PUBLIC VERSION

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

In the Matter of **DETERMINATION OF RATES AND TERMS FOR PREEXISTING SUBSCRIPTION SERVICES AND SATELLITE DIGITAL AUDIO RADIO SERVICES**	)))))))))	**Docket No. 2011-1 CRB/PSS Satellite II**

SIRIUS XM RADIO INC.'S PROPOSED FINDINGS OF FACT

R. Bruce Rich (N.Y. Bar No. 1304534)
Miranda Schiller (NY Bar No. 2295624)
Randi W. Singer (NY Bar No. 2946671)
Todd Larson (N.Y. Bar No. 4358438)
Sabrina A. Perelman (N.Y. Bar No. 4481529)
Jacob B. Ebin (N.Y. Bar No. 4774618)
WEIL, GOTSHAL & MANGES LLP
767 Fifth Avenue
New York, NY 10153
Tel: 212.310.8170
Fax: 212.310.8007
r.bruce.rich@weil.com
miranda.schiller@weil.com
randi.singer@weil.com
todd.larson@weil.com
sabrina.perelman@weil.com
jacob.ebin@weil.com

Counsel for Sirius XM Radio Inc.

October 1, 2012

TABLE OF CONTENTS

INDEX OF WITNESS TESTIMONY BY CITATION FORMAT

Witness Name	Description	Party	Exhibit Number	Citation Format
Jonathan Bender	Testimony of Jonathan Bender	SoundExchange	SX Trial Ex. 75	Bender WDT
Jonathan Bender	Rebuttal Testimony of Jonathan Bender	SoundExchange	SX Trial Ex. 239	Bender WRT
Steven Blatter	Written Direct Testimony of Steven Blatter with accompanying exhibits SXM Dir. Exs. 1, 17-56	Sirius XM	Sirius XM Dir. Trial Ex. 15	Blatter WDT
Stephen Bryan	Corrected Testimony of Stephen Bryan	SoundExchange	SX Trial Ex. 66	Bryan CWDT
Charles Ciongoli	Corrected Testimony of Charles Ciongoli	SoundExchange	SX Trial Ex. 67	Ciongoli CWDT
Steve Cohen	Steve Cohen Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 23	Cohen DWDT
Jeremy M. Coleman	Jeremy M. Coleman Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 21	Coleman DWDT
Stephen R. Cook	Stephen R. Cook Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 6	Cook DWDT
Mark Eisenberg	Amended and Corrected Rebuttal Testimony of Mark Eisenberg	SoundExchange	SX Trial Ex. 245	Eisenberg ACWRT
George S. Ford	Second Corrected Testimony of George S. Ford	SoundExchange	SX Trial Ex. 79	Ford CWDT
George S. Ford	Amended and Corrected Rebuttal Testimony of George S. Ford	SoundExchange	SX Trial Ex. 244	Ford ACWRT
David J. Frear	Written Direct Testimony of David J. Frear with accompanying exhibits SXM Dir. Exs. 6-13	Sirius XM	Sirius XM Dir. Trial Ex. 12	Frear WDT

Witness Name	Description	Party	Exhibit Number	Citation Format
David J. Frear	Revised Written Rebuttal Testimony of David J. Frear with accompanying exhibits SXM Reb. Exs. 1-4	Sirius XM	Sirius XM Reb. Trial Ex. 1	Frear RWRT
David J. Frear	David J. Frear Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 13	Frear DWDT
David J. Frear	David J. Frear Designated Written Rebuttal Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 13	Frear DWRT
Ronald H. Gertz	Corrected Written Direct Testimony of Ronald H. Gertz with accompanying exhibits SXM Dir. Exs. 7-8, 14	Sirius XM	Sirius XM Dir. Trial Ex. 14	Gertz CWDT
Ronald H. Gertz	Revised Written Rebuttal Testimony of Ronald H. Gertz with accompanying exhibits SXM Reb. Exs. 5-36	Sirius XM	Sirius XM Reb. Trial Ex. 8	Gertz RWRT
Raymond M. Hair	Testimony of Raymond M. Hair	SoundExchange	SX Trial Ex. 73	Hair WDT
Aaron Harrison	Corrected Rebuttal Testimony of Aaron Harrison	SoundExchange	PSS Trial Ex. 32	Harrison CWRT
John R. Hauser	Corrected Written Direct Testimony of John R. Hauser with accompanying Appendices A-H	Sirius XM	Sirius XM Dir. Trial Ex. 24	Hauser CWDT
Mel Karmazin	Written Direct Testimony of Mel Karmazin with accompanying exhibits SXM Dir. Exs. 1-2	Sirius XM	Sirius XM Dir. Trial Ex. 19	Karmazin WDT
Mel Karmazin	Mel Karmazin Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 20	Karmazin DWDT
Mel Karmazin	Mel Karmazin Designated Written Rebuttal Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 20	Karmazin DWRT

Witness Name	**Description**	**Party**	**Exhibit Number**	**Citation Format**
Robert Law	Robert Law Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 10	Law DWDT
Eric Logan	Eric Logan Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 22	Logan DWDT
Thomas Z. Lys	Corrected Testimony of Thomas Z. Lys	SoundExchange	SX Trial Ex. 80	Lys CWDT
Thomas Z. Lys	Designated Deposition Testimony	SoundExchange/ Sirius XM	No exhibit number designated	Lys Dep.
Thomas Z. Lys	Rebuttal Testimony of Thomas Z. Lys	SoundExchange	SX Trial Ex. 240	Lys WRT
Anthony J. Masiello	Anthony Masiello Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 8	Masiello DWDT
James E. Meyer	Written Direct Testimony of James E. Meyer with accompanying exhibits SXM Dir. Exs. 3-5	Sirius XM	Sirius XM Dir. Trial Ex. 5	Meyer WDT
Roger G. Noll	Revised Amended Written Direct Testimony of Roger G. Noll with accompanying Appendices A-S and Tables 1-4	Sirius XM	Sirius XM Dir. Trial Ex. 1	Noll RAWDT
Roger G. Noll	Revised Written Rebuttal Testimony of Roger G. Noll with accompanying Appendix A, Tables 1-2 and Exhibits SXM Reb. Exs. 37-41	Sirius XM	Sirius XM Reb. Trial Ex. 6	Noll RWRT
Janusz Ordover	Third Corrected and Amended Testimony of Janusz Ordover	SoundExchange	SX Trial Ex. 74	Ordover CAWDT
Janusz Ordover	Amended Rebuttal Testimony of Janusz Ordover	SoundExchange	SX Trial Ex. 218	Ordover AWRT
Gary Parsons	Gary Parsons Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 9	Parsons DWDT

Witness Name	**Description**	**Party**	**Exhibit Number**	**Citation Format**
Michael Powers	Rebuttal Testimony of Michael Powers	SoundExchange	SX Trial Ex. 243	Powers WRT
William R. Rosenblatt	Corrected Written Direct Testimony of William R. Rosenblatt with accompanying exhibits SXM Dir. Exs. 15-16	Sirius XM	Sirius XM Dir. Trial Ex. 17	Rosenblatt CWDT
Michael A. Salinger	Corrected Written Rebuttal Testimony of Michael A. Salinger with accompanying Appendices A-C	Sirius XM	Sirius XM Reb. Trial Ex. 9	Salinger CWRT
Itamar Simonson	Rebuttal Testimony of Itamar Simonson	SoundExchange	SX Trial Ex. 65	Simonson WRT
Terrence Smith	Terrence Smith Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 11	Smith DWDT
David P. Stowell	Written Direct Testimony of David P. Stowell with accompanying Appendices A-C	Sirius XM	Sirius XM Dir. Trial Ex. 18	Stowell WDT
David P. Stowell	Written Rebuttal Testimony of David P. Stowell with accompanying Appendices A-B and exhibits SXM Reb. Exs. 42-51	Sirius XM	Sirius XM Reb. Trial Ex. 7	Stowell WRT
J. Gregory Sidak	Amended and Corrected Testimony of J. Gregory Sidak	SoundExchange	SX Trial Ex. 78	Sidak ACWDT
Darius Van Arman	Testimony of Darius Van Arman	SoundExchange	SX Trial Ex. 77	Van Arman WDT
John Douglas Wilsterman	John Douglas Wilsterman Designated Written Direct Testimony from *Satellite I*	Sirius XM	Sirius XM Dir. Trial Ex. 7	Wilsterman DWDT

EXECUTIVE SUMMARY

Based on the totality of the hearing record, the requirements of Sections 112, 114, and 801(b)(1) of the Copyright Act, as well as governing case law, Sirius XM Radio Inc. (hereinafter, "Sirius XM" or "the Company") requests that the Copyright Royalty Judges set the satellite digital audio radio service ("SDARS") monthly royalty rate for the public performance of sound recordings and the making of any number of ephemeral phonorecords to facilitate such performances for the period January 1, 2013 through December 31, 2017 in the range of 5% to 7% of Sirius XM's monthly U.S. Gross Revenues. By stipulation of the parties, the fee for ephemeral phonorecords shall be included within, and constitute 5% of, such royalty payments. Sirius XM proposes that, other than the royalty rate and three other modest changes (as set forth in Section VI, *infra*), the terms currently applicable to SDARS, as codified at 37 C.F.R. §§ 382.10-17, be retained in their current form.

In 2007, the Copyright Royalty Judges set the SDARS statutory royalty rate at 6%, increasing to 8% by 2012 (the "*Satellite I*" proceeding) – rates triple those to which Sirius and XM and SoundExchange had previously agreed. The *Satellite I* rate was determined based on a combination of benchmarking from the rates then being paid for related, but substantially more valuable, rights by interactive audio services and application of the statutory § 801(b)(1) factors governing SDARS rate-setting.

The economic impact of the existing rate structure on Sirius XM has been significant. Over the 2007-2012 license period, the Company made no money net of its costs; at the same time, it will have paid the record industry some [redacted] in statutory royalties. Equally, Sirius XM's royalty obligations to SoundExchange have risen disproportionately to its other expenses. Since *Satellite I*, the Company has reduced non-music programming costs by [redacted] or some [redacted] per year. At the same time, the Company's music programming costs have increased by [redacted] or [redacted] per year, even though such programming comprises only about half the channels on the service. Even were the current 8% royalty rate held constant over the upcoming license term, Sirius XM projects that that it would pay more than twice as much for music as for the equally valuable non-music content it offers.

The parties have presented starkly different views as to the proper level of statutory royalties for the 2013-2017 period. As part of its overall cost containment initiatives, Sirius XM has gone directly to individual record companies to acquire statutory (and additional) license authority. Consistent with basic economic tenets, by opening the market to competition for airplay on Sirius XM, the Company has been able to secure nearly 100 licenses (the "Direct Licenses") at levels *below* the prevailing 2012 statutory rate, namely, at rates between 5% and 7% of revenue (and averaging about 6.1%).

Unlike the evidence presented during the *Satellite I* proceeding, these Direct License agreements provide the Judges, for the first time, with competitively negotiated market evidence, not merely of "comparable" agreements, but of marketplace agreements that involve the identical buyer (Sirius XM), sellers (record labels), and rights (performances on SDARS) at issue in this proceeding. These agreements are proffered as Sirius XM's principal benchmark in this proceeding because, as Professor Roger Noll testified, they represent the best possible indication of competitive market rates negotiated by willing buyers and willing sellers who could have relied on the statutory proceeding to establish a rate but instead chose to transact among themselves due to the competitive benefits of the Direct Licenses. Among the record labels that signed the Direct Licenses are prominent entities in the recording industry, with catalogs including Grammy winners, chart-toppers, and tracks that are played regularly across the range of Sirius XM's 70+ music and comedy channels – alongside (and competing for airtime with) songs distributed by other labels, including the majors.

The trial record, summarized in the body of this filing, refutes SoundExchange's efforts to marginalize these Direct License agreements, most ironically, its contention that only a small percentage of record labels – and none of the majors – have entered into them. The hearing record demonstrated the representativeness of these licenses in relation to the range of music offerings by the Company. It also revealed the extensive efforts undertaken by SoundExchange – on whose Board of Directors sit executives of the major labels, as well as representatives of independent labels – to dissuade labels from entering into Direct Licenses out of concern that rates set via the competitive process would serve as compelling evidence of reasonable rates in this proceeding and thereby undermine SoundExchange's efforts, acting for the record industry collectively, to raise rates dramatically above existing levels.

Sirius XM corroborated by two means at trial that the 5% to 7% royalty range of these Direct Licenses is not aberrationally low but, rather, is reflective of how a workably competitive market would value the rights involved. The first was accomplished by Professor Noll's examination of the license agreements reached between non-interactive webcasters such as Last.fm and Slacker and the major record labels. The second (discussed below) was demonstrated by Professor Noll's making appropriate adjustments to the benchmarking models presented by SoundExchange's expert, Professor Ordover, to correct for their basic flaws.

Professor Noll selected non-interactive webcasters to perform a check on the validity of the Direct License data because of those services' much closer fit to the music service offerings of Sirius XM than those of SoundExchange's chosen comparators: interactive/on-demand services such as Rhapsody. Following essential adjustments to the rates paid by the non-interactive services (to account for the non-music portion of Sirius XM's service, as well as Sirius XM's differing cost structure due to its bundling of a delivery platform in the price of its service), the resulting royalty, expressed as a percentage of Sirius XM's average revenue per subscriber, falls squarely within the range of the Direct License royalties.

For its part, SoundExchange seeks a percentage-of-revenue rate beginning at 12% of Sirius XM's gross revenues, which represents a 50% increase above the rate currently in place, with further increases in each year such that, by 2017, Sirius XM would be paying 20% of its gross revenue – or fully two-and-a-half times the culminating 8% rate for the current year set by the Copyright Royalty Judges in the *Satellite I* Determination. SoundExchange separately and additionally has proposed sweeping changes in the prevailing definition of gross revenues that by themselves would increase Sirius XM's royalty payments by more than 30%. As was demonstrated by Sirius XM Chief Financial Officer David Frear's rebuttal testimony, this latter, side-door attempt at a rate increase would entitle the record industry to a share of Sirius XM revenues that bear no relationship whatsoever to the sound recording performance rights at issue in this proceeding, including non-music programming such as The Howard Stern Show and sports and other unrelated Sirius XM businesses.

The sole support for SoundExchange's request for the extraordinarily large rate increases it seeks was provided in the form of expert testimony by Professor Janusz Ordover. Unlike Professor Noll, who took account in his benchmarking of competitive developments in the marketplace since the *Satellite I* proceeding, Professor Ordover determined to reprise – albeit with self-serving twists – the same benchmarking analysis he offered during the *Satellite I* proceeding, entailing an extrapolation from the rates that have been negotiated between interactive music services and major record labels. In selecting this one set of record industry licensing arrangements as the sole basis for defending SoundExchange's rate proposal, Professor Ordover ignored the profound changes he conceded have occurred in the audio entertainment marketplace (and the record industry's licensing activities in that marketplace) over the past five years, including: the dramatically altered audio entertainment landscape from 2007 to the present; the fact that Sirius XM competes in an "intense" and "very dynamic" marketplace for delivery of music and non-music programming into vehicles; and the fact that this competition embraces terrestrial radio as well as a new generation of non-interactive audio services.

As a consequence, among other basic failings, Professor Ordover never considered the license agreements that have been executed between the major labels and non-interactive webcasting services since 2007 – agreements for services that are, by his own admission, more similar to Sirius XM's non-interactive offering than the interactive services on which he continues to rely. (Indeed, so wedded was Professor Ordover to his benchmark interactive agreements that he even ignored the rates and terms for non-interactive service tiers in those very same licenses.)

Resorting yet again to the interactive service benchmark nevertheless presented Professor Ordover with empirical challenges. Most obviously, the royalty rates in the interactive service agreements, by his own admission, have dropped 20% since 2007 – from $7.50 to $5.95 per subscriber – a drop that would imply the top-end of the range of reasonable rates adopted by the Judges in the *Satellite I* Determination (based on Professor Ordover's benchmarking) would likewise drop, from 13% to just over 10%. To support the significantly higher rates sought by SoundExchange in the current proceeding necessitated a new methodology for adjusting from the interactive service benchmarks. Professor Ordover thus essentially abandoned his *Satellite I* methodology for doing so (multiplying the benchmark $7.50 rate times an interactivity adjustment based on relative royalty rates charged to interactive and non-interactive services) in favor of utilizing the relative *retail prices* between such services instead. The anomalous result this generated was rates for Sirius XM two to three times *higher* than Professor Ordover proposed in *Satellite I*, despite a 20% *drop* in the benchmark rate.

What is more, the new methodology adopted here by Professor Ordover was proven at trial to be deeply flawed. As Professors Noll and Salinger demonstrated on rebuttal, notwithstanding purporting to offer the Judges three distinct models, each of Professor Ordover's models in reality reduced, by simple arithmetic, to applying the 60% interactive service royalty rate to the retail price of a non-interactive service (in his first two models, the price of a hypothetical music-only Sirius XM service, in his "second alternative," the price of non-interactive webcasting services). The first significant conceptual error with this model is its dependence on the unsupportable contention that all manner of audio entertainment services – interactive and non-interactive alike – would be expected to, and in fact do, pay record companies roughly the same 60% of their gross revenues regardless of their level of interactivity. This one-rate-fits-all notion was shown at trial to be economically and empirically baseless and thereby to undermine Professor Ordover's entire benchmarking exercise. The record leaves no doubt that record companies charge significantly lower percentage royalty rates for non-interactive services, and do not rely solely on the lower retail prices of less interactive services to calibrate the royalty payment they receive.

Both the distorting impact of Professor Ordover's unified rate construct, and the consequence of replacing it with the percentage rate *actually paid* by non-interactive services, were demonstrated on rebuttal by Professor Noll. As he showed, using Professor Ordover's "Second Alternative" model, one need merely: (a) substitute for Professor Ordover's estimate of the prevailing interactive service rate (60%) the prevailing *non*-interactive rate (26.1% per Professor Noll); and (b) apply that rate to $3.15, a corrected calculation of the average retail price of the non-interactive services computed by Professor Ordover (who conceded that his own calculation was erroneous). The result is the second corroboration of Sirius XM's proposed 5%-7% royalty range: a per-subscriber fee of $0.82, or 6.34% of Sirius XM's retail price.

Professor Ordover's primary and "first alternative" approaches – which are premised on an implicit retail price of $6.475 for Sirius XM's music channels – reveal a second central fallacy in Professor Ordover's benchmarking that was also exposed by Sirius XM's economic experts. Professor Ordover arrived at this price simply by halving the retail price of Sirius XM's most popular "Select" service in order to account for Sirius XM's non-music content. However, he made no further adjustment to account for the fact that Sirius XM, in contrast to the interactive services, provides its subscribers with a bundled service that incorporates the receivers and delivery network needed to listen to music. The extensive costs associated with providing such an all-inclusive service are of necessity built into the price Sirius XM charges its subscribers. Sirius XM's expert witnesses laid bare the economic invalidity of this apples-to-oranges rate base – one which would generate a fee windfall to the record industry derived from investments made by Sirius XM that are unrelated to the intellectual property to be valued here and which would create perverse incentives in relation to offering bundled services were it adopted in actual ratemaking.

To rectify this error, Professors Noll and Salinger explained, the $6.475 implicit price of Sirius XM music channels should be adjusted to $3.00, the retail price of Sirius XM's webcast competitors (who do not have cost of delivery network and receivers built into their retail price). When further corrected for the appropriate (*i.e.*, 26.2%) royalty rate, Professor Ordover's first two models were shown, once again, to yield results within the rates generated by the Direct Licenses. The Judges need not tarry long on this second manifest error, however, since Professor Ordover's Second Alternative model effectively takes the issue off of the conceptual table by utilizing as a proxy for the value of Sirius XM's music service the retail prices charged by other non-interactive music services. In so doing, it adopts one of the very approaches advocated by Sirius XM's expert witnesses. This enables the remaining straightforward adjustments to the Second Alternative model, as described above, to be made to reach a correct approximation of a market-based fee.

The third major conceptual flaw undermining Professor Ordover's efforts to legitimize SoundExchange's fee proposal involves his misconceptualization of the role that the 801(b)(1) factors play in this proceeding. Professor Ordover's view, in a nut shell, is that they play no role whatsoever – that the task to which the Judges are committed is to determine the fees that a willing buyer would pay a willing seller in a competitive market. Professor Ordover arrives at this conclusion by the expedient of treating the first three section 801(b)(1) factors as implicitly accommodated by the workings of such a marketplace, and dismissing the fourth – disruption – as having no applicability to other than a nascent industry. This facile effort to write the 801(b) factors out of the statute, while convenient for Professor Ordover's approach of cherry-picking the most expensive license arrangements in the marketplace and attempting to engraft them on Sirius XM, is nevertheless completely inappropriate.

As Sirius XM's Proposed Conclusions of Law ("PCL") demonstrate, Congress enacted – and, over time, reiterated the propriety of preserving for the benefit of certain pre-existing services, including SDARS – legislation entitling such entities to have their statutory sound recording performance fees determined based, not strictly on marketplace rates, but as well with the protections afforded by the section 801(b)(1) policy factors. While, the governing jurisprudence informs us, rate-setting in the context of section 801(b)(1) "requires evaluating the marketplace points of reference," they must be "temper[ed]" by "the policy considerations underpinning the objectives of Congress in creating the license." *Librarian PSS Determination*, 63 Fed. Reg. at 25,409. Professor Ordover would ignore all of that, notwithstanding that the record industry itself, when the licensing shoe has been on the other foot, has acknowledged these very principles.

To be sure, both parties to this proceeding have proposed rates drawn from marketplace transactions: Sirius XM, from its Direct Licenses as well as from agreements between non-interactive services and major record labels; SoundExchange solely from agreements between interactive services and those same majors. Even if this proceeding were governed strictly by a willing-buyer/willing-seller standard such that the inquiry began and ended with arriving at an approximation of the fair market value of the rights here under consideration, the record would one-sidedly favor an outcome in the 5% to 7% of revenue range proposed by Sirius XM. But the statutory inquiry does not end there.

Professors Noll and Salinger repeatedly invoked various section 801(b)(1) policies as supporting their economic analyses – both in relation to Sirius XM's affirmative rate proposals and in critiquing SoundExchange's. By way of example, in establishing the propriety of adjusting from the various proposed webcasting benchmarks for the differing cost structure facing Sirius XM, these economists drew not only on basic economic reasoning and evidence as to how markets actually work, but also on section 801(b)'s "relative contribution" factor as necessitating the appropriate adjustments. Professor Noll additionally cited the record as to the promotional value afforded the record labels by Sirius XM's music offerings as compared to the likely substitutional effects of the interactive/on-demand services from whose license experience Professor Ordover seeks to derive fees here – a matter directly responsive to section 801(b)'s "availability" and "fair income/fair return" factors.

For their part, Sirius XM executives Mel Karmazin, David Frear and James Meyer, as well as expert witness Professor Stowell, testified at length about the challenging competitive and economic environment in which the Company operates, a history that counsels caution in predicting the Company's future prospects, and attendant risks of disruption to Sirius XM that are posed over the upcoming license term, as further reasons not to impose any meaningfully higher rates than Sirius XM is paying currently. That testimony recounted:

- The post-merger, near-collapse of the newly-combined Company as a result of the catastrophic events of 2008-2009.
- A painstaking rebuilding effort, marked by aggressive cost-cutting and continued strategic investments in programming and supporting technology designed to distinguish Sirius XM from the competition.
- A rapidly evolving technological and competitive landscape that increasingly erodes the uniqueness of satellite radio – seamless nationwide reception of diverse music and non-music audio programming in one's vehicle.

As for Sirius XM's financial condition, the hearing record also reveals that while the Company recently experienced its first period of positive net income, it is still digging out from 20 years of losses amounting to billions of dollars in negative cumulative free cash flow and EBITDA. And while the Company is optimistic about its short-term prospects, the persistently-depressed global economy, the Company's intimate ties to the automobile industry, and the emergence of viable Internet-based competitors like Pandora (and a resurgent terrestrial radio sector that is aggressively incorporating internet radio services into its product offerings) that operate free of the costly infrastructure on which the Company relies, combine to create a precarious environment and uncertain longer-term prospects for its success over the 2013-2017 license term.

Against this history and these considerations, predictions by SoundExchange's experts that Sirius XM's success is "a no-brainer"; that it is a "cash cow"; that it is "impervious to competition"; and that it could, without difficulty, sustain rates as high as 37% (Lys) or even 58% (Sidak), are all too reminiscent of prior advocacy that proved wide of the mark and ring equally hollow here. Through such hyperbole, SoundExchange asks the Judges to turn the limited legislative entitlement conferred upon the record industry by Sections 106(6) and 114(d), designed to protect against undue cannibalization of record sales, into a fee bonanza, with all risk of rate overreach borne by Sirius XM. Even if the Company ultimately is successful, that success does not mean that Congress intended the sound recording performance royalty rate continually to increase as a percentage of a licensee's gross revenues. Royalty payments will naturally increase, even at a stable royalty rate, if the licensee is successful in growing its business. Consistent with the 801(b) factors, Sirius XM should not be penalized for success through a higher facial royalty rate as well. Business success has no such role in this rate-setting proceeding. The policy dictates of section 801(b)(1) require a far more measured approach to rate-setting, with due solicitude for all of its policy factors, including that rates be set so as to minimize the prospect of disruption to the satellite radio industry in an increasingly competitive environment.

Professor Noll's rebuttal testimony summarized well the proper way to view, on the record presented, the relevance of section 801(b)(1) to this proceeding. He testified that the range of rates reflected in his benchmarking analyses, derived as they are from marketplace benchmarks, is conservative and likely overstates the reasonable fee properly payable by Sirius XM. He further testified that, to the extent the Judges were to conclude that a range of rates might be regarded as reasonable, the weight of the 801(b) factors as applied to Sirius XM counsels selection of a rate towards the lower end of the range.

I. RELEVANT FACTUAL BACKGROUND

A. The Nature And History Of Sirius XM

1. Sirius XM's satellite radio service broadcasts music and non-music content on a subscription-fee basis on more than 135 channels throughout the continental United States. Meyer WDT ¶ 8.[1] The programming delivered to Sirius XM subscribers constitutes a mix of compelling, and often exclusive, offerings of talk, sports, news, entertainment and data content as well as diverse genres of music. Meyer WDT ¶ 8; 6/6/12 Tr. 528:2-529:8 (Meyer) ("We obviously deliver . . . entertainment, music, sports, talk, news, special interest programming. We think we have something for everybody. . . . [T]hat's what people pay us for, is the breadth of our content."); *see generally* Blatter WDT ¶¶ 3-37; Karmazin WDT ¶¶ 20-37; *see also* Section I.B.5, *infra*.

2. Sirius XM's predecessor companies Sirius and XM both were first established more than twenty years ago. *See* Karmazin DWDT ¶ 14; Parsons DWDT ¶ 2. Since their founding, Sirius and XM each faced and overcame enormous technological and business challenges and risks in establishing the first-ever seamless, integrated satellite radio services offering uninterrupted programming nationwide to moving vehicles. *See* Karmazin DWDT ¶ 3; Parsons DWDT ¶ 2; Smith DWDT ¶ 4. This effort required massive infusions of capital, the

[1] A list of all witness testimony cited herein, with designated citation abbreviations, can be found in the table at pages vii-x, *supra*. A description of all witness testimony is attached hereto as Appendix A.

formation of significant partnerships, and exceptional levels of technological innovation to take the idea of satellite radio from an on-paper concept to an on-the-air broadcast. *See* Karmazin DWDT ¶¶ 3, 7; Frear DWDT ¶¶ 2, 5-7; Parsons DWDT ¶¶ 2, 5. Essentially, Sirius XM's predecessors independently but concurrently created an entirely new means of providing audio programming, with all of its attendant technological, market and financial risks. Karmazin DWDT ¶ 3 ("Sirius was required to create an entirely new means of providing audio programming . . . Sirius is, in effect, many businesses in one."); *id.* ¶¶ 8-12, 53; Parsons DWDT ¶ 2 ("We built the new satellite radio industry and the XM business from scratch from technological, business, and programming perspectives.").

3. The founders of Sirius first had to convince the Federal Communications Commission ("FCC") that the idea of a satellite radio service actually made sense, over substantial opposition from the terrestrial radio industry. Karmazin DWDT ¶¶ 3, 14-15. In 1990, Sirius' founders proposed that the FCC establish a satellite radio service in the S-Band. Karmazin DWDT ¶¶ 14-15. It was not until the fall of 1992 that the FCC called for license applications; both Sirius and XM applied for the new licenses, and both spent the ensuing four years investing considerable time, resources and money on developing their respective satellite radio technology and researching and analyzing the business prospects of satellite radio. Karmazin DWDT ¶¶ 14-16; Parsons DWDT ¶ 8. After an auction for the spectrum, in 1997 Sirius secured its license from the FCC for $83.3 million and XM secured its license for $90 million. Karmazin DWDT ¶ 18; Parsons DWDT ¶ 8; Masiello ¶ 8.

4. Both companies thereafter proceeded to raise capital and worked on building their businesses, each of which would require the design, manufacture and launch of satellites, chipsets and radios; distribution arrangements in the automotive market (referred to in Sirius

XM's business as the original equipment manufacturers, or "OEM," market) and retail markets; programming; subscriber management systems; and corporate infrastructure and management. Karmazin DWDT ¶ 19; Parsons DWDT ¶¶ 8-10, 12, 14, 18-19; Masiello DWDT ¶¶ 17-25, 31-33, 39; *see also* Cook DWDT ¶¶ 16-20 (describing development of relationships between XM and automakers and retailers); Wilsterman DWDT ¶¶ 4, 7-11 (describing development of relationships between Sirius and OEMs); Law DWDT ¶¶ 3-4, 7-9 (describing development of relationships between Sirius and retailers and equipment manufacturers).

5. In developing the infrastructure necessary to create satellite radio, Sirius and XM both made significant innovations and other creative or engineering contributions, including the design and manufacture of satellite networks, development of terrestrial repeater networks,[2] and invention from scratch of chipsets and radios capable of receiving satellite content – all of which were imperative to ensure consistent, nationwide coverage. *See* Smith DWDT ¶¶ 4-5, 7-19, 21-26; Parsons DWDT ¶¶ 12, 15, 18; Masiello DWDT ¶¶ 2, 8, 24-25, 31-33. These efforts required several billion dollars in capital investment as well as ongoing enormous operating costs for each of the new SDARS. Frear DWDT ¶¶ 9, 13-14, 16-17; Karmazin DWDT ¶¶ 24, 53; Parsons DWDT ¶¶ 2, 8.

6. XM launched its nationwide service in November 2001. Parsons DWDT ¶ 16. Sirius launched its nationwide service in July 2002, following a delay due to unexpected problems with the development of its chipsets. Karmazin DWDT ¶¶ 20, 22; Frear DWDT ¶ 6.

7. Today, Sirius XM continues to make significant investments to monitor and maintain its existing technological infrastructure, as well as in its continuing efforts in

[2] Satellite coverage "provides clear reception only insofar as areas have an unobstructed line-of-sight with one of the satellites." Meyer WDT ¶ 52. But where there are obstructions – *e.g.*, due to tall buildings, tunnels or mountains – satellite signals might be blocked. *Id.* For this reason, Sirius XM has deployed a vast network of terrestrial repeaters to fill in any gaps in coverage. *Id.*

technological innovations, to remain competitive. *See generally* Meyer WDT ¶¶ 45-62; Karmazin WDT ¶ 10; Frear WDT ¶¶ 38-39; Section IV.C, *infra*. Sirius XM's cumulative investment to date in creating and supporting its satellite radio service exceeds $10 billion, and the Company anticipates investing more than [redacted] in support of its technological infrastructure and innovation during the 2013-2017 period. Karmazin WDT ¶¶ 8, 10.

B. Developments During 2007-2012 License Period And The Company Today

1. The Merger Between Sirius And XM, The Combined Company's Near-Death Experience, And Subsequent Significant Efforts To Reduce Costs

8. Since the *Satellite I* proceeding, XM has merged with a subsidiary of Sirius. The proposed merger was announced in February 2007, but was not completed until July 2008 after the FCC and U.S. Department of Justice closed their investigations and approved the merger, citing no harm to consumers or competition. Karmazin WDT ¶ 5; Frear WDT ¶¶ 5-7; Sirius XM Dir. Trial Exs. 65, 67. The companies officially merged on July 29, 2008. Frear WDT ¶ 7.

9. Immediately following the merger, the combined Company encountered significant financial instability and, by late 2008, found itself with insufficient funds to repay, and an inability to refinance, its substantial outstanding debt. Frear WDT ¶ 8. As discussed in further detail in Section IV.D.1.a, *infra*, Sirius XM survived – and narrowly averted a bankruptcy filing – only because Liberty Media offered an eleventh-hour loan, albeit with extremely onerous terms. Frear WDT ¶¶ 8-14; Karmazin WDT ¶ 6.

10. Following the merger, the combined Company undertook an aggressive effort to reduce costs in virtually all categories, including costs associated with subscriber acquisition, sales, marketing and administrative costs. Frear WDT ¶ 19; Karmazin WDT ¶ 42. As part of this effort, Sirius XM sought to "rationalize" its channel lineup by eliminating duplication in

both music and non-music channels and creating a "universal" lineup available to all subscribers. Karmazin WDT ¶ 29; 6/11/12 Tr. 1326:6-1328:12 (Karmazin); 6/7/12 Tr. 645:18-647:13 (Frear). Sirius XM also succeeded in reducing its programming costs by more than $100 million over the 2008-2009 period and continues to renegotiate key agreements with content providers and musical works performing rights organizations to continue to reduce costs. Frear WDT ¶¶ 20, 46; Frear RWRT ¶ 44. Since the *Satellite I* proceeding, Sirius XM has reduced non-music programming costs by [redacted] or [redacted] per year, and [redacted] Frear RWRT ¶ 44 and Table 1; Frear WDT ¶¶ 20, 46; *see also* Stowell WRT Ex. 42 at p. 29.[3]

11. The merger did not result in significant synergies or cost savings in Sirius XM's expenses relating to its satellite systems because the Company continues to operate and maintain two separate proprietary satellite radio systems (the former legacy Sirius and legacy XM systems), including separate satellite networks supplemented by separate terrestrial repeater networks. Meyer WDT ¶ 9; 6/6/12 Tr. 529:9-530:3 (Meyer). This dual-system approach is necessitated by the fact that Sirius XM has millions of installed satellite radios in the market capable of receiving only one or the other service; the Company cannot simply cut off service on one or the other of the legacy networks without shutting off access to approximately half of its existing subscribers. Meyer WDT ¶ 9; 6/6/12 Tr. 530:4-531:11 (Meyer). Sirius XM will continue to maintain the separate Sirius and XM legacy satellite systems for the indefinite future. Meyer WDT ¶ 9; 6/6/12 Tr. 530:4-531:11 (Meyer) ("[W]e have not been able to, nor do I think we will be able to, consolidate those [two satellite] networks in any foreseeable future.").

[3] SXM Rebuttal Exhibits 42-51 were appended to the Written Rebuttal Testimony of David P. Stowell, and were admitted into evidence together with the written testimony as Sirius XM Rebuttal Trial Exhibit 7. All exhibits so attached will be hereinafter referred to as "Stowell WRT Ex. __."

2. Sirius XM's Subscription-Based Service

12. Sirius XM currently has approximately 22 million subscribers to its satellite radio service. 6/6/12 Tr. 528:2-529:8 (Meyer). The vast majority of the Company's revenue is derived from subscription fees; advertising revenue constitutes only 2-3% of the Company's aggregate revenues. Meyer WDT ¶ 8; 6/6/12 Tr. 528:2-529:8 (Meyer).

13. Although Sirius XM continues to offer two different satellite radio services (one for Sirius and one for XM), its various subscription package options enable it to offer essentially the same group of music and non-music channels to both sets of subscribers. Karmazin WDT ¶ 28; *see* Blatter WDT ¶¶ 5-6; Blatter WDT Ex. 1.[4] For example, whether one subscribes to Sirius or XM, one can access any of Sirius XM's marquee non-music programming that previously was available only on one service or the other (for example, Howard Stern on Sirius), simply by accessing it for an additional fee. Karmazin WDT ¶ 28 and n.1. Additionally, the same third-party news and sports programming that formerly was available on both services (for example, CNN and ESPN) continues to be part of the standard package for each service. Karmazin WDT ¶ 28. Moreover, a subscriber to either Sirius or XM can listen to any of Sirius XM's diverse music channels. *See* Section I.B.5.b, *infra* (discussing music offerings on Sirius XM).

14. To obtain access to these content offerings, Sirius XM subscribers choose a subscription package from the options Sirius XM provides. The vast majority of Sirius XM's subscribers take the standard Sirius and XM packages (the so-called "Select") packages, which are currently priced at $14.49 per month. Karmazin ¶¶ 36-37 (noting that as of early 2011, approximately [redacted] combined subscribers took the Sirius Select or XM Select packages);

---

[4] SXM Direct Exhibits 1 and 17-56 were appended to the Written Direct Testimony of Steven Blatter, and were admitted into evidence together with the written testimony as Sirius XM Direct Trial Exhibit 15. All exhibits so attached will be hereinafter referred to as "Blatter WDT Ex. __."

see also Meyer WDT ¶ 65; Frear RWRT ¶ 37. Though this price increase – the first in Sirius XM's history – from the previous price of $12.95 per month was effective as of January 1, 2012, as a result of subscribers' varying renewal cycles, it will not be until mid-2013 that 85-90% of the subscriber base will have experienced the price increase. Frear RWRT ¶¶ 37-38; 8/13/12 Tr. 3056:16-3057:9 (Frear); Meyer WDT ¶¶ 65-66; 6/6/12 Tr. 564:16-566:1 (Meyer); Karmazin WDT ¶ 44 n.7.

15. In addition to the Select Packages, Sirius XM also offers packages that combine the Select package channels for one service with premium content from the other service (the so-called "Premier" packages), packages more tailored to the subscriber (such as Family Friendly, Mostly Music, or News Sports & Talk) and "A la Carte" packages that allow subscribers to choose programming packages of 100 channels, 50 channels, 50 channels plus Howard Stern, 50 channels plus Sports, or 50 channels plus Howard Stern and Sports. Karmazin WDT ¶¶ 36-37. Of those subscribers who choose a package other than the Select package, a small but appreciable number choose the Premium subscription, and only a very small number subscribe to the more tailored packages or A la Carte packages. *Id.* Thus, as of early 2011, approximately [redacted] subscribers had taken the Sirius Premium or XM Premium packages, and only approximately [redacted] subscribers were on the Sirius or XM Mostly Music packages. Karmazin WDT ¶ 36.

3. Sirius XM's Principal Distribution Channels

16. Sirius XM principally distributes its satellite radio service and obtains subscribers through the sale or lease of new vehicles (*i.e.*, via the OEM market). Meyer WDT ¶ 10. The OEM market has become an ever-more-critical distribution channel for Sirius XM in the years since the *Satellite I* proceeding. Illustratively, in 2006 approximately 48% of new subscribers

were obtained through the OEM market, with the majority coming to Sirius and XM through the retail or "aftermarket" channel; today, nearly 90% of Sirius XM's gross additional subscribers are obtained through the OEM market and 70% of its total subscriber count is attributable to the OEM market. Meyer WDT ¶¶ 10, 37-40; 6/6/12 Tr. 528:2-529:8 (Meyer).

17. Sirius XM has entered into agreements with every major automaker to offer satellite radios as factory- or dealer-installed equipment in their vehicles. Meyer WDT ¶ 10. These agreements call for the OEMs to install satellite radio receivers into their vehicles – an expensive and lengthy process – in exchange for a variety of incentives and subsidies provided by Sirius XM. The terms of Sirius XM's agreements with automakers are extremely favorable to the OEMs, and include numerous incentives that cost the Company hundreds of millions of dollars per year. Meyer WDT ¶¶ 41-43 (describing various subsidies and incentives paid to OEMs, amounting to an average annual expenditure to the OEM market based on contractual terms for 2009 through 2012 of more than [redacted].

18. Although making up a substantially smaller portion of Sirius XM's distribution activity, the aftermarket – including retail locations and Sirius XM's website – continues to be a channel for the distribution of the Company's products and services. Meyer WDT ¶ 10. Like the OEM market, the aftermarket also requires Sirius XM to pay a variety of subsidies and incentives, including reimbursement for manufacturing costs, revenue shares and point-of-sale displays, which remain a substantial expense to the Company on an annual basis. Meyer WDT ¶ 44 and n.10 (describing subsidies and incentives paid to retail outlets and consumer electronics manufacturers, totaling approximately [redacted] annually).

4. The Rapidly Evolving Competitive Landscape

19. As numerous Sirius XM witnesses testified, satellite radio faces significantly more intense competition today, particularly in its principal OEM distribution channel, than it did at the time of the *Satellite I* proceeding. The enhanced competition comes from new technology and other media that either did not exist, or were in their very early stages, at the time of the prior proceeding. These propositions are firmly established and not controverted. *See* Karmazin WDT ¶ 40; 6/11/12 Tr. 1331:6-1337:15 (Karmazin) (discussing changes in competitive landscape since *Satellite I* proceeding); 6/6/12 Tr. 533:5-534:13 (Meyer) (describing the competitive landscape as the "biggest change" that has faced the satellite radio business in the last five years and competitive forces as "simply overwhelming"); Rosenblatt CWDT p. 3 ("The developments that have taken place since 2007 have been dramatic; the market for online audio content . . . and the availability of that content in automobiles, the primary venue for satellite radio, has expanded significantly . . . fundamentally alter[ing] the mobile audio landscape in which Sirius XM competes."). SoundExchange's own principal expert, Janusz Ordover, summarized this phenomenon well in conceding that "the competitiveness of the market in which Sirius XM competes [has], if anything, intensified" and that this change "is at least in part because . . . the technologies are improving tremendously, both in terms of devices and also in terms of the way cars, for example, come equipped with connectivity to other devices besides Sirius XM." 6/14/12 Tr. 2351:4-15 (Ordover).

20. While terrestrial radio remains Sirius XM's primary competition, enormous advances in broadband technology and consumer products such as smartphones have enabled a newly-viable class of Internet-based competitors to provide streaming and other forms of music and non-music content that can be accessed on mobile devices. Meyer WDT ¶ 11; *see generally*

6/6/12 Tr. 533:5-552:9 (Meyer). This content is now capable of being easily incorporated into automobiles. Meyer WDT ¶ 11; *see* 6/6/12 Tr. 535:20-537:16 (Meyer). Over the last several years, wireless carriers such as Verizon and AT&T have made significant and costly investments (in the tens of billions of dollars) to enhance wireless networks, resulting in the third-generation (3G) networks and now the dramatically more advanced fourth-generation (4G or LTE) networks. Meyer WDT ¶ 17; 6/6/12 Tr. 533:5-534:13 (Meyer); Rosenblatt CWDT pp. 3, 12-14; 6/8/12 Tr. 1061:19-1064:14 (Rosenblatt). These network upgrades have themselves led to advancements in the technologies of smartphones and other mobile devices such as tablets, and the web browsers or applications ("apps") on those devices, through which users seamlessly access the Internet.[5] Meyer WDT ¶¶ 17 and n.2, 20-21; Rosenblatt CWDT pp. 3, 6-12 (describing "dramatic" changes in portable digital landscape since *Satellite I*).

21. The combination of rapid advances in broadband and wireless network technology, together with devices equipped to take advantage of this technology, has enabled a new generation of Internet-based content providers to deliver content directly to consumers in automobiles in a variety of ways. Meyer WDT ¶ 17; Rosenblatt CWDT pp. 3, 20-34. Through dedicated apps, consumers of content may now use their smartphones or other mobile devices to access apps not only for music content, but also for sports, news, weather, traffic and other talk radio content similar to that currently available on Sirius XM. Meyer WDT ¶ 22; Rosenblatt CWDT pp. 32-34; 6/8/12 Tr. 1086:2-21 (Rosenblatt). As to music content, some of the major competitors to have emerged in the last few years include Pandora, Last.fm and Slacker, among others. Meyer ¶ 21; 6/6/12 Tr. 534:14-535:14 (Meyer); Rosenblatt CWDT pp. 20-31. Streaming

[5] There are now approximately 100 million smartphones in use in the United States; as Mr. Rosenblatt testified, the growth of the smartphone market has been so rapid that more listeners use smartphones for audio listening than satellite radio. *See* Rosenblatt CWDT pp. 8-10; 6/8/12 Tr. 1055:19-1056:8 (Rosenblatt).

of competing non-music content is available from services such as Stitcher, as well as from prominent sources such as NFL.com, MLB.com and ESPN.com. Meyer ¶ 22. Additionally, traditional radio broadcasters like CBS and Clear Channel also now make high-fidelity digital streams of their content available on the Internet nationwide. Meyer ¶ 21. Sirius XM witnesses testified (preciently) that ever-more significant competitors in providing digital streams of audio content – the likes of Apple, Google and Microsoft – could be expected to enter the market in the near future. Meyer WDT ¶ 21; Stowell WRT ¶ 3; 6/8/12 Tr. 1212:11-1213:22 (Stowell); 8/15/12 Tr. 3617:3-3619:12 (Stowell).

22. Significantly for Sirius XM, OEMs are responding to these marketplace developments with technological innovations that enable consumers to access this online music and non-music content in the vehicle with increasing safety and seamlessness. *See generally* Rosenblatt CWDT pp. 14-20 (describing various options of in-car listening; explaining that "a critical mass of automobiles now offer features allowing the easy use of online audio services through vehicle entertainment systems"); Meyer WDT ¶¶ 11-12, 24-32.

23. Although Internet audio content has been available in the car through a physical connection for some time and is incorporated into upwards of 90% of new cars today, this type of connectivity has certain disadvantages, including requiring the listener to control the app through the screen of the smartphone device itself. *See* Meyer WDT ¶¶ 24, 26; Rosenblatt CWDT pp. 14-17. Thus, the "breakthrough" advancement in listening options comes in the form of already-developed and increasingly deployed "connected car" technology, which incorporates smartphone apps seamlessly into the vehicle's in-dash entertainment system and allows the listener to access and operate them directly through the car's controls. Meyer WDT ¶¶ 25-34; Rosenblatt CWDT pp. 16-17; 6/6/12 Tr. 545:5-546:9 (Meyer); 6/8/12 Tr. 1068:16-1070:11

(Rosenblatt); *see also* Rosenblatt CWDT p. 14 (noting ease of use of smartphones and national broadband networks to listen in cars is a "critical factor driving the change in the digital audio landscape").

24. The first generation of this connected-car technology, involving a "tether" between the user's smartphone and the vehicle, has already been implemented and is in cars on the road today. Meyer WDT ¶¶ 25-30; 6/6/12 Tr. 545:5-546:9 (Meyer); *see also* Meyer WDT Exs. 4-5.[6] Automakers also are currently developing a next-generation connected car, known as the "embedded strategy," in which an Internet radio listening experience will be seamlessly built in to the vehicle's in-dash entertainment system, without the need to connect a smartphone. Meyer WDT ¶¶ 25, 31-32; 6/6/12 Tr. 545:5-546:9 (Meyer); 6/8/12 Tr. 1068:16-1070:11 (Rosenblatt). The embedded-strategy technology is already developed and will begin to be deployed widely within the 2013-2017 period. Meyer WDT ¶ 31; 6/6/12 Tr. 550:7-16 (Meyer).[7]

25. Automakers recognize that these technological advancements are attractive to consumers. *See* Meyer WDT ¶¶ 12, 24-34; Karmazin WDT ¶ 40; Rosenblatt CWDT pp. 3-4, 19-20, 37. Connected-car technology has the advantage of providing more choice of content coupled with a safer, more seamless listening experience. Meyer WDT ¶ 27. Further, platforms enabling access to Sirius XM's Internet-based competitors offer consumers many of the same

---

[6] SXM Direct Exhibits 3-5 were appended to the Written Direct Testimony of James E. Meyer, and were admitted into evidence together with the written testimony as Sirius XM Direct Trial Exhibit 5. All exhibits so attached will be hereinafter referred to as "Meyer WDT Ex. __."

[7] Additionally, in the near future, automakers are likely to seek lower-cost opportunities to incorporate into their vehicles a single worldwide wireless audio platform to streamline engineering and reduce costs globally. Meyer WDT ¶ 32. Unlike its new competitors' global reach, Sirius XM is capable of providing its satellite radio service only in North America. *Id.* As Mr. Meyer testified, "[t]his development, in conjunction with the proliferation of connected cars, could have a serious negative impact on Sirius XM's subscriber base within the 2013-2017 licensing period." *Id.*; *see also* Stowell WDT ¶ 22 (noting Sirius XM's "inability to provide a universal service gives an incentive for car manufacturers to move away from Sirius XM in favor of Internet based services"; concluding that "[i]n the likely event that car manufacturers move in this direction, the number of Sirius XM's new subscribers will decline").

features and advantages that formerly set satellite radio apart from terrestrial radio – nationwide, largely commercial-free access to diverse genres of uncensored content – and do so at either no cost or at a price point much lower than Sirius XM's subscription price. Meyer WDT ¶¶ 11, 17, 21; Rosenblatt CWDT pp. 34-37. Many of the Company's emerging competitors also provide the convenience and personalization that consumers have come to enjoy and expect in their entertainment media, which Sirius XM's one-way radio service is incapable of achieving. Meyer WDT ¶ 18; 6/6/12 Tr. 540:15-543:7 (Meyer).

26. For automakers, the new systems have the advantage of being relatively inexpensive to deploy because there is no need to purchase or install hardware to receive the content; thus, contrary to SoundExchange's contentions in this proceeding, Sirius XM's existing relationships with OEMs will not pose a barrier to entry for these new content providers. *See* Meyer WDT ¶ 27; *see also* 6/6/12 Tr. 550:17-552:9 (Meyer). Moreover, to implement the fast-approaching embedded strategy of connected cars, OEMs likely will engage in negotiations for incentives not with content providers (as it does with Sirius XM), but with the wireless companies providing the connectivity.[8] Meyer WDT ¶ 31.[9] Additionally, unlike satellite radio, connected cars eliminate the risk to OEMs of potential obsolescence of certain content providers;

[8] Indeed, in the midst of this proceeding, Verizon announced the formation of the 4G Venture Forum for Connected Cars, which major OEMs including Toyota, Honda, BMW, Hyundai and Kia joined, to collaborate and explore ways to install the embedded strategy of connected cars; as part of this effort, Verizon also purchased Hughes Telematics, a leading in-dash technology provider. *See* Frear RWRT ¶ 43 and Exs. 3-4.

[9] Regardless of whether OEMs demand incentives from other content providers, wireless network providers, or not at all, as Sirius XM CEO Mel Karmazin testified, at bottom OEMs "feel their business is to sell cars, not to sell satellite radio." 6/11/12 Tr. 1399:14-1400:10 (Karmazin). Accordingly, because Sirius XM's existing agreements with OEMs do not require any minimum installation of satellite radios, OEMs are free to reduce the number of satellite radios they install, or stop installing them altogether, in favor of competitive alternatives that they believe consumers will want and will lead to more car sales. *See* Stowell WRT ¶ 20.

in the event a particular provider goes out of business, the corresponding icon on the dashboard display will simply disappear. Meyer WDT ¶ 27.

27. Enhancing the competitive challenges posed to Sirius XM by these Internet-based competitors is their widely divergent cost structure. Unlike Sirius XM, these competitors have not had to invest billions of dollars to acquire spectrum and build from scratch an entirely new category of service, with major investments made to build a national distribution system and to invent and market chipsets and radios that enable subscribers to receive content; nor do they need to make substantial investments annually to maintain and continuously develop these systems. They have taken advantage, instead, of the investments and innovations of third-party hardware providers and distribution networks. Meyer WDT ¶¶ 13, 35-36; 6/6/12 Tr. 539:9-540:14, 550:17-552:9 (Meyer); Karmazin WDT ¶¶ 9-10; Frear WDT ¶ 22.

28. In sum, this "connected-car" technology presents a significant competitive challenge, and poses a significant risk, to Sirius XM during the next licensing period. Meyer WDT ¶¶ 12, 24-34 and Ex. 3; Rosenblatt CWDT pp. 3-4; *see also* Rosenblatt CWDT p. 20 ("Users can now choose from a variety of [music and non-music] audio content and features that in many cases rival the offerings of Sirius XM and . . . stream it in their cars through their car audio systems. This development presents serious threats to the sustainability of Sirius XM's business."); Rosenblatt CWDT p. 37 (explaining that coalescence of emergence of smartphones, pervasive mobile broadband coverage, integration of mobile audio apps with automobiles and wide availability of mobile audio content "seriously threaten[s] satellite radio's place in the market"); Karmazin WDT ¶ 40 (describing competition as the result of the "staggering pace of innovation" in mobile audio content a "significant risk" for Sirius XM that "cannot be overstated"); 6/11/12 Tr. 1331:6-1337:15 (Karmazin) (explaining that, in light of advances in

technology and incorporation rate by OEMs, Sirius XM "believe[s] that … competition is going to be accelerated in the next few years").

5. Significant Efforts In Developing And Programming Diverse And Innovative Non-Music And Music Content

29. As a subscription-based satellite radio company, in order to attract and retain subscribers, and to prevent them from defecting to other "free to the consumer" or modestly-priced competitive services, Sirius XM must demonstrate its value proposition to the consumer by investing in a broad array of unique content offerings. *See* Karmazin WDT ¶ 12. These offerings include both carefully curated music content, including genres and specialized curation that are not available on competing services, as well as compelling, and often exclusive, non-music content. *Id.* at ¶ 20.

30. While Sirius XM's subscribers undoubtedly enjoy spending time listening to the many available music channels on Sirius XM's satellite radio service, and music content certainly is an aspect of the Company's service, "[w]hat [its] customers value is clearly something significantly more than just music listening." Frear RWRT ¶ 48. That something more is nationwide availability of a combination of curated music and a broad array of often exclusive non-music content. *Id.*; Karmazin WDT ¶¶ 12, 20; *see also* Ordover AWRT ¶ 55 ("[S]atellite radio is a service that apparently is valued by most subscribers because of its ubiquitous availability in the car."); 8/14/12 Tr. 3416:1-3417:4 (Ordover).

a. Sirius XM's Non-Music Content

31. It is the Company's non-music content that "sets [it] apart and allows [it] to compete vigorously with new market entrants." Karmazin WDT ¶ 22; 6/11/12 Tr. 1320:17-1322:18 (Karmazin). In other words, "while music is available from a variety of sources other than satellite radio (although not presented as powerfully or with the expertise and focus [Sirius

XM is] able to bring to it), it is [Sirius XM's] non-music content – particularly [its] exclusive non-music content – that drives subscriptions and prevents defections." Karmazin WDT ¶ 25. Indeed, given the dramatically increased availability of streamed music content to compete with Sirius XM in the vehicle, Sirius XM's "unique package of non-music content – both exclusive and from third-parties – has taken on even more importance as a differentiator and selling point of [its] service." Karmazin WDT ¶ 25; *see also id.* at ¶ 26.

32. Sirius XM's exclusive non-music programming offerings include Howard Stern, Oprah Winfrey, Martha Stewart, Opie & Anthony, Mad Dog Radio and The Foxxhole. *See* Karmazin WDT ¶¶ 32, 34. The Company's current non-music offerings also include a wide variety of programming encompassing news, politics, entertainment, family and health, sports, religion, comedy, traffic and weather and more. Karmazin WDT ¶ 34; Blatter WDT Ex. 1. With the introduction of Sirius XM's new XMH channels,[10] additional non-music channels are now available, including two new Latin channels, three new comedy channels, ESPN Sports Center and expanded Spanish-language sports programming. Karmazin WDT ¶ 35.

33. Sirius XM also has added a number of new non-music channels that it has either licensed from third parties or developed on its own, with the goal of augmenting the quality and breadth of its non-music programming. Karmazin WDT ¶¶ 30-32. New third-party content includes MSNBC, PRX Public Radio and Spice. Karmazin WDT ¶ 30. New premium original programming includes Dr. Radio. Karmazin WDT ¶ 31. In addition to creating entirely new channels, Sirius XM also continues to develop new programs on existing channels by attracting

[10] Sirius XM now is able to deliver 25% more content in the form of additional channels on certain of Sirius XM's radios that contain the new x65H chipset, as the result of an innovative project called the "hierarchical modulation scheme." This project, which was a substantial and expensive effort, involved an update to Sirius XM's entire technological infrastructure, including terrestrial repeaters, uplink information, new chipsets for both networks, new error protection technology and the development and implementation of state-of-the-art compression technology. Meyer WDT ¶¶ 53, 56-57.

prominent and popular talent to exclusive programming, including Dr. Laura Schlesinger's exclusive daily broadcast on Sirius XM's "Stars" channel. Karmazin WDT ¶ 33.

b. Sirius XM's Music Content

(i) Sirius XM Offers Unique Music Content Not Available On Terrestrial Radio

34. Each of the Sirius and XM platforms offers approximately 70 full-time music stations without commercials. Blatter WDT ¶ 5; 6/8/12 Tr. 976:22-977:5 (Blatter); Blatter WDT Ex. 1. Most of the music stations continue to be era- or genre-based. Blatter WDT ¶ 6.

35. Sirius XM's music offerings are much broader than those of terrestrial radio, which is dependent on advertising revenues and therefore tends to be limited in its ability to offer anything other than the most mainstream music formats that appeal to adults. Blatter WDT ¶ 21. Sirius XM, with its national footprint and subscription model (and concomitant lack of advertising), is much less risk-averse than terrestrial radio in the formats that it is able to offer. *Id.* at ¶ 26. To that end, Sirius XM offers a variety of niche channels, including Bluegrass, Reggae and Show Tunes, among others, that cannot be found anywhere on terrestrial radio. *Id.* at ¶ 6; 6/8/12 Tr. 977:6-978:11 (Blatter); Karmazin WDT ¶ 21.

36. Additionally, Sirius XM's national reach enables it to offer certain mainstream formats nationwide that are no longer served in some major geographic markets. Blatter WDT ¶¶ 23, 34; 6/8/12 Tr. 977:6-978:11 (Blatter); Blatter WDT Ex. 34. For example, country music – despite being one of the most popular genres of music – is not available on terrestrial radio in major markets such as New York and San Francisco, but is available coast-to-coast on Sirius XM's satellite radio service. Blatter WDT ¶ 23; 6/8/12 Tr. 978:12-979:1 (Blatter); *see also* Blatter WDT Ex. 24 (highlighting channels Sirius XM offers with formats generally not available on full-time basis in most, if not all, local radio markets across America).

37. Because Sirius XM's music channels are listener-driven (as opposed to advertiser-driven), the Company also is able to provide deeper catalog selections that cannot typically be heard in most terrestrial radio markets and regularly plays emerging songs and artists on its channels long before they are played on terrestrial radio. Blatter WDT ¶¶ 27-28, 30-33, 35-37; Blatter WDT Exs. 21, 26, 28-32.

38. In contrast, terrestrial radio stations have become increasingly conservative in terms of their programming and ability to embrace a wide range of music. Blatter WDT ¶ 22. In some instances, terrestrial radio has eliminated even certain mainstream formats that might have been broadcast five years ago; in other circumstances, terrestrial radio programmers have dramatically scaled back their exposure of new music or deeper playlists of music even in the formats that they continue to broadcast. 6/8/12 Tr. 980:3-19 (Blatter); Blatter WDT ¶¶ 22, 24 and Exs. 21-23. Additionally, terrestrial radio does not expose listeners to as much new music as does Sirius XM. Blatter WDT ¶ 29 and Ex. 27.

39. As will be discussed in detail in Section IV.A.3, *infra*, Sirius XM's unique ability to offer rich, diverse and new music content, together with additional promotional activities that Sirius XM undertakes in collaboration with artists and their representatives, have led artists, labels and managers to view Sirius XM as a powerful promotional vehicle for the sale of sound recordings. *See generally* Blatter WDT ¶¶ 38-65. Data from industry-standard services that track record sales and radio airplay corroborates that airplay on Sirius XM results in dramatically increased record sales. *See* Section IV.A.3, *infra*; Blatter WDT ¶¶ 66-73.

(ii) Sirius XM Invests Substantial Resources In Its Curated Music Content

40. Sirius XM invests significant resources into the programming of all of its music channels. These investments include the procurement of quality on-air talent and expert music

programmers. Karmazin WDT ¶ 21; Blatter WDT ¶¶ 8-9, 14-16; Blatter WDT Ex. 18. Far from being mere "jukeboxes" of songs in a given category, each of Sirius XM's music channels has a clearly-defined style and identity that shapes the programming and presentation of the channel in a variety of ways. Blatter WDT ¶¶ 8-10. A channel's style or identity determines its overall energy level, helps identify the appropriate on-air hosts, and guides special programming that may be created and scheduled. Blatter WDT ¶ 8; *see also* Blatter WDT ¶¶ 17-20 (describing artist channels and specialty programming developed by Sirius XM that are not typically heard elsewhere); 6/8/12 Tr. 982:13-983:21 (Blatter); Blatter WDT Exs. 19-20.

41. In addition to the creation of a channel identity or brand, the selection, sequencing and packaging of the music content itself also entails considerable expertise. Blatter WDT ¶ 10. Trained music programming experts who are familiar with the music use both scientific and artistic judgment to curate an optimal musical flow and mood on a song-by-song basis. *Id.* Every hour of music scheduled across all of Sirius XM's music channels is carefully reviewed and selected by a Sirius XM programmer before it is presented to listeners. *Id.*

42. All of these factors – in addition to the music played – work together to enhance the listening experience; as a result, Sirius XM's subscribers develop a strong affinity for their favorite Sirius XM channels. Blatter WDT ¶ 9.

C. Sirius XM's Direct License Initiative

1. Development Of The Direct License Initiative

43. As part of its overall efforts to reduce costs, as well as achieve other efficiencies, Sirius XM has sought to negotiate sound recording performance rights directly with individual record labels. Frear WDT ¶ 46; *see also* 6/11/12 Tr. 1345:10-1347:6 (Karmazin) (describing, from CEO's perspective, why the direct license effort was initiated).

44. Sirius XM views these licenses executed directly with record labels (hereinafter, "Direct Licenses") as having benefits for both the Company and record labels. Frear WDT ¶¶ 46, 48-49; Karmazin WDT ¶¶ 15-16. From Sirius XM's perspective, not only does direct licensing have the potential for controlling costs, it also allows the Company to streamline its approach to licensing by obtaining rights for all of its various platforms – satellite, Internet webcasting, business establishment services, and others – in a single, convenient license form. Frear WDT ¶ 48; Gertz CWDT ¶ 9. Moreover, because the Company already needed to go to the market to obtain the rights required for certain service enhancements that it was considering (*i.e.*, product features not covered by the statutory license), it made sense to seek to secure those rights covered by the statutory license as well.[11] Frear WDT ¶ 48; Gertz CWDT ¶ 9.

45. The Direct License initiative presented a first-ever opportunity for injecting price competition into the licensing of sound recording performance rights covered by the statutory license. It created an environment in which individual record companies could price these rights separately and individually and in competition with one another, taking into account the incentive that entering into a Direct License would provide to Sirius XM to increase that record company's plays on satellite radio. This, in turn, would garner greater exposure for the label's artists' works and provide the label a greater share of the overall royalty pool attributable to satellite radio sound recording performances. Frear WDT ¶¶ 48-49; Gertz CWDT ¶¶ 9-10. This competitive dynamic – what Professor Noll referred to as the competition between record companies for "demand diversion," Noll RAWDT pp. 30-32, 38 – has been absent to this point in time in the licensing of sound recording performance rights covered by the statutory license.

[11] Sirius XM initially approached SoundExchange to attempt to structure such a multi-platform license, but was informed that SoundExchange lacked the authority to engage in those discussions. Accordingly, Sirius XM proceeded to approach record labels directly to obtain the necessary rights. *See* Frear WDT ¶ 47; 6/7/12 Tr. 665:3-669:7 (Frear).

Prevailing practice has instead been for record companies collectively to refrain from such individual price competition in favor of having their royalty rates set uniformly either through negotiations conducted by the industry collective, SoundExchange, or via a rate-setting proceeding such as this one.

46. Other potential advantages of a Direct License to a record label include faster royalty payments as well as transparent royalty and music usage reporting with accurate performance counts. Frear WDT ¶ 49; Gertz CWDT ¶ 10. Additionally, record labels that take a Direct License are not subject to deductions for SoundExchange's administrative fees, or to SoundExchange's well-publicized difficulties in its distribution of royalties. Frear WDT ¶ 49; Gertz CWDT ¶ 10; 6/15/12 Tr. 2509:4-2511:10, 2516:8-2519:10, 2520:9- 2522:3, 2525:8-11 (Bender) (acknowledging publicity surrounding hundreds of millions of dollars in undistributed royalties; conceding SoundExchange's SERENA distribution system had "reached crisis mode"); Sirius XM Dir. Trial Exs. 46-53; *see also* Sirius XM Dir. Trial Ex. 54 p. 3 (Information Systems and Technology department presentation to SoundExchange Board of Directors, assessing SoundExchange's systems as being [redacted].

2. Implementation Of The Direct License Initiative

47. Sirius XM began its efforts to license directly in early 2010 by attempting to engage the four major record companies, individually, in discussions on that subject. These efforts proved fruitless; none of the majors evinced any serious interest in engaging in a meaningful discussion – let alone negotiation over the terms – of a direct license. Frear WDT ¶ 47; 6/7/12 Tr. 669:8-672:9, 713:3-11, 7:14:11-715:4 (Frear); 6/11/12 Tr. 1347:7-21, 1348:20-

1349:4 (Karmazin) (describing conversations with major record companies concerning direct licensing as "[a]bsolutely not productive"); Frear RWRT ¶ 7 ("Not a single one of the majors has indicated a serious interest in entering into negotiations over [a direct license] *at any rate*.") (emphasis in original).

48. Sirius XM was subsequently advised by knowledgeable industry sources that the entrenched interests of the majors in perpetuating the current licensing system, manifested by their active participation on the SoundExchange Board of Directors, made it unlikely that any major label would "break ranks" and enter into discussions about licensing directly with Sirius XM. Frear WDT ¶ 47; Gertz CWDT ¶ 12; 6/7/12 Tr. 672:10-674:17 (Frear); *see also* Noll RWRT pp. 32-33. Sirius XM accordingly decided to focus its direct licensing efforts on independent labels. Frear WDT ¶ 47; Gertz CWDT ¶ 12; 6/7/12 Tr. 674:18-676:18 (Frear).

49. During 2010 Sirius XM engaged Music Reports, Inc. ("MRI") to assist in its efforts to develop a licensing program that would enable Sirius XM to obtain directly from independent record companies the rights it needed to perform and reproduce sound recordings on its various services. Gertz CWDT ¶ 9; Frear WDT ¶ 47. MRI was created in 1989 to assist local television broadcasters implement new forms of ASCAP (and later, BMI) licenses. Gertz CWDT ¶¶ 4-5. Since that time, MRI has expanded in scope to provide copyright research, licensing, royalty accounting and music-use reporting services for music users and distributors across all media. *Id.* at ¶ 7. As a result of this work, MRI has developed extensive experience in negotiating direct licenses from composers, music publishers and record labels for the rights to publicly perform, distribute, reproduce and synchronize the songs and recordings they own or administer. *Id.* In the course of this work with the music publishing and recording industries, MRI has developed a comprehensive database of copyright ownership information called

SONGDEX, which contains data regarding tens of millions of individual song title records. *Id.* at ¶¶ 5-6.

50. In order to assist Sirius XM in deciding which labels to approach with Direct Licenses and in what order, MRI undertook an informal analysis of one year of Sirius XM's playlists from June 2009 to May 2010 to identify the publishers and record companies whose works were played most often on Sirius XM's satellite radio service. Gertz CWDT ¶¶ 10-11; 6/7/12 Tr. 832:22-833:16 (Gertz). MRI also targeted companies that had granted Section 114 waivers to Sirius XM in the past,[12] as well as record labels with which MRI had existing relationships. Gertz CWDT ¶ 11.

51. MRI also worked closely with Sirius XM to develop offer terms and the license form in which those terms would be embodied. Gertz CWDT ¶¶ 10, 13. The goal was to design an offer that used industry-standard terms (representations and warranties, audit rights, and the like) and would not require lengthy negotiations or material variation from agreement to agreement. Gertz CWDT ¶ 13; 6/7/12 Tr. 839:8-840:4 (Gertz). This latter point was particularly important because it would allow Sirius XM and MRI to standardize royalty administration across all directly-licensing record companies. Gertz CWDT ¶ 13; 6/7/12 Tr. 839:21-840:4 (Gertz). Moreover, the offer was designed so that each label would be paid its *pro rata* share of a percentage-of-revenue royalty pool; such a structure would not work if the rate-calculation methodology or revenue definition were to vary from licensor to licensor. Gertz CWDT ¶ 13; 6/7/12 Tr. 839:21-840:4 (Gertz). MRI considered it extremely important that the offer be fair, straightforward, and transparent so that negotiations would not damage MRI's credibility with

[12] These waivers remove the limitations of the Digital Millennium Copyright Act's sound recording performance complement, which limits the number of times certain songs from a particular album or songs by the same artist may be performed within a three-hour window. *See* 17 U.S.C. § 114(j)(13). As will be discussed in Section IV.A.3.a, *infra*, it is quite common for record companies to grant such waivers in recognition of the promotional impact of additional airplay on Sirius XM.

the copyright owners with whom it regularly negotiated on behalf of various clients. Gertz CWDT ¶ 13.

3. Key Terms And Features Of The Direct Licenses

52. The key terms of the Sirius XM direct license offer (with cross-references to Gertz CWDT Ex. 7,[13] a sample direct license with SCI Fidelity Records) include the following (as described by Mr. Gertz in his written direct testimony):

53. Grant of Rights (clause 1(a)): The Direct Licenses grant all the rights Sirius XM requires from the record company to operate all of its various services, including through-to-the-listener public performance rights and reproduction and distribution rights (to cover server copies and, to the extent Sirius XM decides to offer it, the features described on Exhibit A of the agreement, such as single-track recording). As clause 1(b) confirms, the rights grant in this voluntary agreement extends beyond the needs of Sirius XM's statutorily-compliant services. While granting the same rights as are covered in this proceeding, it also authorizes Sirius XM to offer the additional functionality described in Exhibit A to the agreement, which affords additional value to Sirius XM. From the label's perspective, eliminating the statutory restrictions – in particular the sound recording performance complement – promotes increased plays and resulting promotion of its songs on Sirius XM channels and increased royalty payments. *See* Gertz CWDT ¶ 14(a); 6/7/12 Tr. 840:5-841:5 (Gertz).

54. Royalty Rate (clause 2(a)(i)): Under the Direct Licenses, labels are paid their *pro rata* share of 5%, 6% or 7% of gross revenues, with a revenue definition that mirrors that found at 37 C.F.R. § 382.11. Pursuant to clause 2(c), the royalty rate includes both the label and artist

[13] SXM Direct Exhibits 7, 8 and 14 were appended to the Corrected Written Direct Testimony of Ronald H. Gertz, and were admitted into evidence together with the written testimony as Sirius XM Direct Trial Exhibit 14. All exhibits so attached will be hereinafter referred to as "Gertz CWDT Ex. __."

share of the royalties; as is routine under licenses that record companies enter into with music services, the record company is responsible for paying its artists pursuant to the terms of the parties' recording agreements. Gertz CWDT ¶ 14(b); 6/7/12 Tr. 843:7-844:4 (Gertz) (describing Direct Licensor acceptance of revenue definition); *see also* 6/13/12 Tr. 2131:18-2132:19 (Ciongoli) (confirming UMG regularly distributes royalty revenues from its direct licenses with digital music services to its artists pursuant to the terms of its agreements with artists); 6/15/12 Tr. 2559:13-20 (Van Arman) (Jagjaguwar adheres to the terms of its contracts with artists when it receives income from licensed deals.); 8/20/12 Tr. 4178:15-21 (Powers) (Yellow Dog Records abides by its contracts with artists dictating the artist's share.).

55. Royalty Formula (clause 2(a)): Each directly-licensing record company's *pro rata* share of the royalty pool (whether 5, 6 or 7%) is calculated by dividing the number of transmissions of the record company's works in the given period by the total number of transmissions on the Sirius XM satellite radio service during the period (whether or not directly licensed). The royalty pool is "gross" without deduction of any administrative fees and expenses like those deducted by SoundExchange – each licensor receives its share of the entire royalty pool. Gertz CWDT ¶ 14(c); 6/7/12 Tr. 844:5-18 (Gertz).

56. Satellite Radio Performance Proxy (clause 2(a)(iii)): Although the royalty pool is calculated at the rate of 5% to 7% of *all* Sirius XM revenue from all covered services (satellite, Internet, business establishment services, residential television music channels), the label's share of that pool is calculated based on its share of Sirius XM satellite radio transmissions. In other words, the satellite radio performances serve as a proxy for distributing royalties associated with all Sirius XM services. The reasoning behind this approach reflects the recognition that almost all Sirius XM revenue is accounted for by the satellite radio service, so it makes sense to

distribute funds according to plays on that service. In addition, the offerings of the other services are typically simulcasts of the satellite channels – *i.e.*, the content is substantially identical in any event, so a label's share would not materially change by including transmissions on the other services.[14] Gertz CWDT ¶ 14(d); 6/7/12 Tr. 844:19-846:16 (Gertz).

57. Audit Rights (clause 3(b)): Sirius XM's satellite radio play data tracks every transmission on each channel and the frequency with which songs are played, making it an accurate count of performances that is easy for a label to audit, pursuant to the rights conveyed in clause 3(b). Gertz CWDT ¶ 14(e).

58. Quarterly Accountings (clause 3(a)): Payments under the Direct Licenses are made on a quarterly basis, 45 days after the close of the quarter, and accompanied by statements detailing each Direct Licensor's tracks played on Sirius XM during the quarter – a process that will allow the Direct Licensors to flag and correct any errors (and receive payment for any missed tracks) and that will allow Sirius XM and MRI to adjust their databases as necessary to avoid such errors in subsequent reporting terms. 6/7/12 Tr. 835:13-17, 847:19-848:15, 924:21-926:6, 938:17-939:20 (Gertz); *see also id.* at 824:6-825:12 (describing similar reconciliation process developed with ASCAP and BMI); *id.* at 827:13-830:7 (describing licensor portals developed for reporting under Section 115 statutory license). The first set of statements, covering the fourth quarter of 2011, was sent in February 2012. *Id.* at 924:21-925:1; *see generally* SX Trial Ex. 321.

---

[14] Although there are some minor variations (the residential and business establishment services may offer only a subset of the satellite channels, and there are handful of webcasting channels that are not on the satellite), these variations should not have a material effect on the total royalties paid to any direct licensor. Gertz CWDT ¶ 14(d); 6/7/12 Tr. 844:19-845:19 (Gertz).

4. Sirius XM Has Succeeded In Obtaining Nearly 100 Direct Licenses To Date

59. Sirius XM, through MRI, sent out the initial round of Direct-License offers in late July 2011, and has been negotiating direct licenses ever since. Frear WDT ¶ 51.

60. Despite the challenges described in the next section, Sirius XM has met with considerable success in entering into Direct License deals with independent record labels. *See* Frear WDT ¶ 57. As of the time written direct statements were filed on November 29, 2011, Sirius XM had obtained 62 Direct Licenses with independent labels. Gertz CWDT Ex. 14; 6/7/12 Tr. 851:11-852:13 (Gertz); Gertz CWDT ¶ 15; Fear WDT ¶ 52; 6/7/12 Tr. 686:19-688:16 (Frear); Karmazin WDT ¶ 17. By the time of the rebuttal-phase hearings in August 2012, the number had grown to 95 such licenses. 8/13/12 Tr. 3015:16-20 (Frear); 8/15/12 Tr. 3679:22-3680:1 (Gertz). The royalty rates in these 95 agreements uniformly call for payments reflecting the direct licensor's *pro rata* share of 5%, 6% or 7% of revenue. Frear WDT ¶ 51; 6/7/12 Tr. 679:7-680:8 (Frear); 8/13/12 Tr. 3015:21-3016:3 (Frear); 8/15/12 Tr. 3680:2-7 (Gertz).

61. The Direct License initiative is an ongoing effort that Sirius XM intends to continue for the foreseeable future, irrespective of the rate outcome in this proceeding, and has budgeted [redacted] for its continued engagement of MRI in connection with that effort in 2013. *See* Frear RWRT ¶ 10; 6/7/12 Tr. 688:17-692:19 (Frear).

5. The Recording Industry's Coordinated Efforts To Stymie Sirius XM's Direct License Initiative

62. Although Sirius XM has achieved considerable success in obtaining Direct Licenses, there is little doubt that it would have attained still more such licenses were it not for the orchestrated campaign which has been mounted by SoundExchange, in league with other record industry interests, designed to undermine the ultimate success of this license initiative.

Numerous Sirius XM witnesses testified that they "have no doubt" that more Direct Licenses would have been signed were it not for this overt interference by SoundExchange and other record industry organizations. Frear WDT ¶ 53; Gertz CWDT ¶ 17; Karmazin WDT ¶ 18; Gertz RWRT ¶ 6; *cf.* Frear WDT ¶ 57 (calling Sirius XM's success in obtaining Direct Licenses in the face of industry interference "remarkable").

63. This record of obstruction is of especial relevance to the Judges' consideration of SoundExchange's arguments aimed at marginalizing the probative value of the Direct Licenses based on the contention that relatively few record companies have signed on – hence, that the royalty rates reflected therein are not representative of the rates that the broader industry would have agreed to in a competitive market. *See* Ordover WRT ¶¶ 5, 11-20. While the core assertion as to non-representativeness lacks merit, *see* Section II.B.1, *infra*, the very argument is audacious in light of the extensive efforts undertaken by SoundExchange [redacted] Sirius XM Reb. Trial Ex. 3.

a. SoundExchange's Objective: To Stymie The Success Of The Direct License Initiative

64. Beginning immediately following Sirius XM's initial outreach to independent labels and continuing at least through the period up to the filing of the direct cases in this proceeding, SoundExchange, in consultation with its Board of Directors, and in coordination with other record industry trade groups, developed a multi-pronged course of action aimed at stopping the Direct License initiative dead in its tracks. With a communicated sense of urgency, SoundExchange mounted both a public and private campaign to impugn the Direct Licenses and seek their demise, boldly predicting that, if record labels instead cast their licensing lot with SoundExchange, they would be rewarded through significantly higher rates emanating out of this

proceeding. *See generally* Frear WDT ¶¶ 53-56; Gertz CWDT ¶¶ 17-18; Noll RAWDT pp. 49-55; Gertz RWRT ¶¶ 6-10; 6/7/12 Tr. 692:21-697:10 (Frear); 6/7/12 Tr. 857:19-860:4 (Gertz); 6/5/12 Tr. 266:14-270:13 (Noll); 6/6/12 Tr. 459:22-460:13 (Noll); 8/15/21 Tr. 3694:11-3695:14, 3697:3-3702:22, 3705:3-6 (Gertz); 8/14/12 Tr. 3447:1-3448:16 (Noll). The public messaging, while carefully worded, was nonetheless far from subtle in conveying these sentiments. The private messaging, exposed only through discovery, laid these motivations bare.

65. Sirius XM began formally communicating its Direct-License offer towards the end of July 2011. Frear WDT ¶ 51 SoundExchange sent out its first public messaging to members on this topic on August 11, 2011. *See* Sirius XM Dir. Trial Ex. 2. Several days later, on August 15, 2011, SoundExchange Board member Thomas Silverman [redacted]

[redacted]

Sirius XM Reb. Trial Ex. 4; *see also* 8/14/12 Tr. 3385:6-3387:14 (Ordover).

66. This was no renegade reaction by a lone Board member. It captured SoundExchange's resolute determination to halt the Sirius XM Direct License initiative in its tracks lest the market-determined rates reflected in executed Direct Licenses undermine SoundExchange's objective to raise rates for the entire industry by more than 60% from their current levels. This reality was made manifest in another private email exchange several months later, at a time when record labels had begun to sign direct licenses. On October 27, 2011, the day that four industry organizations released statements attacking the *bona fides* of the direct

licenses were released on a coordinated basis, *see* Frear WDT Exs. 6, 11-12[15], [redacted] Sirius XM Reb. Trial Ex. 3 (emphasis added); *see also* 8/14/12 Tr. 3373:14-3377:1 (Ordover).

b. SoundExchange's Implementation Of Its Objective

67. In furtherance of its objective of undermining the success of the direct licenses, SoundExchange, as its own internal Board materials attest, "[redacted]" Noll RWRT Ex. 37.[16] This entailed not only sending out its own communications, but also lending support to, and coordinating the messaging of, other record industry trade organizations with a common interest.[17] This process was facilitated by the overlap in Board memberships of key record label and industry trade association executives in the affected organizations.[18] *See* Gertz CWDT ¶ 18.

[15] SXM Direct Exhibits 6-13 were appended to the Written Direct Testimony of David J. Frear, and were admitted into evidence together with the written testimony as Sirius XM Direct Trial Exhibit 12. All exhibits so attached will be hereinafter referred to as "Frear WDT Ex. __."

[16] SXM Rebuttal Exhibits 37-41 were appended to the Revised Written Rebuttal Testimony of Roger G. Noll, and were admitted into evidence together with the written testimony as Sirius XM Rebuttal Trial Exhibit 6. All exhibits so attached will be hereinafter referred to as "Noll RWRT Ex. __."

[17] Illustratively, [redacted] *See* Noll RWRT Ex. 38.

[18] SoundExchange's Board is composed of members representing industry organizations the American Association of Independent Music ("A2IM"), the Recording Industry Association of America ("RIAA"), the American Federation of Musicians ("AFM), the Screen Actors Guild-American Federation of Television and Radio Artists ("SAG-AFTRA") as well as major record companies Sony BMG, UMG,

68. The record industry's public offensive against the Direct Licenses was launched within days of the first offer being extended to independent labels. On August 9, 2011, the American Association of Independent Music ("A2IM") issued a public statement through its President Rich Bengloff – who sits on the SoundExchange board – in response to the direct license offer. *See* Frear WDT ¶ 53; Sirius XM Dir. Trial Ex. 4.

69. A2IM's statement claimed that statutory licenses (as opposed to Sirius XM's Direct Licenses) are "good for the independent music label community" and that "under direct licenses there are cases where independents have received less than equitable rates." Sirius XM Dir. Trial Ex. 4. It went on to exalt the role of SoundExchange by contending that "[t]he authority of SoundExchange to aggressively pursue the best possible statutory rates and handle all of the administration, including processing and auditing, results in having a central group to protect Indie rights as the statutory rate is working and Indie labels are benefiting from having … this central voice." *Id.* A2IM also made clear that SoundExchange would be seeking to increase rates through this proceeding. *Id.* Although A2IM did not explicitly call for labels to reject Sirius XM's direct license offer, "[t]he underlying message was unmistakable: don't break ranks by signing the Sirius XM direct license." Frear WDT ¶ 53; *see* Noll RAWDT pp. 53-55.

70. Just days later, on August 11, 2011, SoundExchange issued its first public communication on the subject of the direct licenses. While never overtly referring to these licenses, its purpose and messaging were clear. SoundExchange there asserted (falsely) that in the *Satellite I* proceeding "[t]he Judges actually concluded that the appropriate 'market rate' was 13%," and only dropped that rate to current levels based on "Sirius's and XM's precarious financial positions." Sirius XM Dir. Trial Ex. 2. In addition to painting a rosy picture of Sirius

EMI and Warner Music Group ("Warner"). *See* Frear WDT ¶ 53; Gertz CWDT ¶ 12; Noll RAWDT p. 42 and n.30; *see also* http://www.soundexchange.com/about/people/board/.

XM's current and projected financial condition, the release explained (in bold type): "**We . . . are planning to seek a substantial increase in the statutory rate. In other words, we plan to seek rates well in excess of the 2012 rate of 8%.**" *Id.* The release went so far as to claim that "[w]e believe . . . our industry should expect to see a significantly increased statutory rate." *Id.* The release also pointedly observed that individual record label agreements of the type Sirius XM was soliciting would serve as evidence of prevailing market rates in this proceeding, noting they might "play a very significant role in the outcome." *Id.*

71. Two months later, on October 27, 2011 (just before the written direct statements in this proceeding were due to be filed), in what was plainly a coordinated attack on Sirius XM's Direct License initiative, SoundExchange, the Recording Academy, AFTRA and AFM all released statements discouraging labels from licensing directly with Sirius XM. *See* Frear WDT ¶ 55 and Exs. 6, 11-12.

- The SoundExchange release touted its success in the *Satellite I* proceeding in obtaining "a 300 percent increase in the rate paid by Sirius XM," reiterated that "the current royalty rates are artificially low" and reminded the industry that it would be seeking "a substantial increase in the next term." *Id.* at Ex. 6.
- The Recording Academy (also known as the National Academy of Recording Arts and Sciences or "NARAS"), through a letter from its president Neil Portnow, stated that Sirius XM's efforts "will likely result in substantially reduced payments to artists and producers, a lowering of the value of performance royalties, and unnecessary conflict between artists and their labels." *Id.* at Ex. 11. The Recording Academy's letter went so far as to explicitly encourage artists to "call [their] label today and request that it not direct license [their] recordings" and to advise labels that "it is in your interest to refrain from direct licensing. While Sirius may be offering positive terms, the long-term effect of accepting a rate lower than the compulsory rate could be to reduce rates overall in the future." *Id.*
- AFTRA (in a joint statement with AFM) stated that "Sirius XM is seeking to . . . lower the rates for music on the backs of artists and musicians," labeling Sirius XM's direct licensing efforts as "blatantly anti-artist and anti-musician." *Id.* at Ex. 12. It further stated that "[t]he race by Sirius XM and independent record labels to grab performer copyright royalties hurts the music industry . . . [and]

> erodes the value of music industry-wide." *Id.* The organizations called upon their members to "let your labels know that you believe they should . . . refus[e] the Sirius XM offer and insist[] on the statutory license administered by SoundExchange." *Id.*

72. The next day, a fifth organization – the Future of Music Coalition ("FMC") – joined the chorus of opposition with its own statement denigrating Sirius XM's Direct Licenses. *See id.* at Ex. 13. In that statement, FMC "applaud[ed] [its] artist colleagues for urging their members signed to indie labels . . . to not accept these direct licensing deals." *Id.* FMC then explicitly "join[ed] in the chorus" and set forth a multitude of reasons why it believed "the current statutory licensing structure is better for all stakeholders." *Id.* The message was explicit: the record industry is "more powerful collectively than [it is] separately." *Id.*

73. The purpose and intended effects of these multiple industry communications are obvious. As Professor Noll explained:

> [t]he messages from these organizations are clear. Using the process for setting statutory rates is preferred to transactions in a competitive market because a regulatory process in which the industry speaks with a single voice is likely to produce higher rates. The goal of these organizations is explicitly not to seek rates that approximate the outcome of negotiations between willing buyers and willing sellers in a competitive market.

Noll RAWDT pp. 53-54; *see also* 6/5/12 Tr. 266:14-270:13 (Noll); 6/6/12 Tr. 459:22-460:13 (Noll).

74. The record industry's sole chosen witness during the direct phase to address the Direct License initiative was remarkably candid in affirming this preference to avoid competition in the licensing of performances on satellite radio. Darius Van Arman flatly conceded that he "would prefer that record companies didn't compete with one another for airplay on Sirius XM through a mechanism like the direct license." 6/15/12 Tr. 2569:6-10, 2569:19-2590:12 (Van Arman).

c. SoundExchange's Success In Dissuading Labels From Entering Into Direct Licenses

75. The record industry's coordinated campaign against Sirius XM's Direct License initiative has borne fruit. MRI's staff that has direct contact with independent labels has received repeated feedback, both in writing and by telephone, from labels that they "were under tremendous pressure from the industry groups not to sign" because, among other reasons, "their signing a deal at a lesser, competitive rate, would have the impact of setting bad precedent in this proceeding." Gertz CWDT ¶ 17; 8/15/12 Tr. 3694:11-3695:14 (Gertz). In other words, labels that MRI had approached with Direct License offers declined the offer because they were given to understand that to accept it would be to undercut SoundExchange's proposal for substantially higher royalties for the rest of the industry in this proceeding. Gertz CWDT ¶ 17.

76. Numerous communications between prospective licensors and MRI depict the pressure placed upon labels not to enter into Direct Licenses. For example, on August 20, 2011 – just days after the first SoundExchange and A2IM public statements concerning the Direct Licenses were released – independent label [redacted] responded to MRI's email correspondence regarding Sirius XM's Direct License offer by stating, simply: "A2IM is opposed to this I believe." Gertz RWRT Ex. 31.[19] [redacted] did not accept the Sirius XM offer. *See* 8/15/12 Tr. 3700:17-3701:6 (Gertz); Noll RWRT Table 2.

77. In an October 27, 2011 email (the very same day as four industry groups released their public statements against the direct license campaign), Jim Olson of the independent label Signature Sounds reported to MRI that "[a]fter reading about the positions of [A2IM] and NARAS on this issue, we've decided to stay with SoundExchange for now." Gertz CWDT ¶ 17

[19] SXM Rebuttal Exhibits 5-36 were appended to the Revised Written Rebuttal Testimony of Ronald H. Gertz, and were admitted into evidence together with the written testimony as Sirius XM Rebuttal Trial Exhibit 8. All exhibits so attached will be hereinafter referred to as "Gertz RWRT Ex. __."

and Ex. 8. Signature Sounds did not enter into a Direct License with Sirius XM. 6/7/12 Tr. 859:8-12 (Gertz).

78. On November 9, 2011, independent label [redacted] responded to MRI's email correspondence regarding Sirius XM's direct license offer by stating: "[redacted]" Gertz RWRT Ex. 32; *see also* 8/15/12 Tr. 3697:3-3698:1 (Gertz).

79. On November 15, 2011, [redacted] responded to MRI's email communication regarding an offer to [redacted] for a Sirius XM Direct License by stating: "The RIAA has asked everyone to hold off." Gertz RWRT Ex. 30. [redacted] did not accept the Sirius XM offer. 8/15/12 Tr. 3699:15-3700:1 (Gertz).

80. That other labels were taking their cues from industry groups is illustrated by an August 30, 2011 email MRI received from independent label [redacted] informing MRI that they would "look at the license, but also will confer with A2IM and other indies." Sirius XM Dir. Trial Ex. 3; Gertz RWRT ¶ 7.

81. This industry pressure appears to have continued well into these proceedings. For example, on December 14, 2011 [redacted] responded to Sirius XM's Direct License offer by stating: "We're members of A2IM AND MERLIN. I THINK THAT PREVENTS A DIRECT LICENSE." Gertz RWRT Ex. 33. [redacted] did not accept the Direct License offer. *See* Noll RWRT Table 2.

82. Other labels made clear that their reason for declining the offer related to their affiliation with major record companies. On November 17, 2011, [redacted] of independent label [redacted] responded to MRI's email correspondence regarding the Sirius

XM Direct License offer by stating: '[redacted]" Gertz RWRT Ex. 29; 8/15/12 Tr. 3698:2-3699:14 (Gertz); *see also* Frear RWRT ¶ 8; 6/7/12 Tr. 686:19-688:16 (Frear) (discussing lack of availability of independent labels distributed by major record companies to enter into Direct Licenses with Sirius XM).

83. SoundExchange itself weighed in responding to direct-license inquiries from its members. For example, [redacted] *See* Sirius XM Reb. Trial Ex. 5. [redacted] *Id.*; *see also* 8/14/12 Tr. 3391:12-3393:8 (Ordover).

84. The tactics employed by SoundExchange and other industry organizations have not been limited to efforts to discourage labels from accepting Sirius XM's Direct License offer; such interference has extended to urging recording companies that had already entered into Direct Licenses to back out of them. *See* Gertz RWRT ¶¶ 8-9; 8/15/12 Tr. 3701:7-3702:11 (Gertz).

85. For example, Record labels Paracadute and TMB Productions, home to the well-known bands OK Go and They Might Be Giants, respectively, entered into Direct Licenses with Sirius XM on or about November 28, 2011. *See* Gertz RWRT Ex. 35. On approximately February 9, 2012, MRI's licensing contact at the labels with which MRI had negotiated the deals

– Darren Paltrowitz – asked MRI whether there was any opportunity for those entities to "opt out" of their Direct Licenses. *Id.* When asked by MRI for an explanation, Mr. Paltrowitz responded with a list of issues, strikingly similar to SoundExchange's and A2IM's earlier press releases (Sirius XM Dir. Trial Exs. 2 and 4), which Mr. Paltrowitz indicated had been supplied by the bands' business manager, RZO Business Management. Gertz RWRT ¶ 8 and Ex. 35. MRI learned that Paracadute and TMB Productions were being "encouraged" to get out of their agreements by Perry Resnick of RZO, who sits on SoundExchange's Board of Directors. *Id.* at ¶ 8.

86. On February 22, 2012, after intervening phone calls with a representative from MRI regarding the issue, Mr. Paltrowitz wrote MRI that he had "relayed Sirius XM's feedback to RZO and they – per conversations with A2IM and other folks beyond SoundExchange – stand their ground about wanting us to opt out." *Id.* at Ex. 35 and ¶ 9. That same day, Mr. Paltrowitz sent MRI an email copying portions of a note from Mr. Resnick stating that he "know[s] for a fact that Rich Bengloff, the head of A2IM (the indie label body) is against [the direct license offer]" and that he and Bengloff "have had this exact conversation, and are both in agreement that SoundExchange is the better way to go." *Id.*

* * *

87. As will be addressed in detail in Section II.B.1, *infra*, the foregoing facts underlying SoundExchange's campaign to interfere with the Direct License initiative not only provide an explanation for any purported lack of representativeness of the Direct Licenses, but also supply the very underlying justification why the Direct Licenses are the best benchmark to apply in this proceeding. As Professor Noll explained, "[w]hereas many record companies,

including the four majors, are unwilling to enter meaningful negotiations for direct licenses," the industry's coordinated messaging campaign against the direct licenses demonstrates that

> the source of this reluctance is the expectation that letting SoundExchange lead a collective effort to set a single statutory rate for the entire industry will produce more royalty income for all because SoundExchange will not respond to the competitive incentive facing each record company to compete on the basis of price in order to receive more plays. This phenomenon is precisely why the direct licenses between Sirius XM and . . . record companies are the most appropriate benchmark for this proceeding.

Noll RAWDT pp. 54-55; 6/6/12 Tr. 462:22-465:2 (Noll) ("[I]f you have a reasonably competitive marketplace where there are willing buyers and willing sellers entering into transactions, and the right that is being transacted is essentially the same as the right that's . . . at stake here, then that is . . . going to be of profound importance in setting the rate. . . . And it's that phenomena that . . . led SoundExchange and other industry associations to try to . . . convince their members that they shouldn't sign such agreements.").

II. SIRIUS XM'S DIRECT LICENSES WITH RECORD COMPANIES ARE THE BEST BENCHMARK FOR RATE SETTING IN THIS PROCEEDING AND SUPPORT A RATE BETWEEN 5% AND 7% OF REVENUE

88. The best evidence of competitive rates for sound recording performance rights on satellite radio are the direct license agreements between Sirius XM and 95 record companies at rates between 5% and 7% of Sirius XM's gross revenue (as defined in the current regulations).[20] 8/13/12 Tr. 3015:16-3016:3 (Frear); Noll RAWDT pp. 33-34, 36. For the first time, the Judges have direct evidence of competitively-negotiated marketplace rates charged for the exact service at issue in the proceeding (non-interactive satellite radio) and including the same rights covered by the statutory license (non-interactive digital performance rights). Noll RAWDT pp. 7, 11, 34-

[20] The simple mathematical average of the Licenses is 6.1%. *See* Section I.C.3, *supra*, for a description of the basic terms of the licenses.

36. No such evidence existed as the time of the *Satellite I* proceeding. Noll RAWDT p. 33; 6/5/12 Tr. 219:2-4 (Noll); *see also* Gertz CWDT Ex. 7 (sample license), Ex. 14 (listing Direct Licenses signed at time of direct case under standard form); Noll RWRT Table 2 (listing Direct Licenses signed as of July 1, 2012); Gertz RWRT Ex. 5-27 (copies of Direct Licenses signed between filing of direct and rebuttal statements).

89. The Direct Licenses were negotiated between a willing buyer and willing sellers in a competitive market and include the same rights that are the subject of this proceeding. Noll RAWDT pp. 7, 27, 35. They involve the same sellers as the statutory licensors (record companies that own sound recording copyrights), the same buyer (Sirius XM), and same rights as provided by the statutory license (non-interactive digital performance rights).[21] Noll RAWDT pp. 9, 27, 34-35; 8/14/12 Tr. 3443:10-3444:1 (Noll). The directly-licensing labels (the sellers) could have chosen to have their rates set in this proceeding, but instead freely chose to sign a separate license with Sirius XM – at rates below the prevailing statutory rate. Noll RAWDT pp. 34-35. They are direct competitors with the record companies that continue to collect Sirius XM performance royalties via SoundExchange.[22] *Id.* at p. 35.

---

[21] In fact, these agreements license additional rights beyond those covered by the statutory licenses at issue here, including reproduction and distribution rights, performance rights not limited by the sound recording performance complement, and limited device recording rights. *See* Gertz CWDT Ex. 7 at ¶¶ 1(a), 1(b) and Exhibit A. Accordingly, they provide additional value to Sirius XM.

[22] These attributes stand in stark contrast to the interactive Internet music service agreements again relied upon by SoundExchange. Interactive services provide on-demand selection of individual tracks by each individual user – a fundamentally different consumer experience that is more akin to playing tracks from the user's collection of CDs or downloads than the non-interactive, one-to-many, radio-like broadcasts found on satellite radio. Noll RAWDT pp. 33-34. The agreements between interactive services and record companies accordingly provide for a different (and much more valuable) set of rights than those found under the statutory license, including full on-demand performance rights (as opposed to performance rights limited to non-interactive streaming and other 114 limitations) and reproduction rights that allow for tracks to be downloaded to user devices for subsequent on-demand playback. Noll WDT pp. 11, 34; *see also* Section V.A.1, *infra* (discussing SoundExchange use of interactive service benchmark).

90. Notably, the Direct Licenses reflect the result of record companies competing with each other to encourage Sirius XM to substitute their recordings for the recordings of other record companies. Noll RAWDT pp. 9, 35-36; 6/5/12 Tr. 251:2-13 (Noll) (describing importance of workably competitive market in benchmarking). As Professor Noll testified,

> [d]emand diversion is the source of competition in sound recordings. An essential feature of a competitive market transaction for sound recording performance right is that the transaction price must reflect the incentive of the record company to divert demand to its recordings from the recordings of its competitors. . . . In the case of sound recording performance rights for SDARS, the competitive incentive for record companies arising from the possibility of demand diversion is to obtain more playing time and hence a larger share of Sirius XM's royalty payments and increased sales of their sound recordings due to the promotional effect of playing time."

Noll RAWDT pp. 30-31; *see also id.* at p. 35; 6/5/12 Tr. 249:3-250:9; 6/6/12 Tr. 317:2-5 (Noll). Such "demand diversion" is, in Professor Noll's words, the "engine of competition." 6/5/12 Tr. 250:7-9 (Noll).

A. The Direct Licenses Include Agreements With Large, High-Profile Independent Record Companies

91. Among the 95 independent labels that signed the Direct Licenses are prominent entities in the recording industry, with catalogs including Grammy winners, chart-toppers, and tracks that are played regularly across the range of Sirius XM's 70+ music and comedy channels – alongside (and competing for airtime with) songs distributed by the major labels. The labels that have signed Direct Licenses include the following:

92. **eOne Entertainment (formerly known as Koch Records)**: One of the largest independent labels in North America, with dozens of albums having charted on the Billboard independent albums chart over the past 10 years, eOne/Koch Records was one of Billboard's Top 5 Independent Labels for eight of the past nine years (2002-2011), including the #3 spot for

2011. eOne artists have won numerous Grammy awards, including a 2012 Grammy win for Best Instrumental Composition for artist Bela Fleck. Gertz RWRT ¶ 5.

93. [redacted]

- [redacted]
- [redacted]

[redacted]

Id.

94. [redacted] *Id.*

95. **Fair Trade Services**: Many of the artists on the Fair Trade label are supported by Sirius XM's The Message channel. This label boasts significant accomplishments in the Contemporary Christian Music field:

- Fair Trade artist Laura Story won a 2012 Grammy for Best Contemporary Christian Music Song.
- As of the March 17, 2012 Billboard issue, Fair Trade had three songs in the Contemporary Christian Top 10: Laura Story, "What a Savior;" (#6); Phillips Craig & Dean, "When the Stars Burn Down (Blessing and Honor)" (#7); and The Afters, "Lift Me Up" (#10).
- The label's roster includes MercyMe, whose album *The Hurt & The Healer* debuted at #7 on the Billboard 200 and #1 on the Christian Albums chart. The band's song "The Hurt & The Healer" also spent multiple weeks at #1 on the Christian Songs chart and the Christian AC Songs.
- As of July 7, 2012, Fair Trade releases held eight of the 50 spots on the Christian Songs chart, including top spot. Fair Trade was also listed as Billboard's #3 Top Christian Songs label for 2011. *Id.*

96. [redacted] *Id.*

97. **Dangerbird Records**: This label's artist roster includes Silversun Pickups, a Best New Artist Grammy nominee in 2010 whose album *Swoon* was Billboard's #6 independent album in 2009, whose album *Neck of the Woods* debuted at #6 on the Billboard 200 and #1 on the Billboard Independent Albums chart for the week of May 26, 2012 (and was Billboard's "Hot-Shot Debut" for the week), and who is played regularly on the Sirius XM Alt Nation channel. The Dangerbird roster also includes Fitz & The Tantrums, a VH1 "You Oughta Know" artist in April 2011 whose album *Pickin' Up the Pieces* was a #1 Billboard Heatseeker album in 2011, and who is currently played on Sirius XM's Spectrum, Alt Nation, and Radio Margaritaville channels. *Id.*

98. **PS Classics**: A leading producer of Broadway cast albums, including seven by Steven Sondheim and four Grammy-nominated cast albums. Many PS recordings of theatrical productions compete directly with recordings of the same musical, but with a different cast, that are offered by the major record companies. Noll RAWDT p. 44. In addition to cast albums, other releases from the label are studio recordings of musical scores, such as a 2011 version of George and Ira Gershwin's *Strike up the Band!* While not the first recording of this Broadway classic, this is the only recording of the complete original score as the musical was released in 1929. *Id.* Sirius XM, which has an entire channel, On Broadway, devoted to the genre, has more than fifteen PS Classics tracks in active rotation at this time, including tracks from *Sondheim on Sondheim*, *A Little Night Music*, *Finian's Rainbow*, and the cast albums from *Assassins*, *Grey Gardens*, and *Nine*. Gertz CWDT ¶ 15; Blatter WDT ¶ 12.

99. **The String Cheese Incident and Umphrey's McGee (SCI Fidelity Records)**: Sirius XM's Jam On channel has more than twenty active titles for each band in current rotation,

along with tracks by Keller Williams and Greyboy Allstars, also SCI Fidelity artists. Blatter WDT ¶ 12.

100. **Downhere and Aaron Shust (Centricity Music)**: Shust's song "My Hope is In You" was recently #1 on the Billboard Christian charts. Downhere won a 2007 Juno (Canadian Academy of Recording Arts & Sciences) award for Contemporary Christian/Gospel Album of the Year. Each artist is featured on Sirius XM's Christian music channel The Message. Gertz CWDT ¶ 15.

101. **Relient K, Ayiesha Woods, and Jamie Grace (Gotee Records)**: These artists are also featured on The Message. Relient K has released three Gold records, sold over two million records in total, and is Grammy-nominated. Woods's debut album for Gotee Records, *Introducing Ayiesha Woods*, was nominated for Best Pop/Contemporary Gospel album in 2007. *Id.*

102. **Eardrum Records**: This label was created when comedian George Carlin acquired Little David Records, the label that had released his comedy albums. After being renamed Eardrum, the label released only George Carlin records. Carlin won five Grammy awards and was nominated for 12 more. Carlin's records compete for play time on Sirius XM's comedy channels with recordings by other top comedians on labels owned by the four major companies. Noll RAWDT p. 45.

103. As Professor Noll testified, the Direct Licenses are representative, for benchmarking purposes, of the types of sound recordings available across the industry, including those distributed by major labels. Noll RAWDT pp. 39-44. Specifically, he examined the repertoires offered by the Directly Licensing labels to determine whether the Direct Licenses represent "the right distribution by age, by type of music, [and] by popularity of artists that

would cover the full range" of sound recordings played on Sirius XM, concluding that "collectively, they did compete across the board with the major distribution companies in all the various categories." 6/5/12 Tr. 260:21-262:14 (Noll); Noll RAWDT pp. 42-45 and Table 1 (comparing specializations of Direct Licensors with genre classifications of majors and concluding that "[a]s a group, the recordings of the companies that have signed direct licenses with Sirius XM are representative of the type and quality of recordings that are released by a major record company").

104. Professor Noll also concluded that the higher market shares of the major record labels would not "alter the presence of an incentive to create demand diversion . . . As with an independent record company, a major record company would find a direct license at the 7 percent rate more attractive than an industry-wide rate of 8 percent if a lower rate would cause an increase of plays of 6.4%." Noll RAWDT pp. 40-41 (noting that even with the largest label, UMG, such an increase would only require about one extra play per channel every 3.5 hours); 6/5/12 Tr. 263:10-19; 6/6/12 Tr. 359:10-11 (Noll) (same); *see also* Section II.B.1, *infra* (addressing SoundExchange's critique of Direct Licenses for lacking a major label).

B. SoundExchange's Attacks On Sirius XM's Direct Licenses Are Unfounded

105. SoundExchange levels four broad criticisms at the Direct Licenses: first, that the Direct Licenses are too small or too few in number and not sufficiently representative of the broader market for sound recording performance rights on Sirius XM, especially with respect to the major labels; second, that because the license fees are paid directly to the Direct Licensors (who then pay their artists according to the terms of their artist agreements) rather than according to the 50/50 split mandated under the statutory license, the Licenses are somehow inapposite as a benchmark for the statutory license (or that the headline rate of 5-7% must be adjusted in some

way); third, that the record companies that signed the agreements were unsophisticated or lacked certain information necessary to knowingly enter into the Direct License agreements; and fourth, that Sirius XM has monopsony power in the market for performance rights. *See generally* Ordover AWRT ¶¶ 5, 11-12, 21-49; Eisenberg ACWRT ¶¶ 21-23, 27-37, 67; Harrison CWRT pp. 9-11. The record demonstrates that none of these criticisms has merit.

1. Sirius XM's Direct Licenses Are Sufficiently Representative Of The Market, Including Major Labels, To Serve As A Proper Benchmark

106. SoundExchange witnesses argue that the Direct Licenses are not representative of the broader market for performance rights on Sirius XM, whether because they are too small or few in number, represent too small a share of Sirius XM plays, or because the companies that signed them have different incentives than the major labels. Ordover AWRT ¶¶ 5, 11-12, 21-29, 38-45, 49; Eisenberg ACWRT ¶¶ 21-23, 67; Harrison CWRT pp. 9-11. SoundExchange's arguments are contradicted by the evidence.

107. 95 separate record companies – that is, 95 willing buyers – made the independent decision to enter into an agreement with Sirius XM at a rate below the prevailing statutory rate in an effort to compete for increased spins on Sirius XM and increase their royalty revenue and public exposure. The large number of such companies that opted for the Sirius XM Direct License on its own belies SoundExchange's criticism, and is a number that cannot be ignored. 6/6/12 Tr. 464:10-20 (Noll) (evidence of willing buyers and sellers transacting for the statutory rate is of "profound importance in setting the rate" here).

108. Moreover, as discussed above, the Directly Licensed works represent a broad array of prominent, high-quality and award-winning music catalogs that play alongside major-label releases on Sirius XM stations and are key to Sirius XM's music programming. Although some of the individual companies that signed Direct Licenses are small, genre-oriented labels,

many are high profile standouts in their specialties – and thus important to Sirius XM even if not popular more generally. *See* 6/6/12 Tr. 370:16-372:14 (Noll) ("[T]he demand of Sirius XM for music is based upon the demand of its customers, not the demand of the population in general for music. . . . So it's a little bit more complex than simply what do I think the hit record[s] are."). Mr. Gertz, who has spent more than 35 years in the business, explained that

> small labels are often home to critically acclaimed artists who, while not generating top-40 hits, create music that is considered the best in its particular genre (and that fits perfectly on Sirius XM's more specialized stations devoted to those genres). In fact, many artists consciously choose to *remain* independent and seek out independent labels they know will provide a level of attention and artistic freedom that they perceive may be lacking at major labels.

Gertz CWDT ¶ 16.[23]

109. Mr. Gertz also testified as to the professionalism and business acumen of the executives from companies who made the decision to license to Sirius XM: "[S]mall labels tend to be entrepreneurial, innovative businesses devoted to promoting both the financial and artistic best interests of their artists and their catalogs. The executives of these labels (often the founders of the label, or veterans of major labels) routinely consider license requests from all types of users (and uses) and . . . consider such license offers – especially significant offers for catalog-wide license with a major music provider – with a good deal of care and attention." Gertz CWDT ¶ 16.

[23] This testimony reveals the complete irrelevance of Mr. Eisenberg's testimony regarding the market share of the Sirius XM Direct Licensors on terrestrial radio. Eisenberg AWRT ¶ 21. As Sirius XM's Mr. Blatter testified at length, terrestrial radio is dominated by mainstream and top-hit formats, whereas Sirius XM offers a wide variety of niche and specialty formats that are not available on terrestrial radio – a point with which Mr. Eisenberg agreed at trial. Blatter WDT ¶¶ 21-31; 8/22/12 Tr. 4615:1-4616:8, 4616:22-4618:8 (Eisenberg). The obvious implication is that a number of Sirius XM's Direct Licensors that are played regularly on Sirius XM would be unlikely to be represented in a study of terrestrial radio play.

110. Mr. Gertz expanded on this perspective in his oral testimony, explaining that "when you're in the independent record business, you're trying to compete with the major labels, so . . . they're very hands-on, very hard core, in promoting their artists and developing their careers. And, more importantly, they're just really hands-on on almost every license transaction, because everything they do is a license." 6/7/12 Tr. 856:7-857:18 (Gertz). This testimony was corroborated by SoundExchange's own label witness, Darius Van Arman, who explained that independent labels "are closer to artists and [are] intent on how music should be promoted and released and the character of what they are trying to do," and that "the independent community's more responsible with what rights they have." 6/15/12 Tr. 2551:13-2552:3 (Van Arman).

111. Accordingly, there is no reason to believe that the rate agreed to by those who did sign Direct Licenses is not representative of the rates that would be agreed to by the majors (or that the majors necessarily would receive a higher rate just because of their size). As Professor Noll explained, the Direct Licensors as a group "offer rights to [a] scope of sound recordings that is comparable to the scope of sound recordings one would get from the people who are not licensed." 6/5/12 Tr. 261:6-262:14 (Noll); 6/6/12 Tr. 350:13-17 (Noll) ("collectively, they represent a . . . library of sound recordings that is representative of the libraries of sound recordings of . . . other independents and the major distribution companies").

112. SoundExchange witness (and A2IM board member) Mr. Van Arman concurred, confirming that his group of labels, no different than the majors, "spend a great deal of time and effort seeking out recording artists to sign," "devote significant resources to promote their music," are "highly professional," and are interested in "maximizing revenues" – and that that they release music that is "equally or of greater value than what the majors are releasing." 6/15/12 Tr. 2552:4-2553:10, 2555:13-15 (Van Arman); *id.* at 2555:16-20 (JagJaguwar seeks to

"protect that value" and "to be competitive in the royalties [it] receives" when it enters into licenses with digital music services). And Mr. Van Arman's trade group, A2IM, has publicly supported the notion "that all music label copyrights, whether those of the major labels or those of independent labels or artists, are treated equally and paid the same rate amount for each stream (play) of that music." Sirius XM Dir. Trial Ex. 4.

113. Professor Noll also testified that the majors have the same incentive to compete for plays on Sirius XM as other labels, and that a major, like an indie, would need a 6.4% increase in plays to do as well under a 7% license as an 8% statutory rate. 6/5/12 Tr. 263:10-19; 6/6/12 Tr. 359:10-11 (Noll) ("The incentive to get played more is identical for everybody."). This reality is not altered by the observation that a Directly Licensing label might "double" or "triple" its rates while UMG could not, Ordover AWRT ¶¶ 42-43, or that 6.4% of UMG's plays outnumbers 6.4% of a small indie's plays, *id.* at ¶ 40. More generally, neither Professor Ordover nor SoundExchange presented any evidence to support the surmise that Sirius XM could not feasibly increase the plays of a direct-licensing major by some 6.4%.

114. The record evidence suggests that the majors do not typically receive higher royalty *rates* than independent labels; to the extent they receive higher licensing payments, it is because licensing royalty pools typically are divided *pro rata* based on plays and the majors have larger repertoires and play shares. 6/14/12 Tr. 2317:14-21 (Ordover); 6/13/12 Tr. 1998:7-1999:1, 2035:10-2036:10 (Bryan) (explaining *pro rata* division and fact that [redacted]); Bender WRT p. 2; 6/7/12 Tr. 842:11-843:2 (Gertz) (range of rates offered to direct licensors does not reflect view that larger companies deserve higher rates); Noll RWRT pp. 35-36 (noting that if majors received higher licensing rates than indies, there would be no

independent distributors like eOne, since they would choose to distribute through the majors instead to take advantage of the higher rates). While it might be argued that Sirius XM "needs" UMG and the other majors for their hit tracks (and would, by implication, pay more for them than the rates in the current Direct Licenses), it is also likely that Sirius XM would respond to any attempt by the majors to demand a higher facial royalty rate by dramatically scaling back their plays of the majors' other (non-hit) tracks – the result of which would be an effective rate comparable to the other Direct Licenses. 6/6/12 Tr. 366:2-367:2 (Noll).

115. Nor is there reason to believe that because the acceptance rate was relatively low – and that the majors did not enter into Direct Licenses – the rates agreed to by those that did say yes are not representative of competitive market rates. As already addressed, *see* Section I.C.5, *supra*, SoundExchange and other industry groups went out of their way to convince labels not to sign Direct Licenses, making clear that they believed doing so would hurt the industry at large (by setting "bad precedent" for this proceeding), and that the labels could expect higher rates to result from the CRB process. *See also* 6/6/12 Tr. 461:20-462:17 (Noll).

116. No doubt the number of Direct Licenses would have been higher had the record industry, through SoundExchange, A2IM, and others, not determined to uproot the effort. The fact that there are "only" 95 Direct Licenses is the result of industry interference, not a commentary on the competitiveness of the Sirius XM offer. Gertz CWDT ¶ 17; Gertz RWRT ¶ 6 ("While I firmly believe that the licenses already executed are broadly representative of the value of Sirius XM's performances of sound recordings, there remains no doubt in my mind that, were it not for the vehement opposition and interference of SoundExchange and other record industry trade groups, Sirius XM would have been successful in entering into numerous additional direct licenses within the royalty range offered. Numerous labels responded to MRI's

direct-license outreach by making clear that one or more industry organizations had dissuaded them from entering into a direct license."); 6/7/12 Tr. 857:19-860:4 (Gertz) (industry efforts threw "wet blanket" over the Direct License effort); Frear WDT ¶ 53.

117. Having taken steps to prevent labels from entering into Direct Licenses, SoundExchange should not be heard to attack the number or representativeness of the Direct Licensors. Indeed, SoundExchange's activities constitute a virtual concession as to the competitive nature of the Licenses. In the words of Professor Noll, "[i]t was the fear on the part of these organizations that if competition were allowed to happen for direct licenses, it would cause the rate to be lower, because this proceeding would come up with a lower rate." 6/5/12 Tr. 267:17-22 (Noll); *id.* at 269:4-270:5 (Noll) (same). Further,

> the whole issue about the direct licenses," he continued, "is to prevent an important source of information from, first of all, coming into existence; and then, secondly being presented to the . . . Judges as something to take account of in setting rates, with the full expectation that the more of this information is presented to them, the more likely they are to come up with a rate that looks like the direct licenses.

6/5/12 Tr. 273:5-14 (Noll); *see also id.* at 271:3-5 ("The more the number of licenses could be limited, the more of an issue there is about their representativeness."). Mr. Frear testified that:

> [n]ot a single one of the majors has indicated a serious interest in entering into negotiations over such a license *at any* rate. Rather, by their palpable lack of interest in engaging in meaningful discussions and by their active participation on the Boards of SoundExchange and other industry organizations such as the Recording Industry Association of America, all have signaled their intent to avoid creating additional evidence of a market rate that might undermine SoundExchange's rate advocacy here.

Frear RWRT ¶ 7; *see also* 6/7/12 Tr. 713:3-11, 714:11-715:4 (Frear); 8/13/12 Tr. 3020:6-3021:21 (Frear).

118. The refusal of labels to sign – or even engage in negotiations – is also consistent with the economics of a regulated industry. As Professor Noll testified, the presence of a statutory process that sets a uniform rate applicable to all record companies mutes the competition between the labels for plays on Sirius XM: absent direct licenses, Sirius XM is in no position to substitute less expensive tracks for more expensive tracks, and labels are not forced to compete for more plays. Noll RAWDT pp. 32, 54-55; 6/6/12 Tr. 463:11-21 (Noll). Given this dynamic, record companies have a shared interest in refusing to sign direct licenses that might undercut the rate set collectively via SoundExchange. 6/5/12 Tr. 262:21-263:2, 263:17-264:4 (Noll); *see also* 6/6/12 Tr. 315:3-6, 467:9-471:4, 480:16-22 (Noll) (explaining that "the existence of a process for setting uniform rate basically eliminates the incentive of labels to sign direct licenses on their own, even though if they thought they could get away with it and be the only one, they would have a powerful incentive to do so").[24]

119. Indeed, Mr. Van Arman admitted that he "would prefer that record companies didn't compete with one another for airplay on Sirius XM through a mechanism like the direct license." 6/15/12 Tr. 2569:6-10, 2569:19-2570:12; *see also id.* at 2550:3-6 ("we are philosophically committed to performance or a broadcasting landscape, where what we are listening to, as consumers, is not dictated by commercial terms"). Mr. Van Arman's testimony is a textbook example of Professor Noll's arguments.

120. These phenomena – not the fact that the 5-7% rate in the Direct Licenses understated the competitive market rate – likely explain why no major entered into (or even seriously negotiated) a Direct License.

---

[24] Professor Noll notes that this phenomenon is particularly acute among the majors, which are the "princip[al] beneficiaries" of the statutory rate. 6/5/12 Tr. 262:21-263:2; 6/6/12 Tr. 467:9-471:4 (Noll).

2. The Direct Licenses Are 5-7% Licenses, Not Something Higher

121. SoundExchange witnesses argue that the 5-7% rate in the Direct Licenses cannot be used as a benchmark for the statutory license because the Direct Licenses call for payment of the entire license fee to the record company, which then distributes the fees to its artists according to the terms of their agreements with the record company. Ordover AWRT ¶¶ 46-48. To the extent the record company keeps more of that payment than it would under the statutory license, whether because it has paid advances which have yet to recoup, because it owns the tracks outright as works for hire, or because its share of the royalty split is something higher than the 50/50 division mandated by the statute, SoundExchange suggests that the label will net more under a 7% Direct License than it would under a higher statutory rate (where it only receives half of the license proceeds and only after the deduction of administrative fees). *Id.*; Eisenberg ACWRT ¶¶ 27-36.

122. The all-important record is, however, bereft of any evidence to support SoundExchange's suppositions. SoundExchange's chief witness on this point, Mr. Eisenberg, failed to present a single bit of documentary evidence indicating the prevalence in the market, let alone among the pool of Direct Licensors, of the various contract forms and provisions discussed in his testimony. 8/22/12 Tr. 4629:11-22, 4630:17-4631:1 (Eisenberg) (acknowledging he did not have information as to the percentage spread of contracting paradigms in the industry, and that practice can vary by distribution platform even with respect to a single artists). Whatever Mr. Eisenberg's knowledge of the industry (drawn almost entirely from his tenure at a major label),[25] he did not speak to a single one of Sirius XM's Direct Licensors in preparation of his

[25] Mr. Eisenberg, a long-time member of the SoundExchange licensing committee during his tenure at Sony (as well as a repeat witness for SoundExchange and Sony in prior CRB proceedings) acknowledged at trial that during his time at Sony he had not personally negotiated any agreements between an independent label and artist, and refused to provide a number as to how many such agreements he had

testimony, nor review a single contract between any of those Licensors and its artists, nor review the financial statements or information of any of those Licensors. He is, accordingly, in no position to testify from knowledge as to what these Direct Licensors' contracts with their artists provide, let alone how they are to be interpreted in relation to Direct License royalties received by these entities. *Id.* at 4632:15-4633:12.

123. The fact that the Directly Licensing record companies receive 100% of the payment directly in the first instance is, by itself, irrelevant, as those labels are bound by their contracts with their artists to pass along royalties due – a point reinforced by the directive at 17 U.S.C. §114(g)(1) that royalties paid to record companies under voluntary licenses involving statutory rights are to be paid "in accordance with the terms of the artist's contract."[26] SoundExchange has offered no evidence to suggest that the labels are not going to pay their artists as required under their contracts and keep all the proceeds for themselves. 6/6/12 Tr. 478:13-479:7 (Noll); 6/17/12 Tr. 860:6-861:2, 880:1-10 (Gertz); 6/15/12 Tr. 2559:17-20 (Van Arman) (JagJaguwar adheres to artists contracts with respect to license income).

124. Moreover, despite Mr. Eisenberg's unsubstantiated efforts to portray a contrary general practice, the testimony from SoundExchange's only testifying independent record label executives reveals that those contracts routinely call for a 50-50 split for licensing – the same as in the statutory license. Darius Van Arman, SoundExchange's own witness, testified, "when we sign artists, our business philosophy is that we become partners with them with regard to their

---

negotiated with the "three entities" for whom he has consulted on such matters since leaving Sony. *Id.* at 4583:7-9, 4584:11-4585:5, 4608:4-22.

[26] It would pervert the outcome here (and be contrary to the statute) if the very voluntary licenses that the statute encourages the parties to submit to the Judges – and which the statute directs should be paid out according to the artists' contracts with the signing labels – were nonetheless diminished as benchmarks because the labels followed the statutory prescription to pay according to their contracts and not the 50/50 payout that exists under the statutory license. *See* Sirius XM's PCL at ¶ 31 n.6.

recordings, so we share the copyright and the recordings 50/50." 6/15/12 Tr. 2543:1-4 (Van Arman). Likewise, SoundExchange witness Michael Powers of Yellow Dog records testified that digital licensing profits are split with artists. Powers WRT pp. 4-5. *See also* 6/7/12 Tr. 880:11-14 (Gertz) (less than a 50% artist share for performance income "not very common").

125. Mr. Eisenberg's bald claim that label receipts are more typically distributed to artists in the range of 12 to 25%, Eisenberg ACWRT ¶ 29, was not only unsubstantiated; it also failed to distinguish clearly between the royalty splits for sales and distribution of artist tracks and albums, splits for digital licensing, and splits for interactive services like Rhapsody and Napster versus those that would apply to webcasters and satellite radio. For example, Mr. Eisenberg's written testimony regarding "royalty rate" contracts mentions "digital licenses," but his trial testimony made clear that the royalty rate structure typically applies to retail sales of downloads. 8/22/12 Tr. 4601:12-4602:2. Likewise, his written testimony as to "net receipts" contracts mentions digital licensing, but acknowledges that the split may be 50/50 in certain of such contracts.[27] Eisenberg ACWRT ¶ 29. His trial testimony on that point mentioned only interactive service royalties like Spotify. 8/22/12 Tr. 4601:13-4602:2. Finally, he conceded that

[27] Case law in lawsuits challenging record-company distributions to artists makes clear that the 50/50 split for digital licensing is indeed the industry norm. For example, in *Allman v. Sony BMG Music Entm't*, No. 06-cv-3252-GBD (S.D.N.Y. 2006), a class of several thousand artists sued Sony for treating downloads as physical sales and failing to pay the artists the 50% share their contracts promised them for digital licensing. *See Amended Class Action Complaint* (July 10, 2006) at 2-3, 13, ("Sony Music's recording agreements require Sony Music to pay its recording artists 50% of all net licensing receipts . . . when such sound recordings are licensed to third parties."). In *The Youngbloods v. BMG Music*, 2011 WL 43510 No. 07 Civ. 2394 (GBD)(KNF) (Jan. 6, 2011 S.D.N.Y.), another class action where an identical 50% license-share provision was at issue, the court noted the Plaintiffs' allegations that "there [are] likely thousands of artists with identical licensing provisions in their recording contracts…" *Id.* at *6. *See also F.B.T. Prods. v. Aftermath Records*, 621 F.3d 958, 967 (9th Cir. 2010) (describing license between the artist, Eminem, and his record company that provided for a 50% share of royalties). It is widely acknowledged that the 50/50 revenue split is dominant in the context of licensing. *See* William Henslee, "Marybeth Peters is Almost Right: An Alternative to Her Proposals to Reform the Compulsory License Scheme for Music," 48 WASHBURN L.J. 107, 108-109 (2008) (third-party license revenues are split 50-50 with the artist, which is significantly more than the album royalty rate).

royalties under his third category of contracts, "profit splits," are often divided 50/50. Eisenberg ACWRT ¶ 29. In the end, the only reliable evidence as to how any specific record company divides the proceeds of digital licensing is the testimony of SoundExchange witnesses Van Arman and Powers, who share proceeds, typically 50/50, with their artists.

126. Likewise, as to the question of artist advances (and recoupment of up-front expenses more generally), neither Mr. Eisenberg nor any other SoundExchange witness provided quantifiable evidence as to how common the practice of granting advances is among directly licensing labels (or independent labels more generally), how quickly they are recouped (in which case they are irrelevant), or whether the record labels and artists reach any agreement as to how the artist share of statutory royalties is handled for recoupment purposes (*e.g.*, whether labels claw it back in any way). 8/22/12 Tr. 4606:2-19 (Eisenberg). In any event, to the extent performance royalties are applied to recoupment, it simply means that the advances recoup more quickly, 6/6/12 Tr. 345:5-10 (Noll); 6/7/12 Tr. 879:8-13 (Gertz), and royalties for sales and other non-statutory exploitations that otherwise would have gone towards recoupment instead flow to the artist.

127. Similar arguments apply with respect to buyouts or works for hire, *see* Eisenberg ACWRT ¶¶ 32-34; Ordover AWRT ¶ 48. The record is bereft of evidence that any meaningful number of Sirius XM Direct Licensors own their works through buyout or work-for-hire status, save Mr. Eisenberg's speculation regarding two of the 95 Direct Licensors. 8/22/12 Tr. 4635:3-7 (Eisenberg) (acknowledging he had not seen the actual contracts of the first such Licensor); *id.* at 4636:13-4637:4 (information as to second such Licensor based solely on two dated articles from 2005 and 2007, not on review of company-provided information); Eisenberg ACWRT ¶ 34 n.7 (same). The available evidence suggests, to the contrary, that such situations are rare, *see* 6/7/12

Tr. 879:14-20 (Gertz), and there is no evidence that in such situations (where the label owns the artist share) SoundExchange is not paying the artist share to the label that owns it. In any event, what the record does reveal is that 100% ownership amongst the Direct Licensors is most common where the *artist* owns the label – and thus would be receiving both the label and artist share from SoundExchange as well as under the Direct License. *Id.* at 880:1-10; 6/6/12 Tr. 343:3-20 (Noll) (noting as well that there would be no artist advances in such a situation).

128. With respect to advances paid by Sirius XM to Directly Licensing labels (as distinguished from artist advances), SoundExchange suggests they are valuable to the labels because of the time value of money (the implication being that the effective rate or "real" rate is something higher than 7%), as well as the prospect that they will not be fully recouped by Sirius XM. Ordover AWRT ¶ 46. First, it must be noted that of the 95 signed agreements, only five entail payment of advances – and one of those [redacted] was trivial [redacted] relative to the size of the licensor. Gertz RWRT ¶ 3 and Ex. 9. Second, the record shows that the advances [redacted] Gertz RWRT ¶ 3 n. 3. So long as the advances recoup – and such provisions effectively ensure they will – there is no argument that the effective rate of the licenses was higher than the 7% headline rate in the agreement. Third, the record shows that the advances are beneficial, but not in the way SoundExchange suggests. While labels receiving advances no doubt value money now versus money later, any impact of that fact on the effective rate of the license is extremely modest, particularly given the low

interest rates that prevail in the market. 6/6/12 Tr. 349:7-20 (Noll). The real value of the advance is that it *commits* Sirius XM to playing the tracks of the Directly Licensing label as much as or more than in the past (so as to recoup the advance during the license term) – precisely what a label looking to compete for plays on Sirius XM is after, and the embodiment of the competitive forces (demand diversion) described by Professor Noll as epitomizing the dynamics of the Direct Licenses. *Id.* at 348:12-349:1.

129. SoundExchange's argument, in the end, proves too much. SoundExchange failed to demonstrate that the claimed benefits of advances, direct payment of 100% of royalties to the labels, and the like, are peculiar to the independent labels that decided to enter into Direct Licenses. That being the case, if the Direct Licenses provided record companies more generally with the windfall SoundExchange suggests – close to double what the label would receive under the statutory license (that is, the equivalent to, say, the payment the label would receive under a 10% or 12% or even 14% statutory license) – *everyone would have accepted.* Of course they did not. SoundExchange's construct is chimerical. *See* 8/21/12 Tr. 4450:5-12 (Harrison) (comparing 7% Direct License offer to 8% statutory rate).

3. Independent Labels With Which Sirius XM Has Entered Direct Licenses Are Sophisticated Parties That Negotiated At Arms-Length With Full Information Regardless Of Any "Shadow of Regulation"

130. SoundExchange's third attack on the Direct Licenses suggests that the negotiation process was somehow impacted by the "shadow" of the statutory rate – either because the Direct Licensors could not say no to licensing their material, or because they were somehow ignorant of the CRB process (or misled by MRI) in a way that prevented them from making rational, informed decisions relating to entering into the Direct License. Ordover AWRT ¶¶ 30-37, 39;

6/5/2012 Tr. 174:1-20 (SX opening statement); *id.* at 338:9-339:19 (Noll); Harrison CWRT pp. 10-11. Neither attack holds water.

131. To start, the "shadow of regulation" argument simply makes no sense. It is true that, given the statutory license, a record company weighing the Sirius XM direct license offer could not refuse to license its works through the statutory license. Ordover AWRT ¶ 30. But that reality would not give Sirius XM any leverage to force the record company to accept a Direct License, for the simple reason that statutory rate (the "price set by regulation" that is the source of the alleged "shadow," *id.*) was *higher* than the rates offered in the Direct Licenses. The would-be Direct Licensors were not faced with the choice of accepting a Direct License at 7% or licensing their works via the statutory license for free; rather, they faced the decision of licensing directly at 7% or saying no and licensing via the statutory license at 8%, a higher rate. That they willingly entered into such agreements logically shows their willingness to accept a lower rate and compete for additional plays (and hopefully increase their payments), but it cannot be taken as a sign that the statutory license "compelled" them to direct license. Were Professor Ordover's argument correct, every record company approached would have been similarly compelled to accept the offer.

132. As Professor Salinger explained, the fact that 95 record companies accepted the Direct License offer suggests that the statutory rate is, if anything, *above* the competitive rate:

> [I]nformation from markets that are subject to a compulsory license at regulated prices can provide relevant information about a free market rate. When the price is above the competitive price, individual suppliers have an incentive to undercut the market price in order to secure additional business. This price cutting to secure more business is the competitive process at work, and the incentives underlying it are present whether the prevailing price stems from an unfettered market or whether it is a regulated price. This phenomenon is precisely what we have seen with the direct licenses Sirius XM has signed with record labels. The willingness

> of record labels to undercut the existing regulated rate to obtain more business (*i.e.*, plays) is evidence that existing rates are above competitive levels.

Salinger CWRT ¶ 28.

133. The further suggestion that the Direct Licensors were somehow unaware of their options or the "applicable regulatory framework," Ordover AWRT ¶ 35, also finds no record support. Here again, SoundExchange's own witnesses belie the claim. Mr. Powers testified that he (1) exchanged multiple emails with MRI and asked a series of questions regarding the terms of the direct license, 8/20/12 Tr. 4139:8-13, (2) was able to negotiate for a higher royalty rate than that initially offered by MRI, 8/20/12 Tr. 4170:7-16, and (3) that, as part of his evaluation of the direct license terms, he compared the offered royalty rate to the present and potential future statutory rates, 8/20/12 Tr. 4171:1-4172:7 (Powers).[28] Mr. Van Arman likewise testified as to his knowledge of how the rate was set in the last proceeding and his expectation that the statutory rate would increase in this proceeding. 6/15/12 Tr. 2561:3-22 (Van Arman).

134. Mr. Frear's testimony is consistent: "I have personally interacted with the senior executives of a number of these licensors, and can attest to the fact that they are highly-sophisticated and highly-professional business people who fully understood their options. Rather than give away copyright rights for a fraction of their true value, as SoundExchange would suggest, these record companies acted in their profit-maximizing competitive interests. Among other things, they recognized that by entering into direct licenses with Sirius XM, they gained the potential for enhanced airplay and greater exposure for their recording artists." Frear RWRT ¶ 5.

[28] Both Mr. Frear and Mr. Gertz likewise detailed in their rebuttal testimony the instances in which the (allegedly misinformed) Direct Licensors were successful in negotiating advances, different license durations, and limits on functionality. Frear RWRT ¶ 6; Gertz RWRT ¶¶ 3-4 ("These independent record companies regularly and capably negotiate agreements."); 6/7/12 Tr. 857:12-18 ("They're very concerned about making sure that they're getting a good deal, being paid properly . . . because they're in the career building business, of making sure that they can incentivize users to play more of their artists' songs.").

135. Most obviously, the contention that the Direct Licensors lacked necessary information ignores the fact that SoundExchange, A2IM, AFM, NARAS, AFTRA, and FMC (essentially every trade group in the industry) conducted a very aggressive public campaign to educate the market as to the alleged downsides of doing a Direct License deal and SoundExchange's expectations as to "the rates the Court will set in this proceeding." *Compare* Ordover AWRT ¶ 35 (suggesting the Direct Licensors did not know how the rates in *Satellite I* were set) *with* Sirius XM Dir. Trial Ex. 4 (A2IM press describing inquiries from member labels regarding the statutory license and rates) *and* Sirius XM Dir. Trial Ex. 2 (SoundExchange press release providing information about the CRB process, how the rates in *Satellite I* were set, and SoundExchange's expectations for this proceeding).

136. "It is not true that these . . . poor independent labels were operating in a vacuum and didn't know up from down," Professor Noll explained. "They were getting information from the trade associations. There's a trade association of independent labels. There's SoundExchange itself. There's associations of artists who are on independent labels. There's associations of executives who work for independent labels. All of these organizations were putting out information, but, in addition to that, exhorting their members not to sign the licenses." 6/5/12 Tr. 267:5-16 (Noll); *see also* 6/6/12 Tr. at 339:16-340:16 (Noll) (calling it "implausible" to believe labels simply accepted MRI representations about likely CRB rate given industry efforts, and noting that to believe so, "you'd have to make the claim that an independent label would listen to the person that's negotiating with them for a price who has their own agenda, rather than their own trade association about what the likely outcome was going to be"); *id.* at 476:11-478:4.

137. Having itself provided the precise information that Professor Ordover claims the Direct Licensors lacked, *see* Ordover AWRT ¶¶ 35-36, SoundExchange cannot plausibly argue the Direct Licensors misunderstood the tradeoffs between the Direct Licenses and the statutory process.

4. Sirius XM Does Not Have Monopsony Power In The Market For Sound Recording Performance Rights

138. Contrary to SoundExchange's assertions, Sirius XM does not enjoy either monopoly power in the music service marketplace or monopsony power in the market for sound recording performance rights that would call into question the rates negotiated in the Direct Licenses. Noll RAWDT pp. 46-49.

139. First, one must distinguish market power in the satellite radio market (where Sirius XM is a seller) and market power in the market for rights (where Sirius XM is a buyer). Even if Sirius XM enjoyed market power in the former (which the DOJ and FCC determined is does not), it would be irrelevant. 6/5/12 Tr. 275:11-20 (Noll); Noll RAWDT pp. 46-47 (describing FCC and DOJ merger review). Sirius XM is one of many competitors in the market for performance rights, regardless of whether it has monopoly power in some downstream market. 6/5/12 Tr. 275:21-276:3 (Noll); Noll RAWDT pp. 46-47; *see also* Section V.B.1, *infra* (responding to testimony of SoundExchange witness Sidak regarding Sirius XM's alleged monopoly power).

140. Regardless, the relevant issue is not the intensity of competition in the output market that includes Sirius XM, but whether Sirius XM has monopsony power in sound recording performance rights. Noll RAWDT p. 47. A firm that possesses monopoly power in an output market will not possess monopsony power in an input market unless all or nearly all of an input is used to produce the monopoly product. *Id.* at pp. 47-48. Sound recordings are inputs to

many products other than SDARS, so Sirius XM cannot possibly possess monopsony power in the market for sound recording performance rights. *Id.* at p. 48. First, Sirius XM accounts for a small fraction of total revenue of record companies in the U.S. In 2010, the total revenue from sound recordings in the U.S. was $6.85 billion, giving Sirius XM approximately a [redacted] share of the total revenues of record companies. *Id.* (citing "2010 Year-End Shipment Statistics," Recording Industry Association of America). Total revenue from digital sales in 2010 was $3.21 billion, with Sirius XM's share roughly [redacted] Even if the relevant market is restricted to just mobile, subscription and SoundExchange, sales to these sources were $977 million. *Id.* About [redacted] of this revenue came from Sirius XM, which is smaller than the sales shares of three of the four major distribution companies. *Id.*

141. Even if Sirius XM did enjoy monopsony power in the market that contains sound recording performance rights for SDARS, the record companies that signed license agreements could not have regarded the rates that they were offered as monopsony prices. These companies could have elected to have their rates determined in this proceeding. Thus, these record companies must regard the rates that they negotiated as more attractive to them than the outcome of this proceeding – and certainly more attractive than a monopsony rate.

III. LICENSE AGREEMENTS BETWEEN MAJOR LABELS AND CUSTOMIZED NON-INTERACTIVE WEBCASTERS PROVIDE MARKETPLACE EVIDENCE OF RATES FOR SIRIUS XM BETWEEN 6.5% AND 7.25% AND CORROBORATE THE DIRECT LICENSE BENCHMARK

A. The Licensing Experience Of Non-Interactive Webcasters Affords The Best Corroboration Of Reasonable Rates For Sirius XM

142. The rates from the Direct Licenses are corroborated by those found in agreements between major record companies and several non-interactive Internet webcasters, specifically Last.fm, Slacker, and Turntable. Noll RAWDT pp. 16, 72.

143. This group of webcasters, which essentially offer variants of non-interactive streaming, are much closer in functionality to Sirius XM's non-interactive broadcasts than the interactive services offered as a benchmark by SoundExchange. 6/5/12 Tr. 279:13-280:7 (Noll) (describing such services as "the nearest possible substitutes for satellite radio"). They are also tremendously popular. Last.fm, for example, has a registered user base of 40 million users, and charges $3.00 for its subscription tier, while Slacker reports 25 million registered users, and charges $3.99 for its subscription radio service. Rosenblatt CWDT pp. 29-30; Noll RAWDT p. 83 n.77.

144. To be sure, these webcasters offer functionality that extends beyond that afforded Sirius XM's satellite radio subscribers. While not fully interactive or on-demand, these services allow users to influence the selection of tracks to some degree by ranking or rating songs and artists, banning tracks, and the like. *Id.* at pp. 27, 29-30. They also provide for additional features such as unlimited skipping of tracks, pre-announcement of tracks to be played, and even (in the case of Slacker) caching of playlists (temporarily saving the playlist to the memory of a mobile device) for later listening when no Internet connection is available. *Id.*; Noll RAWDT pp. 13-14. Because of such features, these services are sometimes identified as "custom" Internet radio. And because they do not adhere to the strict limitations of the Section 114 statutory license, they must seek voluntary licenses from sound recording owners in order to operate. Rosenblatt CWDT p. 27.

145. The implication of these distinctions for fee-setting purposes here is as described by Professor Noll. While these webcasters provide the closest approximation to the music listening experience afforded by Sirius XM – and hence their own license experience provides the best available benchmarking data for fee-setting apart from Sirius XM's own direct licenses –

the customization features afforded these webcasters' subscribers makes the sound recording performance rights they obtain more valuable than those required by Sirius XM. *See* Noll RAWDT pp. 13-16, 71-72, 75. As a result, reliance for benchmarking here on the (properly adjusted) license fees paid by one or more webcasters falling within this category of services, while distinctly preferable to resort to the license fees paid by fully on-demand, interactive services, overstates the fair market value of the more limited statutory license fees at issue here. *Id.*

146. Although similar non-interactive Internet webcasting services were available on desktop computers (at home, in the office, and the like) at the time of the last proceeding, they were not yet direct competitors to Sirius and XM in the vehicle, and agreements governing such services were discussed only tangentially by either party at that time. Competitive circumstances changed with the advent of smartphones such as Apple's iPhone (which was introduced in 2007), with the development of broadband networks that allow for high-quality audio streaming to such devices, and with the ability to connect the devices to vehicle audio systems and access them through the dashboard, alongside terrestrial and satellite radio. Noll RAWDT p. 12; 6/5/12 Tr. 280:17-281:9 (Noll); 6/14/2012 Tr. 2350:6-2351:15 (Ordover); *see generally* Rosenblatt CWDT. As Mr. Rosenblatt testified, "four key developments [occurred] during the 2007-2010 time period that, when taken in combination, have fundamentally altered the mobile audio landscape in which Sirius XM competes": first, "[t]he massive uptake of smartphones for online audio listening"; second, "[w]ireless broadband coverage rivaling the footprint of satellite radio"; third, "[a] critical mass of automobiles with features that make it easy to connect smartphones to car audio systems"; and fourth, an "expansion of online audio content," much of it free, that rivals that available on Sirius XM. Rosenblatt CWDT p. 3.

147. The relatively recent ability of consumers to stream services such as Last.fm and Slacker in the vehicle in competition with Sirius XM makes the royalty rates payable by such services directly relevant to a degree that simply was not envisioned at the time of the last proceeding. Noll RAWDT p. 12; 6/5/12 Tr. 280:8-281:9 (Noll).

148. The functionality difference between these non-interactive services and the interactive services proffered as benchmarks by SoundExchange is reflected in the distinct royalty rates paid by them. This is illustrated by the experience of Last.fm, which has operated under sound recording performance licenses from the major record labels covering both categories of service. For its non-interactive subscription streaming service (identified as its "Premium Radio Service"), Last.fm agreed to pay the four major record companies as follows:

- [redacted]
- [redacted]
- [redacted]

Noll RAWDT pp. 76-79 and Tables 2.1-2.1c (summarizing agreements) and Appendices E-H (Last.fm agreements); Harrison CWRT p. 4 n.1 [redacted]. These same agreements also provide a rate for Last.fm's paid interactive/on-demand service tier, comprising the greater of [redacted] Noll RAWDT Tables 2.1-2.1c and Appendices E-H.

149. The Last.fm agreements demonstrate conclusively that sound recording rights owners themselves charge significantly less for non-interactive services than they do for

interactive/on-demand services, whether on a per-subscriber basis [redacted] a per-play basis [redacted] or a percent of revenue basis [redacted] *Id.*; Sirius XM Reb. Trial Ex. 99 (Last.fm per-play rate to Universal in 2012 of [redacted]. [redacted] Noll RAWDT Tables 2.2-2.2d and Appendices I-L.

150. Professor Ordover premises his entire approach to fee-setting in support of SoundExchange's rate proposal on the contrary premise – that webcasters pay comparable percentages of their revenue for sound recording performance rights irrespective of the nature of the service or the degree of interactivity it affords. *See* Ordover ¶¶ CAWDT 33-34, 42-43; Noll RWRT pp. 3-4, 10, 12-14; Salinger CWRT ¶¶ 11, 16, 18-19, 22. In so asserting, Professor Ordover simply ignores the fact record to the contrary. As Professor Noll instead correctly testifies: "[I]t's simply not true that all services pay the same royalty rate as a fraction of their revenues . . . . The rate in the marketplace does depend upon the degree of customization or interactivity, the degree of consumer control. And it does depend on it like a factor of two. So it is simply wrong to say everybody pays the same royalty rate." 6/5/12 Tr. 284:8-17 (Noll); *see also id.* at 294:7-9; 6/6/12 Tr. 400:9-13 (Noll).

B. Computing A Reasonable Fee From Available Non-Interactive Webcasting License Agreements

151. As Professor Noll explained, using the custom webcasting license agreements as fee-approximating benchmarks for Sirius XM involves a straightforward process of: (1) identifying the most appropriate benchmark agreements; (2) determining the applicable royalty rate from those agreements; (3) multiplying that rate against the implicit per-subscriber price of Sirius XM's music channels; and (4) dividing the resulting per-subscriber monthly fee into Sirius

XM's average revenue per user (ARPU) in order to express the fee as a percentage of revenue. Noll RAWDT p. 15; 6/5/12 Tr. 285:7-293:9 (Noll).

C. Identifying The Closest Competitor For Benchmarking: Last.fm

152. Professor Noll's testimony described the "spectrum of customized services" that exists in the market, ranging from the least customized and non-interactive services at one end to services much closer in functionality to fully on-demand services at the other. Noll RAWDT pp. 69-72; 6/5/12 Tr. 279:13-280:7 (Noll). To use the custom Internet radio services as a benchmark properly, it is necessary to identify the most appropriate service, that is, a service on the non-interactive end of that spectrum with as little customization as possible that is available in the dashboard. Noll RAWDT pp. 15, 68-72; 6/5/12 Tr. 279:13-280:7 (Noll).

153. Among the custom non-interactive Internet webcasters for which voluntary agreements are available,[29] the service most similar to Sirius XM in terms of functionality – and thus the most appropriate for benchmarking – is the Premium Radio Service offered by Last.fm. Noll WDT 13-14, 72-76; 6/5/12 Tr. 281:18-282:9 (Noll). As Professor Noll testified, "it's the subscription service that has the least degree of customization, no caching, no ability to do on-demand, no infinite skips, you know – its limitations on the degree of customer control that make it the closest thing I can find to Sirius XM." 6/5/12 Tr. 289:7-12 (Noll); *see also id.* at 281:18-282:9; Noll RAWDT pp. 14, 73-76 (explaining the preference for Last.fm over Slacker, which offers caching, unlimited skipping, and user ability to like/ban songs, and over Turntable, which incorporates social networking and a hybrid form of interactivity in which one user can select tracks ("DJ") for other users); Rosenblatt CWDT pp. 29-30.

[29] *See* Noll RAWDT pp. 12-13 (explaining that many webcasters operate under statutory licenses, including licenses the rates for which were made non-precedential by the terms of Webcaster Settlement Act, and that Professor Noll was limited to the voluntary non-interactive agreements provided through discovery).

D. Determining The Royalty Rate For The Benchmark Service: 25 -[redacted] Percent Of Revenue

154. The next step is to identify the applicable royalty rate from the selected benchmark agreements. Noll RAWDT pp. 15, 68. As Professor Noll testified, this rate should be the product of negotiations in a competitive market. *Id.* at p. 68. Given that Sirius XM is a subscription service without advertising on its music channels, it is also appropriate to select a subscription offering with a monthly subscription price rather than a free, ad-supported service.[30] *Id.* at 69.

155. The stated rates paid by Last.fm for its Premium Radio Service, including revenue percentages of 25% to [redacted] were detailed above. *See* Noll RAWDT pp. 76-79. Because those rates are structured as the greater of three different prongs, it would not be appropriate simply to adopt the "percent-of-revenue" royalty rate as the benchmark without determining whether that is the prong under which Last.fm would actually pay. *Id.* Because Last.fm charges $3.00 for its Premium Radio Service, it would owe, under the percent-of-revenue prong, [redacted] *Id.* The remaining question is whether plays on Last.fm are high enough that the fee owed under the per-play prong of the revenue formula would outstrip that generated by the percent-of-revenue rate.

156. At the time of his Revised Amended Written Direct Testimony, Professor Noll did not have available Last.fm play counts for the Premium Radio Service, and so used plays on

[30] The rates governing the free, advertising supported Internet radio services tend to be stated as either per-performance rates or as percentages of advertising revenue. *See, e.g.*, Noll RAWDT Table 2.1 (Tier 1), Table 2.1a (Last.fm agreements). Sirius XM cannot track performances, and collects subscription rather than advertising revenue on its music channels, making the free-tier benchmarks less informative than rates from subscription service benchmarks.

Slacker (data as to which was provided, on a limited basis, in direct-phase discovery) as a proxy for the plays/subscriber/month on Last.fm. Using those plays, which ranged between [redacted] he concluded that Last.fm likely would have paid each of the majors under the percent-of-revenue prong, *i.e.*, **25%** [redacted] *Id.* (calculating fee due under the per-play prong to be less than the [redacted] due under the percent-of-revenue prong).

157. Last.fm statements of account produced during the rebuttal phase of the proceeding confirm Professor Noll's conclusion that the appropriate benchmark percentage of royalty rate for a music-only, Internet delivered, non-interactive service (*i.e.*, prior to adjustment for application to Sirius XM) is 25% [redacted] Sirius XM Reb. Trial Exs. 66-99. The Last.fm statements identify, for each month between January 2008 and May 2012, the number of subscribers to Last.fm's Premium Radio Service, and the total number of performances on that service across all labels. *Id.*; 8/21/12 Tr. 4424:8-17 (Harrison). Determining the number of performances per subscriber is simply a matter of dividing the latter by the former. That simple math reveals plays per subscriber on Last.fm's Premium Radio Service averaging [redacted] plays per subscriber per month, with the highest month [redacted] Sirius XM Reb. Trial Ex. 66 at SX02 00185116 (Columns FF-FM, rows 1-32) and SX02 00185139 (Columns FF-FM, rows 33-73, showing [redacted]. Under the WMG and EMI agreements, which called for a rate of [redacted] per play, even the top end of the range, [redacted] plays, would not lead to per-play royalties high enough to eclipse the [redacted] percent of revenue prong (which would generate [redacted] per subscriber). Under the Sony agreement, [redacted] plays times the 2009 per-play rate

of [redacted] percent of revenue [redacted].[31]

158. Under the Last.fm-UMG agreement, which carries a per-play rate equal to [redacted] *see* Harrison RWRT p. 4 n.1, the conclusion is the same for 2009-2011. [redacted] plays times the 2009 per-play rate of [redacted] results in a per-subscriber fee of [redacted] [redacted] plays times the 2010 per-play rate of [redacted] results in per-subscriber fee of [redacted] plays times the 2011 per-play rate of [redacted] results in a per-subscriber fee of [redacted] Each of these fees is less on a per-subscriber basis than the per-subscriber fee due under the [redacted].

159. For 2012, the UMG result is slightly different, but not in a way that is material to Professor Noll's conclusions. When the average number of plays tops [redacted] per subscriber, the fee under the per-play prong [redacted] will eclipse the payment due under the [redacted] percent of revenue prong [redacted] per subscriber). However, even with an average monthly play count as high as [redacted] (the highest for Last.fm in 2012), the per-play rate results in an effective per-subscriber fee of [redacted] of the $3.00 subscription fee – *i.e.*, still within the benchmark range calculated by Professor Noll.[32]

---

[31] This calculation uses the prevailing rates from the *Webcasting II* decision, which were the highest prevailing per-play rates in 2009. The same result would occur under the Sony per-play rates applicable for 2010 (where the monthly plays per subscriber on Last.fm peaked at [redacted] in January), 2011 (where the plays per subscriber peaked at [redacted] in June) and 2012 (where the plays per subscriber on Last.fm peaked at [redacted] in January). Even under the highest of these totals, [redacted] plays times a 2012 per-play rate of [redacted] would still be less on a per-subscriber basis [redacted] than the per-subscriber fee owed at [redacted] percent of revenue [redacted]

[32] Last.fm [redacted] *See, e.g.*, Sirius XM Reb. Trial Ex. 70. Under that higher rate, Last.fm would have owed UMG [redacted] In every other month of 2009, the implied percentage rate would have been below [redacted] and within Professor Noll's benchmark range. This lone outlier does not materially affect Professor Noll's conclusions, given that it is only modestly above the range identified by Professor Noll [redacted], given that [redacted]

E. Determining The Implicit Price Of Sirius XM's Music Channels: $3.00 - $3.45 Per Month

160. The next step in applying the benchmark rate from the custom Internet radio agreements is to identify the monthly per-subscriber revenue against which the benchmark percentage should be applied. This requires identifying the implicit monthly market price for Sirius XM's music channels. Noll RAWDT pp. 15, 68, 80-88.

161. As Professor Noll testified, the appropriate price for the music offering on Sirius XM "is the price that would emerge from interactions among willing buyers and willing sellers in a competitive market for that component. In a competitive market, the implicit price of accessing performances of sound recordings on advertising-free channels over satellite radio cannot deviate substantially from the price of accessing the same content through a close substitute, which in this case is a non-interactive Internet subscription service that can be accessed in vehicles through mobile wireless devices." *Id.* at p. 80.

162. With this guidance in mind, Professor Noll identified three complementary methods for determining the implicit price, all clustering in the range of $3.00-$3.45 per subscriber per month. *Id.* at 80-88. The first, and best, is the competitive market price of comparable unbundled non-interactive Internet subscription services. *Id.* at pp. 81-82. Both Pandora and Last.fm – those services closest in functionality to Sirius XM and by far the most popular – each charge $3.00. *Id.* at p. 83. The average retail price for non-interactive Internet radio services similar to Sirius XM (of which Pandora and Last.fm constitute some 96% of the

---

[redacted] and given that the rates for custom webcasters in any event tend to overstate the rates that should apply to Sirius XM's more limited functionality. *See* Noll RAWDT pp. 71-72. In addition, Professor Ordover himself made similar calculations for UMG using a 2007 per-play rate of [redacted] Ordover AWRT ¶ 63.

plays according to available data) is $3.15.[33] Noll RWRT Table 1; *id.* These prices are especially informative because they reveal the competitive market price for non-interactive music transmissions unbundled from the fees consumers must pay for delivery and reception of such services, which consumers purchase separately from Internet service providers and computer/device retailers. *See* Noll RAWDT pp. 14, 80-83; *see also* Karmazin WDT ¶¶ 9, 48; Meyer WDT ¶¶ 35-36.

163. A second method for determining the implicit monthly market price for Sirius XM's music channels derives from a consumer survey among Sirius XM subscribers designed to determine the value they place on Sirius XM's music offering. Noll RAWDT pp. 83-85. Sirius XM expert witness Professor John Hauser conducted that survey in September 2011, following standard scientific methods. Hauser CWDT ¶¶ 22-37; 6/12/12 Tr. 1611:15-1613:11 (Hauser). After identifying an anchor market price upon which future responses regarding willingness to pay would depend, respondents were asked a series of questions to measure how much they would be willing to pay for satellite radio if various features were removed one at a time. Hauser CWDT ¶¶ 46-49; 6/12/12 Tr. 1606:20-1608:8 (Hauser). The questions were cumulative with each question removing a new feature in addition to any features that were removed in previous questions. Hauser CWDT ¶ 49; 6/12/12 Tr. 1606:20-1608:8 (Hauser). To remove any bias associated with having a pre-defined order, Professor Hauser removed features randomly and

[33] Professor Ordover calculates an average retail price for non-interactive services of $4.86. For reasons discussed below, most notably the fact that Professor Ordover's average is unweighted and triple counts a particular service, *see* Section V.A.2.c, *infra*, Professor Ordover's calculations are incorrect and misleading; if corrected, the average is $3.15. Noll RWRT Table 1.

averaged the results over all orders. Hauser CWDT ¶¶ 20-21; 6/12/12 Tr. 1599:12-1601:11 (Hauser).[34]

164. Professor Hauser's survey demonstrated that subscribers on average place a value of $3.24 on Sirius XM's music channels (26% of the average "anchor" price of $12.60) or, as Professor Noll explains, $2.93 (when based on Sirius XM's ARPU of $11.38).[35] Noll RAWDT pp. 83-84 and n.78. Adding in an allowance for Sirius XM's comedy channels, which also perform sound recordings, results in monthly per-subscriber valuation of **$3.10 - $3.13** for channels that perform sound recordings. *Id.* at 84-85; *see also* 6/5/12 Tr. 289:15-290:17 (Noll).

165. A third method for determining the implicit monthly market price for Sirius XM's music channels is to calculate the costs of inputs necessary for satellite delivery of Sirius XM's service and its subsidization/installation of radios in vehicles, to deduct these costs from the gross revenues from satellite radio service, and to allocate the revenue that remains between music and non-music content. Noll RAWDT pp. 81-83, 85. This method recognizes that Sirius XM incurs a unique (and massive) set of costs for delivering its service to consumers through satellites to proprietary receivers, while the benchmark webcasters with which Sirius XM competes pay neither for the delivery network nor the reception devices by which their services are consumed. *Id.* (consumers fund these separately through payments to their Internet service providers and purchases of computers and/or mobile devices). This method also accounts for the obvious fact that a sizeable portion of the monthly per-subscriber revenue earned by Sirius XM

[34] Professor Hauser also parsed the value of pre-1972 recordings by asking respondents to allocate 100 percentage points between music that was recorded and released before and after 1970. Hauser CWDT ¶¶ 65-67; 6/12/12 Tr. 1609:22-1611:6 (Hauser).

[35] Professor Hauser noted that his results were consistent with the survey that he conducted for the previous CRB proceeding. Hauser CWDT ¶¶ 16, 70-73. He also found that the $3.24 value was reduced to $2.11 when limited to music recorded since 1970. Hauser CWDT ¶¶ 13, 62, 69, 74; 6/12/12 Tr. 1598:18-1599:2, 1609:8-1611:14 (Hauser) – although Professor Noll conservatively used the higher number in his testimony.

is paid by subscribers for the delivery system and receivers – money they would pay to a wireless broadband carrier and device retailer to provide access to an unbundled music service.

166. Professor Noll calculated Sirius XM's unique delivery costs as amounting to $4.38 per user per month, or $5.11 after adding a return on forward-looking investments (but not start-up costs) of 16.7%. Noll RAWDT pp. 85-88 and Table 3 (adopting rate of return used by SoundExchange witness Pelcovits in *Satellite I* proceeding). When subtracted from Sirius XM's ARPU of $11.38, this cost allocation leaves $6.27 of revenue attributable to music and non-music content. *Id.* Based on channel counts on the service, Professor Noll credited 55.1% of that figure, or $3.45, to channels featuring sound recording performances. *Id.* at p. 88 and Table 3; *see also* 6/5/12 Tr. 290:18-291:18 (Noll).

167. As Professor Noll explained, carving out a portion of Sirius XM revenue to cover unique investments in satellite delivery network and receivers is not only economically appropriate; it also is consistent with the dictates of 17 U.S.C. § 801(b)(1)(C), which provides that statutory rates for satellite radio should reflect the "relative contribution" of Sirius XM to the product made available to the public (the satellite radio service). Noll RAWDT pp. 81-82; Sirius XM's PCL Section V.C. Sirius XM's creation, from scratch, of a nationwide satellite delivery system, as well as its ongoing subsidization of the installation of radios capable of receiving the service (not to mention its investments in non-music content) are its "contribution" to the service – a contribution ratified by more than 22 million subscribers who pay $12.95 (and some now $14.49) (at least $10 more than subscription Internet services with similar non-interactive music streaming options) to subscribe to the service. Noll RAWDT pp. 81-82, 85-87; 8/14/2012 Tr. 3463:13-3464:8 (Noll) (contrasting Sirius XM's development of its delivery system as compared

to Internet-based services which neither developed nor have to pay for the Internet, wireless networks, nor computers on which their services are received).

168. Professor Salinger likewise testified that "Sirius XM's main role in making satellite radio available was to develop the necessary technology, to pay for the satellites and terrestrial repeaters, and to subsidize placement of receivers in automobiles. The third statutory criterion says that the rate the CRB sets should reflect this contribution, which presumably means that it should recognize that part of the monthly Sirius XM subscriber fee should compensate Sirius XM for this contribution." Salinger CWRT ¶ 33. To apply the benchmark percentage rate from services that made no such contribution to Sirius XM revenues properly attributable to consumer payments for non-music content[36] and delivery of the service, Professor Salinger explained, would effectively fail to recognize Sirius XM's relative contribution, as it would allow sound recording owners to expropriate a share of revenue to which they are otherwise not entitled and would not collect from a provider that made no such contribution. *Id.* at ¶ 18 ("Applying the interactive services percentage of revenue rate to Sirius XM would effectively give record labels a share of revenues that have nothing to do with the sound recording rights they are licensing.").

169. As both Professor Noll and Professor Salinger explained, accounting for Sirius XM's unique contribution to the delivery of its service (by adjusting the benchmark rate downward) is not just a matter of sound theoretical economics; it is also supported by marketplace evidence that was not available during the *Satellite I* proceeding. Noll RAWDT pp.

[36] By cutting Sirius XM's payment in half to account for non-music content, Professor Ordover implicitly accepts the premise of making an adjustment for costs incurred by Sirius XM that are not incurred by benchmark services (which are music only). *See* Ordover CAWDT ¶¶ 37-39. Professor Ordover does not provide any economic rationale to distinguish Sirius XM's non-music costs for non-music content (for which he proposes an adjustment) from its non-music costs for its delivery platform and receivers (for which he proposes to make no adjustment). *See* Noll RWRT pp. 14-15.

80-82; Salinger CWRT ¶¶ 19-20. Specifically, each of the major record companies has entered into license agreements with Cricket, a prepaid mobile service provider, for its popular "Muve" service, which bundles mobile telephone service and an unlimited interactive music service into a single package that retails for $55-$65. Noll RAWDT pp. 80-82; Salinger CWRT ¶ 19. The major record companies' license agreements with Cricket provide for a royalty comprising the greater of [redacted] of the retail price of the entire bundle. Noll RAWDT p. 82 and Appendices P-S (agreements); Salinger CWRT ¶ 19.

170. As Aaron Harrison of UMG confirmed, [redacted] Harrison CWRT pp. 5-6; 8/21/12 Tr. 4431:17-4433:4 (Harrison). [redacted] Harrison CWRT p. 6; 8/21/12 Tr. 4431:17-4433:14 (Harrison). This was precisely UMG's motivation in determining the fees it would charge Cricket. Mr. Harrison testified that [redacted][37] Harrison CWRT p. 6; 8/21/12 Tr. 4431:17-4433:14 (Harrison).

[37] This fact renders irrelevant Professor Ordover's attempt to distinguish Cricket as a company that bundles a variety of content and services (music, phone, data services, text messaging) as opposed to one that bundles music content and a delivery network. *See* Ordover AWRT ¶¶ 70-71. Whether accurate or

171. As Professor Salinger explained: "This example clearly illustrates how a benchmark rate for one service can properly be used to set a target rate for another service. . . . Establishing comparable rates for the target (Cricket) from the benchmark (interactive Internet music services) entails charging the same price, not the same percentage of revenue. . . . [T]he appropriate way to determine a target rate would not be to simply apply the same percentage of revenue rate to the different retail price of Sirius XM, but rather to set the rate so as to equalize the price per subscriber." Salinger CWRT ¶ 20. This is precisely the effect of Professor Noll's calculations.

172. UMG's agreement with Rhapsody for its delivery via MetroPCS, another prepaid mobile telephone provider, reveals similar economic logic. Like Cricket, MetroPCS offers interactive music service (provided by Rhapsody) bundled with mobile phone service for a monthly price in the range of $50 to $60. 8/21/12 Tr. 4446:5-4448:6 (Harrison); Harrison CWRT p. 7. UMG's license agreement for the service calls for a payment [redacted] Sirius XM Reb. Trial Ex. 114 at p. 2; Harrison CWRT p. 7; 8/21/12 Tr. 4447:8-16 (Harrison). Again, UMG witness Harrison confirmed that [redacted] 8/21/12 Tr. 4447:8-4448:6 (Harrison); *see also*

---

not, that distinction does not change the fact that [redacted] to the $60 average bundle price.

6/5/12 Tr. 240:21-241:11 (Noll) (describing similar mobile content bundles offered by Verizon, AT&T, Sprint, and T-Mobile).

173. The bottom line from these examples is simple, intuitive, and fully in accord with Professor Noll's methodology for determining the implicit price of Sirius XM's music offering: when the retail price of the "target" service (Sirius XM) includes payments for components other than music performances (such as wireless access or non-music content), that additional revenue needs to be removed prior to applying the benchmark percentage rate from another service that does not collect such revenue. (Or, alternatively, the "benchmark" percentage rate must be reduced by a commensurate proportion, [redacted]) Noll RAWDT pp. 80-81; 6/5/12 Tr. 240:4-14; 244:14-245:11 (Noll). As we later discuss, Professor Ordover's contrary supposition makes no economic sense and finds no empirical marketplace support.

F. Calculating The Appropriate Sirius XM Per-Subscriber Fee Rate [redacted]% x $3.00-$3.45)

174. Having determined (a) that the most reliable estimates of percentage royalty rates for a service that is most comparable to satellite radio service are [redacted]; and (b) that the most appropriate implicit price for the satellite radio channels that feature sound recordings is $3.00 (with the alternative estimates being $3.10, $3.13, and $3.45), the next step simply is to multiply the two to determine the monthly per-subscriber royalty to be paid by Sirius XM:

Implicit Monthly Price	x	Royalty Rate %	x	Per-Subscriber Royalty Payment
$3.00		[redacted]		[redacted]
3.10		[redacted]		[redacted]
3.13		[redacted]		[redacted]
3.45		[redacted]		[redacted]

Noll RAWDT p. 89.

175. The final step in determining the SDARS royalty rate from the preceding calculations is to express the monthly royalty per subscriber as a fraction of average subscription revenue. Sirius XM's average monthly subscription revenue per subscriber in 2010 was $11.38, Noll RAWDT pp. 80, 89. In Professor Noll's view, the most reliable estimate of the price of sound recording content on Sirius XM is $3 (the price charged by webcaster competitors) and the most reliable estimates of the monthly royalty payment for the closest comparable non-interactive Internet subscription service (Last.fm) are [redacted]. The royalty rates as a percentage of Sirius XM revenue (as measured by an ARPU of $11.38 per month) that are implied by these payments are [redacted] The average is 6.76 percent.[38] Noll RAWDT p. 90; 6/5/12 Tr. 293:5-9 (Noll).

176. Thus, the preferred estimates of the benchmark royalty rates support the conclusion that the 5-7% rates in the direct licenses between Sirius XM and record companies

---

[38] Based on Sirius XM's first-quarter 2012 ARPU of $11.77, the range would be [redacted] *See* Lys WRT Ex. 232-RP at p. 31 (first quarter 2012 10-Q).

are reliable indicators of the rate that would emerge from a competitive, unregulated market. Noll RAWDT p. 90.

177. The percentage royalty rates implied by the range of implicit monthly prices of the music content on Sirius XM and of the monthly royalty payments extrapolated from the benchmark agreements and applied to an ARPU of $11.38 are as follows:

Implicit Monthly Price	**Per-Subscriber Royalty Payment**	**Implied Royalty Rate % ($11.38 base)**
$3.00	[redacted]	[redacted]
3.10	[redacted]	[redacted]
3.13	[redacted]	[redacted]
3.45	[redacted]	[redacted]

Noll RAWDT 89-90.

178. As earlier noted, the rates derived from the non-interactive benchmark, if anything, represent the cap or upper end of reasonable rates for Sirius XM as measured by the marketplace because these customized services offer greater functionality and sound quality than Sirius XM's non-interactive channels (which do not allow for any user-influence on the content of the channel in the form of rankings, ratings, "likes," skips, or the like). Noll RAWDT ¶¶ 14-16; 6/5/12 Tr. 292:2-14 (Noll).

G. SoundExchange's Objections To Sirius XM's Non-Interactive Service Benchmark Are Unfounded

179. SoundExchange raises a number of objections that it claims invalidate the value of the non-interactive service agreements as benchmarks for rates to be paid by Sirius XM. These objections are uniformly without merit.

1. Professor Noll's Non-Interactive Service Benchmarking Relied On Multiple Agreements And Months Of Data

180. Professor Ordover contends that Professor Noll relies on only four dated license agreements from a single service and a "single month of usage data." *See* Ordover AWRT ¶ 7. Each contention is incorrect. To start, while Professor Noll did base his calculations on agreements between Last.fm and each of the four major labels (the *sine quo non* of benchmarking value in SoundExchange's view), each of those four agreements was renewed (and in some cases revised and amended) several times, and the agreements between Last.fm and EMI and UMG remain in effect to this day. *See* Noll RAWDT pp. 7, 72-80 and Appendices E-H and Tables 2.1-2.1c; Harrison CWRT pp. 2-3; *see also* Ordover AWRT ¶ 58 (acknowledging that two of the agreements are still in effect). In addition, although Professor Noll concluded that Last.fm was the most comparable service to Sirius XM's music channels (and thus the most reasonable service from which to benchmark), Professor Noll also considered the comparability of a range of other services and analyzed and considered non-interactive service agreements between the four major labels and Slacker (each of which also was amended and renewed several times, and each of which remains in effect), as well as agreements between each of the four major labels and Turntable. 6/6/12 Tr. 383:12-384:4 (Noll) (describing continuum of custom webcaster rates). Although the specific rates in those agreements were not formally incorporated into Professor Noll's calculations – largely because they contain interactive features such as

caching and user-selected "DJ" plays that Sirius XM does not offer, *see* Section III.C, *supra* – the rates in those agreements fall within the same general range of non-interactive rates as the Last.fm agreements, and thus serve to corroborate and support Professor Noll's calculations based specifically on the Last.fm agreements. *See* Noll RAWDT Table 2 (summarizing rates). (As described in Section V.A.2.a, *infra*, they also clearly demonstrate the mistake of assuming that the interactive percentage royalty rate of 60% can or should be applied to a non-interactive service like Sirius XM.)

181. Professor Ordover's related allegation as to the statistical unreliability of Professor Noll's sample, *see* Ordover AWRT ¶ 57, is a red herring. Clearly, Professor Ordover made no attempt himself to establish the statistical reliability of his own sample, *see* 8/14/12 Tr. 3339:19-3340:2, 3341:2-12 (Ordover), and it has never been suggested in CRB proceedings that the number of benchmark agreements considered need represent some statistically significant percentage of existing agreements to be considered. A small number of agreements from comparable non-interactive services is preferable to a large sample of non-comparable interactive agreements. *See* 8/14/12 Tr. 3399:21-3400:14 (Ordover). Indeed, Professor Ordover himself – and the Judges in turn – relied in the *Satellite I* Determination on one rate prong (per-play rates) from video agreements offered by one company (Universal) to determine the interactivity adjustment. *See Satellite I Determination*, Fed. Reg. Vol. 73, No. 16 p. 4093 and n.35; Noll RAWDT pp. 10-11, 33. Moreover, by reviewing every available agreement between the major labels and custom radio services, Professor Noll *did* consider the payment terms for the vast percentage of each such service's plays, and a significant percentage of the custom market (much of which is governed by statutory rate agreements); it is not clear what else could have been included in the sample to make it more statistically valid.

182. The criticism that Professor Noll relied on a single month of play data is likewise misplaced, and now moot. Ordover AWRT ¶¶ 7, 60-63. In his direct-phase testimony, Professor Noll had access only to a small number of Slacker statements, and accordingly relied on a sample month of play data that fell within the range established by the available data as a proxy for plays on Last.fm (in order to determine whether Last.fm likely would have paid its subscription-service royalties under the per-play or percent-of-revenue prong of its license agreements). Noll RAWDT p. 77. However, as detailed above, in the rebuttal phase of the proceeding UMG produced Last.fm statements for every month from January 2008 to May 2012; accordingly, there are 53 months of actual Last.fm play data in the record and no longer any need to rely on the Slacker proxy data that Professor Ordover criticizes. *See* Sirius XM Reb. Trial Exs. 66-99. As described, *see* Section III.D, *supra*, those data confirm in every way Professor Noll's initial conclusions based on the sample Slacker data.

183. Professor Ordover also claims that the fact that Pandora pays an effective rate of 50-60% of revenue in royalties somehow invalidates Professor Noll's reliance on the Last.fm benchmark. Ordover AWRT ¶ 59. He is wrong. First, using the statutory rates by Pandora in a way to set the rates paid by Sirius XM is a violation of the explicit terms of the Webcaster Settlement Act ("WSA").[39] Second, that publicly-stated effective rate is a blended rate that includes plays on Pandora's non-subscription tier, which is by far the most popular aspect of the

[39] Sirius XM is aware that the Judges denied its motion to strike portions of Professor Ordover's testimony alluding to Pandora's royalty payments to SoundExchange. Sirius XM respectfully maintains its objection that the use of Pandora's payments to SoundExchange, which is simply a result of multiplying the non-precedential per-play rate times the number of plays on the service, is a clear violation of the prohibition of the use of Pandora's rates in *Agreed Rates and Terms For Commercial Webcasters Including Small Pureplay Webcasters*, Fed. Reg. Vol. 74, No. 136 p. 34801, even if expressed as a total payment or a percentage of its revenues rather than identifying the per-play rate itself. In short, SoundExchange is blatantly attempting to "use" Pandora's rates to argue that the rate set by the Judges in this proceeding should be higher than that suggested by the Last.fm benchmark – the very antithesis of what is permitted by the WSA. The fact that those non-precedential rates have been translated into an effective percentage of revenue does not alter this conclusion.

service, and which operates under different rates than the subscription service. 6/6/12 Tr. 394:18-20 (Noll) (noting that publicly reported royalty percentage for Pandora is "for all of its services" and "not just the one that would be the benchmark for Sirius XM"). Professor Ordover has failed to identify the effective percent of revenue paid by Pandora for its subscription service – the type of service Professor Noll uses as a benchmark and the type of service that Professor Ordover himself believes is the only appropriate one for benchmarking purposes here. *See id.* at 396:12-397:18 (observing that Pandora offers multiple services, that the Pandora subscription service "is the one that would be the benchmark," and that one cannot determine the rate Pandora pays for its subscription service from the public statements); 6/14/12 Tr. 2287:16-2293:5 (Ordover).

184. Third, and most important, the *effective* rate paid by Pandora as a percent of revenue (whatever the service tier) is simply irrelevant, as it is uniquely dependent on Pandora's play count, Pandora's business model, and Pandora's inability to generate revenue commensurate with its royalty payments. The appropriate benchmark, should one look to Pandora, would be the Pureplay per-play rate applied to *Sirius XM* plays per month and expressed as a percentage of *Sirius XM* revenue, not the effective rate that results from applying the Pureplay per-play rate to *Pandora's* plays and stated as an effective percentage of *Pandora's* relatively low revenues – a result that is solely a function of that company's weak business model. *See* Salinger CWRT ¶ 20 ("Establishing comparable rates for the target . . . from the benchmark . . . entails charging the same price, not the same percentage of revenue."); 6/6/12 Tr. 395:3-396:7 (Noll) (explaining that the result of this proper calculation, based on about 300 Sirius XM plays per month, is well below the public reports for Pandora and in line with the

range of rates calculated using the Last.fm benchmark).[40] There is no reason that Sirius XM should be penalized by application of a royalty benchmark that reflects some other competitor's unique usage patterns and inability to generate sufficient revenue.

2. Play Counts From Other Non-Interactive Services Are Irrelevant

185. In a related argument, Professor Ordover testifies that play-count estimates on Pandora and Sirius XM reveal higher numbers of monthly plays per user [redacted] than the [redacted] initially used by Professor Noll as revealed in Slacker statements from 2008. Ordover WRT ¶¶ 7, 62-63. Professor Ordover's attempt to undermine Professor Noll's use of Slacker data as a proxy for then-unavailable Last.fm data is unavailing. He acknowledged at trial that his concern would be alleviated by use of actual Last.fm play data. 8/14/12 Tr. 3406:2-13 (Ordover). That data is now available and in evidence and confirms Professor Noll's conclusions. *See* Section III.D, *supra*.

186. To the extent Professor Ordover views the cited Pandora play data as providing a better estimate of plays on non-interactive services more generally than does the Slacker data, he misapprehends Professor Noll's methodology and reason for attempting to determine the number of plays on Last.fm. That was simply to determine whether Last.fm would in fact have paid under the percent-of-revenue prong of its license agreements (thus making the percentage of 25% to [redacted] the appropriate benchmark). The appropriate data for making such a determination is not the plays on Pandora, but plays on Last.fm. The point was *not* to come up with a representative number of plays for non-interactive webcasters generally, nor to figure out what some other non-interactive service (or the average non-interactive service) would have paid were it subject to the Last.fm rates. Indeed, it would be unreasonable to assume Pandora,

[40] Again, Sirius XM is not suggesting that such a calculation, even if proper from the economist's standpoint, is legally appropriate in light of the prohibitions in the WSA.

knowing it had [redacted] plays per subscriber, would have signed a deal with a record label at the same per-play rates as agreed to by Last.fm.[41]

187. The same flaws infect Professor Ordover's claimed estimate of plays on Sirius XM. Ordover AWRT ¶ 64. The number of plays on Sirius XM is irrelevant to the question of which prong of the Last.fm rate formula was applicable to Last.fm. Nor, in fact, is such data maintained by Sirius XM, which as a result of its one-way broadcast technology has no way of knowing who is tuning into which satellite radio channel at any given time, or for how long. Frear RWRT ¶ 29; 8/13/12 Tr. 3038:16-3039:1 (Frear). Professor Ordover's claim of 980 plays per Sirius XM subscriber per month is drawn from five-year-old estimates of music-listening time derived by SoundExchange expert Michael Pelcovits during the *Satellite I* proceeding in testimony that has not been entered into evidence here, based on studies that are not in evidence here (but which necessarily date from years prior to 2007), and utilizing a methodology that has nowhere been described. Even if the Sirius XM play count were relevant (and it is not), SoundExchange has presented no dependable data to establish it.

3. The Alleged "Statutory Overhang" Does Not Compromise The Value Of The Non-Interactive Benchmarks

188. SoundExchange also argues that the non-interactive custom Internet radio service agreements cannot be used for benchmarking because the rates in such agreements, albeit licensing services that do not comply with the statutory license, nonetheless are influenced by the prevailing statutory rate for webcasters that do comply with the statutory license. *See, e.g.*, Ordover AWRT ¶ 53; Harrison CWRT pp. 2-5. Again, SoundExchange's arguments are without merit.

---

[41] It appears that Ordover's [redacted] play calculation is, in any event, incorrect. As Professor Noll explained in his rebuttal testimony, Professor Ordover appears to have undercounted the number of subscribers in 2011 and thus over-counted the number of plays per subscriber by as much as a factor of two. 8/15/12 Tr. 3560:14-3562:3, 3574:10-3577:12 (Noll); *see also id.* at 3591:14-3593:11.

189. As an initial matter, as Professor Noll made clear in his testimony, the "overhang" criticism is not unique to the non-interactive webcasting services; the presence of a regulated rate impacts all the competitors in the market, including the interactive services favored by Professor Ordover, and it is a fallacy to believe one can identify a "pure" market alternative to the statutorily licensed service. 6/5/12 Tr. 276:4-278:13 (Noll); 6/6/12 Tr. 333:11-334:4, 481:10-483:1 (Noll).

190. Second, the statutory rate, whatever its impact, was set by the Judges under the Willing-Buyer/Willing-Seller standard to reflect a competitive market rate. 6/5/12 Tr. 276:4-278:13 (Noll). Indeed, Professor Ordover himself acknowledged as much, agreeing that the statutory rates from the webcasting proceedings "in fact approximat[e] those that would be set in a willing buyer, willing seller competitive marketplace"; that "that the rates set by the judges likely reflected the willing buyer, willing seller guideline for setting the rates"; and that "one could use those rates as being indicative of what the world would look like." 8/14/2012 Tr. 3409:13-3411:3 (Ordover). Thus, to the extent the statutory rate influenced negotiations between a custom webcaster and a record company (allegedly by pulling the negotiated rate toward the statutory), that does not present any problem for benchmarking – it simply means the negotiated rate, if influenced by the statutory rate, was influenced by the equivalent of a competitive market rate. 6/5/12 Tr. 276:4-278:13 (Noll) ("So if you get the [statutory] prices right, what's the problem, right? It's not – there isn't some perverse horror show arising from getting that other price right.").[42]

[42] Professor Ordover incorrectly suggests that it was Professor Noll who contended that the rates set by the Judges are of no probative value here. Ordover AWRT ¶ 53. His selective quotations of Professor Noll's testimony mischaracterize Noll's point. Professor Noll's testimony simply stated the truism that rates set by the Judges, because they are not negotiated by market participants, cannot technically be called "market" rates. 6/6/12 Tr. 387:9-388:8. (Noll) ("the regulated rate is not a market-determined rate"). As described in the text, however, Professor Noll made clear that the Judges *do* attempt to set rates

191. The influence of the statutory rate is only a problem to the extent the Judges made a mistake and that the rates in *Webcasting II/III* do not in fact reflect competitive rates. *Id.* ("That's not a distortion unless you believe that there is a fundamental distortion in the rate process."). But SoundExchange witnesses testified directly to the contrary. Professor Ordover, for his part, testified that he did not believe that to be the case, explaining that the Judges are "trying to set the rate that in some sense approximates what a competitive market would deliver" and that he was "not here to criticize the judge's rates." 8/14/12 Tr. 3408:16-3409:12 (Ordover). Mr. Harrison of UMG agreed that the task of the Judges in the *Webcasting* proceedings was to set "the rate that is negotiated between willing buyer and willing seller in a competitive market," and that he "ha[d] no reason to believe [the Judges] got it wrong." 8/21/2012 Tr. 4429:4-4430:15 (Harrison); *see also id.* at 4430:16-22 (acknowledging that the Judges' benchmark in the *Webcasting* proceedings was the same interactive services benchmark being offered in this proceeding against Sirius XM).

192. Professor Ordover also agreed that to the extent the custom radio rates are higher than statutory rates, the overage reflects the competitive price of the extra-statutory features granted under the voluntary licenses, and that "even with that regulatory backdrop, we assume that approximates the value that a workably competitive market has put on the statutory license plus the extra voluntary grants." 8/14/2012 Tr. at 3412:12-22 (Ordover); *see also* 6/13/2012 Tr. 1977:15-1979:20 (Bryan) (describing negotiations over the "value of that incremental functionality" that is "not enabled by the statute").

---

that would be negotiated between a willing buyer and willing seller in a competitive market, and that there is no reason to believe they err in doing so (or that, if they err, they systematically do so by *understating* the market rate). *See also* Noll RWRT pp. 5, 10-12.

193. Even if one did believe the rates set by the Judges in the *Webcasting* proceedings were below the competitive rate for non-interactive webcasting, there is no reason to think the error is significant – and certainly not so great as to justify choosing as a benchmark an interactive service rate that adds another 30-35% onto the custom radio rates. 8/14/2012 Tr. 3459:5-3461:4 (Noll) (describing as "not credible" the suggestion that "rates that create the regulatory overhang can be assumed systematically to understate the competitive market rate").

194. Indeed, as Professor Salinger explained, the Direct License evidence suggests that the statutory rate is, if anything, too high:

> [I]nformation from markets that are subject to a compulsory license at regulated prices can provide relevant information about a free market rate. When the price is above the competitive price, individual suppliers have an incentive to undercut the market price in order to secure additional business. This price cutting to secure more business is the competitive process at work, and the incentives underlying it are present whether the prevailing price stems from an unfettered market or whether it is a regulated price. This phenomenon is precisely what we have seen with the direct licenses Sirius XM has signed with record labels. The willingness of record labels to undercut the existing regulated rate to obtain more business (*i.e.*, plays) is evidence that existing rates are above competitive levels.

Salinger CWRT ¶ 28. This is consistent with Professor Noll's testimony regarding "decades of scholarship" revealing "the expected outcome of price regulation to be prices that exceed the competitive level." Noll RAWDT p. 54 and n.46. The fact that 95 record companies have decided to agree to voluntary licenses at rates below the 8% statutory rate – when they did not need to do so, and when they could have refused the deal and continued to collect royalties under the statutory license – suggests that the statutory rate is, if anything, above the competitive rate. *Id.*

4. The Evidence Of Actual "Statutory Overhang" Is Weak

195. Finally, there is no evidence that the statutory rates, whatever their level of competitiveness, actually had any significant drag-down effect on the rates negotiated by custom radio services. Professor Ordover, for his part, points to the fact that certain Last.fm rates are facially expressed as an uplift from the statutory rate [redacted] Ordover AWRT ¶ 53. But this fact is entirely consistent with what Professor Ordover has acknowledged: that to the extent voluntary agreements offer functionality above and beyond the statutory license, the negotiated rate will reflect the price of the statutory license (acknowledged by Professor Ordover to be competitive) plus the competitive price of the extra features. *See* ¶ 192, *supra*. The Last.fm formula, expressed as [redacted] (what Ordover calls a "sweetener," 8/14/12 Tr. 3411:5-20 (Ordover)), simply makes this theoretical point tangible.

196. Mr. Bryan's reference to a single asserted instance in which a custom radio service may have threatened to modify its services to operate under the statutory license, 6/13/2012 Tr. 1977:15-1979:13 (Bryan), scarcely constitutes probative evidence of such a drag-down effect. Mr. Bryan was unable to furnish any specifics as to what was discussed, when the conversation took place, how Warner responded, and whether the conversation had any impact on negotiated rates.[43] *Id.* at 2030:16-17. Neither did he offer evidence of WMG actually responding to such a threat by altering its requested rate, or of any service actually changing its offering to operate under the statutory license – let alone that such a change would be either

---

[43] The rates for Slacker's subscription basic radio service [redacted] *Compare* Noll RAWDT Table 2.2 *with* Noll RAWDT Table 2.2a. [redacted]

technologically possible, or commercially or financially viable. *See, e.g.*, *id.* at 2029:10-13 [redacted]; *id.* at 2072:8-2074:15 [redacted]; Sirius XM Dir. Trial Ex. 28 (Amendment No. 1 of Interactive Radio and Music Services Agreement).

197. In the end, the claim that a service that does not qualify for the statutory license (because of added functionality) has leverage over the record company from whom it needs a voluntary license to operate – that it can somehow force the record company to accept rates the record company believes to be too low because of statutory rates that are not available to it – does not stand up to scrutiny. Professor Ordover, for his part, agreed that "nobody forces a major label to license beyond the statutory rate if it doesn't feel it's getting fair market value," 8/14/2012 Tr. 3411:21-3412:9 (Ordover), and Mr. Bryan agreed that "[redacted]" 6/13/2012 Tr. 2026:13-18 (Bryan); *id.* at 2027:5-12 [redacted]"). Both Mr. Harrison and Mr. Bryan acknowledged that [redacted][44] *Id.* at 2027:13-2028:3; 8/21/12 Tr. 4428:1-19 (Harrison). None of this suggests any leverage to drive lower rates.

[44] Mr. Harrison pointed out [redacted]

198. The evidence that *is* on the record reveals that Warner (not to mention other majors) has negotiated rates for the subscription tiers of customized webcasters well *above* the statutory rate. With Slacker, for example, the per-play rate for the free basic radio service was initially set at [redacted] *See* Noll RAWDT Table 2.2; Noll RAWDT Appendix I at p. 11 (agreement). When the agreement was [redacted], the per-play rates for 2009-2012 for that service tier were set at [redacted] respectively, more than [redacted] the prevailing "Pureplay" rates ($.00093, $.00097, $.00102, $.00110). *See* Noll RAWDT Table 2.2a; Sirius XM Dir. Trial Ex. 27 at pp. 11-12 (agreement). WMG's more recent agreement with Turntable.fm likewise calls for rates at [redacted] *See* Noll RAWDT Table 2.3; Noll RAWDT Appendix M at p. 3 (agreement).

199. This evidence suggests that record companies (who after all could say no) enter such deals because they get competitive fees for offering the extra functionality. Mr. Bryan, for example, described Warner's voluntary agreements with custom webcasters as Warner's attempt to "maximize how much money we make from that segment." 6/13/12 2028:4-2029:2 (Bryan). Professor Ordover likewise explained that the voluntary agreements reflect the parties' willingness to "to negotiate out an outcome that is desirable [to] both of them otherwise they would not get there." 8/14/12 Tr. 3412:10-22 (Ordover). This applies to the services as well as the record companies: "[T]o the extent that firms negotiate for rates that are different than the statutory one," he added, "there is some kind of a sweetener they are willing to pay because they get some benefits in exchange. Nobody is going to pay the same higher rate for what they can get in the statutory rate." *Id.* at 3411:5-20. In short, if services felt the rights granted under the statutory license were sufficient to market a viable service, or that they could easily abandon the

extra functionality, surely they would do so; the fact that services reach voluntary deals with record companies at rates above the statutory rate suggests that where neither is true, they enter into the deals they do because of their view that it is worth it to pay for extra functionality.

5. SoundExchange's Attacks On The Last.Fm And Cricket Agreements Fail

200. Mr. Harrison offered similar arguments to Mr. Bryan as to the supposed rate-depressing impact of the statutory rate on royalty rates reached with non-interactive services. Harrison CWRT pp. 3-5. Although Mr. Harrison argued the point generally, the only supporting evidence he offered related to UMG's agreement with Last.fm. That evidence proved to be without foundation in every respect.

201. Although he was the nominal sponsor of SoundExchange's testimony regarding the UMG/Last.fm agreement, Mr. Harrison acknowledged that (1) he was not involved in the negotiation of that agreement in any way; (2) he did not speak to anyone who was involved in its negotiation prior to preparing his written testimony; (3) he did not review any documents from the negotiation of the agreement that would have revealed how or why any particular terms were set at the levels they were; and (4) he did not even know who conducted the negotiation until after that testimony was submitted. (He discovered this information after deposition but prior to trial.) 8/21/12 Tr. 4403:20-4409:2 (Harrison).

202. The only conversation to which Mr. Harrison himself was party took place around the time of the agreement (nearly five years ago) with a U.S.-based UMG attorney who was not himself involved in the negotiation of the agreement. *Id.* at 4406:20-4407:17. The lone document Mr. Harrison reviewed was a deal summary [redacted] *Id.* at 4406:14-4408:16. [redacted]

[redacted] Sirius XM Reb. Trial Ex. 113; 8/21/12 Tr. 4395:7-4396:5, 4408:17-4409:2 (Harrison). In short, Mr. Harrison's testimony is based entirely on speculation from the face of the deal.

203. Mr. Harrison's speculations include the suggestion that the 2007 decision in a lawsuit involving Yahoo!'s LaunchCast service somehow gave Last.fm leverage in negotiating lower rates with UMG. Harrison CWRT p. 3. Yet he acknowledged not only that the suit did not apply to any service other than LaunchCast, and that it was on appeal when the Last.fm/UMG agreement was struck, but also that he had no evidence whatsoever to support the claim that the rates in the agreement were in any way impacted by the decision. 8/21/12 Tr. 4418:3-18 (Harrison). Indeed, Mr. Harrison admitted that he didn't know whether the negotiators were even aware of the decision. *Id.* at 4418:19-22. [redacted] Sirius XM Reb. Trial Ex. 113; 8/21/12 Tr. 4419:1-3 (Harrison).

204. Mr. Harrison also contended that the Last.fm/UMG agreement [redacted] that renders the agreement an "outlier." Harrison CWRT p. 3. He admitted, however, that he has no evidence that [redacted] 8/21/12 Tr. 4412:20-4414:16 (Harrison). [redacted] Sirius XM Reb. Trial Ex. 113. What is more, the very premise of Mr. Harrison's testimony is illogical. It simply makes no sense that [redacted]

[redacted] And that is precisely what happened: Last.fm agreed not only [redacted] Noll RAWDT Appendix H at p. 9, 51, 54; 8/21/12 Tr. 4416:8-13 (Harrison).

205. Mr. Harrison further speculated that [redacted] Harrison CWRT p. 4. The apparent premise of Mr. Harrison's argument is that [redacted] *Id.* But Mr. Harrison undercut his own argument by conceding that [redacted] *See* 8/21/12 Tr. 4415:8-18 (Harrison). What is more, he was unable to support his claim by reference to any evidence – and the deal summary memo is again silent as to this asserted tradeoff. *Id.* at 4417:18-4418:2; Sirius XM Reb. Trial Ex. 113.[45]

206. At trial, Mr. Harrison essentially abandoned this line of argument, instead claiming (for the first time) that [redacted] Apart from the lack of evidentiary support for this assertion,[46] the [redacted]

---

[45] Mr. Harrison's written testimony [redacted] Harrison CWRT pp. 3-4. The documentation makes clear [redacted] Sirius XM Reb. Trial Ex. 113 at p. 1; 8/21/12 Tr. 4410:5-15 (Harrison).

[46] [redacted] Moreover, Last.fm offers several service tiers, and he

[redacted] paid by Last.fm is irrelevant. What matters is what the parties agreed to when they signed, and there is not a stitch of evidence that either Last.fm or UMG believed Last.fm [redacted] irrelevant to the question of what rate the parties agreed to at the time of agreement and what they *expected* to occur.

207. In yet another attempt to rewrite his testimony, Mr. Harrison claimed at trial that [redacted] – only to withdraw that assertion on cross-examination. 8/21/12 Tr. 4385:14-4386:16, 4421:7-16 (Harrison). [redacted] *See* Harrison CWRT pp. 3-5; 8/21/12 Tr. 4420:16-4421:16 (Harrison). [redacted] that Professor Noll uses in his calculations.

208. Mr. Harrison also spent a significant portion of his written testimony [redacted] Harrison CWRT pp. 7-8. But the

---

failed to [redacted]

[redacted] are simply irrelevant as compared to the way UMG structured the agreement [redacted] Moreover, the record leaves no doubt that Cricket was in fact a successful first-tier service [redacted] even prior to the Muve agreement, and is now [redacted][47] *See, e.g.*, Sirius XM Reb. Trial Ex. 123 at p. 9 (UMG earning about [redacted] from Cricket prior to entering into the Muve deal); 8/21/12 Tr. 4438:21-4439:13 (Harrison) (discussing current ranking). There is simply no evidence that UMG [redacted][48] Harrison CWRT pp. 6-7; 8/21/12 Tr. 4443:6-4444:3, 4447:8-4448:6 (Harrison); Sirius XM Reb. Trial Ex. 114.

---

[47] Warner records likewise reveal that [redacted] Sirius XM Dir. Trial Ex. 25 at pp. 35, 39; Salinger CWRT ¶ 19 n.6.

[48] [redacted] *See id.* at 4440:14-4442:3.

6. Professor Noll's Computation Of The Implicit Price For Sirius XM Music Channels Correctly Accounts For The Costs Of Sirius XM's Satellite Delivery Network

a. It Is Not Economically Relevant That Sirius XM's Platform Has No Value Without Content

209. Professor Ordover attacks Professor Noll's computation of the implicit price for Sirius XM music channels (the third step in Professor Noll's adjustment process) on several grounds, the first being that that Sirius XM's delivery network has no value (and cannot be sold) without content. Ordover AWRT ¶¶ 67, 70-71. Professor Ordover (echoed by Mr. Harrison) suggests that the Cricket situation is distinguished from that of Sirius XM by the fact that the non-music components of the Cricket mobile music bundle (for example, telephone service and text messaging) have separate value to consumers (and a separate price) in the marketplace. *Id.* at ¶¶ 70-71; Harrison CWRT pp. 5-6. The conclusion that Professor Ordover would draw is that unlike Cricket, Sirius XM allegedly cannot avoid sharing its entire revenue base (including the additional revenue earned on account of delivering as well as programming the service) with its content providers; it is therefore improper, in Professor Ordover's view, to adjust Sirius XM's retail price downward to account for such revenue as Professor Noll does when calculating the implicit price of Sirius XM's music channels. 8/14/2012 Tr. 3418:1-22 (Ordover).

210. As an initial matter, Professor Ordover's formulation conveniently sidesteps the fact that Sirius XM has highly valued non-music content to deliver – and that the loss of music alone would not render its delivery network valueless. *See* Karmazin WDT ¶ 20, 22-28, 30-35; 6/11/12 Tr. 1320:13-1322:18 (Karmazin); Karmazin DWDT ¶¶ 3, 40-42, 47. Moreover, as Professor Noll testified, "[e]conomic theory provides a clear explanation for why the argument for ignoring platform costs is incorrect" even if it is the case that the Sirius XM delivery system cannot be marketed without content of some kind. Noll RWRT p. 21. Professor Noll illustrated

this point through a commonly used mathematical representation of a production process, the Cobb-Douglas function, in which output, Q, is assumed to be determined by the amount of inputs, K (for capital investment) and L (for labor), according to the following equation:

$$Q = AK^aL^b,$$

where A, a and b are constants and a and b are less than one. If either K or L is zero, output is zero, just as Sirius XM would have zero subscribers if it lacked either content or a platform. If a firm acquires K and L to maximize profits, the shares of each factor in total revenue are a for capital and b for labor. A more capital-intensive technology has a higher value of a relative to b, which means that a higher share of revenue goes to investment, even though output still is zero if no labor is used. *Id.* at pp. 21-22; 8/14/2012 Tr. 3466:7-3467:10 (Noll).

211. As Professor Noll further testified, in some cases (*e.g.*, restaurants and satellite radio), Q is produced by a single firm and the combined product is sold to consumers. In other cases (*e.g.*, home-cooked meals and Internet music services), Q is produced by the consumer after acquiring the components from separate vendors. This difference does not alter the fact that all inputs must receive a share of the total revenue for Q in order to remain viable, even though each input may be valueless all by itself. Noll RWRT pp. 21-22. Conversely, the fact that certain components of an aggregated or bundled product *do* have an independent value in the market does not give license to ignore the value of those that do not; what matters is not that the components have some separate value apart from the aggregated product, but their contribution to the value *of* the aggregated product – that is, their marginal product: "the thing that determines the rewards going to factors of production," Professor Noll testified, "is their marginal product." 8/14/2012 Tr. 3466:7-3467:10 (Noll). In short, as Professor Noll, explained at trial, "you

literally get nowhere in trying to understand how to price a particular input by observing that if all the other inputs weren't present there'd be zero output attributed to that input." *Id.*

212. The argument that it somehow matters that Cricket sells its service separately boils down to the claim that whereas Cricket could refuse any effort by the labels to expropriate some share of mobile-service revenue and return to selling its (separately valued) mobile service only, Sirius XM, having invested in a satellite network that it cannot separately market without music content, could not. The necessary implication is that, unlike Cricket, Sirius XM would be forced to choose between sharing a portion of its returns on its investment in its transmission network with record companies, or risk being shut down. *See* 8/14/2012 Tr. 3418:1-3419:3 (Ordover). This argument should be rejected.

213. First, as noted above, Sirius XM offers content other than music on its service, and music is therefore not the sole driver of its value. *See* Karmazin WDT ¶¶ 20, 22-28, 30-35; *see also* Karmazin WDT Ex. 1.[49] Second, by framing the question as whether Sirius XM (as compared to Cricket) could operate without music content, Professor Ordover necessarily (and artificially) assumes a monopoly rather than a competitive supplier of music. 8/16/12 Tr. 3807:1-9 (Salinger). It may be true that if Sirius XM were faced with the choice of having no content at all to offer on its service, then it might be forced to forgo a competitive return on its investments in its delivery system and give up some share of the revenue earned on account of that system to its content suppliers, at least in the short run. But only a monopoly supplier – one that could withhold all or a substantial portion of content from Sirius XM – would have such power; in a workably competitive environment, the ability of a single record company, for

[49] SXM Direct Exhibits 1-2 were appended to the Written Direct Testimony of Mel Karmazin, and were admitted into evidence together with the written testimony as Sirius XM Direct Trial Exhibit 19. All exhibits so attached will be hereinafter referred to as "Karmazin WDT Ex. __."

example, to drive such a bargain would be more limited, as Sirius XM could and would substitute away to providers willing to offer a competitive rate. *Id.*

214. Third, any royalty that would force a service to forgo a return on sunk investments in its delivery infrastructure, while perhaps acceptable in the short run, would not be viable in the long run, especially if that royalty were in excess of those paid by non-bundled rivals. 6/5/12 Tr. 232:6-234:3 (Noll) ("The idea that we should evaluate the long-term viability of Sirius XM on the basis purely of its ability to have . . . positive cash flow and to cover its operating expenses is completely false"); Salinger CWRT ¶¶ 33-36; *see also* Sirius XM's PCL Section V.D, *infra* (critiquing claim that Sirius XM will not be disrupted so long as it can cover variable costs). As a practical matter, if Sirius XM had to pay a music royalty rate that had the effect of disallowing a competitive return on investment – for example, the costs of investing in the installation of satellite radios in new cars, or the XM replacement satellites slated to begin development in 2016, *see* Meyer WDT ¶ 51 – it would have no incentive to continue making those investments, and would lose the primary source of revenue for the company. Noll RWRT p. 54; 6/5/12 Tr. 233:4-16 (Noll) (describing Sirius XM as "basically gone if they have no incentive to make these additional investments"); *id.* at 295:5-10 (describing such a result as "disruptive").

215. These economic arguments – in addition to exaggerating the distinctions between Cricket and Sirius XM[50] – comport with sound policy. As Professor Noll explained, the approach championed by Professor Ordover would penalize a service that creates an attractive

[50] The record is clear that [redacted] 8/21/2012 Tr. 4439:14-4440:13 (Harrison). [redacted]

bundled service by charging that service more for music royalties than its disaggregated competitors (who do not sell delivery), and more than it would pay if it outsourced the delivery function to a third party:

> So to apply the royalty rate to all these other costs that they have to recover to have a viable business is to say, well, thank you very much for creating this entire technology, now that you've done it, we are going to tax you relative to your competitors. We are going to cause you to pay more for royalties all else equal than the guy who is doing interactive services over the Internet because you had to invent the product and so because you had to invent the product, because you invented a radio not just the content itself, you therefore have to pay more. That's taxing innovation and taxing the soft costs and fixed costs that are necessary to enter a regulated industry.

8/14/2012 Tr. 3464:9-22 (Noll); *see also id.* 3462:14-3463:6 (same).

216. There is no dispute that record companies selling downloads (or interactive services for that matter) are not able to demand a share of the payment made by the consumer for wireless Internet access or the computer or smartphone used to enjoy other (non-bundled) music services;[51] likewise, there is no dispute that if Sirius XM limited its operation to producing music programming, and outsourced the delivery of the service and provision of receivers to a third-party, the revenue base upon which Sirius XM would pay royalties would include none of the revenue paid by consumers to the third-party delivery service. 8/14/2012 Tr. 3420:2-19 (Ordover). It defies logic, then, that the revenue earned by Sirius XM for delivery of its service, simply because that delivery is packaged with programming, should be taxed to the benefit of the record companies under the current corporate arrangement, when it would not be so taxed if delivery were disaggregated. *See id.* at 3462:5-13 (Noll) (describing why, "both as a matter of

---

[51] This is true even of Apple, which is the leading seller of downloads (via iTunes) and the leading seller of devices for listening to those downloads (iPods, iPhones, and iPads). The labels are not able to take a cut of Apple's device sales, or charge Apple a higher rate for downloads to reflect the additional revenue Apple earns from devices. Noll RWRT p. 44.

economic theory and as a matter of policy . . . it's a horrendous mistake," to apply the benchmark royalty rate from an unbundled service against the retail price of the bundled service).

217. Professor Ordover, for his part, acknowledges that it is the "ubiquitous availability of Sirius XM in the car" that causes 22 million subscribers to value the service more than non-interactive Internet-based services, 8/14/2012 Tr. 3416:1-14 (Ordover), and acknowledges that such availability is the result of investment made by Sirius XM in its delivery network and receivers, *id.* at 3416:15-3417:4.[52] There is no reason Sirius XM should be economically penalized for bundling programming and delivery together in an attractive package when its non-bundled competitors are not, or incentivized to spin off delivery so as to avoid paying more than it would in the unbundled situation.[53] *See* 8/14/2012 Tr. 3462:17-3463:1; 3467:17-3468:5 (Noll) (describing competitive disadvantage of bundling to regulated firm and resulting incentive to disaggregate products). The regulatory process should not "stack the deck" in favor of one competitor over another. 6/5/12 Tr. 295:11-296:2 (Noll); *see also* Salinger CWRT ¶ 27 (same).

218. The 801(b) rate-setting factors compel a similar conclusion. Professor Noll justified his cost-structure adjustment in part by reference to the "relative contribution" factor.

---

[52] As explained in Section V.A.2.c below, Professor Ordover's argument is also contradicted by his own benchmarking. Professor Ordover's second alternative approach, which is premised on the retail rate of non-interactive Internet-based services, implicitly makes the very sort of "platform adjustment" that Professor Ordover claims elsewhere to be improper.

[53] Professor Ordover's contention that Professor Noll's approach would cause the content providers' payment to vary from service to service, depending on the costs incurred by each service, mischaracterizes Noll's approach. Ordover AWRT ¶ 69 n.55. The point is not that two services offering the *same* product should pay *different* royalties depending on their costs; presumably competition would compel such services to charge the same fee in the market, and to minimize the costs necessary to do so. Rather, Professor Noll's point is that a service that incurs additional costs to provide an *additional* service component – one that consumers value and are willing to reward with payment of a higher price – should not have to share the additional revenue generated by that investment with providers of other inputs. This does not place content providers at the mercy of inefficient services with higher costs. Indeed, Professor Noll's approach ensures that content providers received the same payment from different services that offer the same product.

See Noll RAWDT pp. 81-83, 85-88. Professor Salinger likewise makes the point that ignoring the contribution of sunk costs would violate the statutory mandate to consider the relative contribution of Sirius XM: "It is a basic principle of economics that firms will continue to operate in the short run as long as they can cover their variable (*i.e.*, non-sunk) costs and, as a consequence, market prices can fall, under some circumstances, to average variable cost. When this happens, the market price provides the seller no margin to contribute to its sunk costs. I would not interpret such an outcome as reflecting the contribution of the sunk costs to the provision of the service." Salinger CWRT ¶ 33; *see also id.* at ¶ 36 ("In most markets, a range of market prices is feasible, and that range is generally broader in the economic short run than it is in the economic long run. As a matter of economics, I read the third statutory criterion as restricting rates to those that are sustainable in the economic long run."); *id.* at ¶ 37 (suggesting that a fee that parties would not voluntarily agree to in the long run likewise would be unfair under the second statutory criterion).

219. It is also wrong, Professor Salinger testified, to reduce the inquiry to one of disruption: "Dr. Ordover's suggestion that the fourth statutory criterion (disruption) provides the appropriate framework for evaluating Sirius XM's sunk costs makes no sense and indeed gets matters completely backwards. To the extent that Sirius XM's investments in its satellite network are sunk, then it would rationally continue operation even if the CRB set rates that left it with no contribution to the recovery of those costs. This situation would violate the relative contribution factor even if it did not cause Sirius XM to cease operations." *Id.* at ¶ 35; *see also* 6/5/12 Tr. 295:5-10 (Noll) (explaining that taxing a service in way that does not allow a competitive return on investments would impact its willingness to continue to invest in installation of radios, and thus would be "disruptive" in the long run).

b. Sirius XM's Pricing Of Its News And Sports Packages Does Not Undermine Professor Noll's Platform Adjustment

220. Professor Ordover suggests that Sirius XM's $9.99 pricing for its news/sports/talk package (approximately $6.00 less than the new price of Sirius XM's Select package ($14.49) plus the $1.42 Music Royalty Fee) belies the claim by Professor Hauser (relied upon by Professor Noll) that consumers would pay only $3.24 less for a package with no music than one with music, Ordover AWRT at ¶¶ 73, 75a. If the music offering was only worth $3.24 to them, he asks, why wouldn't consumers pay $9.99 for the news/sports/talk package and subscribe to a non-interactive webcaster (e.g., Pandora One) for $3.00 rather than paying an extra $5.92 to Sirius XM for a music package – unless consumers value the Sirius XM music at greater than $3.24?

221. The answer is provided by SoundExchange's own witness, Professor Sidak: subscribing to Pandora or some other non-interactive service does not just cost the subscriber $3.00 – one also needs to purchase a receiving device (a computer or smartphone) and a broadband Internet access plan to access and receive the service. Sidak ACWDT ¶ 59 (noting that webcasters "require the user to incur the cost of data usage"); *id.* at ¶ 60 ("Mobile Internet radio thus can be substantially more expensive than a subscription to Sirius XM"). When an appropriate portion of those fees is allocated and added to the $3.00 Pandora subscription, the additional fee would be higher than the upcharge between the $9.99 news/sports/talk package and the Select package with music as well. The record does not provide sufficient data to make that calculation with precision, but Professor Sidak suggested that one would need to spend as much as $20/month in data charges to stream a non-interactive service for an hour a day. *Id.* at ¶

60. Although that number is likely an overestimation,[54] it thoroughly undercuts Professor Ordover's argument.

c. Professor Noll's Alternate Method Of Deducting Costs From The Sirius XM Revenue Per User Is Appropriate

222. In addition to conceptual arguments against the platform adjustment, Professors Lys and Ordover argue that Professor Noll's methodology for calculating the unique delivery costs incurred by Sirius XM was incorrect. Lys WRT ¶¶ 122-126; Ordover AWRT ¶ 78. The gravamen of Professor Lys's criticism is that the subscriber acquisition costs and OEM revenue shares deducted by Professor Noll (as a cost uniquely borne by Sirius XM to subsidize the manufacture and installation of receivers in vehicles) are simply marketing costs like those incurred by any other webcaster. Lys WRT ¶ 123. Professor Ordover suggests that Internet webcasters' costs for transmission and delivery do not get deducted first before calculating royalties (using Pandora's costs on Music Genome project and servers as an example). Ordover AWRT ¶ 69.

223. As Professor Lys appears to understand, the subscriber acquisition costs and OEM revenue shares deducted by Professor Noll are ongoing costs paid to manufactures and automakers to pay for the manufacture and installation of radios in vehicles. Noll RAWDT Appendix D; Lys WRT ¶ 123. As such, they most assuredly are costs that Internet-based webcasters, who do not manufacture or subsidize consumer devices, do *not* incur – and are not the sort of general marketing/advertising costs that Internet services do incur. 6/6/12 Tr. 434:16-435:18 (Noll). To claim that Internet services also incur costs of "attracting and retaining

[54] The Verizon bandwidth calculator used by Mr. Sidak, *see* Sidak ACWDT ¶ 60 n.97, assumes a streaming audio rate of 60MB/hour, or about 134kbps (60*1000/60/60 x 8 kb/KB), which is roughly twice the mobile streaming rate (64kbps) of most mobile music streaming services. *See* Rosenblatt CWDT pp. 12-13; Verizon Wireless, Data Usage Calculator, http://www.verizonwireless.com/splash_includes/datacalculator.html.

subscribers," Lys WRT ¶ 123, or to suggest the subscriber acquisition costs are not technically *delivery* costs, *id.*, fails to distinguish between categories of costs and to recognize that whatever one might call them, Internet services do *not* subsidize the purchase of receivers by their customers. 6/6/12 Tr. 438:4-22 (Noll).

224. In short, this argument intentionally blurs different kinds of costs together and then shoots arrows at the straw man that results: Professor Noll is *not* arguing that Sirius XM should be able to net out general marketing costs, or its costs generally, before determining what is left to pay out in royalties. Rather, he argues that benchmarking should account for costs that are truly unique to Sirius XM's creation of its delivery network and subsidization of consumer reception devices – costs that the benchmark Internet service providers inarguably do not incur. Noll RAWDT Appendix D at p. 1. Thus, he did *not* deduct costs for the creation of programming, marketing, advertising, customer care, or any of the type that Sirius XM has in common with benchmark services. *Id.* at p. 3 (identifying programming and content costs, customer service and billing costs, general and administrative costs, costs of equipment, and restructuring costs as categorically similar to those incurred by the benchmark services). The "marketing and sales" costs that he counted as unique to Sirius XM focused on OEM and retail radio installation and sales, and he did not count as unique costs in those categories comprising more general sales and marketing activities. *Id.* at pp. 1-2 (separating out [redacted] million out of Sirius XM's [redacted] million sales and marketing costs, [redacted] million out of [redacted] million in revenue share and royalty costs, and [redacted] million out of [redacted] million in depreciation and amortization costs). Professor Ordover's reference to Pandora's Music Genome Project – a programming cost – is thus totally inapposite.

d. Professors Simonson And Ordover's Critiques Of Professor Hauser Are Unfounded

225. SoundExchange also offered the testimony of Professor Simonson to rebut the testimony of Professor Hauser about the survey results showing Sirius XM's subscribers' willingness to pay for music. Professor Simonson did not provide his own survey. 8/21/12 Tr. 4504:4-9 (Simonson). His chief complaint was that Professor Hauser's survey randomized the order in which features were removed from the Sirius XM service. *See* Simonson WRT ¶¶ 12-16, 39.

226. The criticisms are unavailing. Professor Hauser randomized the removal order because consumers view satellite radio as having a bundle of features and removing any one feature first could have a misleadingly large impact on willingness to pay. Hauser CWDT ¶¶ 20-21.[55] Although Professor Simonson contended that music should always be removed first, he conceded that it would be improper to do so if a consumer did not value music the most – and that he was aware some consumers did not value music more than other features of satellite radio. 8/21/12 Tr. 4507:12-4509:2 (Simonson). The fact that 53% of respondents had no price left by the time that they were asked to value music does not demonstrate that Professor Hauser's randomization methodology was incorrect, as Professor Simonson claims. Rather, removing the other features first left a service comparable to terrestrial radio for which people were understandably unwilling to pay as it is available for free. *See* 8/21/12 Tr. 4534:17-4542:16 (Simonson); Hauser CWDT ¶ 21; 6/12/12 Tr. 1599:12-1601:11 (Hauser). As there is no reasonable basis for eliminating all respondents who were unwilling to pay for what they could get for free (music on terrestrial radio), Professor Simonson's attempt to calculate an erroneously

[55] Removing music first resulted in a willingness to pay of $10.37, but if removed last, willingness to pay was $0.51, Hauser CWDT Appendix G – thus the need to average the results. Similarly, if talk was removed first, willingness to pay was $5.20, but if removed last it was $0.06. *Id.*

higher willingness to pay by doing so should be rejected. *See* 8/21/12 Tr. 4543:14-4548:12 (Simonson); 6/12/12 Tr. 1599:12-1601:11 (Hauser); Hauser CWDT ¶¶ 20-21.

IV. THE RATES PROPOSED BY SIRIUS XM BEST ACHIEVE THE 801(b)(1) POLICY OBJECTIVES

227. While the hearing record would thus one-sidedly support Sirius XM's rate proposal were this proceeding governed solely by the willing-buyer/willing-seller standard, as explained in detail in Sirius XM's accompanying Proposed Conclusions of Law, the propriety of that conclusion is further corroborated and reinforced by the recognition that this proceeding instead requires application of the four policy factors set forth in section 801(b)(1) of the Copyright Act to arrive at a "reasonable" SDARS rate. *See* Sirius XM's PCL, Sections IV-V. As the sections that follow will demonstrate, Sirius XM has made a strong record in these proceedings as to each of the four Section 801(b) factors, which counsels setting a royalty rate at the low end of the range of reasonable rates.

A. Sirius XM Contributes Significantly To Maximizing The Availability Of Creative Works To The Public

228. The first of the Section 801(b)(1) objectives is to "maximize the availability of creative works to the public." 17 U.S.C. § 801(b)(1)(A). As a matter of logic and economics, and contrary to Professor Ordover's implicit assumption to the contrary, the term "availability" encompasses both the incentives to produce creative products, as well as the delivery of those products to consumers on a nationwide basis. Noll RAWDT pp. 17-18; Noll RWRT pp. 51-52 (the availability factor "makes economic sense only if it also is concerned with access and usage of works by consumers"); 6/5/12 Tr. 222:6-16 (Noll). Thus, the "availability" factor under Section 801(b)(1) considers the tradeoff between the number of creative works created and

encouraging the use of creative works by making them available to more people. *See* Noll RWRT p. 52.

229. An analysis of the availability factor involves consideration of two distinct yet interrelated elements: first, whether satellite radio is unique in the range of music content it delivers to consumers, the audiences it reaches, or the features and attributes of its music-related offerings, *see* Noll RAWDT pp. 18-20; 6/5/12 Tr. 222:17-224:11 (Noll); and second, the "inducement effect," or the effect of delivering sound recording performances via SDARS on the total revenue of record companies. *See* Noll RAWDT p. 20. This latter element is multifaceted and involves taking into account both the effect that a lower royalty rate would have on the production of creative product, as well as the promotional or substitutional effect of the service on the sale of sound recordings. *See* 6/5/12 Tr. 224:15-226:18 (Noll). The evidence underlying each of these elements plainly demonstrates that Sirius XM's rate proposal will maximize the availability of creative works to the public.

230. Sirius XM's satellite radio service enhances the delivery and availability of sound recordings by: providing an uninterrupted nationwide broadcast of unparalleled breadth and depth; exposing listeners to music that is not played elsewhere; and creating original music programming to promote artists, typically at artists' and their representatives' request. Additionally, since SDARS sound recording performance royalties are such an insignificant proportion of record companies' overall revenue, they clearly are not the driving force behind decisions to produce such works and accepting Sirius XM's rate proposal will not reduce the record industry's incentive to do so. To the contrary, unlike in the *Satellite I* proceeding, the record contains data supplied by industry standard services that track radio airplay and record sales that demonstrate Sirius XM's direct promotional impact on the sale of sound recordings; in

other words, the evidence demonstrates conclusively that airplay of sound recordings on Sirius XM promotes the sale of sound recordings – thus generating *additional* revenue for the rightsholders and *additional* incentives to create new sound recordings. SoundExchange has offered no evidence to refute these conclusions, nor has it presented any evidence that indicates the availability analysis counsels in favor of any increase in the royalty rate for Sirius XM.

1. Sirius XM Reaches A Nationwide Audience And Plays Music Not Heard Elsewhere

231. One of the ways Sirius XM fosters greater availability of music is through its nationwide geographic coverage. This national footprint sets Sirius XM's satellite radio service apart from both its terrestrial radio and mobile subscription service competitors, each of which has gaps in coverage, particularly in sparsely populated areas. *See* Noll RAWDT pp. 18-20; 6/5/12 Tr. 222:6-224:11 (Noll).

232. Reaching more than 22 million subscribers nationwide with its broad channel capacity, Sirius XM offers access to rich and diverse music content by supporting many different music channels with distinctive formats that typically are not featured on terrestrial radio. Blatter WDT ¶ 25; 6/6/12 Tr. 528:2-529:8 (Meyer). "Even where a particular niche genre – bluegrass, for example – may not attract enough listeners in a given city to justify devoting a local station to the format on a full-time basis, the audience for the genre on a national basis is large enough, and [Sirius XM's] channel capacity [is] great enough, to allow [it] to devote an entire channel to the genre" – thus bringing it to communities that would not otherwise have access to such programming. Blatter WDT ¶ 25. Because Sirius XM does not rely on advertising revenue, it can provide even further flexibility in making available on its satellite radio service musical genres that are unavailable in particular geographic regions, or anywhere at

all, on terrestrial radio. *See also id.* at ¶¶ 5-6, 21-37 and Exs. 1, 21-24, 26, 28-32; 6/8/12 Tr. 976:22-979:10, 980:3-19 (Blatter).

233. This diversity of music programming exposes many subscribers to new genres and artists, as well as to artists they have not heard in years. *See* Blatter WDT ¶ 27 (discussing Sirius XM's ability to "dig much deeper into an artist's music catalog" than what is typically heard on terrestrial radio), ¶¶ 28-37 (discussing Sirius XM's exposure of new artists); ¶ 58 (discussing ability to promote legacy artists). This varied programming is beneficial for listeners, who receive a more satisfying listening experience, as well as for artists and their labels, which get exposure to consumers of music they would not otherwise reach. *See id.* at ¶¶ 26-27.

2. A Higher Royalty Rate Would Not Induce Additional Production Of Creative Works

234. A critical element of the availability factor involves analyzing the effect the royalty rate set in this proceeding would have on the record industry's incentive to produce creative works – namely, whether increasing or decreasing the royalty rate would have any discernible impact on the number of recordings created by record companies. *See* 6/5/12 Tr. 224:15-225:5 (Noll). Although SoundExchange, through its record company witnesses, emphasizes the importance of satellite radio revenues, these royalties actually account for too small a percentage of labels' overall revenues to have any measureable impact on the creation of new recordings – certainly not enough to counterbalance Sirius XM's daily delivery of recordings to an audience of some 22 million listeners.

235. For example, in 2012, Warner forecasts that its total receipts from SoundExchange, across all service categories, will represent [redacted] *See* Sirius XM Dir. Trial Ex. 25; 6/13/12 Tr. 2005:4-2006:6 (Bryan). Royalties from

Sirius XM SDARS performances represent [redacted] 6/13/12 Tr. 2008:1-5 (Bryan). Even if performances on Sirius XM's satellite radio service represent half of the SoundExchange total, the proportion of Warner's total revenue attributable to royalties from Sirius XM's satellite radio service for 2012 is [redacted]

236. Similarly, in 2010, UMG's total share of royalties received from SoundExchange amounted to approximately [redacted] of UMG's total revenue for that year. *See* Ciongoli CWDT pp. 7-8; Sirius XM Dir. Trial Ex. 39; 6/13/12 Tr. 2136:9-12, 2137:17-2139:3 (Ciongoli). That [redacted] encompassed royalties received from SoundExchange for all performances across all non-interactive subscription services in 2010. 6/13/12 Tr. 2138:20-2139:3 (Ciongoli). UMG's royalty revenues attributable solely to Sirius XM's SDARS performances [redacted] *Id.* at 2142:3-9. Even if performances on Sirius XM's satellite radio service accounted for half of UMG's total receipts in 2010, the proportion of UMG's total 2010 revenues attributable to SDARS [redacted] In 2011, UMG's royalty revenue from SoundExchange attributable to Sirius XM's satellite radio service amounted to [redacted] of its total revenues. *See id.* at 2411:11-2145:11; Sirius XM Dir. Trial Exs. 37, 59.

237. As these facts demonstrate, the royalty revenues earned by the record companies on account of Sirius XM performances on its satellite radio service are relatively insignificant to the industry's bottom line; any increase or decrease in the rate would represent a "small difference . . . in the generation of revenue for the record industry." 6/5/12 Tr. 224:15-225:5 (Noll). Maintaining or even reducing the current royalty rate is unlikely to impact the record industry's incentive to produce creative works. *See id.* Indeed, the record facts amply demonstrate that it is not sound recording performance royalties that are the life-blood of record

companies, but rather the sale of sound recordings, in both digital and physical form. *See* Sirius XM Dir. Trial Ex. 25 [redacted]; Sirius XM Dir. Trial Exs. 33-34 [redacted].

3. Airplay On Sirius XM Promotes Record Sales

238. Beyond simply the royalties paid, a service's performance of sound recordings may also affect the total revenue of the record companies by promoting or substituting for the sale of sound recordings, whether in physical (*e.g.*, CDs) or digital form. *See* Noll RAWDT p. 20. As Professor Noll explained, this promotion and substitution effect plays into Section 801(b)'s "availability" factor because, to the extent a promotional effect on the sale of sound records can be shown, it results in a "pecuniary externality to the record industry" – *i.e.*, additional revenues to the record industry not only from royalties, but also from a different source (sales revenue), that flow to the creation of new recordings. *See* 6/5/12 Tr. 225:6-226:18 (Noll).

239. The evidence demonstrates that the performance of sound recordings on Sirius XM's satellite radio service is highly correlated with record sales. *See, e.g.*, 6/8/12 Tr. 993:1-17 (Blatter). Professor Noll, after reviwing Mr. Blatter's testimony, as well as studies conducted by record companies and their trade associations, concluded: "consumers of Sirius XM are more likely to buy music in other forms than they would have . . . had they not subscribed to Sirius XM. So that would be a promotional effect." 6/5/12 Tr. 226:19-227:15 (Noll). In fact, as terrestrial radio has become increasingly less diverse, Sirius XM provides access to genres and

other content on its music channels that is not available elsewhere – in some cases, becoming the only way consumers learn about music and new releases in those genres. *Id.* at 228:17-230:14.

240. The conclusion that Sirius XM airplay promotes record sales is also supported by feedback Sirius XM receives directly from artists and labels; by other conduct of artists and labels that demonstrates their understanding that airplay promotes their music (including participation in special programs, artists' channels, and advertisements in trade publications); and, most important, by industry-standard data correlating airplay on Sirius XM with nationwide increases in record sales.

a. Record Companies Aggressively Seek Airplay On Sirius XM Because Of Its Promotional Value

241. Consumers can be exposed to music in a variety of ways, but radio airplay is generally considered to be the biggest driver of record sales. Blatter WDT ¶ 47. Record companies recognize that it is difficult for an album or song to be successful without extensive radio airplay; accordingly, they make major investments to secure airplay for their songs, including in entire marketing and promotional operations tasked with obtaining radio airplay and hiring independent record promoters to encourage programmers to play their music. *Id.* at ¶¶ 47-48; *see also* 6/5/12 Tr. 228:17-230:14 (Noll) (noting record companies "wouldn't do that if it weren't for the fact they believed it's promotional").[56]

242. Consistent with decades of practice in the terrestrial radio context, record companies encourage Sirius XM to play their sound recordings by providing free copies of

[56] In the past, record companies went so far as to use "payola" – cash payments and other gifts – to induce radio stations to play their recordings. Noll RAWDT p. 21. As Professor Noll explains, taking such actions (and risking FCC sanctions) would make no sense if record companies did not believe radio airplay would lead to greater sales of sound recordings. *Id.* at pp. 21-22. This is particularly so given the fact that terrestrial radio does not pay royalties to the recording industry for its performance of sound recordings, so promotional effect on sales would be the only rational reason to act in this manner. *See, e.g.*, Blatter WDT ¶ 47.

recordings, providing promotional materials for new releases, and making artists available for interviews. Blatter WDT ¶ 48; Noll RAWDT p. 21. In recognition of the promotional benefits of airtime on Sirius XM's music channels, artists and/or their record labels also are often willing to grant waivers of certain of the Section 114 statutory license restrictions. Blatter WDT ¶ 51 and Ex. 40. These waivers relieve Sirius XM of the Digital Millennium Copyright Act's performance complement, which restricts the number of times a song may be played within a given period of time. *See id.* at ¶ 51. Artists and record labels grant these waivers because "they recognize, by [Sirius XM's] ability to play more music from that particular artist, it's going to subsequently lead to more record sales." 6/8/12 Tr. 987:8-13 (Blatter); Blatter WDT ¶ 51.

243. Sirius XM, for its part, goes to great lengths to develop channel brands, identify meaningful music selections and develop relationships between on-air talent and Sirius XM listeners. Record companies and artists recognize the value of Sirius XM's channel brands, and acknowledge that airplay on a Sirius XM channel connects with listeners in a more engaging manner than other audio content providers. As a result, they view satellite radio as an important promotional vehicle for the sound recording industry. Blatter WDT ¶ 46; 6/8/12 Tr. 988:9-989:20 (Blatter).

244. Indeed, the industry has become increasingly vocal in acknowledging the benefits that exposure of their works on Sirius XM has had on digital sales of those works. Blatter WDT ¶ 60; 6/8/12 Tr. 992:1-22 (Blatter). Steven Blatter offered just a small sample of the feedback that Sirius XM has received, including labels' saying that:

- "sales are pretty spread out around the nation, *which I am attributing to [Sirius XM's] airplay*," Blatter WDT ¶ 61 and Ex. 42;
- sales increases "*[s]eem[] to coincide[] pretty well with [Sirius XM's] airplay.* Other stations just starting to play," *id.* at ¶ 62 and Ex.43; and

- "You guys re-engaged and my single sales doubled this week! *It's rare that I can directly correlate my sales like that.* You're the best!" *id.* at ¶ 63 and Ex. 44.

See also id. at ¶¶ 64-65 and Exs. 45-47, 50.

245. Record labels also often publicize airplay on Sirius XM – which regularly occurs before any other radio station picks up a song – in an effort to promote individual artists and songs and influence programmers on more mainstream terrestrial radio stations and other media outlets to play the works as well. *Id.* at ¶ 49 and Ex. 36; 6/8/12 Tr. 989:21-991:6 (Blatter).

b. Sirius XM Provides An Enormous Promotional Opportunity For Both Emerging Artists And Established Artists

246. In addition to regular airplay on Sirius XM's music platform, there are numerous other promotional benefits of arrangements with Sirius XM for artists and labels. For example, Sirius XM has developed "artist channels," which are either entirely devoted to one artist's music (for example, Elvis Radio, which plays exclusively music from Elvis Presley) or features the music of several artists of a similar type or style (*i.e.*, Jimmy Buffett's Radio Margaritaville). Blatter WDT ¶¶ 53-54; 6/8/12 Tr. 982:13-983:5 (Blatter). Among other benefits, artist channels allow Sirius XM to provide additional promotion to legacy artists whose music is no longer played regularly on terrestrial radio. Blatter WDT ¶ 54.

247. Artists are willing to participate in – and often seek out – such channels in part because "they see it as another creative vehicle . . . to express themselves," but mostly because "they see the promotional value of having their own radio station on a national satellite network." *Id.* at 983:12-21. Dedicated channels enable artists (particularly legacy artists) to generate more interest in the sale of their recorded music, promote upcoming concert tours, and the like. 6/8/12 Tr. 983:22-984:7 (Blatter); *see also* Blatter WDT ¶ 55.

248. In addition to full-time artist channels, artists and labels often ask Sirius XM to create artist-themed "pop-up" channels, which are programmed similarly to full-time artist channels but on a limited-run basis. Blatter WDT ¶¶ 56-58; 6/8/12 Tr. 984:8-20 (Blatter). As Mr. Blatter explained, pop-up channels help generate sales in older catalogs of music that may not otherwise receive much promotional exposure. Blatter WDT ¶¶ 56, 58; 6/8/12 Tr. 984:21-985:11, 987:14-988:8 (Blatter).

c. Sirius XM Offers Unique Promotional Benefits, In-Studio Interviews And Live Performances

249. Sirius XM can efficiently reach millions of listeners on a national scale, providing marketing and promotional opportunities that are unique to satellite radio and not available on terrestrial radio. Blatter WDT ¶ 38. These promotional benefits include:

- hosting special programming such as live performances, interviews, question-and-answer sessions with fans, and guest DJ sessions,[57] *id.* at ¶¶ 39, 52 and Ex. 35;
- national on-air promotion of artist-specific programs or contests, typically revolving around a new album release, *id.* at ¶ 40;
- retail marketing, including point-of purchase materials featuring an artist and/or song; *id.* at ¶ 41;
- direct marketing through email newsletters or dedicated email blasts distributed to subscribers nationwide, *id.* at ¶ 42;
- online promotion using Sirius XM's website social media presence, *id.* at ¶ 43;
- press releases and other publicity announcing launches of special programs, *id.* at ¶ 44; and
- national contests created to promote an artist's event, *id.* at ¶ 45.

[57] To further heighten the promotional value of such special appearances, artists – with such notable examples as Aretha Franklin, Carrie Underwood, Queen Latifah, and Lady Antebellum – regularly grant Sirius XM the right to use their name, image and likeness and any recordings of the interview or appearance. Blatter WDT ¶ 52 and Ex. 41.

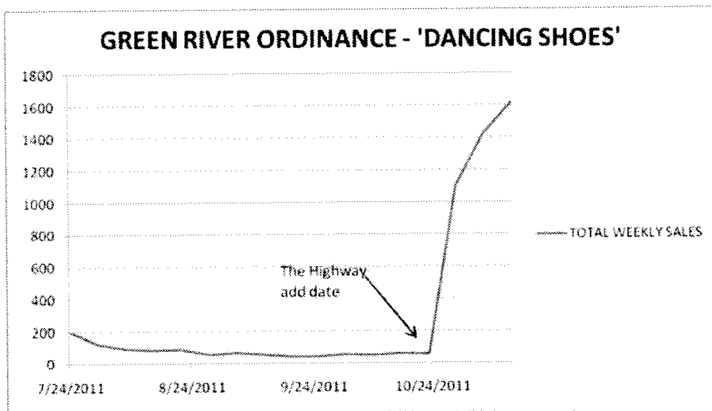
d. Industry Data Prove That Airplay On Sirius XM Promotes The Sale Of Sound Recordings

250. Industry data tracking record sales and radio airplay demonstrates conclusively that airplay on Sirius XM leads to increased record sales.

251. As but one of the many examples provided by Mr. Blatter, the song "Dancing Shoes" by Green River Ordinance shows the clear effect Sirius XM airplay has on digital record sales. Data from MediaBase (one of the primary firms that monitor radio station airplay in America) show that Sirius XM's country music channel, The Highway, became the first and only radio station to play "Dancing Shoes" on October 24, 2011. Blatter WDT ¶ 72 and Ex. 53 at 1; 6/8/12 Tr. 993:1-17, 994:3-995:6, 996:3-998:5 (Blatter); *see also* Blatter WDT ¶¶ 67-73 and Exs. 47-56; 6/8/12 Tr. 995:7-996:2 (Blatter) (noting examples cited in testimony "are just actually a small handful" and "[t]here are numerous other stories like this"). The Highway remained the only channel in America playing "Dancing Shoes" the following week. *See* 6/8/12 Tr. 998:7-21 (Blatter).

252. The corresponding data from SoundScan (an industry-standard source that provides weekly digital sales data on a by-track or by-album basis throughout the country) for "Dancing Shoes" show sales of the track increased dramatically following its airplay on The Highway. *See* Blatter WDT ¶¶ 66, 72; 6/8/12 Tr. 993:1-17, 994:3-995:6 (Blatter). Specifically, during the week ending October 23, 2011 – the week before The Highway picked up "Dancing Shoes" – the track sold 58 digital copies, but during the week ending October 30, 2011 – the week during which The Highway played "Dancing Shoes" for the first time – digital sales of the track skyrocketed to 1,105 copies, a *999% increase*, when no other radio station was playing the song. Blatter WDT ¶ 72 and Exs. 53-54; 6/8/12 Tr. 998:22-1000:22 (Blatter). The following week the track sold 1,426 copies, a further increase of 29%. Blatter WDT ¶ 72 and Ex. 54;

6/8/12 Tr. 1001:1-10 (Blatter). As the SoundScan data show, these sales were spread relatively evenly throughout the country, consistent with Sirius XM's national reach. *See id.* The upward trajectory in sales after Sirius XM picked up "Dancing Shoes" is presented graphically as follows:



e. SoundExchange's Witnesses Representing The Recording Industry Conceded That Satellite Radio Provides A Unique Promotional Venue

253. The record contains myriad instances of record labels actually espousing the conclusion that Sirius XM airplay promotes record sales. For example, SoundExchange's witness Darius Van Arman, co-owner of several independent record labels, conceded that "one of the goals of [his labels'] promotional activities [is] to get [his] artists airplay . . . includ[ing] airplay on Sirius XM." 6/15/12 Tr. 2557:4-9 (Van Arman).[58]

254. Similarly, a survey by the NPD Group for the RIAA, which examines the effect of satellite radio on purchases of music, stated it best, concluding that satellite radio causes

[58] Mr. Van Arman also discussed promotional activities undertaken by artists signed to his record labels on Sirius XM's station Sirius XMU, including Bon Iver's week-long co-hosting stint leading up to release of their self-titled album in June 2011 (which debuted at #2) and Here We Go Magic's live studio performance that aired in June 2012. On the very day Mr. Van Arman gave live testimony in the direct-phase hearings, his artist Yeasayer was at Sirius XM taping the premier of its new single. 6/15/12 Tr. 2557:10-2559:8 (Van Arman).

"[redacted]" which "[redacted]" Noll RAWDT pp. 20-21.

255. Despite SoundExchange's refrain that Sirius XM's satellite radio service substitutes for record sales, it produced no witness, and adduced no evidence, to refute the conclusion that airplay on Sirius XM is in fact promotional of record sales. Warner Music Group's Stephen Bryan, for example, acknowledged that he was not aware of any research conducted by WMG that showed the impact of any supposed substitution by Sirius XM. 6/13/12 Tr. 2036:11-2037:16 (Bryan). UMG's Charles Ciongoli also conceded that he had not seen any studies that proved any substitutional effect of satellite radio airplay on record sales. *See* 6/13/12 Tr. 2095:16-2099:20 (Ciongoli).

256. Apparently acknowledging its lack of evidence that Sirius XM's satellite radio service substitutes for record sales, SoundExchange designated testimony of witnesses from the *Satellite I* proceeding who, nearly five years ago and without any supporting data, opined on that score. *See* SX Trial Exs. 403-409 (designated testimony of Mark Eisenberg); SX Trial Exs. 412-413 (designated testimony of Lawrence Kenswil). However, that outdated testimony, like the current testimony of Messrs. Ciongoli and Bryan, is replete with bald assertions of the witnesses' personal opinions, without any evidence to support it. *See* SX Trial Ex. 403 at 8-13; SX Trial Ex. 407 at 11-12; SX Trial Ex. 412 at 3-5. As the Judges have previously determined, "mere assertion[s]" that airplay is substitutional "without more is insufficient," *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4095; indeed, this same designated testimony was held to be "neither adequately supported nor quantified in the record," *id.* at 4096. In short, the designated testimony of Messrs. Eisenberg and Kenswil was not persuasive in the last

proceeding and certainly cannot, by definition, rebut the evidence of Sirius XM's promotional effect on record sales presented in this proceeding.

4. Interactive Subscription Services On Which SoundExchange Relies As Its Sole Benchmark Lack Any Promotional Effect On Record Sales

257. In stark contrast to the promotional value of Sirius XM airplay, the interactive Internet subscription services that SoundExchange offers as a benchmark have no promotional effect – and, in fact, are likely to substitute for the purchase of sound recordings because "[o]n-demand services let customers play a specific recording on request, allowing the same control over play sequence that customers have in playing recordings from personal libraries." Noll RAWDT p. 22; *see also* 6/5/12 Tr. 227:16-228:16 (Noll) (noting "there's no question" that interactive subscription services have no promotional impact on record sales).

258. As the record industry group A2IM conceded in a public statement: "the effect on other revenue streams of . . . interactive [streaming services] has been the subject of numerous research reports; some noting *interactive streams of music may in some cases have a revenue replacement effect while non-interactive digital broadcasts of music in many cases may prove to be promotional and lead to increased revenues* from other sources." Sirius XM Dir. Trial Ex. 4 (emphasis added). One such example was a joint study by NPD Group and the National Association of Recording Merchandisers (NARM) that concluded that on-demand services detract from sales of sound recordings. Noll RAWDT p. 23.[59]

259. Internal Warner documents corroborate this conclusion. In a draft presentation to its board of directors, titled [redacted]

[59] In response to this study, ST Holdings, which owns about 200 record labels, notified interactive services Spotify, Napster, Rdio and Simfy that it would no longer permit its recordings to be included on their services due to their detrimental effect on sales. Noll RAWDT p. 23 (citing Corey Tate, "Rdio, Spotify and Napster Lose 200 Record Labels Due to NARM Study," Spacelab, November 19, 2011, at http://www.thespacelab.tv/spaceLAB/2011/ 11November/ MusicNews-064-Rdio-Spotify-Napster-NARM-NPD.htm).

[redacted] *See* PSS Ex. 7 at 29; 6/13/12 Tr. 2058:8-11 (Bryan). As part of the analysis, [redacted] PSS Ex. 7 at 29; 6/13/12 Tr. 2058:12-2059:2, 2059:10-16 (Bryan). The same document states that [redacted]" PSS Ex. 7 at 30; 6/13/12 Tr. 2059:17-2060:5 (Bryan). Mr. Bryan conceded that [redacted] 6/13/12 Tr. 2060:6-13 (Bryan).

260. In another internal document [redacted] PSS Ex. 8 at 3; 6/13/12 Tr. 2061:16-2063:1 (Bryan).

* * *

261. In sum, the record compellingly demonstrates the important contribution Sirius XM makes to maximizing, on a nationwide basis, the availability of music content that cannot otherwise be heard on the radio. SoundExchange has produced no evidence to rebut Sirius XM's showing or to conclude that a rate increase is warranted based on the availability factor. The evidence also amply supports the conclusions that Sirius XM's satellite radio service is promotional of record sales for the sound recordings that it performs, and that a lower royalty rate will not adversely affect the record industry's incentive to produce creative works. All of these elements, when taken in conjunction with the other Section 801(b) factors, counsel in favor

of selecting a royalty rate towards the lower end of the range of reasonable rates. *See* 6/5/12 Tr. 230:17-232:3 (Noll).

B. The Rate At The Lower End Of The Range Of Reasonable Rates Will Best Afford A Fair Return To The Copyright Owners And A Fair Income To Sirius XM

262. Section 801(b)(1)'s second policy objective requires that royalty rates be set so as "[t]o afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions." 17 U.S.C. § 801(b)(1)(B). "The ultimate question [under this statutory factor] is whether it is necessary to adjust the result indicated by marketplace evidence in order to achieve this policy objective and, if so, is there sufficient evidence available to do so." *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4095.

263. As Professor Noll explained, the implementation of this factor requires assessing whether the royalty rate allows both the buyer (Sirius XM) and the sellers (the record labels) to recover their costs, including the financial cost of capital used to make investments. Sirius XM's investments include not only the physical investments in satellites and vehicle receivers, but also the research and development that was undertaken to create a satellite radio system, the costs of obtaining authorization from the FCC to launch the satellite service, and the operating losses that were incurred in initiating the system. Noll RAWDT pp. 23-24. Sirius XM's costs must be measured cumulatively, not as a snapshot of annual operating costs. Simply put, a rate fails to satisfy the fair return statutory factor if it expropriates the investments of Sirius XM while allowing record companies to earn profits in excess of the return that is necessary to be profitable. Noll RWRT p. 54; *see also* Salinger CWRT ¶ 37.

264. The evidence clearly demonstrates that Sirius XM is still a long way from earning any return – let alone a fair one – on its billions of dollars of investments. SoundExchange, on

the other hand, has presented no evidence that the record industry is not currently earning a fair return on its investments in the production of creative works, nor that any upward adjustment in Sirius XM's royalty rates is justified in order to permit the record industry to earn a fair return.

265. SoundExchange makes much of the fact that Sirius XM is now on sound financial footing and, according to its own public statements, expects its revenues to exceed its operating costs for at least the next 12 to 18 months. Yet, as the trial record demonstrates, that presentation entirely ignores the enormous investments made by Sirius XM (and its predecessors) to date – not least of which is its accumulated net operating losses of approximately $8 billion. Frear WDT ¶ 18. As of September 30, 2011, Sirius XM had amassed a cumulative free cash flow of negative $5.5 billion and a cumulative EBITDA of negative $3.7 billion. *Id.* Even if the Company is able to continue its recent trend of profitability, Mr. Frear explained, it will be years before Sirius XM recoups all of its losses from the last two decades; thus, any increase to those costs, such as an increase in the SoundExchange royalty rate, will only lengthen the time it takes to recoup these losses and directly interfere with Sirius XM's ability to achieve a fair return on its investments. *Id.*; *see also* 6/7/12 Tr. 658:8-659:11 (Frear).

266. The record companies, meanwhile, have earned and will continue to earn hundreds of millions of dollars from Sirius XM under the prevailing statutory royalty rate. Mr. Karmazin put it best: "After two decades of substantial losses, even our recent profitability hardly makes a dent in recovering the several billions of dollars in capital that were invested to launch Sirius and XM and bring the Company to where it is now. Over the last five-year licensing period, Sirius XM's made no money net of its costs – while, by the end of the current licensing period in 2012, it will have paid the recording industry nearly [redacted] in royalties." Karmazin WDT ¶ 43.

267. Ignoring these billions in investments and losses which Sirius XM and its stockholders endured for years in an effort to create a profitable enterprise – as SoundExchange would do – constitutes bad public policy because it deters future services that would make use of sound recording performance rights if they expect to face significant early losses in building a market for their product from coming into existence. *See* Noll RAWDT pp. 24-25. It is also contrary to the position taken by SoundExchange's own witness - Charles Ciongoli of Universal Music Group. In his view, at least when it is the investments of Universal that are on the line, it is critical that they be able to recoup their investments and earn an appropriate rate of return on that invested capital. 6/13/12 Tr. 2146:15-2147:7 (Ciongoli): ("[redacted]"). Sirius XM only asks for the same treatment.

268. Further delaying a fair return to Sirius XM through yet another royalty rate increase cannot be justified by the need to provide a fair income to the record industry. Contrary to Sirius XM's decades-long struggles to earn a positive income (much less a fair return on investment), SoundExchange for its part has adduced no evidence to indicate that the record industry is not currently earning a fair return on its investments or that any adjustment in the rate is required to ensure that it does. The only testimony submitted in this regard was that of UMG's Mr. Ciongoli, who testified regarding his belief that royalties from Sirius XM must be increased to help make up for a decrease in revenues as the result of what he terms the "digital revolution"

– *i.e.*, the shift from physical sound recordings to digital products and services. *See* Ciongoli CWDT pp. 2-8; 6/13/12 Tr. 2105:6-14, 2125:7-18 (Ciongoli). But declining sales does not mean that UMG is failing to earn a fair income at current sales levels. As Mr. Ciongoli conceded, UMG has made a profit in every year between 2005 and 2011, and is projected to continue to make a profit in each year from 2012 through 2016. Sirius XM Dir. Trial Exs. 37-38; 6/13/12 Tr. 2125:19-2126:1, 2127:8-2128:13, 2129:1-2131:17 (Ciongoli).

269. Mr. Ciongoli testified that UMG had a total of [redacted] in revenues in 2010 and spent [redacted] "to create, market, and distribute recorded music (including compensation to composers)." Ciongoli CWDT pp. 7-8. Accordingly, UMG earned a profit of [redacted] in 2010 – about [redacted] of its total revenues. Noll RWRT p. 54. "Thus, the lower bound on keeping Universal financially viable is a rate that is substantially less than the current rate." *Id.*

270. Additionally, Mr. Ciongoli conceded that declining revenues as a result of the so-called "digital revolution" are at least partially offset by declining costs in virtually every category, including manufacturing, distribution and marketing. Sirius XM Dir. Trial Exs. 32, 36; 6/13/12 Tr. 2109:3-13, 2010:1-2111:7, 2113:1-6, 2123:9-14 (Ciongoli). From 2013-2016, UMG projects decreased costs of sales but increased gross margins every year. *See* Sirius XM Dir. Trial Ex. 38; 6/13/12 Tr. 2130:5-2131:17 (Ciongoli). Despite all of UMG's claimed financial distress and suggestions that royalty rates must be increased to supplement UMG's lost revenues,[60] it in fact already is earning more than a fair return based on the existing royalty rate.

[60] Despite Mr. Ciongoli's numerous complaints about the rise of digital distribution, physical album sales by UMG still account for several times the amount of sales as digital albums. *See* 6/13/12 Tr. 2108:7-2109:2 (Ciongoli). Similarly, while Mr. Ciongoli laments that consumers have begun to purchase singles instead of albums, in reality, most of UMG's sales revenues come from album sales, and overall album sales actually increased in 2011 over 2010 for both UMG and the record industry as a whole. *See id.* at 2106:3-2107:3; *see also* Sirius XM Dir. Trial Exs 30-31.

271. Notably, neither SoundExchange's proposed increase nor Sirius XM's proposed decrease in royalties will materially impact UMG's financial picture. *See* Noll RWRT p. 54 ("Universal would be viable if it received no royalties from Sirius XM."). As discussed in Section IV.A.2, *supra*, UMG's (and other record companies') receipts from SoundExchange for SDARS royalties are so insignificant in the overall scheme of their respective businesses that a determination to maintain royalty rates at current levels or even to decrease them would have no discernible effect on the record industry's bottom line – certainly not an impact that would justify depriving Sirius XM of a fair return on investment. *See also* Sirius XM Dir. Trial Exs. 25, 37, 39, 59; 6/13/12 Tr. 2005:4-2006:6, 2008:1-5 (Bryan); 6/13/12 Tr. 2136:9-12, 2137:17-2139:3, 2141:11-2145:11 (Ciongoli).

272. Moreover, while record companies may be adjusting their business models in the face of a changing landscape of technology and consumer preferences, SoundExchange has put forward no evidence whatsoever that suggests that Sirius XM should be responsible for subsidizing an obsolete business model. Sirius XM should not be put to the task of supporting or making up for losses experienced by the recording industry that are unrelated to Sirius XM – as Mr. Ciongoli testified, there are no additional or incremental costs associated with creating digital sound recordings that are attributable to their performance on Sirius XM.[61] *See* 6/13/12 Tr. 2120:15-22 (Ciongoli) ("I don't believe there is an increased cost to put [digital sound recordings] up on satellite."). This is particularly true where the industry continues to receive a fair return at current sales levels and the record shows that Sirius XM actually *promotes* record

[61] Indeed, nearly all of the costs that Mr. Ciongoli sets forth in his testimony (for manufacturing, distribution and marketing, among other things) are incurred for the purpose of selling records, not for the purpose of having sound recordings performed on Sirius XM's satellite radio service. *See* 6/13/12 Tr. 2118:19-2119:20, 2120:15-22, 2122:3-13 (Ciongoli).

sales and thus contributes to the bottom line of the record companies through sales as well as royalties. *See* Section IV.A.3, *supra.*

273. In short, that the record industry is earning less revenue as a result of consumers' preference for digital consumption as opposed to purchase of physical products has not been shown to have any bearing on the setting of the rate in this proceeding.

* * *

274. In sum, SoundExchange has failed to adduce any evidence that current rates must be increased to ensure the record industry earns a fair return – all available evidence indicates the record companies are and have been earning a fair return over the entirety of the previous license term, and are expected to continue to do so for the next license term as well. Sirius XM, on the other hand, has decades of cumulative losses and, as Mr. Frear and Professor Stowell testified, Sirius XM's ability to finally earn a return on its investments would only be further frustrated were SoundExchange awarded an increase in the prevailing royalty rate. A high percentage of Sirius XM's current revenues is consumed by such royalty payments, hampering its ability to earn a return on its investments, while the record industry already earns a fair income, so this policy objective, when considered in conjunction with the other Section 801(b) factors, counsels in favor of selecting a royalty rate towards the lower end of the range of reasonable rates. Stowell WDT ¶ 33 and Ex. 5.

C. The Relative Contribution Factor Also Weighs In Favor Of A Rate At The Lower End Of The Range Of Reasonable Rates

275. Section 801(b)(1)'s third policy objective is to account for the relative roles of copyright owners and users in making the product "available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk and contribution

to the opening of new markets for creative expression and media for their communication." 17 U.S.C. § 801(b)(1)(C).

276. As Professor Noll explained, the economic implementation of the relative contribution factor requires taking account of the costs and creative contributions of the owner and the user of the sound recording performance rights. Noll RAWDT p. 24. Likewise, Professor Salinger testified that "Sirius XM's main role in making satellite radio available was to develop the necessary technology, to pay for the satellites and terrestrial repeaters, and to subsidize placement of receivers in automobiles. The third statutory criterion says that the rate the CRB sets should reflect this contribution, which presumably means that it should recognize that part of the monthly Sirius XM subscriber fee should compensate Sirius XM for this contribution." Salinger CWRT ¶ 33.

277. Professor Noll's testimony demonstrated how, in practice, Sirius XM's relative contributions can be taken into account in rate-setting. Specifically, when using the royalty rate paid by an Internet-based music service as a benchmark for setting royalty rates for Sirius XM, one must first identify the contributions that are unique to Sirius XM (as described in Section 1 below) and then compare these contributions to those made by the Internet-based services that are being proposed as a benchmark (as described in Section 2 below). Noll RAWDT pp. 25-26; 8/14/2012 Tr. 3463:13-3464:8 (Noll) (contrasting Sirius XM's development of its delivery system as compared to Internet-based services that neither developed nor have to pay for the Internet, wireless networks, nor computers/smartphones on which their services are received).

278. To date, Sirius XM has spent over $10 billion in creating and supporting its service – capital costs that have not been recovered. Karmazin WDT ¶¶ 8-9. Sirius XM's

massive contributions only continue to increase, and far outweigh those made by the Internet-based services that serve as benchmarks for setting royalty rates for Sirius XM.

279. SoundExchange, on the other hand, has presented no evidence that even remotely suggests that the relative contribution of the record labels has changed in any meaningful way since rates were last set in the *Satellite I* proceeding, and has certainly made no showing that would justify the substantial rate increase that SoundExchange seeks here. In addition, SoundExchange has presented no evidence that suggests that the contribution made by the record labels to Sirius XM differs in any way from the contribution made by the record labels to the Internet-based music services that have been proposed as benchmarks in this proceeding. Thus, so long as the record labels receive essentially the same per-subscriber royalty as they receive from the services that are most similar to Sirius XM, exactly as Professor Noll has proposed, they cannot be heard to complain that they are receiving anything less than their full contribution. 8/16/12 Tr. 3840:2-3842:4 (Salinger).

1. Sirius And XM's Contribution Was To Create An Industry At Enormous Expense

280. Sirius XM's predecessor companies, Sirius and XM, created a new satellite-based audio entertainment business delivered to vehicles and handheld receivers, by expending years of effort and investing billions of dollars in an unproven technology and business before receiving a single subscriber dollar. *See* Parsons DWDT ¶ 5; Karmazin DWDT ¶ 3. *See also* Section I.A, *supra* (discussing the hurdles overcome by both companies in convincing the FCC that the idea of satellite radio even made sense, securing licenses, raising capital and building the necessary technological infrastructure).

281. When Sirius and XM undertook the risky and costly endeavor to develop a new means of delivering sound recordings to the public, they quickly realized that the ubiquity of

music – especially free music offered by terrestrial radio stations – required a new business strategy if Sirius and XM were to be successful in getting consumers to pay a subscriber fee for their services. To that end, Sirius and XM went to great lengths to creatively enhance the presentation of sound recordings by developing unique programing offerings and compelling (and often exclusive) non-music content. *See* Karmazin WDT ¶¶ 20-25; Karmazin DWDT ¶ 3 ("Even when we program music, we incur substantial costs to add significant value to that music."), ¶¶ 40-47; Parsons DWDT ¶¶ 2, 24-28, 30-32. The need to deliver superior programming remains as compelling today and Sirius XM continues to invest in making such creative contributions. Karmazin WDT ¶ 20; *see* Section I.B.5, *supra* (discussing Sirius XM's ongoing efforts to deliver unique music and non-music programming).

282. In addition, Sirius and XM built the entire infrastructure necessary to sustain two reliable satellite digital audio radio services from scratch, and in doing so, made significant creative, technological and engineering contributions. *See, e.g.*, Karmazin DWDT ¶¶ 3, 53 ("Sirius has built an entirely new audio service for the public… [T]he company has created its own transmission network, from broadcast studio, to uplink, to satellite, to terrestrial repeater, to antennas, chip sets and radios designed specifically for Sirius, all at huge costs."); Smith DWDT ¶¶ 4-5; Parsons DWDT ¶¶ 2, 12 ("XM had to invent, design and build all aspects of the business needed to create and distribute this service.").

283. Sirius spent more than ten years developing what became the world's first commercial satellite broadcast system using non-geostationary orbits. Smith DWDT ¶¶ 7, 9.[62]

[62] The three-satellite system that it developed featured satellites deployed in highly inclined, elliptical orbits on three different planes to ensure that there would always be at least one satellite at a high elevation to minimize blockage and reliance on terrestrial repeaters. Smith DWDT ¶ 7. Although Sirius employed an innovative geosynchronous orbit to reduce the need for an extensive terrestrial repeater network, approximately 140 repeaters were still required to ensure continuous coverage, particularly in dense urban areas. *Id.* at ¶¶ 7, 21-22; Frear DWDT ¶ 16.

Sirius also made significant advances in the area of audio compression that permitted it to deliver more channels simultaneously with better sound quality from the satellites to subscriber's audio receivers. *Id.* at ¶ 19. In addition, Sirius pioneered a system that could receive, decode and decompress satellite signals, and developed technology that allowed the radios to select the strongest signal from any two transmitting satellites or a repeater; the radios could also buffer signals so that the user could hear seamless programming even if all satellite signals were momentarily blocked. *Id.* at ¶¶ 24-25. Sirius also developed a small, extraordinarily sensitive antenna that could discern a very lower-power signal, just a few decibels above cosmic background radiation. *Id.* at ¶ 26; Karmazin DWDT ¶ 10.

284. XM also developed and launched its own satellites. Masiello DWDT ¶ 24. It recognized that the commercial communications satellites in existence at the time generally transmitted low-power signals that could be received by stationary dishes of various sizes, but could not be effectively received in moving vehicles. *Id.* at ¶ 24. XM realized that it needed satellites "capable of blanketing the country with an extremely high power signal" and accordingly developed a complex system using geostationary satellites. *Id.* at ¶¶ 24-25. XM initially launched two satellites with two transponders each, as having multiple satellites and transponders would help to make reception more robust. *Id.* at ¶ 25.

285. Terrestrial repeaters also were developed as a central aspect of the XM system. *Id.* at ¶ 21 ("Our system, which was initially designed entirely on paper, included repeaters from the outset . . . XM had to participate in the design of the repeaters, as satellite radio was the first . . . satellite based service that uses S-band repeaters this extensively."). XM employed a network of approximately 800 terrestrial repeaters to receive its signal, amplify it, and retransmit it at a higher strength to overcome any obstructions. *Id.* at ¶ 20. In addition, XM designed all

aspects of the radios used to receive the XM signal, including the chipsets, the "XM stack" (the software used to control hardware, tune channels and display information), and the antenna, evolving these radio elements over time to provide additional functionality in a much smaller format. *Id.* at ¶¶ 30-34, 40 ("In less than five years, XM not only released the first satellite radio receivers, we reduced the size of the entire radio – including the chipset and antenna – to a device that could fit in the palm of a subscriber's hand.").

286. Such contributions continued after the merger of Sirius and XM as the combined entity has continued to develop and maintain its satellite networks and terrestrial repeaters; has continued to innovate with respect to its chipsets, receiver products, and broadcast facilities; and has continued to improve its content offerings (both music and non-music). Meyer WDT ¶ 46; Karmazin WDT ¶ 20.

2. Sirius XM Continues To Innovate And Contribute To The Development Of The Industry Today

287. Technological developments aimed at helping the Company to remain relevant in an increasingly competitive marketplace will continue through the next licensing term. *See* Meyer WDT ¶¶ 45, 47-48; Frear WDT ¶¶ 38-39 (discussing the need for ongoing research and development to improve product offerings and remain competitive). Sirius XM anticipates investing more than [redacted] just to maintain, upgrade and, where necessary, replace its technological infrastructure during the 2013-2017 period. Karmazin WDT ¶ 10.

288. The delivery of content via satellite remains an expensive and inherently risky endeavor. Meyer WDT ¶¶ 49, 51; 6/7/12 Tr. 661:16-663:5 (Frear). Sirius XM still operates and maintains the former Sirius and XM legacy systems and it will continue to do so for the indefinite future. Meyer WDT ¶ 9; 6/6/12 Tr. 529:9-531:11 (Meyer). The dual-system approach

is necessitated by the fact that millions of installed satellite radios are capable of receiving only one service or the other. Meyer WDT ¶ 9; 6/6/12 Tr. 529:9-531:11 (Meyer).

289. Maintaining and updating this dual-network system requires Sirius XM to engage in continuing technological innovation. Over the past six years, the Company has spent approximately $1.5 billion replenishing the satellites in the Sirius and XM systems. Meyer WDT ¶ 49. Today, there are four satellites in the XM constellation, including the two original XM satellites, which are only expected to be useful for a few more years, and two replacement satellites that were launched in 2005 and 2006. *Id.* at ¶ 50; 6/6/12 Tr. 531:22-532:22 (Meyer). In the Sirius constellation, there are four satellites, three of which are dying. Meyer WDT ¶ 50; 6/6/12 Tr. 531:22-532:22 (Meyer). The fourth satellite was launched in 2009 and a fifth satellite, which was originally expected to launch in late 2012, is now expected to launch in early 2013. *See* Meyer WDT ¶ 50; 6/6/12 Tr. 531:22-532:22 (Meyer); 6/7/12 Tr. 661:16-663:5 (Frear). A final satellite, called XM-5, is in orbit but not turned on. It was launched in October 2010 to operate as a spare for both the XM and Sirius systems. Meyer WDT ¶ 50; 6/6/12 Tr. 531:22-532:22 (Meyer). Creating a satellite that could function as a spare for either system "took a tremendous amount of work and expense." Meyer WDT ¶ 50.

290. Each satellite requires an investment of approximately $300 million, which includes construction, launch, insurance, capitalized labor and new ground equipment to support telemetry, tracking and command and uplink. *Id.* at ¶ 49; 6/6/12 Tr. 533:1-4 (Meyer). Moreover, Sirius XM must diligently monitor its current satellites, as the sudden and unexpected failure of a satellite can result in a crippling loss of revenue. Meyer WDT ¶ 51; 6/7/12 Tr. 661:16-663:5 (Frear) ("[E]very day, you're dealing with [an] incredibly hostile environment, and the risks are severe if you have a failure. To our business plan, it's potentially catastrophic.").

291. Absent unforeseen circumstances, Sirius XM expects that its newly replenished satellite networks will maintain its services through approximately 2020; however, satellite development requires significant time, planning, and investment. Meyer WDT ¶ 51. In 2016 or 2017, the Company will begin investing in the next generation of satellites. By 2017, Sirius XM plans to have commenced construction of replacement satellites for the XM constellation. *Id.*

292. In addition to its continued investment in its satellites, Sirius XM continues to invest in its repeater network to further improve its product offering. *Id.* at ¶¶ 52-53; 6/6/12 Tr. 529:9-530:3 (Meyer). For example, over the next several years, various components on the XM repeater network will be replaced, Meyer WDT ¶ 53, and, in an effort to improve its signal coverage, Sirius XM plans to increase the number of Sirius repeaters in use. *Id.* at ¶ 54. In addition, Sirius XM is researching the possibility of housing repeaters for the XM and Sirius systems in a single site, an effort that will involve a substantial reengineering of the entire two repeater networks. *Id.* at ¶ 53 n.12.

293. Sirius XM also continues to make innovations in its chipsets and radios. For example, in an effort to remain competitive and increase the programming that can be delivered to its subscribers, Sirius XM has, at a substantial expense, developed new chipsets (the x65H chipset) and radios (the Edge and Lynx radio products as well as others that continue to be developed and will be introduced by the end of 2012). *Id.* at ¶ 57. Today, the chipsets are smaller in size, yet are capable of providing more features and better processing at a lower cost than previous models. *Id.* at ¶ 55.

294. Sirius XM and its predecessors have also had to make substantial incentive payments to OEMs to ensure that their radios are installed in new cars. *See id.* at ¶¶ 35, 41-43; 6/6/12 Tr. 539:9-540:14 (Meyer); Karmazin WDT ¶ 12; Wilsterman DWDT ¶¶ 10-19; Parsons

DWDT ¶¶ 18-19. As Mr. Meyer explained, "[w]ith some exceptions, OEMs generally earn approximately [redacted] of net subscription revenues from their enabled vehicles." Meyer WDT ¶ 42. For contract years 2009-2012, the Company's average annual expenditure on incentives to the OEM market – including revenue shares, commissions, hardware subsidies and marketing costs, has been over [redacted] *Id.* at ¶ 43. While the Company has been able to reduce the revenue share in some agreements and unit installation costs have been improving as well, these expenses are expected to increase in the future as auto volume, revenue share payments, and commissions increase. *Id.* at ¶ 43.

3. Sirius XM's Contributions Are Substantially Greater Than Those Of Its Internet-Based Competitors

295. The costs and risks undertaken by Sirius XM when it invested billions of dollars in creating an entirely new means of delivering sound recordings to the public are not shared by its Internet-based competitors. As Professor Noll explained, Sirius XM "is unlike music services that are delivered over the Internet because the latter do not make the same contributions. Internet-based service providers did not create the information technology that is used to deliver Internet services to consumers." Noll RAWDT p. 26; *see also* Karmazin DWDT ¶ 7 ("I can think of no other audio programming service that has had to invest the kinds of resources we have been required to invest . . . Internet radio certainly did not invent the Internet, did not need to create and build it, did not need to build receivers. . . ."). Consumer electronics companies developed the computers, smartphones, and other reception devices needed to use Internet music services, and consumers separately pay for these devices as well as the high-speed Internet connections necessary to access the programming content. Noll RAWDT p. 26; Meyer WDT ¶ 36; Frear WDT ¶¶ 22-23.

296. Additionally, Sirius XM's Internet-based competitors need not make any payments to OEMs to have their products incorporated into vehicles. Meyer WDT ¶ 35; 6/6/12 Tr. 539:9-540:14 (Meyer). Indeed, automakers have been increasingly eager to incorporate wireless access to audio content because they believe that having such technology will help them to sell more cars. Meyer WDT ¶ 35; *see* Rosenblatt CWDT pp. 14-20.

297. Accordingly, as Professors Noll and Salinger explained, the royalty rate paid by Internet-based music services cannot simply be applied to Sirius XM without a substantial adjustment to account for the different, and greater, contribution made by Sirius XM than that made by the Internet-based services. Noll RAWDT p. 26; Salinger CWRT ¶ 33 and n.12 ("[T]he contribution of [Internet-based music services] is quite different than the contribution of Sirius XM . . . it would therefore be inappropriate to apply the same percentage royalty for the music input.").

298. As Professor Salinger explained, simply applying the percentage-of-revenue rate paid by the benchmark Internet-based music services to the full revenues of Sirius XM without adjustment (to either the rate or the revenue base) would fail to recognize Sirius XM's relative contribution and "would effectively give record labels a share of revenues that have nothing to do with the sound recording rights they are licensing." Salinger CWRT ¶ 18.

299. Professor Noll's approach to adjusting the royalties paid by the Internet-based music services explicitly accounts for Sirius XM's relative contributions. As discussed in greater detail above, *see* Section III.E, *supra*, rather than apply the royalty rate paid by the non-interactive Internet music service that he uses as a benchmark to Sirius XM's per-subscriber revenue, Professor Noll applies the royalty rate paid by the benchmark service to an adjusted revenue base that accounts for Sirius XM's contributions. Noll RAWDT pp. 80-88.

300. Professor Ordover, on the other hand, asserts that one need not make any adjustment to the royalty paid by the interactive Internet-based music services that he proposes as a benchmark to account for the unique contributions made by Sirius XM.[63] Ordover CAWDT ¶¶ 21-22. In an effort to defend this overreaching position, Professor Ordover observes (and therefore asserts as relevant) that Sirius XM's contributions are largely "sunk" investments (the costs of which have already been incurred), and that in competitive market transactions, companies are often unable to earn a return on their "sunk" investments. *Id.* Thus, at least in Professor Ordover's view, so long as the benchmark rate being used to set a rate for Sirius XM is one that is negotiated in a workably competitive marketplace, the Judges need not worry about taking account of Sirius XM's contributions. *Id.*; 6/14/12 Tr. 2338:16-2339:6 (Ordover). To do otherwise, according to Professor Ordover, would be tantamount to guaranteeing Sirius XM a competitive rate of return on its investments. Ordover AWRT ¶ 69 and n. 55.

301. As Professor Salinger explained, this is incorrect. First, Professor Ordover's reading of the third statutory factor renders it effectively meaningless. Sirius XM's primary contributions – such as the innovations in satellite distribution and reception devices that were necessary to make satellite radio possible – are "sunk" investments and there is no way to account for them if the standard is interpreted to mean that the Judges should ignore "sunk" investments. Salinger CWRT ¶¶ 32-33; 8/16/12 Tr. 3808:4-3809:10 (Salinger); *see also* Noll RWRT p. 55 (noting that the relative contribution statutory factor requires that Sirius XM's investments in its distribution platform be taken into account when setting rates.).

[63] As is discussed in greater detail below, *see* Section V.A.2.C, *infra*, in his second alternative approach for determining a royalty rate for Sirius XM, Professor Ordover does make a conceptually appropriate adjustment to account for Sirius XM's unique contributions.

302. Second, a downward adjustment of the royalty rates paid by Internet-based music services to account for Sirius XM's contribution does *not*, as Professor Ordover asserts, guarantee Sirius XM a competitive (or even any) return on these investments. Salinger CWRT ¶ 34; Ordover AWRT ¶ 69 and n. 55. For Sirius XM to earn a competitive rate of return on its investments, it would not only have to reserve a certain portion of its subscriber fee to cover the costs of its investments, but it would also have to attract at least as many subscriber as it anticipated when it made its investments. Salinger CWRT ¶ 34; 8/16/12 Tr. 3809:11-3810:12 (Salinger). This has not happened – in fact, Sirius XM has come nowhere close to attracting the subscriber base it anticipated when it made its initial investments. Salinger CWRT ¶ 34. Thus, accounting for Sirius XM's investments in its distribution platform does not guarantee a competitive rate of return on these investments – it merely recognizes the "fair expectations" of Sirius XM at the time it made its investments. *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4095; Salinger CWRT ¶ 34.

* * *

303. Sirius XM's tremendous contributions – technological developments, capital investments, massive costs, the risks of creating a new industry that serves as a new market for the creative product of the record industry – should be accounted for in setting a royalty rate. In contrast, the record industry does not incur any additional incremental cost in making digital sound recordings available to Sirius XM. Accordingly, this factor, when considered in conjunction with the other Section 801(b) factors, counsels in favor of selecting a royalty rate towards the lower end of the range of reasonable rates.

D. The Company's Past Experience, Combined With The Continued Challenges It Is Likely To Face During The Coming License Term, Counsels In Favor Of A Rate At The Lower End Of The Range Of Reasonable Rates

304. The final 801(b) policy objective is "[t]o minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices." 17 U.S.C. § 801(b)(1)(D). This factor protects the satellite radio industry from license fees that might pose the risk of disruption, the proper evaluation of which requires consideration of both Sirius XM's tumultuous financial history (detailed in Section IV.D.1 below) as well as the increasing risks the Company is likely to face in the coming license term (detailed in Section IV.D.2 below). As Professor Stowell testified, when those risks – in particular the disruptive industry impact of new (and often free) Internet-based competitors – is considered in tandem with the Company's financial history and substantial accumulated losses, it is evident that Sirius XM faces a threat of disruption that is "equal to or even greater than the one it faced at the time of the last rate proceeding." Stowell WDT ¶ 41.

1. Sirius XM's Tumultuous Financial History

a. Sirius XM's Near Brush With Bankruptcy

305. In the immediate aftermath of the July 2008 merger of the formerly separate, Sirius XM struggled with the challenging conditions that had plagued the pre-existing entities. Less than seven months after the merger and less than a year after the close of the *Satellite I* proceeding, Sirius XM nearly filed for bankruptcy. Frear WDT ¶ 8.

306. By late 2008, just months after the merger closed, and in the midst of the credit crisis, Sirius XM had insufficient cash to repay the outstanding balance due on its 2.5% notes that matured on February 17, 2009 (the "2009 Notes"). Frear WDT ¶ 8. In an effort to avert a Chapter 11 bankruptcy, Sirius XM engaged Evercore Partners to assist with raising the financing it needed to pay the 2009 Notes. Stowell WDT ¶ 14. In an effort to obtain such financing before

the February 17, 2009 deadline, Evercore and other investment bankers approached 21 prospective investors, all of whom declined, citing, among other reasons: that the Company had sustained nearly 20 years of losses and continued to experience negative EBITDA; the risky nature of the satellite business; and the threats of emerging competition. Frear WDT ¶¶ 8-9; *see also* Stowell WDT ¶ 14. Part and parcel of these concerns was Sirius XM's dependence on the cyclical, volatile OEM industry, which was itself on the precipice of bankruptcy in late 2008. Frear WDT ¶¶ 8-9.

307. The royalty rate paid by Sirius XM to SoundExchange also was viewed as a significant deterrent to potential providers of capital during Sirius XM's crisis. These royalties represent a very large portion of future EBITDA, Stowell WDT ¶ 15, and, as Professor Stowell explained, impact the Company's credit rating:

> Credit rating agencies look at leverage, how much debt versus equity; but in addition to that and more important than that, they would tell you, is they look at cash that is available to service debt. So to the extent that cash is being claimed by SoundExchange in the form of higher royalty payment, that means there's less cash left over to pay principal and interest for the bondholders ... The less cash that's available to pay principal and interest when due, the more alarming it is to them. And that is what gives rise to a reduction in credit ratings, which, in turn, gives rise to an increase in the cost of credit for the issuer.

6/8/12 Tr. 1228:3-1229:1 (Stowell).

308. Faced with a lack of financing, Sirius XM prepared a Chapter 11 petition to file on the date the 2009 Notes were to come due. Frear WDT ¶¶ 11-12.

309. The day before Sirius XM's planned bankruptcy, Liberty Media agreed to provide a $380 million dollar loan that enabled the Company to avert a bankruptcy and avoid a default on its debt. Frear WDT ¶12; Stowell WDT ¶ 16. Although Sirius XM accepted Liberty Media's offer given the dire circumstances of the Company at the time, the rescue came at a considerable

cost. Stowell WDT ¶ 16. The loans carried an extremely high 15% interest rate, and the Company was required to pay Liberty Media a $30 million restructuring fee, further increasing the effective cost of the loans. *Id.* Liberty received 12.5 million preferred shares of Sirius XM stock that are convertible into approximately 40% of the common stock of the Company (after giving effect to such conversion), so the effect of the bailout was to dilute existing equity shareholders' value by 40%. *Id.* It is therefore highly unlikely that pre-2008 equity investors will ever realize an adequate return on their Sirius XM investments. *Id.*[64]

310. Sirius XM was only days away from defaulting on the very same notes that Mr. Butson, a SoundExchange expert witness in the *Satellite I* proceeding, "conservatively" opined only months earlier it could have readily refinanced at a 10% interest rate. Frear WDT ¶ 10. As Mr. Frear recounted, "I remember Mr. Butson providing expert testimony in the last proceeding on behalf of SoundExchange saying all of our debts could easily be refinanced [at] 10 percent, yet we went into the market seven or eight months after the close of this proceeding, and the bond debt that we raised – the junk bonds that we issued cost us 16 percent. We had to price a convertible bond to finish the refinancing. On the night of the pricing, the stock fell 30 percent. So did we get the financing done? Yeah, we did. The interest rate on it was 7 percent, but the equity option given to those investors, that drove the price of the stock down by 30 percent in a single night. So it was incredibly expensive financing." 6/7/12 Tr. 649:15-653:2 (Frear).

[64] On September 15, 2009, Sirius XM received a delisting notice from NASDAQ because its common stock had closed below $1.00 per share for 30 consecutive days and was therefore not in compliance with the NASDAQ Marketplace Rules. Frear WDT ¶ 16. The stock price still has not recovered; the share price at the time of the hearing remained substantially below its January 2007 market price. *Id.* Consequently, investors who purchased stock in January 2007 have lost over 50% of their investment and those who purchased stock in February 2000 have lost over 97% of their investment. *Id.*; *see also* Stowell WRT Ex. 42 at 23 (comparing performance of $100 invested in Sirius XM since 2006 to $100 invested in the NASDAQ Telecommunications Index and S&P 500 Index and reflecting that as of December 31, 2011, a $100 investment in Sirius XM would be worth $51.41).

b. The Company's Recent Financial Success In Perspective

311. After nearly 20 years of losses and following the Company's near bankruptcy experience, Sirius XM achieved positive annual Free Cash Flow and EBITDA for the first time in 2009 and it reported positive annual net income for the first time in 2010. Frear WDT ¶ 17; *see also* 6/7/12 Tr. 658:8-659:11 (Frear). This achievement was primarily due to the merger, which enabled Sirius XM to reduce subscriber acquisition, sales, marketing, and administrative costs by more than $500 million; were it not for the one-time cost savings that were achieved through the merger, Sirius XM would not be profitable today.[65] *Id.* at ¶ 19. Now that many of the efficiencies and cost-savings from the merger have been realized, Sirius XM expects that its total operating expenses will increase through the 2013-2017 period. *Id.* at ¶ 40.

312. Notwithstanding generalized optimistic statements made during the Company's earnings calls,[66] Sirius XM is still a long way from recouping the massive expenditures that were necessary for it to provide a product that only recently, after 20 years of losses, generates sufficient annual revenues to cover its ongoing costs. Frear WDT ¶¶ 18, 33. As of the third

---

[65] While other content costs have been reduced through contract renegotiations – Sirius XM succeeded in reducing its programming costs by more than $100 million over the 2008-2010 period by re-negotiating its contracts with Howard Stern, the National Football League, Oprah, Bruce Springsteen, the National Basketball Association, and NASCAR – the fees paid to SoundExchange have not historically been the product of a marketplace dynamic enabling Sirius XM to engage in similar renegotiations. Frear WDT ¶¶ 20-21.

[66] As Professor Stowell testified, it is very common for corporate management to make optimistic public statements touting the Company's performance, but such hyperbole is not material to investors: "Based on my experience, it was a very unusual company that did not engage in short-term discussion about robust expectations. The people who run these companies, CEOs and CFOs, generally speaking, are very competent people. Many of them are sales oriented people. They project we have confidence and conviction that I think is entirely appropriate for that role, but I think many people understand that they are playing to an audience that expects these things, but I think many of the professional, myself and advisors and sophisticated investors, are cautious in what they hear in terms of accepting all that is suggested may happen." 8/15/12 Tr. 3611:9-3612:8 (Stowell). This type of management puffery is so commonplace (and frequently challenged by investors who lose money when such optimism is not borne out) that Circuit Courts of Appeal have repeatedly held that soft puffing statements by management that lack specific financial predictions are immaterial as a matter of law because investors place no reliance on such vague general statements. *See* Sirius XM's PCL at Section V.D.

quarter of 2011, cumulative FCF was negative $5.5 billion and cumulative EBITDA was negative $3.7 billion; as of November 2011, Sirius XM had net operating losses of approximately $8 billion. *Id.* at ¶ 18. The recent profitability of Sirius XM, therefore, is a drop in the bucket compared to in recovering the billions of dollars in capital invested to launch Sirius and XM and it likely will take years of sustained performance for the Company just to break even on a cumulative basis. Stowell WDT ¶ 33 and Ex. 5; *see also* Karmazin WDT ¶ 43. Any increase in SoundExchange royalty rates will only serve to lengthen the time it takes to recoup these losses and threatens Sirius XM's ability to do so. Frear WDT ¶ 18.

313. Sirius XM also remains highly leveraged; as it warns in its most recent Annual 10-K Report, its substantial debt poses a material risk. Stowell WRT Ex. 42 at 17 (warning that the Company had an aggregate principal amount of approximately $3.1 billion of indebtedness as of December 31, 2011). Sirius XM's significant debt requires it to divert a substantial portion of its cash flow to repayment, which limits its ability to make capital expenditures and readily adapt to changes in the audio entertainment industry. Sirius XM is thus at a competitive disadvantage compared to competitors with greater free cash flow that need not be allocated to such debt repayment obligations. Frear WDT ¶¶ 30-32; Karmazin WDT Ex. 2 at 18.

314. In light of Sirius XM's debt and near-bankruptcy, the consequences of running out of cash, the increased difficulty in predicting the long-term cash needs of the Company, and its increased size following the merger, as well as the current economic uncertainty, Sirius XM's CFO, Mr. Frear, believes that it is necessary to maintain a cash reserve of at least $750 million. 6/7/12 Tr. 663:17-665:2 (Frear); *see also* Frear WDT ¶ 41. An increased royalty rate will divert cash and make it difficult to maintain a sufficient reserve.

2. Future Challenges

315. It has become even more difficult to predict the Company's future financial performance since the time of *Satellite I*, due to the current economic climate and rapid, dramatic changes to the competitive landscape, featuring a new host of competitors that were, in large part, non-existent at the time of the last proceeding. Frear WDT ¶¶ 35-37. Some of the more salient risks faced by Sirius XM are detailed below.

a. Reliance On Risky Satellite Infrastructure

316. Sirius XM is dependent upon its satellite delivery infrastructure, such that any number of events could seriously impact Sirius XM's signal integrity and thus its ability to deliver content. Frear WDT ¶ 21; Karmazin WDT ¶ 41. Satellites experience failures of component parts and operational and performance anomalies in the ordinary course of their operation, none of which can be repaired once a satellite is in orbit. Karmazin WDT ¶ 41. Each satellite replacement project is extremely expensive, time-consuming, and fraught with risk, particularly since the Company is not insured for all risks of loss associated with its satellites. Meyer WDT ¶ 51; *see also* 6/7/12 Tr. 795:11-798:22 (Frear) (stating that Sirius XM operates under an insurance shortfall, and that insurance does not cover all costs, including launch delays or other events prior to "intentional ignition"); Karmazin WDT ¶ 41; Stowell WRT Ex. 42 at 4, 12 ("the insurance does not cover the full cost of constructing, launching and insuring new satellites nor will it protect us from the adverse effect on business operations due to the loss of a satellite," and warning that "failure of our satellites would significantly damage our business.")

317. This risk is doubled for Sirius XM because it operates and must continue to operate dual proprietary satellite systems for the indefinite future because there are millions of

installed satellite radios that are capable of receiving only one or the other service. Meyer WDT ¶ 9; 6/6/12 Tr. 530:4-531:11 (Meyer).

b. Risks Posed By Macroeconomic Conditions

318. Like many other companies, Sirius XM is affected by the overall state of the economy. Sirius XM's satellite radio service is a luxury, not a necessity, and in the current uncertain economic environment, it simply is not a foregone conclusion that subscribers will continue to pay for it irrespective of price. As James Meyer testified:

> I know today, when I offer [Sirius XM] service to new car buyers, whether they ask for satellite radio or not ... only 44 percent of them subscribe. And the 56 percent that didn't, two-thirds of those tell me the reason they didn't is they don't want to pay...The fundamental reason they leave, again, two-thirds of the time, is I don't want to pay. And so while I don't have any set research that tells me the exact elasticity of our business, what I can tell you is there is a concern at some point, customers won't pay.

6/6/12 Tr. 566:21-568:16 (Meyer); *see also* Meyer WDT ¶ 39.

319. The annual "conversion" rate, which is the number of trial subscribers who convert to paid subscriptions, has dropped since 2007 from over 50% for Sirius and over 52% for XM to approximately 45% for the Company today. Meyer WDT ¶ 64. The monthly churn rate during the past year ranged from approximately 1.9% to 2.0%. *Id.* Thus, the Company loses roughly 300,000 to 400,000 paying subscribers per month – or about one quarter of its subscribers each year – who leave primarily because they believe they can access the audio content they desire elsewhere more cheaply or for free. *Id.*; 6/6/12 Tr. 566:21-568:16 (Meyer). To offset this attrition and grow subscriptions, Sirius XM must provide a service that is price- and quality- competitive with the increasing array of viable consumer alternatives, all the while supporting a delivery structure that is far more costly than that of Sirius XM's competition. Meyer WDT ¶ 64; *see also* 6/6/12 Tr. 558:13-560:18 (Meyer) (describing current conversion and

churn rates); *id.* at 560:19-563:11 (stating that approximately two-thirds of customers who leave the service do so because they no longer wish to pay).

320. Although the Company experienced notable efficiencies from the merger that resulted in decreased per-subscriber costs, it expects this downward trend to slow, as such cost-saving measures have already been realized or are limited in duration. Frear WDT ¶ 40. Accordingly, effective January 1, 2012, Sirius XM implemented its first post-merger price increase, raising the annual subscription price from $12.95 to $14.49. Frear RWRT ¶ 37. The Company expects that the price increase will impact Sirius XM's self-pay churn levels; however, it is too early to tell what that full impact will be. *Id.* at ¶ 38. Because subscriptions expire at varying points in time, only about a third of the Company's overall subscriber base had been affected by the increase at the time the Written Rebuttal Testimony was filed. *Id.* Because many subscribers are on a multi-month, annual, or even longer-term subscription plan, and their prices will not be increased until their current subscriptions expire, it will take approximately 18 months post-implementation – until mid-2013 – for 85-90% of the Company's subscriber base to experience the price increase. *Id.* Thus it will take at least that long (and likely longer) for the impact of the price increase to be reflected fully in the Company's subscriber metrics such as churn and conversion rates. *Id.*; *see also* 8/13/12 Tr. 3056:16-22 (Frear) (noting it will take about 18 months for any price change to work its way fully through the customer base); *id.* at 3057:1-9 (only about 9.5 million of Sirius XM's subscribers are currently paying under the new pricing plan); 6/6/12 Tr. 564:16-566:1 (Meyer) (roughly 50% of customers are on annual subscriptions, 20% are on longer than annual, and 30% are on monthly or quarterly subscriptions, and thus the price increase will take 18 to 20 months or longer to work fully through the subscriber base); Karmazin WDT ¶ 44 n.7; Meyer WDT ¶¶ 65-66.

321. To date, even without the full impact of the price increase in effect, the Company's annual churn rate for self-paying subscribers approaches 25%. This is significantly higher than it was at the time of the last proceeding. Frear RWRT ¶ 39. Sirius XM's executives uniformly confirmed that price increases impact churn and that Sirius XM's pricing policy must be sensitive to competition from free-to-the-consumer alternatives: "When you are competing with free, the higher your price is, the more difficult it is to get a subscriber. I have also testified that I believe having nonexclusive music that is, you now, ubiquitous doesn't add – with additional cost connected to that, doesn't add more value to us. We can play Lady Gaga, but so can everybody else…." 6/11/12 Tr. 1430:2-16 (Karmazin). David Frear echoed these concerns:

> [Y]ou know, we are very cautious about changes in pricing policy, knowing that we're competing against free-to-the-consumer alternatives, knowing that the OEMs are moving very rapidly on connected car, knowing that's going to bring, in addition to AM/FM radio to every car, that over the course of this new rate term, I expect the OEMs to get as far with installing modems in cars or smoothly integrating your smartphone so it can be controlled from the dash, as far into their production as they currently are with satellite radio, where something in excess of 60 percent of cars will be enabled with that technology. That is going to vastly expand the competitive universe. And we're going to continue to be very sensitive to any changes in price when we're competing against free-to-the-consumer alternatives.

8/13/12 Tr. 3042:5-3043:9 (Frear).

c. Risks Posed By Reliance On OEM Distribution Channels

322. Sirius XM has become more dependent on the volatile OEM distribution channel since the time of the last proceeding, when it derived more than half of its subscribers from other channels, including the sale of satellite radios in retail stores. Meyer WDT ¶ 37. In 2007, 46% of all subscribers came from the sale of new cars. Stowell WDT ¶ 21. By 2010, that number had risen to 65%. *Id.* at ¶ 21 and Ex. 2. As Mr. Meyer testified, today, nearly 90% of new subscribers come from new car sales: "If you went back five years ago, the bulk of those

subscribers, new subscribers coming into our business, came through what we would call the aftermarket… That business has dropped very, very significantly as the carmakers have incorporated the technology and the hardware into the vehicles. And today, close to 90 percent of our new subscribers come from when they buy a new car." 6/6/12 Tr. 528:2-22 (Meyer).

323. Sirius XM's dependence on the U.S. auto industry is a risk that cannot be hedged – there currently is no viable channel for its product that can generate sufficient revenue to sustain the Company outside of the new car market. Stowell WDT ¶ 20. As an essentially one-product Company, Sirius XM's increased reliance on the auto industry leaves it highly vulnerable to any scenario in which the market for new cars declines, as it did in 2008 and 2009. *Id.* at ¶ 22.

324. Automotive sales, and thus Sirius XM's subscriber levels, are dependent on the availability of consumer credit, general economic conditions, consumer confidence, and fuel costs – not to mention unpredictable events like the tsunami in Japan in early 2011. Meyer WDT ¶ 39. While it appears that the auto industry is on the slow mend, it is difficult if not impossible to project how the industry will perform and, in particular, how Sirius XM will perform more than 12-18 months into the future. *Id.* at ¶ 40; *see also* 6/6/12 Tr. 557:3-558:12 (Meyer).

d. Risks From The Robust And Rapidly-Advancing Competitive Landscape

325. Perhaps the most substantial and potentially disruptive challenge to Sirius XM in the near future and during the 2013-2017 license term is the rapidly-evolving competitive landscape in which it operates. New Internet-based competitors, whose emergence was enabled by rapidly-expanding wireless broadband capabilities and the explosion of smartphone use, will increasingly offer the same advantages over terrestrial radio that Sirius XM once claimed all to itself (*e.g.*, uninterrupted nationwide coverage, wide variety of exceptional non-music content

and commercial-free music). Meyer WDT ¶¶ 11-12, 17-18, 20-23; Rosenblatt WDT pp. 12-14, 20-37. Such competitors can also offer their customers the added benefits of increased customization and personalization (which Sirius XM is incapable of providing on its satellite radio service), and do so without incurring the burden of investing in the deployment of the network to distribute their content or the devices to receive it. Meyer WDT ¶¶ 17-18; Rosenblatt WDT pp. 20-31. Moreover, although new market entrants lack Sirius XM's curation of music and exclusive non-music content, the availability of generally comparable music and non-music content through mobile apps is undoubtedly a powerful competitive challenge, particularly in view of the excellent sound quality, increasingly seamless wireless coverage area, and integration into the automobile listening experience afforded by these alternatives to the consumer. Meyer WDT ¶ 23; Rosenblatt WDT pp. 12-14, 20-37; *see also* Section I.B.4, *supra.*

326. Many of these new competitive products are quickly being incorporated into automobiles, accelerating and intensifying their competitive impact in light of Sirius XM's near-complete dependence on the OEM distribution channel. *E.g.*, Meyer WDT ¶ 11-12, 24-34; Rosenblatt WDT at 3; Stowell WDT ¶¶ 22-23; Karmazin WDT ¶ 40; 6/8/12 Tr. 1212:11-1213:9 (Stowell); 8/13/12 Tr. 3042:5-3043:9 (Frear). Automakers are eager to incorporate these technological advancements, in part due to the significant advantages it is perceived to offer both consumers and automakers. Meyer WDT ¶¶ 12, 24-34; Rosenblatt WDT pp. 3-4, 19-20, 37; *see also* Section I.B.4, *supra.*

327. Sirius XM expects that, "[b]ecause connected-car technology is ubiquitously accepted as the future of infotainment in the market today, . . . within three years – *i.e.*, during the next licensing period – all major automakers will be incorporating similar systems into their cars." Meyer WDT ¶ 30. By 2015-2016, Sirius XM estimates that approximately 70-80% of

new car production will incorporate the tethered strategy of connectivity, Meyer WDT ¶ 30; 6/6/12 Tr. 544:20-545:4 (Meyer); *id.* at 549:11-550:6, and by 2016-2017, approximately 50% of new cars will come equipped with the one of Sirius XM's competitors integrated into the dashboard. *Id.* at 550:7-16; *see also* Meyer WDT ¶ 31; 6/8/12 Tr. 1071:15-1072:1 (Rosenblatt) ("pretty much every major automaker is rolling out something similar" to Toyota and Ford); Stowell WRT ¶ 21 (noting that by year-end 2012, at least 16 automakers will be producing vehicles with Pandora Radio integrated in the dashboard). Indeed, it is projected that "the incorporation rate of connected car capabilities into vehicles will exceed the incorporation rate of satellite radios before the end of the 2013-2017 licensing period." Meyer WDT ¶ 34.

328. In light of the increased availability of competitors' service in cars, Professor Stowell explains that "it is reasonably likely that Sirius XM will suffer a reduction in its subscriber base between 2013 and 2017." Stowell WDT ¶ 23; *id.* at ¶ 7. This competitive reality, combined with its overwhelming reliance on the OEM market and the ongoing uncertain economic climate, lead Professor Stowell to conclude that "it is not prudent to assume that the status quo will continue" and in fact, "Sirius XM is reasonably likely to experience financial distress during the 2013-2017 period."[67] Stowell WDT ¶¶ 24, 42. *See also* Karmazin WDT ¶ 7 (growing competition presents "enormous challenges for the Company in the period covered by this rate proceeding"); 6/11/12 Tr. 1421:20-1422:9 (Karmazin) ("[W]ith the competition that we are going to face in [the next rate period], . . . our business could be disrupted."); Rosenblatt

[67] To stay competitive in this rapidly evolving marketplace, Sirius XM must make large investments to acquire and retain subscribers and to continually monitor, upgrade and innovate its technological infrastructure and product offerings. *See* Meyer WDT ¶¶ 47-62; Stowell WDT ¶ 30. As Sirius XM well knows, the failure to effectively respond to rapidly emerging technologies, particularly with respect to Internet-based channels, can be fatal, as illustrated by the recent high profile bankruptcies of Blockbuster and Borders – profitable industry leaders that quickly slid into financial turmoil with the advent of Netflix and online booksellers. Meyer WDT ¶¶ 47-48; Stowell WDT ¶¶ 28-29; *see also* 6/8/12 Tr. 1236:6-1238:1 (Stowell).

WDT p. 4 (competitive developments "will present increasing and . . . perhaps even life-threatening competitive challenges to the business of satellite radio during the 2013-2017 license term"); *id.* at 20 (advent of Internet-based competitors and connected car technology are "development[s] [that] present[] serious threats to the sustainability of Sirius XM's business").

3. SoundExchange's Efforts To Depict Sirius XM As A "Cash Cow" Are Meritless

329. Despite all of the foregoing, SoundExchange asserts that the Judges need not worry about raising royalty rates, as Sirius XM is a "cash cow," 8/20/12 Tr. 4046:3 (Lys), the financial success of which is practically guaranteed in the coming years. In an effort to demonstrate this baseless assertion, SoundExchange, through Professor Lys, adopts a long-term financial forecast of Sirius XM prepared by third party financial analysts – just as it did in the *Satellite I* proceeding.[68] Based on this forecast, Professor Lys concludes that Sirius XM could pay a royalty rate of up to 37% in 2017 before the royalty rate would have any disruptive impact on Sirius XM. Lys CWDT ¶ 84; 8/20/12 Tr. 4077:19-4078:22 (Lys).[69] Yet, as the Judges recognized in *Satellite I*: it is a "well-known fact that financial projections … increase in uncertainty over the course of the period projected, with the last year in a six-year period of projections … being the least reliable." *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4092.

[68] SoundExchange also has attempted to portray Sirius XM as a monopolist that is both immune to competitive threats and is impervious to macro-economic downturns. As is discussed in Sections V.B-C, *infra*, these assertions were also demonstrated during the hearings to be baseless.

[69] Another of SoundExchange's experts, Professor Sidak, took an even more extreme position. He asserted that Sirius XM could afford a royalty rate of nearly 58% before there would be any risk of disruption to Sirius XM's business. 6/18/12 Tr. 2797:7-16 (Sidak). Beyond the many fallacious assumptions on which such opinion was based, as Professor Stowell explained, Professor Sidak's definition of disruption – a shut-down of the Company – is so extreme as not to be meaningful or relevant. Stowell WRT ¶25.

330. The Judges' previous skepticism regarding the reliability of financial projections proved well-founded as both sides' financial forecasts offered during the *Satellite I* hearing proved to be vastly over-optimistic as compared to the Company's actual performance. In *Satellite I*, SoundExchange expert witness Mr. Butson, relying on consensus Wall Street analyst forecasts, missed the mark by a wide margin. Apart from failing to foresee that Sirius XM could find itself on the brink of a bankruptcy, Mr. Butson's projections for the period 2006-2012 wildly over-estimated the combined subscriber base of the Company, as well as its revenues and free cash flows. Frear WDT ¶ 36 and n.12; *see also* Stowell WDT ¶ 38.

331. Predictions made by Sirius XM's Chief Financial Officer David Frear in his 2006 written direct testimony in *Satellite I* also proved to be overly optimistic. He there predicted that Sirius XM would experience its first positive free cash flow by 2008 and positive EBITDA by 2009. Frear WDT ¶ 36. Instead, fewer than seven months after the 2008 merger (and less than a year after the close of the *Satellite I* proceeding), Sirius XM was literally on brink of bankruptcy. Stowell WDT ¶ 9; Frear WDT ¶¶ 8, 34.

332. This difficulty in accurately predicting Sirius XM's financial future is not limited to the predictions made during the *Satellite I* proceeding. As Mr. Frear explained, Sirius XM for years has had difficulty forecasting metrics such as its subscriber base, revenues, earnings, and free cash flows over the long-term. Year after year, Sirius XM has come up well short of where it predicted it would be. Frear WDT ¶ 35.

333. Given the poor track record of financial analysts and even Sirius XM itself in forecasting its long-term financial performance, the expedient of adopting a new set of long-term analyst forecasts, as Professor Lys urges, does not afford any more reliable a basis for

determining the likelihood of potential future disruption than did the forecasts proffered in *Satellite I*. Stowell WRT ¶¶ 6, 8.

* * *

334. In light of Sirius XM's long history of financial turmoil and the varied and increasing risks it faces, including as compared to the risks that existed at the time of the *Satellite I* proceeding, the disruption statutory factor, taken in conjunction with the other 801(b) factors, counsels in favor of a rate at the lower end of the range of reasonable rates.

V. SOUNDEXCHANGE HAS FAILED TO PROVE THAT ITS FEE PROPOSAL YIELDS REASONABLE RATES FOR SDARS SERVICES WITHIN THE CONTEMPLATION OF SECTIONS 114(f)(1)(A) AND 801(b)(1) OF THE COPYRIGHT ACT

335. For the license period 2013-2017, SoundExchange has proposed a percentage-of-revenue rate beginning at 12% of Sirius XM's gross revenues, a 50% increase above the culminating 8% rate for the current year set by the Copyright Royalty Judges in *Satellite I*, with further increases in each year such that, by 2017, the Company would be paying fully 20% of its gross revenue – or two-and-a-half times the prevailing rate. At that, this astonishing proposed increase in percentage-of-revenue fees understates the actual impact of SoundExchange's fee proposal considered *in toto*. The changes to the prevailing revenue definitions that are, in addition, proposed by SoundExchange, as discussed in Section VI.A-B, *infra*, would further increase the fees payable by Sirius XM by more than 30%, generating an all-in level of fees that would be more than three times the prevailing rate by the end of the next license term. SoundExchange has utterly failed to make its case for *any* increase above the current 8% rate, let alone one of the dimension it seeks.

A. Professor Ordover's Attempt To Value Sound Recording Performance Rights Using The Interactive Services As A Benchmark Is Fatally Flawed

1. Professor Ordover Failed To Consider The Full Panoply Of Possible Benchmarks

336. SoundExchange's sole support for its rate proposal is the analysis presented by its economic expert, Professor Janusz Ordover.

337. Acting on the apparent premise that the digital audio marketplace has remained static since the time of the *Satellite I* proceeding, Professor Ordover resorts to working exclusively from the same body of license agreements – those reached between interactive Internet music services and major record labels – as formed a principal basis of his previous testimony. Ordover CAWDT ¶ 9. In *Satellite I*, Professor Ordover argued that the $7.50/subscriber paid by interactive services, after an appropriate interactivity adjustment, translated to a fee of $1.40/subscriber for satellite radio, which the Judges calculated as being about 13% of Sirius and XM revenue and identified as the upper end of the zone of reasonable SDARS rates for the 2007-2012 license term.[70] *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, pp. 4093-94.

338. In so proceeding here, Professor Ordover has failed to take account of the dramatic changes in the digital audio service competitive landscape that he elsewhere acknowledges have occurred. 6/14/12 Tr. 2350:6-2351:15 (Ordover). This failure led Professor Ordover to ignore altogether other categories of Internet webcasters that, as he conceded on cross examination, are a closer analytic fit to Sirius XM, *see*, *e.g.*, 8/14/12 Tr. 3400:5-12 (Ordover), as well as to ignore the logic of his own prior analysis as applied to interactive services to his work

[70] Professor Ordover initially multiplied this $1.40 by an adjustment of 1.25/.70 to account for what he called "immediacy," but later acknowledged that the immediacy adjustment was not supported by marketplace evidence. *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4093.

in this proceeding. Whether negligent or simply expedient, these omissions have resulted in a deeply flawed benchmarking analysis that forms no basis for fee-setting.

339. This disconnect from the reality of the current licensing landscape has led Professor Ordover to conclude that royalty rates of between 22.3% and 32.5% of Sirius XM's gross revenue are reasonable, even though the rates paid to the very major record labels by the very interactive services on whose license interactions Professor Ordover relies have *dropped* by approximately 20% since 2007, from $7.50 to $5.95 per subscriber. Ordover CAWDT ¶¶ 46, 57 and Table 6; *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4093. Professor Ordover nowhere has attempted to rationalize, let alone demonstrate, why, despite this 20% drop, his recommended rate for Sirius XM in this proceeding, as derived from that same benchmark, more than doubled as compared to the 13% rate found to constitute the upper end of the zone of reasonableness based on the prevailing market facts and circumstances in *Satellite I.* All logic (at least within Professor Ordover's chosen universe of benchmarks) would suggest instead that the very upper zone of reasonable fees now cannot exceed 80% of 13% – or a rate of some 10% of Sirius XM's revenue. More generally, Professor Ordover has failed to demonstrate how it is that the value of sound recording performances by Sirius XM has escalated by a factor of three to four since the Judges last set rates in 2007. 6/14/12 Tr. 2334:16-22 (Ordover).

340. Likewise, while Professor Ordover has acknowledged that the audio entertainment landscape has changed dramatically between 2007 and the present, that Sirius XM competes in an "intense" and "very dynamic" marketplace for delivery of music and non-music programming to vehicles (its primary market), and that this competition embraces terrestrial radio as well as both interactive and a new generation of non-interactive audio services, 6/14/12 Tr. 2350:6-2351:15 (Ordover), his benchmark analysis fails to account for any of these dramatic

marketplace changes. Indeed, despite the existence of license agreements between the major labels and the now-viable group of competitors constituting non-interactive services, Professor Ordover failed so much as even to consider any of the non-interactive services as potential benchmarks. *Id.* at 2330:4-21. This is the case even though these services are offered by some of the very same entities from which Professor Ordover drew his interactive service benchmarking data. *See, e.g.*, Noll RAWDT Appendix I (Slacker/WMG agreement including rates for both interactive and non-interactive service tiers).

341. In an effort to support his reliance on interactive music services as a benchmark, Professor Ordover testified that "identification of a candidate benchmark marketplace should place heavy emphasis on the extent to which the service under consideration is comparable to satellite radio along the relevant dimensions." Ordover CAWDT ¶ 33. That testimony noted that both Sirius XM and the interactive services: (1) require sound recording rights as an essential input; (2) distribute music content through a digital channel; (3) charge subscribers a monthly subscription fee that affords those subscribers with unlimited usage; and (4) provide subscribers with the ability to listen to music while "on the go." Ordover CAWDT ¶ 34. But, as Professor Ordover conceded, each of these attributes applies with equal force to the non-interactive services, 6/14/12 Tr. 2360:12-21 (Ordover), and thus, none would distinguish interactive services as the preferable benchmark. In fact, as Professor Ordover also acknowledged, the non-interactive services are in many respects more similar to Sirius XM than are the interactive services. *See, e.g.*, 8/14/12 Tr. 3400:5-12 (Ordover) (agreeing that the functionality offered by Sirius XM is more similar to that offered by non-interactive services than that offered by interactive services). What is more, as Professor Noll points out, Professor Ordover's listing of attributes leaves out at least one other key one: "both services use the same

or similar performance rights to offer the same or similar services" – an attribute that is *not* satisfied by the interactive service benchmark, but is by the non-interactive benchmark. Noll RWRT p. 9.

342. The only attribute that Professor Ordover was able to offer in support of using the interactive services that does not, at least in his view, apply equally to the non-interactive services, is the claimed absence of a "regulatory overhang." 6/14/12 Tr. 2256:18-21 (Ordover). But, as fully discussed in Section III.G.3, *supra,* this proposition is insupportable for multiple reasons. These include, as Professor Noll explained, the fact that *all* license agreements implicating sound recording performance rights are influenced in some measure by such regulatory overhang. Noll RWRT p. 11. Moreover, as Professor Ordover himself has conceded, the regulated proceedings claimed to cast a rate-distorting shadow over voluntary non-interactive licenses – this Tribunal's webcasting determinations – are by statute designed to arrive at, and have in fact resulted in, reasonable approximations of willing buyer/willing seller outcomes. 8/14/12 Tr. 3409:13-3411:4 (Ordover). When coupled with the further conceded fact that the voluntary agreements reached between non-interactive services and the majors permitting extra functionality beyond that afforded by the statutory license reflect fair market valuation of those extras, *Id.* at 3411:5-3412:22, the prospect for distortion of the sort to which Professor Ordover alludes evaporates. Noll RWRT pp. 11-12.

343. In sum, Professor Ordover's myopic focus on interactive service license agreements with the majors, and the fees implied by the results of his analysis, fly in the face of current market realities – as to the nature of competition in the audio entertainment marketplace, the attributes of Sirius XM's music product in relation to the range of its competitors, and the license fees paid for comparable rights and services by Sirius XM's closest competitors. A

detailed analysis of how these misconceptions fatally infect Professor Ordover's benchmarking analysis follows.

2. Professor Ordover Failed To Appropriately Adjust The Interactive Service Benchmark Agreements To Account For Salient Differences Between Sirius XM And The Chosen Benchmark Services

344. To the extent consideration were to be given to Professor Ordover's reliance on the license fee experience of certain interactive webcasters, account would need to be taken of several critical differences between those services and Sirius XM that Professor Ordover (with one exception) simply has ignored. Noll RWRT p. 3. First, the interactive services require different and more valuable copyright rights – namely, permitting interactivity and full on-demand access to sound recordings – than is the case for Sirius XM. Salinger CWRT ¶ 18. Sirius XM, on the other hand, provides a one-way broadcast that affords no interactivity and is subject to the restrictions of Section 114(d) of the Copyright Act in its selection and broadcasts of sound recordings. *See* Meyer WDT ¶ 18; 6/6/12 Tr. 540:15-543:7 (Meyer). Second, the interactive services afford subscribers programming content, but no access to or delivery of that programming. Salinger CWRT ¶ 18. These offerings are of no value whatsoever unless a consumer supplies his or her own personal computer or smartphone-type receiver, as well as subscribes to a broadband Internet service through which the consumer can access the interactive service. Sirius XM, by contrast, has built and provides its subscribers with a delivery platform to moving vehicles – via a unique satellite and terrestrial repeater system that it created at enormous expense and in-vehicle receivers that it designed and subsidizes. Necessarily, the subscription fees charged by Sirius XM reflect the costs of that delivery platform. *Id.*

345. Professor Ordover advances three approaches to estimating reasonable fees. The first two of these ignore both of the afore-cited basic differences in purporting otherwise to make

adjustments to fit the fundamentally different Sirius XM service offering. 8/16/12 Tr. 3797:5-3798:16 (Salinger). Professor Ordover's third approach does implicitly account for the fact that Sirius XM provides a delivery platform while the interactive services do not. 8/14/12 Tr. 3469:4-3471:22 (Noll). Proper adjustments to all three of Professor Ordover's approaches reinforce the reasonableness of the fees proposed by Sirius XM in this proceeding.

a. Professor Ordover's Primary Approach Is Riddled With Conceptual Errors

346. In his primary model, Professor Ordover proposes but a single adjustment to the 60-65 percentage-of-revenue rate "cluster" he derives from the interactive Internet services agreements with the major labels, to account solely for the fact that Sirius XM, in contrast to the interactive services, offers significant (not to mention exclusive) non-music programming. 6/14/12 Tr. 2390:15-2391:12 (Ordover). The resulting fee, 30-32.5% of Sirius XM revenue, is the mathematical equivalent of applying the 60-65% interactive rate he derives to the retail price of his "hypothetical music-only satellite radio service," calculated as 50% of the $12.95 Sirius XM retail price which he utilized (60% x $6.475 = 30% x $12.95). Ordover CAWDT ¶ 50. In short, Professor Ordover contends that Sirius XM should pay 60-65% of its music-service revenue to SoundExchange, no different than the interactive services.

347. Professor Ordover asserts that one need not make any other adjustment to the percentage-of-revenue rate paid by the interactive services to account for any other differences between Sirius XM and the interactive services because, in his view, "there is no reason to expect that a hypothetical negotiation between Sirius XM and a major record label would culminate in a percentage-of-revenue rate that differs materially from the observed rates agreed to by the record companies and Microsoft, Rhapsody, and other interactive streaming providers." Ordover CAWDT ¶ 34.

348. Yet, as is discussed in detail by both Professor Noll and Professor Salinger, economic theory provides every reason to expect that a hypothetical negotiation between Sirius XM and a record label would culminate in a percentage-of-revenue rate that differs materially from the observed rates agreed to by the record companies and interactive service providers. Noll RWRT pp. 13-15; Salinger CWRT ¶ 18; 8/14/12 Tr. 3456:18-3459:4 (Noll); 8/16/12 Tr. 3798:17-3802:11 (Salinger). Indeed, as the direct licenses that have been negotiated between Sirius XM and record labels plainly demonstrate, the percentage-of-revenue rate agreed to in *actual* negotiations between Sirius XM and record labels (not to mention those negotiated between non-interactive services and record labels) are far lower than those paid by the interactive Internet services.

(i) Professor Ordover Failed To Account For The Difference In Value Of The Copyright Rights Used By Sirius XM And The Interactive Services

349. The first flaw in Professor Ordover's primary approach is his failure to account for the fact that Sirius XM and the interactive services require very different sets of rights from the sound recording copyright holders, which have very different marketplace values. 8/16/12 Tr. 3798:6-13 (Salinger). Unlike Sirius XM, the interactive services grant a user full on-demand, interactive access to (essentially complete control over) the music that is streamed, without any of the limitations of the Section 114 statutory license. Both parties to such agreements perceive these rights to be of greater value than those conferred by a Section 114 statutory license: the services, as reflected in the higher subscription fees they can command; and the record companies, because of that recognition as well as of the greater risk of cannibalization of physical and digital purchases of sound recordings that is presented by the high degree of user

control and discretion over what music the user listens to and when.[71] 8/14/12 Tr. 3456:18-3459:4 (Noll); 8/16/12 Tr. 3798:17-3802:18 (Salinger). *See generally* Sections IV.A.3-4, *supra*. While Professor Ordover pronounced that there is "no sound basis on which to conclude that the balance of substitution and promotion effects for satellite radio differs in any meaningful degree from the interactive subscription services," Ordover CAWDT ¶ 18, it became clear on cross examination that the extent of Professor Ordover's investigation into the issue was a handful of conversations he had with self-interested record label executives who provided Professor Ordover with no documentary support for contentions that are at odds with the extensive record evidence here. 6/14/12 Tr. 2340:8-2341:21 (Ordover); *see also* Section Sections IV.A.3-4, *supra*.

350. It follows as a matter of basic economics that if one is to use the rate paid by the interactive services as a benchmark for Sirius XM's music offerings, one must reduce the rate to account for the difference in value of the rights conveyed. Simply put, Sirius XM should pay a lower percentage rate for the less valuable bundle of rights it acquires. Salinger CWRT at ¶18; 8/16/12 Tr. 3798:17-3802:18; 8/14/12 Tr. 3456:18-3457:7 (Noll). *See also* 8/15/12 Tr. 3525:9-3527:15 (Noll) ("When you bundle together more and more rights, you pay more and more . . . the broader the list of rights that are conveyed in a license, the higher percentage rate ought to be.").

351. Professor Ordover made no serious effort to address this fundamental distinction in the nature of the rights granted. He instead attempted to gloss over these important differences by the glib, and inaccurate, assertion that both "interactive subscription services and

[71] As Professor Noll explained, a record label's optimal strategy in negotiating royalty rates with a music service will be impacted by whether that music service tends to promote or cannibalize other of the label's revenue streams – those that promote other revenue streams will be able to negotiate lower rates than those that cannibalize other revenue streams. 8/14/12 Tr. 3457:7-3458:3 (Noll).

satellite radio require access to *the same* sound recording rights." Ordover CAWDT at ¶ 34 (emphasis added). As became clear on cross-examination, he surprisingly had not bothered to investigate, and perhaps did not fully understand, the distinct grants of rights to interactive services on the one hand and a statutory licensee like Sirius XM on the other. 6/14/12 Tr. 2373:12-2377:19 (Ordover); *id.* at 2377:6-12 ("Q: You made no investigation, in fact, of the different potential scope of licenses available and copyright rights being conferred, on the one hand, under the statutory license to Sirius XM and, on the other, the label agreements you cite for the interactive services, correct? A: That is true…); *id.* at 2374:5-9 (Q: To your knowledge, as a result of the license that will come from this proceeding, will Sirius XM be able to offer its subscribers on-demand streams? A: That, I don't know); *id.* at 2375:17-22 (Q: To your knowledge, as a result of the license Sirius XM will acquire in this proceeding, will subscribers to Sirius XM be able to engage in conditional downloads of sound recordings? A: You are asking me questions about a subject that I have not investigated…).[72]

352. Just as economic theory does not support Professor Ordover's assertion that Sirius XM should pay the same percentage-of-revenue royalty rate as the interactive services (after accounting for non-music content), the record evidence as to marketplace behavior does not support Professor Ordover's position. Indeed, the very evidence Professor Ordover offers to justify his assertion refutes his claim. The rates just for interactive services in 2011 as laid out in Table One of Professor Ordover's Written Direct Testimony vary between [redacted]

[72] Professor Ordover evinced a similar lack of familiarity with, among other matters: many of the very interactive licenses on which his analysis depends, 6/14/12 Tr. 2318:21-2321:1 (Ordover); the majors' agreements with non-interactive services, which he could not recall if he had even looked at, *id.* at 2368:19-2369:3; and SoundExchange's and other record industry trade organizations' efforts to thwart the success of Sirius XM's direct licensing efforts, 8/14/12 Tr. 3383:6-17 [redacted]. *See generally id.* at 2308:16-2309:12 (limited time devoted to preparation of direct testimony); 8/14/12 Tr. 3332:10-3333:1 (Ordover) (same as to time devoted to rebuttal testimony).

and 10 of the 24 rates for 2011 (over 40 percent) fall outside of his "cluster" of 60-65%. Noll RWRT p. 16. The other types of services that provide user-control of content all have ranges of rates that fall above (permanent downloads) or below (ringtones, ringback tones, interactive subscription to non-portable devices) the 60-65 percent range that Professor Ordover asserts to be the norm. Ordover CAWDT Table 2. The percentage rates for ringtones/ringback tones are between [redacted] *id.*, which is well below Professor Ordover's "cluster" of rates. Rather than undertake an economic analysis to ascertain why different services have different royalties, Professor Ordover simply concluded that these rates are similar enough to support the 60-65 percent he uses as the assertedly common market (and thus benchmark) rate. *Id.* at ¶¶ 42-43; Noll RWRT p. 16.

353. Moreover, Professor Ordover simply ignored the royalty rates paid by non-interactive services that do not qualify for the statutory license. 6/14/12 Tr. 2329:14-2330:21 (Ordover). These non-interactive service royalty rates, however, plainly demonstrate that Professor Ordover's assertion that different services with different attributes nevertheless will pay essentially the same percentage-of-revenue royalty rates is false. Certain of the contracts that were used by Professor Ordover in analyzing royalties for interactive services also contain rates for non-interactive services that do not qualify for the statutory rate operated by the same licensed entity. 6/14/12 Tr. 2328:17-2330:21 (Ordover). If Professor Ordover were correct that all differences in royalty payments among broadly similar services would be due solely to differences in retail prices, with no or little difference in percentage rates, then the percentage rates for the various service offerings, especially under a common ownership umbrella, would be approximately the same. But, as the Last.fm and Slacker licenses with the major labels clearly demonstrate, this is not the case. For example, [redacted]

[redacted] *See* Noll RAWDT Appendix J at SX02 00076552-53. In all cases, across all four major record labels, the percentage of revenue royalty rates called for in the Slacker and Last.fm licenses for the interactive tier are significantly higher than the rates applicable to the non-interactive tier. Noll RWRT pp. 16-17.

354. A comparison of the Slacker agreements to the Last.fm agreements further demonstrates that the services that offer more user functionality (and thus require a more valuable bundle of rights) pay higher percentage-of-revenue rates than those that offer less functionality. The non-interactive service offered by Slacker allows for caching – or storing programming for later listening. The Last.fm non-interactive service does not offer this functionality. Noll RAWDT pp. 74-75. [redacted]

355. These differences demonstrate conclusively that royalty rates are *not* the same for all services – indeed, not even close – but rather vary according to service attributes, consumer value, and levels of substitution for other record company income streams. Examination of the contracts shows that royalty rates are higher as functionality and user control of content increases – exactly as economic theory predicts. 8/14/12 Tr. 3458:20-3459:4 (Noll). Importantly for purposes of evaluating Professor Ordover's primary model, they demonstrate that the labels do not rely solely on differences in retail prices to adjust the amounts due under the agreements: for service tiers with lesser interactivity, lesser royalties do not derive simply from applying a

constant percentage-of-revenue rate to a lower consumer price ($3.00 for non-interactive versus $9.99 for interactive); the percentage-of-revenue rate to be applied itself is lower [redacted] versus 60-65%). 8/16/12 Tr. 3802:19-3803:16 (Salinger).

(ii) Professor Ordover's Primary Approach Failed To Account For The Delivery Platform Provided By Sirius XM

356. The second fundamental flaw in Professor Ordover's primary approach is his failure to account for the fact that the retail prices of Sirius XM and the interactive services reflect vastly different cost structures as a result of Sirius XM's investment in, and provision of, its delivery network and proprietary receivers.[73] Salinger CWRT ¶ 18; 8/16/12 Tr. 3803:17-3805:5 (Salinger). Unlike the interactive Internet services, which require both a subscription to the service as well as a smartphone and a data plan which must be purchased separately, the Sirius XM subscription price is fully inclusive – it reflects consumer payment for both the content costs as well as the cost of providing the delivery platform. Professor Ordover's primary approach, which applies the interactive services percentage-of-revenue rate to the Sirius XM retail price without taking account of this fact, effectively gives record labels a share of revenues that have nothing to do with the sound recording rights they are licensing. Salinger CWRT ¶ 18; Tr. 3803:17-3805:5 (Salinger). Much as record labels are not entitled to a share of the revenues generated from the sale of smartphones and data plans – both of which are necessary for a consumer to enjoy the interactive Internet services – record labels are no more entitled to a share of the revenues generated by the Sirius XM delivery platform. Professor Ordover's failure to account for the Sirius XM delivery platform in his primary approach is improper as a matter of basic economics; its implementation into rate-making would, moreover, have adverse policy

[73] As is discussed below, Professor Ordover does account for the Sirius XM delivery platform in a conceptually appropriate manner, albeit using flawed estimates, in his second alternative approach.

implications. (See Section IV.C, *supra*, for a discussion of why it also contravenes the 801(b)(1) relative contribution factor.)

357. As Professor Noll explained, it is a mistake, both as a matter of economic theory and as a matter of policy, to charge the same percentage-of-revenue royalty rate to firms that sell bundled products as to those that sell unbundled products. 8/14/12 Tr. 3461:22-3463:6 (Noll). To do so is equivalent to imposing a tax on firms that create integrated products, as these firms will be paying more than the firms that sell unbundled products for the same inputs (sound recording performance rights in this case). This tax, in turn, provides firms with the incentive to discontinue developing or supporting integrated products. *Id.* at 3462:14-3463:6; *see also* Section III.G.6, *supra*. In fact, as Professor Ordover acknowledged, by failing to account for the cost of the delivery platform, his framework incentivizes Sirius XM to disaggregate its product offering by selling off the distribution platform component of its service to a third party. 8/14/12 Tr. 3420:2-3421:20 (Ordover). Under such a scenario, Sirius XM would be providing the identical music content to the identical subscriber base, but, because the delivery platform is no longer included in the revenue base against which the percentage-of-revenue rate is applied (as it is sold by a third party), Sirius XM would pay out substantially lower royalties to the record labels. *Id.* This would clearly be a nonsensical result.

358. Once again, Professor Ordover's construct is at odds not simply with sound economics; it ignores actual commercial practice. 8/16/12 Tr. 3805:6-3806:17 (Salinger); Salinger CWRT ¶ 19. As described at length in Section Section III.G.6, *supra*, in comparable circumstances in the marketplace, percentage-of-revenue royalty rates for music content are adjusted to take account of delivery platform costs. Specifically, when a delivery platform is

bundled with a music service and a percentage-of-revenue royalty rate is imposed, the rate is lower than the rate for a comparable music service that is not bundled with a delivery platform.

359. The agreements between Cricket – a mobile wireless carrier that offers a bundled product that includes a smartphone, telephone service, as well as an interactive music service for a fixed monthly fee – and the major labels clearly demonstrates this point. The interactive music service offered by Cricket is similar to the standalone interactive Internet music services that, according to Professor Ordover, pay royalty rates of 60-65% of revenue and charge a monthly retail price of $9.99. Ordover CAWDT ¶¶ 36, 51. Applying the 60-65 percent-of-revenue rate to the $9.99 retail price equates to a monthly music royalty payment of approximately $6.00 - $6.50 per subscriber. Unlike the interactive Internet services, Cricket charges a retail price of between $55 and $65 per month for its bundled product. Harrison CWRT p. 6. Had Professor Ordover's theory of fair market value been applied to this setting, Cricket would have been required to pay the same 60-65 percent-of-revenue royalty rate as applied to its full retail price. Cricket's resulting music license fees would have been between $33 and $42 per subscriber per month (a result that would have almost certainly either put Cricket out of business or force it to abandon offering an interactive music service). Instead, as one would expect, Cricket pays a [redacted] reflecting the reality that a percentage rate applied to a retail price that incorporates costs incurred unrelated to music content must be a lesser one than were the circumstance otherwise. Harrison CWRT p. 6. [redacted] Indeed, as Mr. Harrison of UMG explained, [redacted]

[redacted] *Id.* As Professor Salinger testified, the result reflects the marketplace reality that comparably valued rights will be paid for at comparable *fee levels*, not comparable *royalty percentages* applied to retail prices that potentially reflect the cost of many different inputs. Salinger CWRT ¶ 20; 8/16/12 Tr. 3805:6-3806:17 (Salinger).

360. The implication for Sirius XM's license circumstance is plain – an adjustment must be made to account for Sirius XM's distribution platform – as the below corrections to account for Professor Ordover's basic misconceptions elucidate.

(iii) Correcting For The Flaws In Professor Ordover's Primary Approach Yields A Royalty Rate Of 7%

361. As Professor Noll testified, several adjustments are necessary to correct for the above-discussed flaws in Professor Ordover's primary approach. First, it is necessary to adjust for the fact that non-interactive services, which provide a much closer analogy to Sirius XM in terms of the rights acquired, pay a substantially smaller percentage of their revenues to the record labels than do interactive services. As explained by Professor Noll, this can be accomplished by replacing the 60% of revenue paid by the interactive services that Professor Ordover uses with the 26.1% rate paid by Last.fm – the non-interactive service that most closely resembles the music service offered by Sirius XM. Noll RWRT pp. 19-20.

362. Second, Professor Ordover's failure to account for the value of the delivery platform when estimating the price of music content on Sirius XM can be corrected by removing both the value of the non-music content (which Professor Ordover also has done) and the value of the delivery platform (which Professor Ordover has not done) from the full Sirius XM revenue per user. Using Professor Noll's conservative assumptions, and only accounting for the forward

looking costs of investments into the delivery platform, the price of the Sirius XM music content is at most \$3.45, versus the \$6.48 estimate used by Professor Ordover. Noll RWRT pp. 19-20.

363. Replacing Professor Ordover's 60% royalty rate with the more appropriate 26.1% rate and replacing Professor Ordover's \$6.48 estimate of the price of the Sirius XM music content with the conservatively calculated \$3.45 price, the resulting royalty rate, without making any other adjustments to Professor Ordover's primary approach, is 7%.[74] Noll RWRT p. 20. Notably, this rate is within the range of rates negotiated directly between Sirius XM and record labels and, consequently, is within the range of rates proposed by Sirius XM in this proceeding.

b. Professor Ordover's First Alternative Approach Is No Different Than His Primary Approach

364. Professor Ordover presents what he refers to as a first "alternative" approach for deriving a royalty rate for Sirius XM using the interactive Internet services as a benchmark. Rather than start with the 60-65 percent-of-revenue rates paid by the interactive services, Professor Ordover begins this analysis with the actual monthly per-subscriber royalty fees paid by the interactive services: some \$5.95 per subscriber per month. Ordover CAWDT ¶ 46. He then adjusts this \$5.95 per subscriber monthly royalty fee by the ratio of the retail price of his hypothetical music-only satellite radio service (\$6.475) to the retail price of the interactive Internet subscription services (\$9.99). *Id.* at ¶ 51. According to Professor Ordover, this adjustment accounts for all of the differences in the service characteristics between the interactive Internet services on the one hand and a hypothetical music-only satellite radio service on the other. *Id.* at ¶ 49.

---

[74] Mathematically, this can be accomplished by adjusting Professor Ordover's 30% rate by the ratio of the non-interactive rate to the interactive rate (thereby correcting the first flaw) and by the ratio of the properly calculated price of music content to the flawed estimate of the price of the Sirius XM music content (thereby correcting the second flaw). The resulting royalty rate is: 30% * (26.1% / 60%) * (\$3.45 / \$6.48) = 7%.

365. As Professors Noll and Salinger explained, this assertion is incorrect. Noll RWRT p. 22; Salinger CWRT ¶ 23. Professor Ordover's supposed first alternative approach is nothing more than a convoluted repackaging of his primary approach. Rather than eyeballing the percentage-of-revenue royalty rates paid by the various interactive Internet services he relies on – from which he derives his 60-65 percentage-of-revenue range in his primary model – Professor Ordover here actually calculates the average royalty rate paid the interactive Internet services – \$5.95. 8/16/12 Tr. 3795:10-3796:6 (Salinger). But, as Professor Salinger explained, the \$5.95 royalty fee so calculated is derived from the very same 60% rate that Professor Ordover works from in his primary approach. Salinger CWRT ¶ 23 and n.10; 8/16/12 Tr. 3794:10-3796:6 (Salinger).

366. Simple algebra demonstrates how the balance of Professor Ordover's calculations under this second approach reduce to exactly the same analysis as drives his primary approach. The primary approach entails multiplying the 60% interactive percentage-of-revenue rate by Professor Ordover's \$6.475 estimate of the price of a music-only satellite radio service or 60%*\$6.475. In this alternative approach, Professor Ordover multiplies the interactive royalty (\$5.95) by the ratio of the retail price of his hypothetical music-only satellite radio service (\$6.475) to the retail price of the interactive Internet subscription services (\$9.99) or \$5.95 x \$6.475/\$9.99. This equation can be rewritten as \$5.95/\$9.99 x \$6.475 – they are mathematically equivalent. 8/16/12 Tr. 3794:10-3796:6 (Salinger). Because \$5.95/\$9.99 is 60%, this reduces to the identical 60% x \$6.475 that represents Professor Ordover's primary approach. *Id.* Thus, the net result of Professor Ordover's first alternative approach is exactly the same as that of his primary approach: a percentage-of-revenue royalty rate of 60% multiplied by his estimate of the

price of a music-only satellite radio service. This approach adds absolutely nothing to the primary analysis put forward by Professor Ordover and suffers the same flaws.[75]

c. Professor Ordover's Second Alternative Overcomes One, But Only One, Of The Flaws That Plague His Other Approaches

367. Professor Ordover's second alternative approach, while still flawed, does provide further insight into why rates in the range proposed by Sirius XM, rather than SoundExchange, reflect reasonable SDARS fees for the next license term. This is the case because, unlike Professor Ordover's first two approaches, this last model does effectively adjust for the Sirius XM distribution platform. 8/14/12 Tr. 3477:8-15 (Noll). (In fact, it accomplishes this by using the same methodology as one of the approaches used by Professor Noll for this purpose – to look to the retail prices of non-interactive Internet services. *See* Section III.E, *supra.*) As Professor Noll's rebuttal testimony established, thus narrowing the points of difference between the parties' approaches to fee-setting, this second alternative approach readily lends itself to two necessary, easily calculated adjustments that bring it in line with Professor Noll's own calculations predicated on the fee experience of the non-interactive services. 8/14/12 Tr. 3471:12-3477:20 (Noll).

368. As with his first alternative approach, Professor Ordover begins with the monthly $5.95 per-subscriber royalty fee paid by the interactive services. Ordover CAWDT ¶ 55. He then claims to adjust this rate to account for the fact that his benchmark services are interactive while Sirius XM is not. *Id.* To make the asserted interactivity adjustment, Professor Ordover multiplies the $5.95 interactive services royalty fee by the ratio of the average retail price of non-interactive subscription Internet services which, by his math, is $4.86, to the retail price of

[75] Despite Professor Ordover's efforts to explain away this math as purely coincidental, 6/14/12 Tr. 2407:4-12 (Ordover), Professor Salinger established that this so-called alternative approach will always reduce to applying a percentage-of-revenue royalty rate of 60% ($5.95/$9.99) to the retail price of the music-only satellite service (or 30% of the total price of the satellite service). Salinger CWRT ¶ 23 n.10.

interactive subscription Internet services, or $9.99. Ordover CAWDT ¶ 54. The ratio of $4.86 / $9.99, or 0.4865, is the asserted interactivity adjustment factor that Professor Ordover adopts in his second approach. *Id.* at ¶ 55

369. Once again, the purported nature of this alternative is quite different from its reality. As Sirius XM's economic experts elucidated, it merely applies the same 60% interactive services percentage-of-revenue royalty rate to an estimate of the price of the Sirius XM music content. Noll RWRT p. 23; 8/16/12 Tr. 3796:7-3797:12 (Salinger). In this approach, rather than apply the 60% rate to the $6.475 estimate used in the earlier-discussed approaches, Professor Ordover applied the 60% rate to an average of the retail prices of five non-interactive Internet services, which Professor Ordover calculated to be $4.86. Noll RWRT p. 23; Salinger CWRT ¶¶ 24-25. As noted above, Professor Ordover multiplied the $5.95 interactive royalty by $4.86/$9.99. This can be rewritten as $5.95/$9.99 x $4.86 which is equivalent to 60% x $4.86. 8/16/12 Tr. 3796:7-3797:12 (Salinger). For all the reasons discussed above and testified to, applying the interactive services percentage-of-revenue royalty rate (60%) to an estimate of the price of the Sirius XM music content is inappropriate; the royalty rate itself remains vastly overstated.

370. Professor Ordover, at least as of 2007, appeared to agree. The 0.4865 adjustment factor calculated by comparing the retail prices of non-interactive and interactive services differs dramatically from the interactivity adjustment factor that Professor Ordover proposed in the *Satellite I* proceeding. There, Professor Ordover chose not to compare retail *prices*, but instead, compared the per-play *royalty fees* found in non-interactive and interactive video service agreements. 6/14/12 Tr. 2408:5-14 (Ordover). This prior analysis resulted in an interactivity adjustment factor of 0.1875 – one that yields an adjustment that is substantially greater than the

one that results from use of the adjustment factor that Professor Ordover has proposed in this proceeding. *Id* at 2408:21-2409:3; *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4093. Had Professor Ordover continued to use the 0.1875 adjustment factor here, and made no other adjustments to his second alternative approach, the resulting royalty rate for Sirius XM would have been *less than 9%* ($5.95 x 0.1875 / $12.95 = 8.6%). 6/14/12 Tr. 2409:4-14 (Ordover).

371. Professor Ordover's putative interactivity adjustment in his second alternative approach does, perhaps unwittingly, account for the delivery platform that is included in the bundled product provided by Sirius XM in one of the precise fashions proposed by Professor Noll: by adopting the retail prices of Internet-delivered non-interactive webcasters as a proxy for the value of the music service provided by Sirius XM. Because these non-interactive services are all Internet-based and are not bundled with a delivery platform (the subscriber to these services must separately purchase a smartphone device and delivery platform), their prices reflect payments solely for music content and need not be further adjusted to account for Sirius XM's delivery platform. Noll RWRT p. 23; 8/14/12 Tr. 3477:8-15 (Noll).

372. This recognition enables two relatively straightforward adjustments to correct for this last model's remaining flaws. As Professor Noll testified, one only needs to substitute the proper non-interactive percentage rate (26.1%) for Professor Ordover's inappropriate interactive rate (60%) as well as a proper estimation of the weighted average retail price of the surveyed non-interactive services ($3.15) for Professor Ordover's improperly calculated average retail price ($4.86) to arrive at a viable approximation of a reasonable SDARS fee. Noll RWRT pp. 24-26; 8/14/12 Tr. 3471:17-3477:7 (Noll).

373. The rationale for the first of these adjustments has already been explained and the record support for it set forth. Professor Noll testified as to the flawed methodology in Professor

Ordover's calculation of the average retail prices of the non-interactive services he identifies that requires the second adjustment. Noll RWRT pp. 24-25; 8/14/12 Tr. 3473:1-3475:16 (Noll). To perform his calculation, Professor Ordover selected five services, whose identities and retail prices are listed in Table Five of Professor Ordover's Third Corrected and Amended Testimony. Professor Ordover listed one retail price for two services, two retail prices for one service, and three retail prices for two services. The differences among the retail prices for a particular service are due solely to the duration of a consumer's commitment to the service. Professor Ordover included multiple prices only for the higher-priced services. Because he included all of the listed retail prices in his average, his averaging technique placed greater weight on the higher-priced services – resulting in an artificially inflated average retail price for the non-interactive services. Noll RWRT pp. 24-25.

374. The retail prices that Professor Ordover used for the lower-priced services – the services for which he includes only one retail price – are for one year of service. Accordingly, a more accurate and consistent method for calculating the average price would have been to include only one observation – the price for a year of service – for each of the five services. This adjustment alone reduces the average retail price from \$4.86 down to \$4.01 – a reduction of 17.5%. Noll RWRT p. 25.

375. A second flaw in Professor Ordover's calculation of the average retail price for non-interactive services is that it fails to account for the fact that the five listed services are not all equally popular. Noll RWRT p. 25. The different services have dramatically different numbers of subscribers and plays and the lower priced services tend to be more popular than the higher priced services. In fact, Professor Ordover acknowledged that accounting for the difference in popularity of each of the five services would be appropriate, and it is only because

he lacked the data necessary to do so that he did not account for such differences. 6/14/12 Tr. 2412:7-2413:7. Professor Noll did, however, perform this calculation. When appropriately weighted, and using only the price for a year of service for each of the five services, the average retail price of the non-interactive services falls to $3.15 – a price that is some 35% lower than that used by Professor Ordover. Noll RWRT at 25-26

376. Correcting Professor Ordover's second alternative approach to (i) incorporate the proper percentage-of-revenue rate and (ii) properly compute the average retail price of the non-interactive services generates a rate – 6.34% – that falls squarely within the range of rates that were negotiated in the competitive marketplace between Sirius XM and nearly 100 independent record labels.[76]

B. Professor Sidak's Analysis Is Misleading, Inaccurate, And Largely Irrelevant

377. SoundExchange attempts to further bolster its overreaching rate proposal through the testimony of Professor J. Gregory Sidak, the force of which is to suggest that the Judges need not worry about drastically increasing rates because Sirius XM now, after 20 years of losses, has finally turned the financial corner and can afford to pay the rates proposed by SoundExchange – indeed, assertedly could pay without undue difficulty any rate up to nearly 58% of its gross revenues. Sidak ACWDT ¶¶ 72, 75.

378. To be sure, Professor Sidak nowhere opines on, or even addresses, whether the royalty rates proposed by SoundExchange are reasonable. He simply addresses whether Sirius XM will be able to afford the rates proposed by SoundExchange and whether those rates will allow Sirius XM to earn a fair return. Sidak ACWDT ¶¶ 1-2; 6/18/2012 Tr. 2732:20-2733:3 (Sidak) (the purpose of the Sidak testimony is to "examine competitive issues involving audio

[76] The underlying math is: 26.1% x $3.15 / $12.95 = 6.34%.[76] 8/14/12 Tr. 3475:17-3477:7 (Noll).

entertainment distribution suppliers that are relevant to the question of whether Sirius XM would be able to pay the royalty that is being proposed by SoundExchange in this proceeding").

379. In an effort to support his claim that Sirius XM can afford to pay the royalty rates proposed by SoundExchange while still earning a fair return, Professor Sidak asserts that Sirius XM faces no competition from other infotainment providers that constrain its pricing, that, as a result of the merger, Sirius XM has monopoly power, and even that Sirius XM is "relatively impervious" to macroeconomic downturns. Sidak ACWDT ¶¶ 19, 37, 43, 54, 58. For the reasons discussed below, each of these assertions is baseless.

1. Professor Sidak's Assertion That Sirius XM Faces No Competition And Has Monopoly Power Has Been Rejected By Multiple Government Agencies And Should Be Rejected Again

380. Professor Sidak continues his relentless, multi-year, multi-client campaign to brand Sirius XM as a monopolist that can raise prices at its whim. 6/18/12 Tr. 2750:14-2753:19 (Sidak). He continues this campaign despite the rejection of this very same advocacy by both the Antitrust Division of the Department of Justice (DOJ) and the Federal Communications Commission (FCC). *See id.* at 2787:8-9 ("there's no doubt in my mind that the FCC and the anti-trust division got the wrong answer"); Sirius XM Dir. Trial Ex. 65 (Statement of the Department of Justice Antitrust Division on Its Decision to Close Its Investigation of XM Satellite Radio Holdings Inc.'s Merger with Sirius Satellite Radio Inc., March 24, 2008); Sirius XM Dir. Trial Ex. 66 (FCC Memorandum Opinion and Order, *In the Matter of Applications For Consent to the Transfer of Control of Licenses XM Satellite Radio Holdings, Inc., Transferor to Sirius Satellite Radio Inc., Transferee*, 23 F.C.C.R. 12348, August 5, 2008).

381. Despite this repeated rejection by government agencies following extensive investigation, Professor Sidak continues to assert that the merger of Sirius and XM increased

Sirius XM's market power by giving it a monopoly in satellite radio. Professor Sidak's basis for concluding that Sirius XM enjoys monopoly power consists of the following: (1) Sirius XM is the only provider of satellite radio; (2) Sirius XM increased its prices, first by passing on licensing costs and then by increasing the sticker price of Sirius XM Select by $1.50 earlier this year; (3) Sirius XM has been able to reduce certain other content costs; and (4) Sirius XM's Tobin's q (the ratio of the market value of financial investments to the replacement costs of its assets) exceeds one. Sidak ACWDT ¶¶ 19, 25, 29, 30-34. These facts, if true, would be the beginning, not the end, of an analysis of whether Sirius XM, in fact, has monopoly power. Noll RWRT p. 39. For Professor Sidak, they constitute the entire analysis.

a. Professor Sidak's Observation That There Is Only One Provider Of Satellite Radio Is Irrelevant

382. Professor Sidak's first observation – that there is only one provider of satellite radio – is irrelevant unless no other technology is a competitive substitute for the product offered by Sirius XM. Noll RWRT p. 39. This is clearly not the case. The uncontested evidence plainly demonstrates that Sirius XM competes with a number of music and non-music content providers that are currently available in the automobile – including, to name a few, terrestrial radio, interactive and non-interactive Internet services, CDs, and MP3 downloads. *See* Section I.B.4, *supra*. In fact, even SoundExchange's own expert, Professor Ordover, acknowledged the clear evidence of the dynamic and rapidly evolving technological and competitive landscape in which Sirius XM competes. 6/14/2012 Tr. 2350:16-21 (Ordover) (Q: It is correct, is it not, that Sirius XM is competing against a large number of different modes of distribution, including not only terrestrial radio, but also interactive and non-interactive streaming services? A: Yes . . .); *id.* at 2351:4-15 (Q: In your view, the competitiveness of the market in which Sirius XM competes is, if anything, intensified? A: Yes, I would assume so. Yes. Q: And this is at least in part because

broadband is growing very rapidly. And the technologies are improving tremendously, both in terms of the devices and also in terms of the way cars, for example, come equipped with connectivity to other devices besides Sirius XM, correct? A: I agree with that. I think those might even be my words.").

383. Moreover, the FCC and the DOJ were well aware that in approving the merger, they were reducing the number of satellite radio providers from two to one. Had they believed that satellite radio does not compete with these other content providers, they almost certainly would have blocked the merger. Their decision to allow the merger and to give Sirius XM full pricing flexibility starting in 2012 reflected their judgment that Sirius XM does, in fact, face competition. Sirius XM Dir. Trial Ex. 65; Sirius XM Dir. Trial Ex 66.

384. For its part, the FCC recently reaffirmed its view that the market in which Sirius XM operates is a dynamic and competitive one:

> There is evidence that new competitive alternatives have arisen since 2008.... [T]he marketplace has evolved since the merger closed, and consumers now have additional audio entertainment choices ... indeed, it appears that since the merger order new audio services have emerged as viable consumer alternatives, including smartphone internet streaming applications that can be used in a mobile environment such as automobiles equipped with user-friendly interfaces.

Sirius XM Dir. Trial Ex. 67.

385. Professor Sidak attempts to distinguish Sirius XM from its competitors by pointing out the truism that there are differences between satellite radio and the services offered by Sirius XM's competitors. While there is no doubt that Sirius XM has attributes that distinguish it from its competitors, this observation is not a sufficient basis on which to conclude that these competitors do not constrain Sirius XM's ability to increase prices. Salinger CWRT ¶ 47; 8/16/12 Tr. 3819:4-18 (Salinger); Noll RWRT pp. 39-40. Under this flawed economic logic,

one would conclude that Pepsi does not constrain the pricing of Coke or that Rhapsody does not constrain the pricing of Napster. Salinger CWRT ¶ 47. Professor Sidak has simply failed to perform any analysis that answers the relevant question – whether these other music and non-music content providers create competitive constraints on Sirius XM. Noll RWRT pp. 39-40. Professor Sidak has simply assumed his conclusion.

b. Professor Sidak's Observation That Sirius XM Has Increased Its Prices Falls Well Short Of Demonstrating That Sirius XM Possesses Monopoly Power

386. In a second effort to demonstrate that Sirius XM has monopoly power, Professor Sidak notes that Sirius XM has been able to charge a music royalty fee and has recently increased the sticker price of its primary product. Sidak ACWDT ¶¶ 23, 25. In his view, this is enough to demonstrate that Sirius XM's pricing is unconstrained by competitors. As with the prior analysis, this one is woefully incomplete and is flawed as a matter of basic economics. Salinger CWRT ¶¶ 48-50.

387. First, the music royalty fee represents nothing more than Sirius XM passing on its costs. As Professor Salinger explained, cost increases will affect prices even in competitive markets, so Sirius XM's decision to pass on higher royalty costs, in a clear and transparent fashion, is hardly evidence of market power. Salinger CWRT ¶ 49; *see also* Noll RWRT 41 ("In all industries, prices must cover costs, so an increase in costs must be accompanied by a price increase or a firm will go out of business."). Moreover, the mere fact that a company increases its prices to reflect higher costs does not in any way imply that the cost increase fails to harm the company. It is a general principle in economics that a cost increase, even for a firm with some discretion over its price, lowers profits. Salinger CWRT ¶ 49.

388. Second, to conclude that Sirius XM must have market power simply because, after years of holding its price constant, it has finally implemented a price increase, is unsound as a matter of basic economics. As Professor Salinger explained, without a thorough examination of other explanations for a price increase – such as cost increases and product improvements – one cannot infer market power from such a price increase. Salinger CWRT ¶ 51. Once again, Professor Sidak has no supporting analysis and has simply assumed his conclusion.

389. Moreover, it is a mistake to look to the change in sticker price when calculating the actual price increase. To evaluate the true impact of the price increase, one must look to the change in the average revenue per user ("ARPU") – which only increased by 2.4% between the first quarter of 2011 and the first quarter of 2012. Noll RWRT pp. 41-42. The change in ARPU is much lower than the change in sticker price for at least two reasons. First, the new sticker price applies only to subscribers when they renew their subscriptions (or first sign up). Second, many customers do not pay the full sticker price as they receive discounts – in some cases substantial ones. Thus, the increase in the sticker price will only slowly and incompletely translate into an increase in ARPU. Noll RWRT p. 42; Frear RWRT ¶ 38.

c. Professor Sidak Failed To Demonstrate That The Decline In Sirius XM's Non-Music Content Costs Is The Result Of Monopoly Power

390. Professor Sidak infers from the fact that Sirius XM has achieved certain cost reductions, such as in its contractual relationship with Howard Stern, that this must reflect the exercise of market power. Sidak ACWDT ¶ 29. This simplistic formulation again attempts to equate an observed price change with market power, without more. Professor Sidak engages in no additional analysis, such as of the degree to which the cited activity reflects changing demand and supply conditions. Salinger CWRT ¶ 54. Professor Sidak simply fails to present any

evidence that these new non-music content contracts reflect market power versus a more sober forecast of the prospects for satellite radio. *Id.*

d. Professor Sidak's Discussion Of Tobin's q Is Misleading And Incorrect

391. Professor Sidak attempts to use Tobin's q – the ratio of the market value of a firm to the replacement value of its assets – to demonstrate that Sirius XM has monopoly power. But, as Professor Salinger, who has written extensively on the estimation of and use of Tobin's q,[77] explained, Professor Sidak's use of Tobin's q is not appropriate in this setting and, in any case, is flawed. Salinger CWRT ¶¶ 5, 58; 8/16/2012 Tr. 3823:5-3824:3 (Salinger). First, Professor Sidak seems to be of the view that any firm with a Tobin's q of above one has market power. Sidak ACWDT ¶¶ 30-31. This is incorrect. A "q" value that is greater than one only means that the firm has earned a rate of return that is above the competitive level, which many firms that are subject to the rigors of competition have done. Salinger CWRT ¶ 56. For a firm to undertake an investment that has some element of risk to it, there must be the prospect of earning a return that exceeds the competitive level (such that the upside of a return that exceeds the competitive level offsets the downside of a return that is less than the competitive level); otherwise the investment would never be made. As a result, the mere fact that a company may have earned a rate of return that is above the competitive level cannot mean that the company necessarily has market power. *Id.* at ¶ 59.

392. In any event, Professor Sidak has failed to even demonstrate that Sirius XM in fact has a Tobin's q that is greater than one. First, Professor Sidak's estimates of Tobin's q reflect straight-line accounting depreciation of Sirius XM's assets, but a properly calculated

[77] In fact, Professor Sidak cites to one of Professor Salinger's papers when discussing Tobin's q. Sidak ACWDT ¶ 30 n.33.

economic depreciation substantially reduces the "q" value. Salinger CWRT ¶ 60. Second, the current book value of Sirius XM reflects non-cash impairment charges of several billion dollars arising from the merger. Because Professor Sidak has failed to properly account for these massive impairment charges, his calculations are meaningless. *Id.*; Noll RWRT pp. 40-41.

2. Professor Sidak's Claim That Sirius XM Is "Relatively Impervious" To Macro-Economic Downturns Is Fanciful

393. In yet another effort to suggest that Sirius XM can afford to pay the royalty rates that SoundExchange proposes while still earning a fair return, Professor Sidak makes the stunning assertion that "Sirius XM is relatively impervious to macroeconomic downturns." Sidak ACWDT Section II. In an effort to support this claim, Professor Sidak attempts to demonstrate that the growth in Sirius XM subscribers continued throughout the recent recession. Sidak ACWDT ¶ 37 and Figure 1.

394. Professor Sidak's claim is belied by his own Figure 1. As Sidak Figure 1 demonstrates, Sirius XM's subscriber count was growing dramatically up until the start of the recession, at which point the growth rate slowed. By the end of the recession, Sirius XM's subscriber growth turned negative: for the first time since 2003, Sirius XM was losing subscribers. Sidak ACWDT ¶ 37 and Figure 1. Shortly after the official end of the recession, the number of subscribers began to grow again, albeit at a slower pace as the tepid recovery took hold. Given this clear and significant drop-off in the rate of subscriber growth experienced by Sirius XM during the recession, as compared to the growth rate prior to the recession, it is hard to fathom how Professor Sidak could conclude that Sirius XM is "impervious to macro-economic downturns." Salinger CWRT ¶ 42; 8/16/2012 Tr. 3818:13-22 (Salinger).

395. In an effort to reinforce his point, Professor Sidak attempts to show in Figure 2 of his written testimony that the decline in the number of Sirius XM subscribers during the recent

recession was small relative to the decline in the median household income. Sidak ACWDT ¶ 39 and Figure 2. But, as Professor Salinger explained, Professor Sidak is only able to generate the appearance of a dramatic difference by using misleading scales on his figure. When the scaling is corrected, as Professor Salinger has done in his Figure 1B, the apparent dramatic difference between the Sirius XM subscriber growth and the change in the median household income falls away. Salinger CWRT ¶ 43 and Figure 1B.

396. Furthermore, the trial record clearly demonstrates that Sirius XM's fortunes are tied directly to the automotive industry. *See, e.g.*, Stowell WDT ¶¶ 19-20 and Ex. 1; Salinger CWRT ¶ 44. In fact, the dramatic reduction in Sirius XM subscribers in 2008 and 2009 mirrors the drop in new car sales. Salinger CWRT ¶ 44 and Figure 2. This clear tie to an industry that is indisputably impacted by changes in the macro-economy only serves to further confirm that Professor Sidak's opinion that Sirius XM is relatively impervious to macro-economic downturns in simply wrong. Salinger CWRT ¶ 44. *See also* Stowell WDT ¶¶ 19-21 and Ex. 1 and 2.

C. Professor Lys's Analysis Is Unreliable And Misleading

397. SoundExchange's final effort to bolster its overreaching rate proposal is through the testimony of Professor Thomas Lys. Like Professor Sidak, Professor Lys nowhere opines on, or addresses, whether the royalty rates proposed by SoundExchange are reasonable – he simply attempts to determine whether the proposed rates will have a disruptive impact on Sirius XM's business. Lys CWDT ¶ 16. In an effort to perform this single task, and in place of any actual analysis, Professor Lys simply adopted the long-term forecasts of Sirius XM's financial performance put forward by Morgan Stanley – an entity that has a poor track record of forecasting Sirius XM's long term financial performance. Stowell WDT ¶ 37 and Exs. 7, 8. Using these forecasts, Professor Lys opines that Sirius XM could pay a royalty rate of up to 37%

in 2017 before its business would be disrupted, which he defines as having a free cash flow of zero. Lys CWDT ¶ 84; 8/20/12 Tr. 4077:19-4078:22 (Lys). Of course, Professor Lys' analysis is only as good as the forecast on which he relies. His results are entirely contingent on Sirius XM's future financial performance being as Morgan Stanley predicted. For the reasons discussed below, there is every reason to be skeptical of Morgan Stanley's long-term forecasts.

1. The Long Term Projections Of Morgan Stanley Are Speculative At Best

398. As Mr. Frear explained, projecting the long term financial health of Sirius XM is a highly speculative endeavor that requires substantial conjecture about largely unknowable events such as changing consumer preferences and spending, new car sales, investment decisions by automotive manufacturers, the ability of competitors (including ones that have yet to emerge) to achieve technical advances that may have the effect of replacing satellite radio in the dashboard, and Sirius XM's ability to repay or refinance its substantial debt. Frear RWRT ¶ 41. Indeed, it is for this reason that Sirius XM does not provide the public with guidance or projections of its expected financial performance that goes out more than 12 to 18 months into the future. *Id.* Any such projections would simply be too speculative.

399. This same logic applies with even greater force to the projections made by a third party such as Morgan Stanley.[78] While, as Professor Stowell noted, it is likely that Morgan

---

[78] History has shown that many equity analysts are biased and often forecast unrealistically favorable financial results for the companies they cover, for reasons that may include: (1) the expectation of better access to information from corporate management if they take a favorable position of the Company's stock; (2) pressure from the banking side of an investment bank if there is significant activity with a corporate client; and (3) when analysts initiate research on a company's stock because they expect the stock to do well, it is problematic for those analysts to subsequently advise investors to sell stock they had previously influenced those investors to purchase. Stowell WDT ¶ 35. The tendency of analysts to be unduly optimistic about the stocks they cover is illustrated in Professor Stowell's Exhibit 6 to his Written Direct Testimony, which shows that analysts rate 61% of all companies they covered in 2011 with a "Buy" and only 4% with a "Sell" recommendation. Stowell WDT ¶ 36; *see also* 6/8/12 Tr. 1222:19-1225:10 (Stowell) (expanding on Ex. 6).

Stanley will be able to project Sirius XM's financial performance over a year-long period with some degree of accuracy and reliability, it is simply implausible that Morgan Stanley (or anyone, for that matter) will be able to forecast Sirius XM's financial state with any reasonable degree of accuracy over a five-year period. 8/15/12 Tr. 3598:9-3599:11 (Stowell) ("I think Morgan Stanley is a fine firm in the context of a one-year or so period of time. They are likely to be fairly accurate, but beyond a year, especially going out five years, I think it's virtually impossible for Morgan Stanley or anyone else to have a lot of confidence regarding what SDARS will be out five years, what consumer behavior will be out five years, especially in a technology-based industry.").

400. Indeed, as Professor Stowell explained, the Morgan Stanley projections have no greater predictive value than the consensus projections of equity analysts proffered by SoundExchange's expert, Sean Butson, in the *Satellite I* proceeding. Stowell WRT ¶ 6. In evaluating Mr. Butson's analysis, the Judges noted that it is a "well-known fact that financial projections of the kind undertaken by Mr. Butson increase in uncertainty over the course of the period projected, with the last year in a six-year period of projections (in this case, 2012) being the least reliable." *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4092. The Judges went on to note that "Mr. Butson's projections . . . rest on a number of growth assumptions that either merely track past experience at best, or are arbitrary at worst, leading us to question the degree to which such data is reliable." *Id.* The reasoning of the *Satellite I* Determination applies with equal force to Professor Lys' analysis.

401. The CRB's skepticism regarding the reliability of analysts' projections proved well-founded. Stowell WRT ¶ 7 and Figures 1a and 1b. Mr. Butson, in relying on analyst projections, concluded that Sirius XM would have no problem refinancing its bond debt at a 10%

rate "conservatively." That conclusion turned out to be dramatically wrong: financing came at an extraordinary price that included 40% of Sirius XM's equity. Frear WDT ¶¶ 10, 13. Mr. Butson also vastly overestimated the combined subscriber base of Sirius and XM, projecting that they would have 33.3 million subscribers by 2010 – 57% more than Sirius XM has even today. Stowell WDT ¶ 9. His revenue and free cash flow predictions were also wildly over-optimistic; the Company's actual revenues turned out to be 42% lower than Mr. Butson originally predicted for 2010 and its free cash flow was 58% below his original prediction. Frear WDT ¶¶ 12, 36.[79]

402. Given the poor track record of financial analysts in forecasting Sirius XM's long-term financial performance, the expediency of adopting a new set of long-term analyst forecasts, as Professor Lys urges, does not afford any more reliable a basis for determining the likelihood of potential future disruption than the forecasts proffered by Mr. Butson in *Satellite I*. Stowell WRT ¶¶ 6, 8.

2. Professor Lys's Efforts To Bolster His Conclusions By Pointing To Sirius XM's Statements And Internal Analyses Are Misplaced

403. Professor Lys contends that Morgan Stanley's projections are reliable because they are consistent with management's expectation of continued growth. Lys CWDT ¶ 77. For this assertion, he cites optimistic, forward-looking statements that were made by Sirius XM management on investor calls. But, Professor Lys fails to note that none of these statements that he asserts support his conclusions actually contain any specific projections about Sirius XM's financial performance for the period 2013 through 2017. Stowell WRT ¶ 11. Moreover, as Professor Stowell notes, it is quite common for CEOs to make optimistic statements about the companies that they run; it is not uncommon for their optimism, no matter how well-founded and

[79] While SoundExchange posits that Butson's bottom line numbers were not far off, as Professor Stowell testified, "to end up where you expect to be on the bottom line is just happenstance" if you "can't forecast the top line and subscription accurately." 8/15/12 Tr. 3632:4-12 (Stowell).

genuinely believed, to turn out to be dramatically wrong. *Id.* at ¶ 12. This point is clearly illustrated by the numerous optimistic statements that were made on earnings calls by the CEOs of Blockbuster and Borders in the face of multiple ratings downgrades, declining stock prices, and less than two years prior to bankruptcy. *Id.* at¶¶ 12-13 and Figure 2.

404. Professor Lys also attempts to support his conclusions by pointing to certain of Sirius XM's internal planning documents. In his view, these long term plans are reliable predictors of the five-year financial performance of Sirius XM because they are "the marching order over the next five years" (8/20/12 Tr. 4026:3-14 (Lys)) and the "blueprint" for the business (*Id.* at 4026:14). This view is incorrect. As Mr. Frear explained, the planning documents to which Professor Lys points have a very limited use. In fact, despite Professor Lys' assertions to the contrary, they are *not* used to forecast revenue, subscriber growth or other top line numbers beyond one year; rather, they are used to chart strategies for cost reductions which may be achieved through upcoming contract negotiations. 6/7/12 Tr. 799:17-802: 18 (Frear); *see also* 8/13/12 Tr. 3141:18-3142:7 (Frear).

3. Professor Lys Failed To Account For The Possibility That Sirius XM Might Experience A Downturn In The Coming Years

405. In all but one of Professor Lys' models, he assumes that Sirius XM will experience continued revenue growth. It is only in his "worst-case scenario" model that he entertains the possibility that Sirius XM might experience no subscriber growth over the coming rate term. 8/20/12 Tr. 4091:21-4092:5 (Lys) (Judge Roberts: "Professor Lys, with respect to the sky falling in, your sky falling in scenario is that subscriber growth remains zero, correct?" Professor Lys: "Yes."); *see also* Lys WRT Appendix A.5; 8/20/12 Tr. 4039:20-4040:7 (Lys). Professor Lys failed to consider how downturns in subscriber counts, penetration, conversion, ARPU, or increases in churn might alter his conclusions. Nor does he make any adjustment to

his projections to reflect the risk that Sirius XM's business could undergo a downturn prior to December 2017. Stowell WRT ¶ 9; *see also* 8/20/12 Tr. 4080:15-4081:14 (Lys) (Professor Lys testifying that he had not done any modeling that alters the churn rate beyond the current 2% rate, nor done any modeling that decreases penetration rate or decreases current ARPU to see how these metrics could affect free cash flow over the next rate term). His worst case scenario simply assumes that revenues will remain as high as they were in the Company's best years.

406. But, as Mr. Frear explained, "Professor Lys's projections for revenue, EBITDA and free cash flow growth are . . . at odds with the Company's 20-year history and ignore the rapidly changing pressures and risks that the Company faces, including those posed by the terms and amount of its debt that matures before 2017 and the fast-paced technological advances that have led to substantially more competition in its market. Professor Lys incorrectly assumes that the Company functions in a static market of steady, continued revenue growth." Frear RWRT ¶ 42.

407. Indeed, even Morgan Stanley – the architect of the forecast on which Professor Lys relies – recognizes that Sirius XM faces substantial risks. Along with its analyst reports, Morgan Stanley warns of many specific risks to Sirius XM, including the risk of losing subscribers due to increased competition. As Professor Stowell explained, while Morgan Stanley does not factor these risks into its model, Morgan Stanley does explicitly state that if any one (or all) came to pass, they would have a material impact on its projections. 8/15/12 Tr. 3600:5-3601:3 (Stowell).

408. As but one example of Professor Lys' failure to account for the real risks faced by Sirius XM today is his insistence that Sirius XM's significant debt (which he cites as roughly $2.7 billion), poses no risk, 8/20/12 Tr. 4043:15-4044:7 (Lys); instead, he cavalierly likens the

Company's risk of default on its debt to snow falling in June. When asked whether a repeat of the two near bankruptcy experiences is likely, Professor Lys testified, "[a]s I said, they refinanced over $2 billion with no difficulty. Now, could we get another crisis? Yes. But it could also snow in June. Is it likely? Highly unlikely." *Id.* at 4045:4-4046:9.

409. But, as Professor Stowell explained, this view is entirely at odds with that of both Moody's and Standard & Poor's – the two largest credit ratings agencies. Both of these entities currently are of the view that there is a reasonable risk that Sirius XM will default on its debt. This is evidenced by the fact that Sirius XM's bonds remain classified as "junk" non-investment grade. Stowell WRT ¶ 15. While Moody's did recently upgrade Sirius XM's debt in August 2012 to a B1 rating, the five-year default rate for B1 rated debt is 21.1%, meaning that Moody's believes there is a better than one-in-five chance that Sirius XM will default on its credit obligations over the next five years. *Id.* at ¶ 16.

410. In short, Professor Lys's analysis fails to analyze the impact that any of the risks of which Sirius XM, Morgan Stanley, and the credit ratings agencies all warn could come to pass in the coming years. By simply ignoring all of the potential risks faced by Sirius XM and only considering the upside, it is no wonder that Professor Lys, like Professor Sidak, concludes that there is little risk that an increase in the royalty rate will disrupt Sirius XM.

* * *

411. As the above discussion makes plain, SoundExchange has failed to demonstrate that the royalty rates it seeks are reasonable.

VI. SOUNDEXCHANGE'S REVISED SDARS REGULATIONS SHOULD BE REJECTED

412. SoundExchange proposes a radical revision to the current definition of Gross Revenues at 37 C.F.R. § 382.11 that removes almost every current deduction and exclusion from

the carefully constructed definition the Judges crafted in the *Satellite I* Determination. SoundExchange presented no evidence, however, that the current definition is unworkable in practice or in need of revision, or that Sirius XM has in any way manipulated the definition to curtail its royalty obligation; nor has SoundExchange adjusted its proposed royalty rates to account for the additional revenue that would be swept in under its proposed changes to the revenue base – the result of which would be an unwarranted 30% in increase in Sirius XM's fee obligations even without any change to the royalty rate.

413. Sirius XM accordingly proposes that the current regulations be maintained essentially as is, with three modest changes: (1) to clarify that the crediting mechanism for directly licensed performances be based on satellite radio plays of such tracks (as opposed to the infeasible methodologies recommended by SoundExchange); (2) to clarify that Sirius XM need not report performances or aggregate tuning hours ("ATH") for its satellite radio transmissions (a technological impossibility nonetheless recently demanded by SoundExchange); and (3) to clarify that a late fee be assessed only for late payments, and not for both late payments and statements of account. Sirius XM is submitting Proposed Rates and Terms under separate cover comprising these revisions.[80]

A. SoundExchange's Proposed Revenue Definition Is Unnecessary, Unfair, And Should Be Rejected

414. The supposed rationale for SoundExchange's sweeping revisions is an alleged need to simplify license administration and to remove the opportunity for Sirius XM to "manipulate" and "obfuscate" its revenue reporting. *See* Bender WDT pp. 12-13. SoundExchange presented no evidence of any such manipulation. Mr. Bender admitted on the

[80] Sirius XM's proposed revisions also incorporate the parties' stipulation with respect to ephemeral fees. *See* 37 CFR § 382.12(c).

stand that he had not provided a single example of Sirius XM manipulating a revenue definition in a statement of account, obfuscating its revenue reporting, or failing to comply with existing reporting requirements. *See* 6/15/12 Tr. 2492:15-2493:14 (Bender). Indeed, the only "evidence" Mr. Bender provided was the fact that the revenue that Sirius XM reports to SoundExchange is less than the enterprise-wide revenue reported in accordance with generally accepted accounting principles ("GAAP") in Sirius XM's public filings. *See* Bender WDT pp. 5-6. He suggested that the fact that Sirius XM paid royalties on something less than its total reported revenues "is not consistent with the equivalence [that the Judges] defined" in the *Satellite I* Determination. *See* 6/15/12 Tr. 2485:20-2486:10 (Bender).

415. This assertion is simply incorrect. To start, Sirius XM's Annual Report on Form 10-K includes a significant amount of revenue from programming and services unrelated to the statutory license, such as revenue earned from the sale of radios and hardware accessories, revenue earned from business establishment services and internet webcasting, data services revenue, and Canadian revenue. Frear RWRT ¶ 15. Only by starting with a total figure that includes revenue having nothing to do with satellite radio can one argue that the revenue Sirius XM actually has reported to SoundExchange is significantly below 100% of the total, at odds with the Judges' ruling in the *Satellite I* Determination, or somehow wrongly calculated.

416. Moreover, SoundExchange's contention that Sirius XM is to be faulted for its exclusion of revenue that is unrelated to the statutory license misapprehends the Judges' rulings in *Satellite I* as well as the rationale behind the current regulations, which Sirius XM's reports and payments to SoundExchange have faithfully implemented. *Id.* In *Satellite I,* the Judges stated that "[i]n order to properly implement a revenue-based metric, a definition of revenue that properly relates the fee to the value of the rights being provided is required." *Satellite I*

Determination, Fed. Reg. Vol. 73, No. 16 p. 4087. The Judges adopted a definition "Gross Revenue" that included a variety of exclusions to "more clearly delineate the revenues related to the value of the sound recording performance rights at issue." *Id.* The exclusions of which Mr. Bender complains – and which SoundExchange's fee proposal eliminates – were intentionally and purposely adopted by the Judges to ensure that the revenue against which Sirius XM pays royalties includes only revenue attributable to activities conducted under the SDARS statutory license.

417. Lest there be any doubt, when SoundExchange moved for rehearing of the *Satellite I* determination on the precise grounds expressed by Mr. Bender here – that the revenue base set by the Judges contained exclusions that made it less than and different from total subscriber revenue – the Judges rejected the motion. *See Order Denying Motion for Rehearing, In the Matter of Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, Docket No. 2006–1 CRB DSTRA, pp. 1-5 (January 8, 2008). The D.C. Circuit, reviewing the determination on appeal, likewise stated that "the CRJ never opined that revenue from such non-music sources should be included in calculating the royalty payments." *SoundExchange, Inc. v. Librarian of Congress*, 571 F.3d 1220, 1225 (D.C. Cir. 2009). On cross examination, Mr. Bender admitted that he had not read SoundExchange's motion for rehearing on the *Satellite I* decision, was not aware that the bases for SoundExchange's motion for rehearing were the same as those expressed in his testimony here, and did not know that the Judges had flatly rejected SoundExchange's contention that the revenue definition should be based on all subscriber revenue. 6/15/12 Tr. 2486:11-2487:4 (Bender).

418. That the definitions *might* lead to some form of unspecified manipulation does not, without more, justify the wholesale *elimination* of existing deductions and exclusions, especially where (as discussed next) the revenue that SoundExchange would sweep into the definition is (a) earned for performances and activities that are totally unrelated to the SDARS statutory license and (b) hundreds of millions of dollars over the five-year license term. To the extent reporting issues or disputes arise – a not unexpected outcome given that Sirius XM is SoundExchange's largest licensee – SoundExchange has failed to explain why it cannot resolve those issues using the audit process provided by the regulations. *See* 6/15/12 Tr. 2493:12-2495:2 (Bender); *see also* Frear RWRT ¶ 13.

B. Adopting SoundExchange's Gross Revenue Definition Would Result In Millions Of Dollars Of Royalty Payments To SoundExchange Bearing No Relation To The Performance Of Sound Recordings On Sirius XM's Satellite Radio Service

419. As noted above, under the guise of "simplifying" reporting, SoundExchange is attempting to garner a rate increase of more than 30%, even without any accompanying increase in the royalty rate. Frear RWRT ¶¶ 14, 16; 8/13/12 Tr. 3024:17-3025:9 (Frear). As Mr. Frear testified, SoundExchange's proposed definitional changes would create royalty payment obligations for, among other things, separately-priced sports, talk and other programming that make only incidental use of sound recordings, performances of sound recordings not covered by federal copyright law, and webcasts – and undermine Sirius XM's direct licensing efforts. Frear RWRT ¶ 14. These new obligations, at 2011 fee levels, "would have swept in some ***$700 million*** a year . . . in unrelated revenue and nearly ***$54 million*** in additional royalties based on revenues having nothing to do with music." *Id.* at ¶ 16. Over the course of the five-year license term at issue, these revisions would give SoundExchange a windfall of over ***$300 million*** in

undeserved royalties based on revenue in categories unrelated to the SDARS statutory license, assuming 2012 royalty fee levels. *Id.*

1. Non-Music Programming

420. SoundExchange has proposed eliminating sub-clause 3(vi)(B) of 37 C.F.R. 382.11, which excludes revenues recognized by Sirius XM for "[c]hannels, programming, products and/or other services offered for a separate charge where such channels use only incidental performances of sound recordings." The biggest impact of this change would be to sweep in a portion of revenue from Sirius XM's "Premier" packages. The bulk of Sirius XM subscribers, whether on the Sirius or XM platform, subscribe to a "Select" package that includes a mix of music and non-music channels. Some subscribers choose to pay an additional fee to gain access to marquee channels on the other platform: subscribers on the XM platform, for example, get access to Howard Stern and NFL games, while subscribers on the Sirius platform can gain access to Oprah, Opie & Anthony, and the NHL. The additional channels that come with the Premiere upgrade are talk and sports channels that make only incidental use of sound recordings (if any at all). Frear RWRT ¶ 17; 8/13/12 Tr. 3028:19-3029:18 (Frear); 6/15/12 Tr. 2503:20-2504:10 (Bender).

421. This attempt to take a cut of the additional Premier-package revenue is at odds with the *Satellite I* Determination, where the Judges recognized that "[t]he separate fee generated for such nonmusic premium channels is not closely related to the value of sound recording performance rights at issue" and suggested that Sirius XM might offer non-music programming in a package for a separate charge. *See Satellite I Determination*, Fed. Reg. Vol. 73, No. 16 pp. 4087; *see also* 6/15/12 Tr. 2489:11-2491:5 (Bender) (discussing same). If adopted, this change

would pull an additional [redacted] into the revenue base and generate an extra [redacted] per year in royalty obligations to SoundExchange, at 2012 royalty levels.[81] Frear RWRT ¶ 18.

2. Performances Of Sound Recordings Separately Licensed Under A Direct License Or Exempt From A License Requirement

422. SoundExchange also advocates changing sub-clause 3(vi)(D) of the Gross Revenue definition to eliminate the current exclusion of revenue recognized from "[c]hannels, programming, products and/or other services for which the performance of sound recordings and/or the making of ephemeral recordings is exempt from any license requirement or is separately licensed."[82]

423. This proposed revision would prevent Sirius XM from deducting revenue on account of performances of sound recordings that are not even protected by federal copyright law (primarily sound recordings fixed prior to February 15, 1972) and thus not subject to the statutory license at issue here. Frear RWRT ¶ 20; 8/13/12 Tr. 3030:3-15 (Frear); *see also* 6/15/12 Tr. 2501:19-2503:19 (Bender). Subject to the caveat discussed below, it would also prevent Sirius XM from deducting revenue on account of performances that are not subject to the SDARS statutory license because Sirius XM and the copyright holder have entered a Direct License. Frear RWRT ¶ 20. In 2011 alone, [redacted] of Sirius XM performances were directly licensed or not covered by federal copyright law; Sirius XM reduced its reportable subscription

[81] To be clear, Sirius XM does not deduct the entirety of its Premiere package revenue – only the upcharge from the standard fee for the Select package (which does have music channels) to the Premier package (which adds non-music channels to the Select lineup). To the extent SoundExchange suggested otherwise at trial (*see* 8/13/12 Tr. 3101:3-3108:5 (Frear)), it is (a) incorrect and (b) an audit issue and in no way a justification for altering the revenue definition to cause Sirius XM to pay royalties on revenues clearly generated only on account of non-music programming.

[82] SoundExchange's revised definition allows an exception for revenue earned for a separately licensed service that is "priced separately from Licensee's SDARS, and offered at the same price both to subscribers to Licensee's SDARS and persons who are not subscribers to Licensee's SDARS." That allowance would not apply here, where the issue is not a separate *service* but separately licensed *performances* on the satellite radio channels.

revenue (less bad debt expenses and transaction fees) by that percentage – resulting in a [redacted] revenue deduction (and [redacted] in royalties savings). *Id.*

424. In its rebuttal case, SoundExchange retreated from its initial position and proposed four methodologies for calculating a credit for directly licensed performances.[83] It is not clear, however, whether SoundExchange is conceding that a credit is appropriate, or simply proposing crediting mechanisms to apply should the Judges decide such a credit is appropriate.

425. There can be no doubt that such a credit is appropriate. Absent such an allowance, Sirius XM would be forced to double-pay for such performances: once directly to the copyright owner and again to SoundExchange under the statutory license *Id.* Sirius XM and SoundExchange agreed that this would create a major disincentive for Sirius XM to enter direct licenses. *See* 8/13/12 Tr. 3030:16-3031:3 (Frear) (stating that needing to pay twice for such performances "certainly would kill our interest in directly licensing"); 6/15/12 Tr. 2501:3-8 (Bender) ("Q: You would agree with me that eliminating the reduction of revenue rates from record license performances creates a disincentive for Sirius XM to enter licenses? A: In the absence of a mechanism to value them fairly, yes."); *see also* Noll RWRT pp. 46-47 (describing the elimination of direct license credit as "anticompetitive" because it "gives Sirius XM no escape valve, not even a small one, for reducing the cost of the statutory rate by seeking less costly direct licenses" and "prevents a label from offering a lower rate in return for more plays").

426. Each new license that Sirius XM signs would only increase the double-payment injury to the Company while increasing the reward to non-directly licensed labels (as such labels would divide an unreduced royalty pool over a presumably smaller number of performances). Frear RWRT ¶ 20 and n.12. As Professor Noll observed, "[t]his proposal effectively grants

[83] The (de)merits of those methodologies for crediting directly licensed tracks are discussed below. *See* Section VI.C, *infra*.

SoundExchange an exclusive right to license sound recordings from all record companies to SDARS and assures that an unregulated competitive market will never develop." Noll RWRT p. 8. This is wrong as a matter of law, deeply unfair, and would usurp Sirius XM's contribution to the service it makes when it secures and pays separately for directly licensed material.

427. As to the deduction for pre-1972 recordings, SoundExchange has made no such crediting allowance. Mr. Bender suggested in his direct-phase testimony that the exclusion is not allowed under the current regulations because Sirius XM does not separately account for revenue according to whether it was earned from directly licensed or pre-1972 performances (something impractical if not impossible to do given that such performances are inevitably comingled with non-directly licensed and post-1972 performances on Sirius XM channels). *See* 6/15/12 Tr. 2487:17-2489:10, 2494:21-2497:7 (Bender). SoundExchange's interpretation is incorrect: the regulations merely require that the revenue from such "programming" be "recognized" according to GAAP (which it clearly is) and do not require a separate charge, channel, or accounting treatment for that programming. *See* 37 C.F.R. § 382.11.

428. Moreover, there is no reasonable distinction between the credit for directly licensed performances (which SoundExchange concedes) and a credit for pre-1972 recordings (which SoundExchange protests). They are treated no differently in Sirius XM's revenue accounting, and neither is covered by the statutory license here. Having proposed to allow for such a credit for directly-licensed performances (putting aside for the moment concerns over how the performance share is actually determined), SoundExchange cannot argue that pre-1972 performances should not similarly be credited because Sirius XM does not separately recognize the revenue for such performances. *See* ¶ 447, *infra* (proposing that credit be calculated using a *pro-rata* credit methodology based on satellite radio plays).

3. Webcasting And Other Separately-Licensed Services

429. SoundExchange's proposed change to sub-clause 3(vi)(D) also would prevent Sirius XM from excluding revenue for its webcasting and other non-SDARS services unless "such services are provided on a standalone basis." As Mr. Frear explained, because satellite radio subscribers pay $3.50 per month for a "linked" webcasting subscription – as compared to the $14.49 paid by standalone subscribers – revenue from linked subscribers would come into the SDARS revenue base. Frear RWRT ¶ 21. Thus, Sirius XM would be forced to pay satellite radio royalties for a service that it already pays for under the webcasting statutory license. *Id.* at ¶ 22; 8/13/12 Tr. 3036:2-17 (Frear).

430. Revenue from linked subscribers is budgeted at approximately [redacted] in 2012; at the current 8% rate, including this revenue in the base would generate an additional [redacted] payment to SoundExchange to which it is not entitled. Frear RWRT ¶ 22.

4. Data Services

431. Similar to its proposal involving webcasting revenue, SoundExchange seeks to eliminate the exclusion for revenue from data services in sub-clause 3(vi)(A) if the services are priced differently for satellite radio and "standalone" subscribers. This category includes revenue from a number of Sirius XM services other than its satellite radio service: NavTraffic, NavWeather, Sirius XM Traffic, Sirius XM Travel Link, XMWX Marine, Sirius Marine Weather, and XMWX Aviation, at least some of which are priced differently for standalone subscribers and SDARS subscribers who add them to existing subscriptions. Frear RWRT ¶ 22 n.13.

432. SoundExchange should not be entitled to a share of this revenue, which is budgeted at [redacted] in 2012, merely because the SDARS subscribers may receive a discount. *Id.*

5. Equipment Sales

433. SoundExchange's proposal to eliminate the current exclusion of Sirius XM revenue attributable to equipment sales found in sub-clause (3)(i) and to explicitly include "[r]evenues attributable to the sale, lease or other distribution of equipment and/or other technology for use by U.S. subscribers to receive or play the SDARS service, including any shipping and handling fees therefor" would sweep an additional [redacted] into the revenue base and generate an extra [redacted] in royalties at 2012 levels. Frear RWRT ¶ 23.

434. Mr. Frear testified that Sirius XM has spent hundreds of millions of dollars developing receivers, and the Company continues to pay substantial subsidies to automakers to pre-install the radios in new cars. *See* Sections I.B.3, IV.C.2, *supra*. It would be unfair for SoundExchange to be paid a share of equipment revenue that is essentially just an offset – and a partial one at that – of Sirius XM's vastly greater manufacturing and distribution costs, especially when SoundExchange shares fully in the subscription revenue generated by these investments. Frear RWRT ¶¶ 23 n.14, 24 (noting that Sirius XM cannot, as a practical matter, separate revenue earned for devices that receive services other than (or in addition to) satellite radio programming).

435. Moreover, as Professor Noll testified, this proposal is economically inefficient, unfair, and would disadvantage Sirius XM relative to its competitors. Noll RWRT pp. 42-46. Sirius XM's competitors in providing music service do not pay royalties to the record companies on the devices that consumers use to access their services – whether they sell devices themselves

(such as Apple selling iPhone and iPods) or not (internet webcasters accessed through separately purchased smartphones). *Id.* at pp. 43-45; Frear RWRT ¶ 24. Mr. Bryan, for example, explained that [redacted] and testified that [redacted] 6/13/12 Tr. 2021:16-2024:8 (Bryan); Sirius XM Dir. Trial Exs. 27-28. Nor does SoundExchange receive a share of equipment revenue earned by webcasters or by preexisting subscription services.[84] And, as discussed in preceding sections, the Cricket licenses [redacted] Noll RWRT pp. 7-8; Sections III.E, III.G.6, *supra*.

436. Sirius XM should not, merely by virtue of operating under the statutory license (especially one governed by the 801(b) factors), be subject to an added tax on its equipment sales, and in effect higher sound recording rates, that its competitors do not pay. *Id.* at p. 45 ("A royalty on equipment (or data service) causes an increase in its price. As a result services that sell the taxed input lose business to competitors that do not sell both equipment and content for a reason that is unrelated to either the quality or the cost of the equipment and the services that benefit from driving a cost wedge between them and the company that sells both.").

---

[84] As Professor Noll noted, a similar proposal by ASCAP to impose royalties for musical performances on data usage fees of wireless telecommunications carriers that are used to deliver audio and video entertainment to smart phones was firmly rejected by both the U.S. District Court and the Court of Appeals for the Second Circuit. *ASCAP v. MobiTV, Inc.*, 681 F.3d 76 (2d Cir. 2012); *see* Sirius XM's PCL at Section V.C.6.

6. Credit Card Fees And Bad Debt

437. SoundExchange also proposes to eliminate the current exclusions for transaction fees contained in sub-clause 3(iv) and bad debt expense contained in sub-clause 3(v).[85] As Mr. Frear explained, although Sirius XM recognizes subscription revenue for transaction fees, credit card companies deduct fees off the top before passing the revenue to Sirius XM. Frear RWRT ¶ 25. Thus, Sirius XM collects less money than what is initially recognized as revenue. *Id.* Bad debt expense also reflects revenue that was initially booked as earned but not ultimately collected from the customer. *Id.* The allowance for credit card fees and uncollectible bad debt serves the important function of ensuring that Sirius XM only reports revenue that it actually collects. *Id.* at ¶ 26. Through its proposed elimination of that allowance, SoundExchange is attempting to take a cut of "revenue" – [redacted] in credit card fees and [redacted] in bad debt in 2012 – that is never actually collected. *Id* at ¶ 25.

438. Moreover, the exclusion for bad debt is common in revenue-based agreements and consistent with the definition that applies to New Subscription Services (37 C.F.R. § 383.2), Preexisting Subscription Services (37 C.F.R. § 382.2), and the agreement between Sirius XM and SoundExchange for residential cable music service. Each agreement only requires the inclusion of bad debt if it is ultimately recovered. Frear RWRT ¶ 26.

7. Other User Fees And Taxes Unrelated To Statutorily Licensed Performances

439. Sirius XM charges fees for various activities related to customer account administration, such as activation fees, invoice fees, swap fees, and in certain cases early termination fees. These fees are not included in the current definition of Gross Revenues either because they do not constitute "subscription revenue," or because the current definition explicitly

[85] Credit card fees and uncollectible bad debt differ from other exclusions in that each is technically an allowance for an expense paid rather than an exclusion of revenue earned. Frear RWRT ¶ 26.

excludes "[s]ales and use taxes, shipping and handling, credit card, invoice and fulfillment service fees" (clause (3)(iv)). Frear RWRT ¶ 27. As Mr. Frear explained, these fees, which are projected to total about [redacted] in 2012, simply enable the Company to recover a portion of the equipment subsidies, call center and other costs that it incurs to initiate subscription revenues. *Id.* SoundExchange seeks to include in the revenue definition all fees and payments from Sirius XM subscribers. Such an unwarranted expansion would even allow SoundExchange to share in, among other things, Gross Tax Receipts, which are passed through to the appropriate taxing authority. *Id.* at ¶ 28. These administrative fees and taxes are wholly unrelated to performances under the statutory license, and SoundExchange has no entitlement to any of them. *Id.*

C. SoundExchange's Proposed Methodologies For Crediting Directly Licensed Tracks Are Fatally Flawed

440. SoundExchange's initial rate proposal lacked a mechanism for adjusting Sirius XM's royalty payments to reflect direct licensing. As noted above, in its revised proposal SoundExchange conceded that such a credit is merited. *See* Bender WRT pp. 1-3 ("If Sirius XM is committed to direct licensing, it is easy to contend that there should be some mechanism for adjusting its royalty payments to reflect the value of directly-licensed usage."). SoundExchange has proposed four alternatives for computing the direct license adjustment, in decreasing order of preference. Each of the four alternatives is flawed, and should be rejected in favor of a crediting mechanism based simply on plays on Sirius XM's satellite radio channels.

1. The First Two of SoundExchange's Four Proposals Are Technologically Impossible

441. SoundExchange's first two proposals, calculating the direct license share based on actual total performances of directly licensed material, or weighting directly licensed plays by the ATH on each Sirius XM channel, are technologically impossible. 8/13/12 Tr. 3033:8-

3035:18 (Frear). Because the SDARS service is a one-way broadcast, Sirius XM does not know who is listening to any of its channels at any time. Thus, the Company cannot report the number of performances or hours of listening. Frear RWRT ¶ 29; 8/13/12 Tr. 3038:16-3039:1 (Frear). Mr. Bender himself admitted that he was aware that Sirius XM cannot track actual performances or ATH on its satellite radio service. *See* 8/16/12 Tr. 3985:17-3986:21, 3987:13-3988:7 (Bender). In response to questioning from Judge Roberts, Mr. Bender also conceded that he lacked any specific information indicating that Sirius XM would be able to develop such tracking abilities within the next license term. *Id.* at 3986:1-21, 3987:17-3988:7.

442. Mr. Bender's testimony is consistent with SoundExchange's longstanding understanding on this point. In a November 24, 2008 letter agreement between SoundExchange and Sirius XM, SoundExchange specifically excused Sirius XM from reporting ATH for its SDARS channels for precisely this reason (though the Company was required to – and does – report ATH for its webcasting services). Frear RWRT ¶ 29 and Ex. 1.[86] Nonetheless, just a few days after Mr. Bender testified in the direct phase of this proceeding, SoundExchange sent a letter to Sirius XM on June 22, 2012 unilaterally renouncing the 2008 agreement and demanding that Sirius XM comply with every reporting requirement to the letter, including reporting ATH for all its satellite radio channels. Frear RWRT ¶ 30 and Ex. 2. SoundExchange's change in position does not alter the fact that it is impossible for Sirius XM to comply with sub-clause (d)(2)(vii) of 37 C.F.R. §370.4. *See* 8/13/12 Tr. 3041:11-14 (Frear).

[86] SXM Rebuttal Exhibits 1-4 were appended to the Revised Written Rebuttal Testimony of David J. Frear, and were admitted into evidence together with the written testimony as Sirius XM Rebuttal Trial Exhibit 1. All exhibits so attached will be hereinafter referred to as "Frear RWRT Ex. __."

443. Accordingly, Sirius XM has proposed revisions to the regulations to clarify that the requirement of reporting ATH or performances does not apply to SDARS. Frear RWRT ¶ 30.

2. SoundExchange's Third Proposal Is Infeasible

444. SoundExchange's third alternative, calculating direct license share based on a monthly survey of listenership data, is infeasible as well. *See* Bender WRT p. 7. There are several problems with this alternative (which would require Sirius XM to commission a third party to ascertain the relative listenership on Sirius XM's channels), not the least of which is that hiring a measurement firm would create a significant ongoing cost for Sirius XM. *See* 8/13/12 Tr. 3033:8-3035:18 (Frear). In addition, SoundExchange has failed to sufficiently describe the type of regulation that could be adopted to specify the survey service to be selected:

> JUDGE ROBERTS: Mr. Bender, are you proposing a particular choice of service?
>
> THE WITNESS: There are multiple services out there. We believe that – we leave it up to Sirius to find a service they can use.
>
> JUDGE ROBERTS: You have no input then or any interest in an input in a regulation that allowed Sirius XM to pick any service that they wanted?
>
> THE WITNESS: Surely it would have to be statistically valid. We would want to ensure that they use a methodology which is accepted in the marketplace.
>
> JUDGE ROBERTS: Well, you're asking us to consider this, and how would we do this to assure that a service was picked that would satisfy SoundExchange's interests and concerns?
>
> THE WITNESS: I'm –
>
> JUDGE ROBERTS: If Sirius XM has a myriad of choices, I have to assume that some are better than others. They could have a number of different methodologies as to how they calculate performances and you're asking us to consider this. How can we consider it if you're advocating that there be some sort of standards

> at least in the selection of these services. You haven't proposed any standards.

See 8/16/12 Tr. 3988:22-3990:2 (Bender). Selecting among a number of measurement firms in the absence of such standards would be problematic.

445. SoundExchange posits that if its third alternative were adopted, the firm or data to be used could be addressed in a future notice and recordkeeping. Bender WRT p. 7 n.8; 8/16/12 Tr. 3991:12-20 (Bender). But as Judge Wisniewski indicated, requiring additional notice and recordkeeping would deprive the parties of certainty at the close of this proceeding. 8/16/12 Tr. 3992:18-3993:18 (Bender). Judge Roberts likewise noted that "in this case in particular ... there has been, in the past, disagreement over the verification procedures and in particular the selection of the auditor." 8/16/12 Tr. 3992:6-10 (Bender); *see also* 8/13/12 Tr. 3033:8-3035:18 (Frear) (observing that there has been a fair amount of criticism surrounding Nielsen and its accuracy). In light of the foregoing deficiencies, SoundExchange's third methodology is not a viable alternative.

3. SoundExchange Has Failed To Demonstrate That Its Fourth Alternative (Webcasting Proxy) Is Necessary

446. SoundExchange's fourth alternative proposes to weight the direct license share from each satellite radio channel according to the listenership of the corresponding channel on Sirius XM's internet webcasting service. Whatever its technical feasibility, this option is simply unnecessary given the more obvious method conspicuously absent from SoundExchange's menu of alternatives: determining the direct license share on Sirius XM's satellite radio service based on the number of plays of directly licensed sound recordings on that very service. 8/13/12 Tr. 3032:19-3033:7 (Frear). This is the method of tracking and paying directly licensed performance royalties that has been agreed to in every direct license between an independent label and Sirius

XM. 8/15/12 Tr. 3680:8-11 (Gertz). The direct licensors were aware of this methodology for determining their royalties, and indicated no concerns on this point during the negotiations. *Id.* at 3680:18-3681:4. In other words, the market itself has accepted the satellite radio play measurement without reservation.

447. SoundExchange has demonstrated no need for creation of a second system to account for the very same performances. In fact, as Mr. Frear noted, using a per-play allocation method is also fair given the fact that "SoundExchange distributes money according to per play." 8/13/12 Tr. 3032:19-3035:18 (Frear). SoundExchange's expressed concern that, without weighting performances for listenership, Sirius XM would have an incentive to load less popular channels and off-hours with directly-licensed recordings proved at trial to be unfounded. Multiple witnesses, including SoundExchange's own, recognized instead that Sirius XM would not jeopardize the quality of its music offerings or the integrity of its channels by so manipulating its play lists. 8/13/12 Tr. 3033:8-3034:6 (Frear); Blatter WDT ¶ 13; 6/8/12 Tr. 981:8-982:12 (Blatter) ("Q: Would you ever allow any of the programmers who work with you to sacrifice the quality or the integrity of the channel to benefit a direct license just for that reason? A: Absolutely not. The quality of our channels and the integrity of them will always come first.").[87]

448. Accordingly, Sirius XM's Proposed Rates and Terms, which are being submitted in conjunction with its Proposed Findings of Fact, include a revision to section (3)(vi)(D) of the Gross Revenues definition to provide for the following simple pro-rata reduction of Sirius XM payments based on satellite radio plays:

---

[87] SoundExchange's own witnesses acknowledged that they understood this to be Sirius XM's intended approach to programming directly licensed recordings. 6/15/12 Tr. 2565:22-2566:10 (Van Arman) ("[H]ow it has been described to me anecdotally, is that [Sirius XM's] programmers are basing their programming decisions on the merits of – of the music and the quality of the performance of the artist. That is my belief."); 8/20/12 Tr. 4174:12-4177:13 (Powers).

> (3) Gross Revenues shall exclude: . . . (vi) Revenues recognized by Licensee for the provision of. . .
>
> (D) Channels, programming, products and/or other services for which the performance of sound recordings and/or the making of ephemeral recordings is exempt from any license requirement or is separately licensed, including by a statutory license and, for the avoidance of doubt, webcasting, audio services bundled with television programming, interactive services, and transmissions to business establishments. **Pursuant to this sub-clause, Licensee's monthly royalty fee shall be calculated by reducing the payment otherwise due by the percentage of Licensee's total transmissions of sound recordings during the month that are exempt from any license requirement or separately licensed (e.g., if 10% of licensee's transmissions are exempt from any license requirement or separately licensed, Licensee's monthly royalty fee shall be reduced by 10%).**

D. SoundExchange's Other Proposed Changes To The Terms Are Not Justified

449. SoundExchange also seeks a revision to 37 C.F.R. § 382.13(d) that would enable it to collect separate late fees for the payment and for the statement of account. In *Satellite I*, the Judges rejected a similar request from SoundExchange as "onerous." 73 Fed. Reg. at 4100. Although the Judges held that a (single) late fee was justified for late statements of account to aid the efficient distribution of royalties, *see id.*, that justification no longer exists given that there is but a single SDARS in operation. Sirius XM's statement of account simply identifies the amount of Sirius XM's payment for the month, and thus does not provide any additional information that would impact SoundExchange's ability to distribute Sirius XM royalties. Frear RWRT ¶ 28 n.15. Sirius XM thus proposes a clarification to the regulations to ensure that a single late fee is to be charged in a given reporting period only in the case of a late payment.

CONCLUSION

For the reasons set forth herein, and in Sirius XM's accompanying Proposed Conclusions of Law, the Copyright Royalty Judges should adopt the Proposed Rates and Terms submitted by Sirius XM.

Dated: September 26, 2012

Respectfully submitted,

R. Bruce Rich (N.Y. Bar No. 1304534)
Miranda Schiller (NY Bar No. 2295624)
Randi W. Singer (NY Bar No. 2946671)
Todd Larson (N.Y. Bar No. 4358438)
Sabrina A. Perelman (N.Y. Bar No. 4481529)
Jacob B. Ebin (N.Y. Bar No. 4774618)
WEIL, GOTSHAL & MANGES LLP
767 Fifth Avenue
New York, NY 10153
Tel: 212.310.8170
Fax: 212.310.8007
r.bruce.rich@weil.com
miranda.schiller@weil.com
randi.singer@weil.com
todd.larson@weil.com
sabrina.perelman@weil.com
jacob.ebin@weil.com

Counsel for Sirius XM Radio Inc.

APPENDIX A

Fact Witnesses

1. Mel Karmazin is Chief Executive Officer of Sirius XM. He held the same position with Sirius Satellite Radio Inc. ("Sirius") from 2004 until the 2008 merger with XM Satellite Radio Holdings, Inc. ("XM"). Karmazin WDT ¶ 1; 6/11/12 Tr. 1311:9-22 (Karmazin). Prior to joining Sirius, he served as President and Chief Operating Officer of Viacom, Inc. and as Chief Executive Officer of CBS Corporation. Karmazin WDT ¶ 1. Mr. Karmazin testified before the Judges during the direct phase of the proceeding on June 11, 2012. 6/11/12 Tr. 1310:20-1443:21 (Karmazin).

2. James E. Meyer is President, Operations and Sales, of Sirius XM. Meyer WDT ¶ 1. He held that position since joining Sirius in 2004 before the merger with XM. *Id.* Mr. Meyer is responsible for Sirius XM's technological operations, its sales and marketing, and its substantial customer-facing organization. *Id.* at ¶ 3. He testified before the Judges during the direct phase of the proceeding on June 6, 2012. 6/6/12 Tr. 510:7-627:12 (Meyer).

3. David J. Frear is Executive Vice President and Chief Financial Officer of Sirius XM. He has worked in this capacity (including for Sirius prior to the merger) for the past nine years. Frear WDT ¶ 1; 6/7/12 Tr. 637:8-10 (Frear). He is responsible for managing the financial and accounting aspects of Sirius XM's business. Frear DWDT ¶ 3; Frear WDT ¶ 1. Mr. Frear testified before the Judges during the direct phase of the proceeding on June 7, 2012. 6/7/12 Tr. 636:8-817:21 (Frear). Mr. Frear also testified during the rebuttal phase of the proceeding on August 13, 2012. 8/13/12 Tr. 3008:16-3204:4 (Frear).

4. Steven Blatter is Senior Vice President and General Manager of Music Programming at Sirius XM. Blatter WDT ¶ 1. Prior to the merger of Sirius and XM, he worked

for Sirius beginning in 2003. *Id.*; 6/8/12 Tr. 965:14-966:2 (Blatter). Mr. Blatter oversees all of Sirius XM's commercial-free music programming, including the employees who are responsible for the curation and presentation of channels to subscribers. 6/8/12 Tr. 966:10-16 (Blatter). He testified before the Judges during the direct phase of the proceeding on June 8, 2012. *Id.* at 965:2-1037:7.

5. Ronald H. Gertz is Chairman of Music Reports, Inc. ("MRI") and has worked in the music licensing and rights administration business for thirty-five years. Gertz CWDT ¶¶ 1-2. MRI has assisted Sirius XM with its ongoing effort to secure direct licenses from record companies at competitive rates in lieu of the statutory license administered by SoundExchange. *Id.* at ¶¶ 1, 9-13. Mr. Gertz testified before the Judges during the direct phase of the proceeding on June 7, 2012. 6/7/12 Tr. 818:4-953:17 (Gertz). He also testified during the rebuttal phase of the proceeding on August 13, 2012. 8/15/12 Tr. 3678:6-3771:13 (Gertz).

Expert Witnesses

6. Roger G. Noll is a Professor of Economics *Emeritus* at Stanford University, a Senior Fellow and the Co-Director of the Program on Regulatory Policy of the Stanford Institute for Economic Policy Research, and a Senior Fellow in the Stanford Center for International Development. Noll RAWDT p. 1. He received a B.S. with honors in mathematics from the California Institute of Technology and an M.A. and a Ph.D. in economics from Harvard University. Noll RAWDT Appendix A at p. 1. Professor Noll has provided testimony in several cases in the past. 6/5/12 Tr. 193:8-16 (Noll); Noll RAWDT at pp. 2-5. He testified before the Judges during the direct phase of the proceeding on June 5, 2012 and June 6, 2012. 6/5/12 Tr. 192:1-297:2 (Noll); 6/6/12 Tr. 305:3-509:1 (Noll). He also testified during the rebuttal phase of the proceeding on August 14, 2012 and August 15, 2012. 8/14/12 Tr. 3441:20-3489:21 (Noll);

8/15/12 Tr. 3497:7-3593:22 (Noll). The Judges accepted Professor Noll as an expert in the economics of industrial organization, including the economics of antitrust regulation and intellectual property. 6/5/12 Tr. 205:21-207:20 (Noll).

7. William R. Rosenblatt is the President of GiantSteps Media Technology Strategies, a management consulting firm. Rosenblatt CWDT p. 1. He has consulted to a range of clients on digital content technology strategy, including the areas of digital rights technologies, digital copyright, online content business models, and digital content management and distribution. *Id.*; 6/8/12 Tr. 1043:1-8 (Rosenblatt). Mr. Rosenblatt has served as an expert witness or consultant in the past. Rosenblatt CWDT p. 2; 6/8/12 Tr. 1049:6-22 (Rosenblatt). Mr. Rosenblatt testified before the Judges during the direct phase of the proceeding on June 8, 2012. 6/8/12 Tr. 1037:17-1194:13 (Rosenblatt). The Judges accepted Mr. Rosenblatt as an expert in the technology of and the market for Internet-delivered audio services. *Id.* at 1050:2-16.

8. David P. Stowell is a professor of finance at Northwestern University's Kellogg School of Management. Stowell WDT ¶ 1. He has a B.A. in economics from Utah State University and an M.B.A. in finance from Columbia University's Graduate School of Business. *Id.* at ¶ 4. Prior to joining the faculty of Kellogg, he worked in the investment banking industry for twenty years. *Id.* at ¶ 1. Professor Stowell has been recognized as an expert in prior cases. 6/8/12 Tr. 1201:12-1202:1 (Stowell). He testified before the Judges during the direct phase of the proceeding on June 8, 2012. *Id.* at 1197:19-1299:17. He also testified during the rebuttal phase of the proceeding on August 15, 2012. 8/15/12 Tr. 3594:7-3672:17 (Stowell). The Judges accepted Professor Stowell as an expert in investment banking and capital raising. 6/8/12 Tr. 1202:2-13 (Stowell).

9. John R. Hauser is the Kirin Professor of Marketing at the MIT Sloan School of Management at the Massachusetts Institute of Technology ("MIT"). Hauser CWDT ¶ 1. He graduated from MIT with an S.B. in Electrical Engineering, an S.M. in Civil and Electrical Engineering, and a Sc.D. in Operations Research. Hauser CWDT Appendix A at p. 1. Professor Hauser has served as an expert witness in connection with a range of disputes, most of which involved surveys and other market research to measure consumers' attitudes, beliefs, and intentions. Hauser CWDT ¶ 4. He testified before the Judges during the direct phase of the proceeding on June 12, 2012. 6/12/12 Tr. 1595:1-1652:3 (Hauser). The Judges accepted Professor Hauser as an expert in marketing, market research, and survey design. *Id.* at 1597:15-1598:2.

10. Michael A. Salinger is the Jacqueline C. and Arthur S. Bahr Professor in Management and Professor of Economics at the Boston University School of Management and a senior academic advisor to Charles River Associates. Salinger CWRT ¶ 1. He has a B.A. in economics from Yale University and a Ph.D. in economics from the Massachusetts Institute of Technology. *Id.* at ¶ 5. Dr. Salinger has testified as an expert in numerous proceedings, including proceedings before the Copyright Royalty Board. *Id.* at ¶ 6; Salinger CWRT Appendix A at pp. 6-7; 8/16/12 Tr. 3789:12-3790:2 (Salinger). He testified before the Judges during the rebuttal phase of the proceeding on August 16, 2012. 8/16/12 Tr. 3785:12-3843:6 (Salinger). The Judges accepted Dr. Salinger as an expert in the economics of industrial organization and antitrust regulation. *Id.* at 3790:6-13.

CERTIFICATE OF SERVICE

I, Sabrina A. Perelman, hereby certify that a copy of the public version of Sirius XM Radio Inc.'s Proposed Findings of Fact was served on October 1, 2012 via email and overnight mail on the following parties:

David A. Handzo
Michael B. DeSanctis
Jared O. Freedman
JENNER & BLOCK LLP
1099 New York Ave., N.W.
Washington, D.C. 20001
Phone: (202) 639-6000
Fax: (202) 639-6066
dhandzo@jenner.com
mdesanctis@jenner.com
jfreedman@jenner.com

Counsel for SoundExchange, Inc.

Paul M. Fakler
Martin Cunniff
ARENT FOX LLP
1675 Broadway
New York, New York 10019-5874
Phone: (212) 484-3900
Fax: (212) 484-3990
cunniff.martin@arentfox.com
fakler.paul@arentfox.com

Counsel for Music Choice

Sabrina A Perelman

Sabrina A. Perelman