively controlled about 50% of ASCAP's music, threatened to make ASCAP a weaker organization. Sony and UMPG had also made clear to LoFrumento that they wanted to negotiate direct licenses with Pandora and opposed ASCAP entering into a final license with Pandora. There was, of course, a chance that by placating the major publishers, they might later exercise their option to rejoin ASCAP for all purposes. LoFrumento also had to consider the writers who had become restive and were doubtful about the supposed benefits of the publisher withdrawals. In the midst of all of this, LoFrumento cast the lot of ASCAP with the withdrawing major publishers and chose to let the rate court decide the dispute between Pandora and ASCAP. On December 14, ASCAP surprised Pandora and rejected the terms they had negotiated.

C. The Pandora-Sony License Negotiations

Since the Fall of 2010, Sony had been discussing with ASCAP the possibility of a withdrawal of rights so that it could directly negotiate with Pandora. In July 2012, Sony notified ASCAP that it would exercise its right under the modified Compendium to withdraw new media rights. In late September, Pandora (along with the rest of the world) learned that Sony would be withdrawing new media rights from ASCAP effective January 1, 2013. As already described, Sony worked with ASCAP during late 2012 to effect a second change to the Compendium that would permit a partial withdrawal of new media rights from ASCAP. Under the Standard Services exception, Sony allowed ASCAP to retain licensing authority for smaller new media services while assuming responsibility for the direct licensing of larger entities such as Pandora.

As of the Fall of 2012, Sony was the world's largest music publisher. It owned or controlled between 25% and 30% of the market. It had taken this frontrunner position

in the summer of 2012, when it became responsible for licensing EMI's catalog.[42] Combined, the Sony and EMI catalogs contain roughly 3 million songs.

. . . .

The first substantive discussion between Pandora and Sony occurred in a telephone call on October 25 between Sony's Brodsky and Pandora's Rosenbloum. Sony promptly set the tenor for the negotiations with a not-too-veiled threat. Brodsky stated "[i]t's not our intention to shut down Pandora." In his many years of negotiating music licenses, Rosenbloum testified that had never before heard such a threat. In some ways, this threat put on the table no more than what was obvious. Sony's works were already being played on Pandora; they were incorporated in the MGP. Unless Pandora could do without those works and remove them from its repertoire by January 1, Pandora had to obtain a license from Sony or face crippling copyright infringement claims. Sony was in the driver's seat and the clock was ticking.

The remainder of the conversation was largely devoted to Sony's statement of the reasons why it needed Pandora to pay for the public performance of music at a substantially higher rate. The principal reason was the "massive unfair disparity" between what Pandora was paying the record labels for sound recording rights and what it was paying the music publishers for composition rights. Brodsky explained that if the labels were getting 50% of Pandora's revenue, then it would be "fair" for music publishers to get 12% of the revenue, although Brodsky acknowledged that Pandora could not afford to pay that much. As Brodsky emphasized, it was the "differential" between the rates paid to the labels and the publishers that was the problem, and that Pandora was really just caught in the middle of a tug of war between the labels and publishers. Brodsky admitted that if the labels were getting only 25% of Pandora's revenue, then Pandora's current industry-wide rate of 4% for the licensing of rights to publicly perform compositions would probably be alright and there wouldn't be any need to increase it.

Brodsky identified a second, subsidiary reason for needing Pandora to pay more. Referring to the writers' skepticism over the motives of the publishers in withdrawing from the PROs, Brodsky added that Sony had to show the writer-members of the PROs that there was some "reasonable justification" for Sony's withdrawal. At the end of the call, Rosenbloum threw out the possibility that Pandora might pay a "modest" increase to Sony for a year as they all waited to see what happened to the rates Pandora was paying the labels.

Following this conversation, Pandora decided on a two-prong strategy. It would intensify its efforts to get an ASCAP license before the end of the year. To bring ASCAP to the negotiating table it filed its petition in this rate court for an ASCAP license on November 5. Secondly, Pandora attempted to obtain leverage in its negotiations with Sony. It requested a list of the Sony catalog so that it could take the Sony works off, or at least threaten to take them off, of the Pandora service if no deal could be reached. In his years of negotiating licenses, this was the first time that Rosenbloum had ever requested a list of works from a publisher.

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42 Sony Corporation and other investors purchased EMI Music Publishing companies in June 2012. With that purchase, Sony/ATV undertook the administration of EMI, which remains a separate entity.

Pandora's first request for the list came on November 1, 2012, in an email from Rosenbloum to Brodsky. . . .

Brodsky received this request for a list of the Sony works, but never responded. In their telephone conversations during the month of November, Rosenbloum reiterated the request for a list of works on several occasions but never got any response. Rosenbloum repeated the request once more at a breakfast meeting that he and Pandora's Kennedy had with Sony's Brodsky and Bandier on November 30. Again, Sony did not respond.

The list of Sony works was potentially important for several purposes, and Pandora referred to those several purposes in its discussions with Sony. In addition to wanting to be able to remove the Sony works from its service if Pandora and Sony could not come to terms, Pandora needed the list so that it could understand how to apportion any payments between the EMI and Sony catalogues since the payments would apparently be made at two different rates. Pandora also wanted the list so it could evaluate whether the substantial, non-refundable advance that Sony was demanding would likely be recouped.

Sony had a list readily at hand, since the Compendium required that a publisher and ASCAP work together during the 90 day period before the effective withdrawal date to confirm precisely which works were being withdrawn. Sony understood that it would lose an advantage in its negotiations with Pandora if it provided the list of works and deliberately chose not to do so. Brodsky's explanation at trial that he did not provide the list because he believed that negotiations were proceeding smoothly and did not want to impose an unnecessary "burden" on Sony's staff is not credible. The negotiations were not going smoothly; the list had already been prepared and its production imposed no burden. As Brodsky recognized in his testimony, the list was "necessary" to Pandora in the event the parties did not reach a deal. Sony decided quite deliberately to withhold from Pandora the information Pandora needed to strengthen its hand in its negotiations with Sony.

Ultimately, Sony made an offer to Pandora in early December. Still hoping to reach an agreement with ASCAP which would obviate the need for license from Sony, Pandora did not respond to the offer or to a follow-up email of December 6.

On Friday, December 14, with two weeks left in the year, and one week remaining before the music industry took its annual holiday break, ASCAP notified Pandora that it would not execute the agreement they had negotiated. The following Monday, Pandora urgently made two renewed written requests for the list of Sony's works, one to Sony and another to ASCAP.

Since the repeated requests from Pandora's outside counsel Rosenbloum had gone unanswered, Pandora's general counsel Delida Costin sent her own email to Brodsky on December 17 requesting the list of works. Not wishing to empower Pandora, Sony never responded.

That same day, Pandora also asked ASCAP for the list of Sony works in ASCAP's repertoire. It would have taken ASCAP about a day to respond to Pandora's request with an accurate list of the Sony works. But, ASCAP, like Sony, stonewalled Pandora and refused to provide the list.

In making the request to ASCAP, Pandora's counsel wrote that "Pandora must prepare for the possibility of being unlicensed by Sony/ATV or ASCAP for [Sony's] works effective January 1st, so it is important that we get this information from ASCAP as soon as possible." This request set off a flurry of emails within ASCAP. ASCAP ultimately decided to contact Sony to see if it would give its permission to share the list of works. On Wednesday, December 19, ASCAP notified Sony of Pandora's request and that it would be providing Pandora with the list of Sony works that ASCAP had previously given to Sony in connection with its withdrawal of rights. Not surprisingly, given its own refusal to share the list with Pandora, Sony did not give ASCAP permission to provide the list. As a result, neither Sony nor ASCAP provided the list of works to Pandora.

If either Sony or ASCAP had provided Pandora with a list of the Sony works, Pandora would have been able to remove Sony's compositions from its service within about a week.[47] Although ASCAP attempted at trial to show that Pandora could have used public sources of information to identify the Sony catalog, it failed to show that such an effort would have produced a reliable, comprehensive list, even if Pandora had made the extraordinary commitment necessary to try to compile such a list from public data.

The terms of the Pandora license with Sony were negotiated in four business days during the single week that ran between ASCAP's rejection of the Pandora term sheet and the start of the holiday break. On December 18, Brodsky sent Rosenbloum a term sheet. As proposed in that document, the license term would be one year, starting January 1, 2013. It required Pandora to pay a non-refundable but recoupable advance of [REDACTED] and a non-refundable [REDACTED] advance as an administrative fee. The royalty rate was set at Sony's pro-rata share of an industry-wide rate of 5%. Sony understood this to be a 25% increase over the then prevailing industry rate of approximately 4%. In his March 2013 report to his Board of Directors, Sony's Bandier bragged that Sony had leveraged its size to get this 25% increase in rate.

The term sheet also allowed Pandora to take an adjustment for advertising expenses . . . . This would include a deduction for Pandora's internal advertising sales personnel "to the extent deducted from revenue in connection with the calculation of performance right license fees under Licensee's agreements with other major music publishers" or PROs.

On a December 21 draft of the agreement, Rosenbloum wrote to Sony that, to the extent Pandora was willing to conclude the license without receiving "actual data" from Sony, it "at least" needed confirmation of the approximate percentage of the ASCAP repertoire that consisted of Sony and EMI compositions. Sony's Brodsky responded to this request not by giving a list but with a rough estimate that the Sony/EMI share of the ASCAP repertoire was 30%.

Although the agreement was predominately on Sony's terms, the December 21 draft agreement did include a change in Pandora's favor regarding the adjustment for advertising sales from a previous draft of the agreement. Unlike a draft delivered from

47 Pandora needed the publishers' list of works before it could take any steps to remove them from the Pandora service. Once Pandora had the list, it could quite quickly remove any song with an identical title and eliminate the copyright infringement risk. It would take Pandora more than a week, however, to identify which songs with identical titles but from other publishers could be reintroduced into the Pandora playlist.

Sony to Pandora on December 18 which only allowed for a deduction from internal advertising costs if Pandora got a similar deduction from another PRO or publisher, the December 21 agreement allowed for a reduction of up to [REDACTED] that included both outside commissions and direct internal costs of such sales without reference to another agreement with a PRO or publisher. The parties executed a Binding Heads of Agreement on December 21, 2012.

By mid-January 2013, and despite the existence of a confidentiality agreement, Sony leaked the key terms of the Pandora license to the press. The headlines in three articles said it all: "Sony/ATV 'Now Has the Power to Shut Pandora Down...'"; "Sony/ATV gets 25 percent increase in Pandora royalties"; and "Sony/ATV's Martin Bandier on new 'quite reasonable' Pandora deal." A *New York Post* article featured a photograph of Sony's Bandier in shirt sleeves with a large cigar in his mouth, as it reported that Sony had "wrangled a 25 percent increase in royalties" for a one year license. Bandier was quoted as saying that "[a]t the end of the day, we got a terrific deal for our songwriters. Our thinking has been vindicated." In his interview with Billboardbiz, reported on January 18, Bandier explained that the rates "are quite reasonable. When you compare it to the rate record companies are getting, it was really miniscule." One article reported: "[m]any other publishers were rooting for Sony to deliver a higher rate . . . so that if [the PRO's] deal with Pandora heads to rate court, the judge will consider the Sony rate the market rate and raise performance royalties accordingly." The press coverage focused on Sony's leverage in negotiations due to its outsize market power: "Look a little closer, and this is ultimately a very lopsided negotiation . . . . Pandora absolutely needs Sony's catalog to run an effective radio service. And if they don't pay what Sony/ATV wants, they can't use it, by law."

D. The Pandora-UMPG License Negotiations

Pandora did not have to wait long for the next publisher to leave ASCAP and demand a yet higher rate for a direct license. In February 2013, Pandora learned that UMPG was scheduled to withdraw its new media licensing rights from ASCAP effective July 1, 2013.

. . . .

The negotiations between UMPG and Pandora were even more contentious than the negotiations between Sony and Pandora. After difficult conversations in March in which UMPG asked for an industry-wide headline rate of 8%, Pandora essentially placed the negotiations on hold. While a license agreement was executed in June, it was for a six month term only and was contingent on several events.

The negotiations between these parties were conducted principally by Horowitz for UMPG and Rosenbloum and Kennedy for Pandora. . . .

. . . .

Like Sony, Horowitz justified a substantial increase in the rate Pandora needed to pay by stressing the disparity between the rates at which Pandora paid for sound recording rights and public performance rights for compositions. Showing confidence that he knew the material terms of the Sony-Pandora license, Horowitz repeatedly asked

Kennedy, (as Kennedy paraphrased) "how did you get Marty [Bandier] at Sony to agree to such a low payment?"

Avoiding invitations to discuss the specific terms of the Sony license, Kennedy explained to Horowitz that Pandora felt it should be treated just like entities covered by the ASCAP-RMLC license. Kennedy argued that Pandora was competing for listeners with, and taking listeners from, radio companies covered by the RMLC deal. Those radio services, including iHeartRadio, would be paying the PROs for many years into the future at a rate lower than the roughly 4% range that Pandora had been paying the PROs.

Kennedy indicated a preference for negotiating with the PROs, but added that, if UMPG wanted to negotiate directly with Pandora, then UMPG should provide Pandora with a list of the withdrawn compositions and UMPG's proposal for a rate. Horowitz said he was "not sure" he was able to provide Pandora with a list, and indicated that Pandora should just make a deal based on UMPG's representation of its overall market share.

. . . .

In late April 2013, UMPG provided to Pandora a complete list of the UMPG works in the ASCAP repertoire, but in a way that prevented Pandora from using the information to remove UMPG compositions from its service. The list was subject to an NDA. The list itself was the very information that the NDA deemed confidential. The NDA provided that:

> [Pandora] has requested that Universal provide to [Pandora] titles of songs in Universal's music catalog controlled by ASCAP, corresponding writer names and corresponding shares owned or controlled by Universal and such writers, all of which Universal deems to be confidential ("Confidential Information").

The NDA then restricted Pandora's use of the list. It provided that

> [Pandora] agrees not to use any Confidential Information for any purpose except to evaluate and engage in discussions concerning a potential business relationship between the Parties.

Pandora correctly interpreted this provision as forbidding it from using the list to remove the UMPG works from its service.

On May 21, Pandora's Rosenbloum and Horowitz met. While Horowitz expressed his admiration for Pandora and assured its representatives that UMPG wanted it to thrive, he did not move much from his initial proposal for a 8% industry rate, only revising it downward to 7.5%. Rosenbloum responded by reminding Horowitz that ASCAP had agreed to a 1.70% ASCAP rate with a generous advertising deduction for Pandora's competitor, iHeartRadio.

Pandora believed that UMPG's rate request was unreasonable, and that UMPG would be inflexible in any negotiations. Therefore, instead of engaging further with UMPG, Pandora went on the offensive. First, Pandora purchased KXMZ-FM, a terrestrial radio station in Rapid City, South Dakota. With this purchase, Pandora hoped to shoehorn itself into the ASCAP-RMLC license. Then, Pandora believed, it would be in a

position to argue that it was entitled to the RMLC 1.70% rate.[52] The agreement of purchase is dated June 5, 2013. Second, on June 11, Pandora moved in this Court for partial summary judgment. Its motion argued that any purported new media withdrawals by publishers following the 2011 ASCAP Compendium modification did not affect the scope of the ASCAP repertoire subject to Pandora's application for an ASCAP license.

During this interim period, as it worked on these two projects, Pandora did not respond to emails from Horowitz. In his emails to Pandora, Horowitz expressed increasing levels of anxiety and exasperation about Pandora's "radio silence." Then, on the heels of announcements of its purchase of a radio station and the filing of the summary judgment motion, Pandora reached out to UMPG. In an understatement, Pandora observed in a June 13 email that "[a]s you may have read or heard, this week Pandora made a couple of announcements that are related to our discussions regarding a direct license with UMPG." Pandora expressed optimism that it would win the summary judgment motion and recognition of its entitlement to the RMLC license, all before July 1. But, it added,

> In the unlikely event we don't have a decision on either of these points by July 1, it is our preference to continue to perform works in the UMPG catalog. To help facilitate that, we propose accepting UMPG's 7.5% of revenue offer on a provisional basis starting July 1, 2013, pending the Court's rulings, with the understanding that if the ASCAP rate court subsequently rules in Pandora's favor that Pandora will immediately thereafter -- and on a retroactive basis back to July 1, 2013 -- license the right to works in the UMPG repertory through ASCAP at whatever rate the rate court decides.

The parties memorialized a six month license agreement on July 1, 2013. The agreement provided for an industry rate of 7.5%, with no deduction for advertising expenses, which would be contingent on the two contingencies outlined in the June 13 email from Pandora. The agreement provided that "in the event that a final decision not subject to any further appeal is rendered in the pending ASCAP Rate Court . . . [that] UMPG's July 1, 2013 withdrawal from ASCAP of [New Media licensing rights] . . . is not effective" or if "Pandora's acquisition of the KXMZ-FM qualifies Pandora for the RMLC-ASCAP license" then the agreement would "be of no further force or effect."

. . . .

IX. September 17 Partial Summary Judgment Opinion

On September 17, 2013, Pandora's motion for partial summary judgment was granted. *See* In re Pandora Media, Inc., 2013 U.S. Dist. LEXIS 133133, 2013 WL 5211927. The Opinion held, *inter alia*, that AFJ2 prohibited ASCAP from withdrawing from Pandora the rights to perform any compositions over which ASCAP retained any licensing rights. Consequently, the publishers' purported withdrawals of only new media rights under the Compendium modification were held inoperative. The Court found that AFJ2 prohibited a regime in which publishers allowed ASCAP to license a composition to

52 Pandora's purchase of KXMZ-FM remains pending. ASCAP has petitioned the FCC to deny the transfer of the station's FCC license to Pandora.

some music users but not others. AFJ2 required each work that was in the ASCAP repertoire to be available to any user who requested a blanket license. The publishers, of course, remained free to withhold works from ASCAP entirely.

. . . .

[The court describes several other licenses that ASCAP or Pandora claim should be used as benchmarks for setting a royalty rate in this proceeding. This opinion was originally filed under seal, and then publicly released with redactions. Many of the details of the licenses described by the court have been redacted. The court notes a number of respects in which the proposed benchmark licenses are significantly different from the ASCAP-Pandora license.]

CONCLUSIONS OF LAW

Pandora requests that this rate court set a fee for its license with ASCAP. Section IX of AFJ2 requires the rate court to set a "reasonable" fee for a requested license, but that term is not defined in AFJ2. Governing precedent dictates, however, that in determining the reasonableness of a licensing fee, a court "must attempt to approximate the 'fair market value' of a license -- what a license applicant would pay in an arm's length transaction." MobiTV, Inc., 681 F.3d at 82. "In so doing, the rate-setting court must take into account the fact that ASCAP, as a monopolist, exercises market-distorting power in negotiations for the use of its music." Id. The Second Circuit has recognized that, because music performance rights are largely aggregated in the PROs which operate under consent decrees, "there is no competitive market in music rights." ASCAP v. Showtime/The Movie Channel, 912 F.2d 563, 577 (2d Cir. 1990). Consequently, fair market value is a "hypothetical" matter. Id. at 569. In such circumstances, "the appropriate analysis ordinarily seeks to define a rate or range of rates that approximates the rates that would be set in a competitive market." Id. at 576.

Helpfully, both ASCAP and Pandora have endorsed the same definition of "fair market value," drawn from a recent textbook:

> A widely used description of fair market value is the cash equivalent value at which a willing and unrelated buyer would agree to buy and a willing and unrelated seller would agree to sell . . . when neither party is compelled to act, and when both parties have reasonable knowledge of the relevant available information. . . . Neither party being compelled to act suggests a time-frame context — that is, the time frame for the parties to identify and negotiate with each other is such that, whatever it happens to be, it does not affect the price at which a transaction would take place. . . . The definition also indicates the importance of the availability of information — that is, the value is based on an information set that is assumed to contain all relevant and available information.

ROBERT W. HOLTHAUSEN & MARK E. ZMIJEWSKI, CORPORATE VALUATION 4-5 (2014).

In rate court proceedings, a determination of the fair market value "is often facilitated by the use of a benchmark -- that is, reasoning by analogy to an agreement reached after arm's length negotiation between similarly situated parties." United States

v. BMI (In re Application of Music Choice), 316 F.3d 189, 194 (2d Cir. 2003) ("Music Choice II"). . . .

ASCAP and Pandora have each proposed a set of benchmarks for assessing the appropriate rate for an ASCAP license to Pandora. Interestingly, they both agree that the Pandora license with EMI is a valid benchmark. Their sets of proposed benchmarks share no other common element.

. . . ASCAP relies principally on the three direct licenses negotiated between Pandora and EMI, Sony, and UMPG in the wake of the April 2011 Compendium modification. ASCAP arrives at proposed rates of 1.85% for 2011-2012 (the Pandora-EMI license rate), 2.50% for 2013, and 3.00% for 2014-2015. This is the first time that ASCAP has sought a license rate of over 1.85% from any non-interactive internet music service.

Pandora recognizes the Pandora-EMI license agreement as a suitable benchmark, as well as the historical ASCAP-Pandora license rate of 1.85% under the 5.0 License. But, in addition to its analysis of appropriate benchmarks, Pandora argues that it is "similarly situated" to the RMLC licensees and is accordingly entitled by the terms of AFJ2 to the RMLC 1.70% rate.

In summary, ASCAP has carried its burden of demonstrating that its rate proposal of 1.85% is reasonable for the years 2011 and 2012. It has failed to carry its burden of demonstrating that its rate proposals of 2.50% and 3.00% for the years 2013 and 2014-2015, respectively, are reasonable. Pandora has failed to show that it is entitled to the 1.70% RMLC rate as the result of being similarly situated, within the meaning of AFJ2, to the RMLC member radio stations.

In conducting an independent inquiry into a reasonable rate, this Court is guided by the following parameters. First, having determined a reasonable rate for the first years of the five-year license period, there is a presumption that that rate will continue to be a reasonable rate for the entire license period. Second, the historical division between interactive and non-interactive internet music services requires that Pandora be licensed well below the 3.0% rate at which ASCAP licenses interactive music services. Third, the circumstances under which Sony imposed upon Pandora an implied ASCAP headline rate of 2.28% confirm that any reasonable rate for an ASCAP-Pandora license is below 2.28% by a measurable margin. For these and the other reasons described below, the 1.85% license rate is the reasonable rate for the entirety of the five year term of the ASCAP-Pandora license.

I. ASCAP's Rate Proposal of 1.85% for 2011 and 2012

For the years 2011 and 2012, ASCAP proposes a rate of 1.85%. ASCAP's benchmark for this proposal is the Pandora-EMI license (which is for the years 2012 and 2013), which provided for a headline rate of 1.85%. For confirmation that 1.85% is a reasonable rate, ASCAP relies on the fact that it is the same rate under which Pandora was licensed under the 5.0 License from 2005 to 2010.

Pandora agrees. It admits that a headline rate of 1.85% is within a range of reasonable rates in the event that Pandora is not entitled to the 1.70% rate in the ASCAP-

RMLC license. According to Pandora, the 1.85% rate is the "upper bound of a range of reasonable rates for Pandora." Since AFJ2 only requires ASCAP to demonstrate that its rate proposal is "reasonable," Pandora's concession makes further discussion unnecessary.

II. ASCAP's Rate Proposal of 2.50% for 2013 and 3.00% for 2014 and 2015

. . . .

ASCAP has not carried its burden of showing that its proposed rates for 2013, 2014, and 2015 are reasonable. . . .

A. Presumption of a Single Rate

Having accepted ASCAP's proposal of a rate of 1.85% as a reasonable rate for the first two years of the Pandora license (2011 and 2012), there is a strong basis to recognize a presumption that the rate of 1.85% would also be a reasonable rate for the last three years of the Pandora license (2013 through 2015). . . .

Also, adoption of an escalating rate over the term of a five year license would be out of step with historical practice. ASCAP has never negotiated nor issued a five year license with an escalating rate, and rate court jurisprudence is devoid of any example of an escalating ASCAP rate for a single license term. . . .

There appear to be good reasons why ASCAP and the industry generally adopt a single rate for the term of a license. . . . Adoption of a single rate facilitates business planning, encourages reliance on historical data, and discourages resort to contested projections. Likely for these reasons, and others, there is a well developed practice that supports the adoption here of a headline rate of 1.85% for not just the first two years, but also for the last three years of the license.

ASCAP has failed to overcome any presumption that exists in favor of a unitary rate. But, even without such a presumption it has not carried its burden to establish that the rates of 2.50% and 3.00% are reasonable.

. . . .

ASCAP has not shown that either the Pandora-Sony or the Pandora-UMPG licenses are good benchmarks for its license with Pandora. Sony and UMPG each exercised their considerable market power to extract supra-competitive prices. The UMPG agreement is a particularly flawed benchmark. . . *[In a later part of the opinion, the court notes that there were virtually no meaningful negotiations between Pandora and UMPG because UMPG, controlling roughly 20% of the music market, began with and insisted upon a demand that Pandora pay an extraordinarily steep increase over the prevailing rate, and bore no relation to the then-existing market price.]*. In addition, the evidence at trial revealed troubling coordination between Sony, UMPG, and ASCAP, which implicates a core antitrust concern underlying AFJ2 and casts doubt on the proposition that the "market under examination reflects an adequate degree of competition to justify reliance on agreements that it has spawned." Music Choice IV, 426 F.3d at 95 (citation omitted).

. . .

D. ASCAP's Theoretical Arguments and Motivations

In addition to offering benchmarks, either ASCAP or its witnesses presented five arguments in support of either a higher rate for a Pandora license than it had historically paid, or an escalating rate within a single Pandora license. These theoretical arguments seek to justify ASCAP's request for an otherwise hard-to-explain sharp rate increase from 1.85% in 2011 and 2012 to 2.50% and 3.00% in the years between 2013 and 2015. . . .

1. An Increase in Competition

Dr. Murphy posits, on behalf of ASCAP, that an increase in the demand for public performance rights in musical works on the internet would lead to an increase in market prices in a competitive market. Dr. Murphy and ASCAP list a number of recent customized radio services which have emerged in support of the relevance of this theory here. They tender this observation to support an increase in the Pandora licensing rate from 1.85% in 2012 to 3.00% by 2015. This theory of economic behavior in a competitive market is so untethered to actual music industry market conditions and historical evidence that it provides minimal assistance when the task at hand is to set the rate for this five year Pandora-ASCAP license.

. . . .

2. Demand for Variety

Dr. Murphy offers a second theoretical argument in support of ASCAP's requested fee structure. He contends that, all else being equal, "listeners prefer more variety to less." From this observation, he concludes that the demand for variety increases the competitive market price of rights to publicly perform musical works and justifies an increased rate for a Pandora license.

As was true with Dr. Murphy's first theoretical assumption, this theory comes undone when applied to the real world. Dr. Murphy's claim that listeners prefer variety above all is unsupported and cannot form the basis for an upward departure from a rate of 1.85%. Dr. Murphy did not conduct any research or analysis into consumer listening behavior to arrive at his conclusion that listeners prefer variety above all. And it is likely that once a certain minimal variety threshold is reached listeners don't actually [**134] prioritize extra variety. The record evidence suggests that, as a general matter, listeners are not so eclectic in their tastes that the addition of a song to a music service will necessarily provide added value. Listeners often like to hear music that they already know that they like, or music very similar to music they already like.

. . . .

3. Disparity Between Sound Recording and Composition Fees

It is worth observing that there is no evidence in the record that any of the licensing negotiations in this industry have been driven by either of the rationales proffered by Dr. Murphy. There was no evidence that ASCAP, EMI, Sony, UMPG, or any other licensor negotiated with any music user on the ground that their service required a larger catalogue or that there had been a recent surge in competition in the market. But, there was ample evidence

of the actual driving force behind the Sony and UMPG withdrawal of new media rights from ASCAP and their negotiations with Pandora. That driving force was the music publishers' envy at the rate their sound recording brethren had extracted from Pandora through proceedings before another rate setting body, the CRB.

ASCAP has not offered any theoretical support for raising the rate for public performance of a composition by a comparison to the rate set for sound recording rights. There may be several reasons for this, but first and foremost is the statutory prohibition on considering sound recording rates in setting a rate for a license for public performance of a musical work. See 17 U.S.C. § 114(i) ("License fees payable for the public performance of sound recordings . . . shall not be taken into account in any . . . proceeding to set or adjust the royalties payable to copyright owners of musical works for the [**140] public performance of their works."). Thus, this Court may not take the rates set by the CRB into account in determining the fair market rate for a public performance license from ASCAP to Pandora.

Despite this statutory prohibition, one observation may be safely made. Unhappiness about the gap between what Pandora pays record companies and what it pays the PROs drove the modification to the ASCAP Compendium, the publishers' withdrawals from ASCAP, and the Sony and UMPG negotiations with Pandora. The corporate rivalries over digital age revenues explain a great deal of this history. In any event, the record is devoid of any principled explanation given by either Sony or UMPG to Pandora why the rate for sound recording rights should dictate any change in the rate for composition rights.

4. Cannibalization of Music Sales

There is agreement between the parties that it is appropriate to require a higher licensing fee from a music service that acts as a substitute for the sale of a musical work, when compared to one that does not. To the extent that a music service is a replacement for sales, it is said to cannibalize the sales; to the extent it encourages sales, it is said to be promotional.

The reasons for this distinction arise, at least in part, from a separate stream of rights belonging to composers. Composers have a copyright interest in the reproduction and distribution of musical works, an interest that is referred to as "mechanical rights." . . .[W]hen hard copies (e.g., vinyl records, CDs) or digital downloads of compositions are sold, the composers receive mechanical rights payments. On-demand services, as well, are required to pay mechanical rights. As described earlier, Spotify pays a 10.5% fee for both mechanical rights and the right to publicly perform a musical work.

The parties have argued about the extent to which Pandora and services like it are promotional or cannibalistic. There is apparently no industry consensus on this question. It is worth noting, however, that what evidence was presented at trial suggests that Pandora is promotional.

To begin with, radio has traditionally been considered promotional. The record industry has long sought to have its music played on radio stations.[83] Pandora is no exception. Record labels have taken advantage of Pandora Premieres to feature new work in advance of release, with the hope that that exposure will engender sales. Pandora itself has buy buttons that permit listeners to buy digital downloads from Amazon and Apple, and they use them with some frequency.[84] There is no evidence that artists have taken steps to prevent Pandora from playing the artist's work. As significantly, one of Pandora's principal competitors --

83 There is a well-documented history of record promoters going so far as to use bribes, or "payola," to increase the number of times songs are played on a radio station.

iTunes Radio -- was created to complement Apple's iTunes Store and promote sales in that digital store.

In contrast, on-demand streaming services like Spotify are widely considered cannibalistic and are licensed at a higher rate accordingly. After all, a listener has no need to purchase a digital download when the listener has any song that she wants to hear instantaneously available through Spotify. For this very reason, some prominent performers have acted to prevent Spotify from playing their recordings. In sum, while this metric -- whether a service is promotional or cannibalistic -- could justify a differentiation of rates between services, ASCAP failed to show that Pandora is anything other than promotional of sales.

5. Music Intensity

ASCAP argued at trial that Pandora's licensing fee should exceed the RMLC rate of 1.70% because its channels use music more intensively than terrestrial radio stations. Music intensive broadcast stations play, on average, 11 songs per hour; Pandora's stations play 15 or so. This difference is attributable at least in part to the difficulty of placing advertising on internet radio, which is a challenge that Pandora is addressing through its substantial investment in an in-house advertising department. In any event, ASCAP has not shown that this current differential justifies any increase in the last three years of the Pandora license above the 1.85% rate it has requested for the first two years.

. . . .

. . .ASCAP agrees that Pandora's rate for 2011 and 2012 should be 1.85%. And it has presented no evidence that the music intensity of Pandora's services will change in any material way for the last three years of the license term. For this reason, as well, the music intensity metric cannot provide a basis to justify the hike in rates to 2.50% and 3.00% that ASCAP seeks.

6. Pandora's Success

There is one final motivation for ASCAP's requested rates that must be acknowledged. The backdrop for this rate court dispute is the arrival of the digital age in the music industry, the resulting disruption to the business models of the music industry, and Pandora's current success in the digital radio market.

A rights holder is, of course, entitled to a fee that reflects the fair value of its contribution to a commercial enterprise. It is not entitled, however, to an increased fee simply because an enterprise has found success through its adoption of an innovative business model, its investment in technology, or its creative use of other resources. It appears that Sony, UMPG, and ASCAP (largely because of the pressure exerted on ASCAP by Sony and UMPG) have targeted Pandora at least in part because its commercial success has made it an appealing target.

Pandora has shown that its considerable success in bringing radio to the internet is attributable not just to the music it plays (which is available as well to all of its competitors), but also to its creation of the MGP and its considerable investment in the development and maintenance of that innovation. These investments by Pandora, which make it less dependent

84 Pandora's "buy button" resulted in over $3 million per month in music sales on Amazon and the iTunes Store during 2013.

on the purchase of any individual work of music than at least some of its competitors, do not entitle ASCAP to any increase in the rate it charges for the public performance of music. To the extent Pandora prospers because of its innovations and because of its separate investment in an initiative to develop advertising revenue, ASCAP and its members will prosper through the increased revenue stream that is generated by the application of an appropriate rate to Pandora's revenue base.

. . . .

III. Whether Pandora is Entitled to the RMLC 1.70% Rate

Before concluding that the rate for an ASCAP license to Pandora for the five years from 2011 through 2015 should be 1.85%, it is necessary to address Pandora's contention that it is similarly situated to the RMLC licensees and entitled to the RMLC license rate of 1.70% under the anti-discrimination provisions of AFJ2. See AFJ2 §§ IV(C), IX(G). Pandora has not shown that a ruling in this Opinion that requires ASCAP to license Pandora at a rate of 1.85% from 2011 to 2015 will violate the anti-discrimination provisions of AFJ2.

. . . .

Although Pandora contends that it is similarly situated to all RMLC licensees, it emphasizes its similarity to Clear Channel's iHeartRadio generally, and more specifically to customized radio offerings by RMLC members Clear Channel and CBS, the Create Station and Last.fm services, respectively. Pandora has shown that its service is indistinguishable for licensing purposes from these components of Clear Channel and CBS.

More generally, Pandora has shown that it is radio and competes with programmed radio, including terrestrial radio, for listeners and advertising dollars. Its most direct competitors within the radio industry are other internet radio services, especially customized radio services. Although terrestrial radio stations generally play about four fewer songs per hour than Pandora, Pandora has shown that this difference is not material given the broad categories of music use in the ASCAP-RMLC license. . . .

. . . .

In light of these similarities, the question that is fairly presented by Pandora's application is whether it is entitled by AFJ2 to the RMLC rate. The answer to that question, while close, is no. Pandora is not entitled to the 1.70% RMLC rate for at least three reasons.

First, the RMLC rate applies to a large-scale license agreement that binds a variety of licensees in both the terrestrial and the internet radio sphere. Moreover, the revenues from terrestrial radio swamp those from the internet services. Second, while Pandora's service is, for the purpose of this analysis, identical to services offered by some RMLC members, AFJ2 forbids discrimination among licensees, and Pandora has not shown that it is similarly situated to any RMLC licensee. Pandora relies heavily on comparison with Clear Channel's iHeartRadio's customized Create Station feature. But Clear Channel is the licensee, and the Create Station feature constitutes a very small part of Clear Channel's business at present. Third, Pandora is as similarly situated to internet music services covered by the 5.0 License at the rate of 1.85%. Since this Opinion sets the rate for the Pandora license at 1.85%, it is difficult, if not impossible, to find that there is any violation of AFJ2 due to a discrimination in rates.

What this discussion may underscore is a lack of coherence in the present rate structure of ASCAP licenses. This is understandable given the evolving nature of the radio

market. Any change in rate structure (for instance, to create a rate structure for customized music services) would have to be made with care based on a thorough understanding of the market and the uses of music in the market, informed by a desire not to discriminate among similarly situated licensees or between similar services simply because of a difference in the mode of distribution.[90] After all, if there is no commercially legitimate reason for a distinction in rates, then the distinction would not survive in a competitive market.

IV. Publisher Concerns Regarding the Consent Decree and the Rate Court

There is one remaining issue to address. ASCAP, Sony, and UMPG witnesses expressed frustration with the Consent Decree and the rate court process, both in their communications with each other and in their trial testimony. LoFrumento explained that this frustration arrived with the digital age and reflects a fear that the record industry will grab all of the available revenue from the digital transmission of music. According to ASCAP, AFJ2 and its processes, in particular the requirement that ASCAP issue a license to any applicant, hamper ASCAP's ability to negotiate a fair market rate. Sony and UMPG witnesses asserted that they had to withdraw their licensing rights from ASCAP in order to negotiate effectively with Pandora and achieve appropriate parity with sound recording licensing rates. They expressed skepticism that the rate court proceedings could determine a fair market value for a Pandora license.

The Court is sensitive to ASCAP's concerns and understands that the unique characteristics of the market for music licensing and the Consent Decree regime produce challenges for all parties. But, for the reasons already discussed, ASCAP did not show that the upshot of the negotiations conducted by either Sony or UMPG with Pandora was a competitive, fair market rate.

CONCLUSION

The headline rate for the ASCAP-Pandora license for the years 2011 through 2015 is set at 1.85% of revenue for every year of the license term. Pandora is entitled to take a deduction for any direct payments to publishers made following their partial withdrawals from ASCAP.

SO ORDERED.

90 If ASCAP revises its rate structure it will no doubt be attuned to the need to treat major competitors in a market fairly.

[Edited. You can read the full opinion here.]

Pandora Media, Inc. v. Am. Soc'y of Composers, Authors & Publrs.

785 F.3d 73 (2d Cir 2015)

LEVAL, STRAUB, AND DRONEY, CIRCUIT JUDGES.

PER CURIAM:

These appeals are taken from an opinion and order of the United States District Court for the Southern District of New York. . . .

At issue are two separate decisions of the district court. The first granted summary judgment to Petitioner-Appellee Pandora Media, Inc. ("Pandora") on the issue of whether the consent decree governing the licensing activities of Respondent-Appellant American Society of Composers, Authors and Publishers ("ASCAP") unambiguously precludes partial withdrawals of public performance licensing rights. [Citation.] The second decision, issued after a bench trial, set the rate for the Pandora-ASCAP license for the period of January 1, 2011 through December 31, 2015 at 1.85% of revenue. *See In re Pandora Media, Inc.*, 6 F. Supp. 3d 317 (S.D.N.Y. 2014).

. . . .

For the reasons set forth below, we **AFFIRM** the orders of the district court.

. . . .

DISCUSSION

I. Summary Judgment on Partial Withdrawals

. . . .

Appellants contend that publishers may withdraw from ASCAP its right to license their works to certain new media music users (including Pandora) while continuing to license the same works to ASCAP for licensing to other users. We agree with the district court's determination that the plain language of the consent decree unambiguously precludes ASCAP from accepting such partial withdrawals. The decree's definition of "ASCAP repertory" and other provisions of the decree establish that ASCAP has essentially equivalent rights across *all* of the works licensed to it. The licensing of works through ASCAP is offered to publishers on a take-it-or-leave-it basis. As ASCAP is required to license its entire repertory to all eligible users, publishers may not license works to ASCAP for licensing to some eligible users but not others.

Appellants would have us rewrite the decree so that it speaks in terms of the right to license the particular subset of public performance rights being sought by a specific music user. This reading is foreclosed by the plain language of the decree, rendering Appellants' interpretation unreasonable as a matter of law. [Citation.]

This outcome does not conflict with publishers' exclusive rights under the Copyright Act. Individual copyright holders remain free to choose whether to license their works through ASCAP. They thus remain free to license—or to refuse to license—public performance rights to whomever they choose. Regardless of whether publishers choose to utilize ASCAP's services, however, ASCAP is still required to operate within the confines of the consent decree.

The partially withdrawn works at issue remain in the ASCAP repertory pursuant to the plain language of the consent decree. Since section VI of the decree provides for blanket licenses covering *all* works contained in the ASCAP repertory, it necessarily follows that the partial withdrawals do not affect the scope of Pandora's license.

II. Rate-Setting

. . . .

Having reviewed the record and the district court's detailed examination thereof, we conclude that the district court did not commit clear error in its evaluation of the evidence or in its ultimate determination that a 1.85% rate was reasonable for the duration of the Pandora-ASCAP license. We likewise conclude that the district court's legal determinations underlying that ultimate conclusion—including its rejection of various alternative benchmarks proffered by ASCAP—were sound. [Citation.]

Although ASCAP challenges the district court's presumption that a rate found to be reasonable for part of a license term remains reasonable for the duration thereof, the district court expressly observed that its holding did not depend on the existence of such a presumption. ASCAP failed to carry its burden of proving that its proposed rate was reasonable. Under these circumstances, it was not clearly erroneous for the district court to conclude, given the evidence before it, that a rate of 1.85% was reasonable for the years in question.

. . . .

CONCLUSION

We have considered Appellants' remaining arguments and find them to be without merit. For the foregoing reasons, we **AFFIRM** the orders of the district court.