Before the
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Washington, D.C.

In the Matter of	)	
	)	
Adjustment of Rates and Terms for	)	
Preexisting Subscription and Satellite Digital	)	**Docket No. 2006-1 CRB DSTRA**
Audio Radio Services	)	
	)	
	)	

WRITTEN DIRECT TESTIMONY OF DAVID J. FREAR

Introduction and Witness Background

1. I am an Executive Vice President and the Chief Financial Officer of Sirius Satellite Radio Inc. ("Sirius"). I submit this statement in support of Sirius' direct case. As described in this statement, Sirius is a provider of satellite digital audio radio service ("SDARS"). The Sirius SDARS offers a variety of digital quality radio programming primarily targeted to subscribers in their cars, other vehicles, homes and on the go.

2. I offer this testimony:

- To describe the enormous financial costs and investments Sirius has made, and risks it has faced, in order to bring to the public a new and improved way to obtain programmed audio entertainment, anywhere in the 48 contiguous United States, any time, including, among other things:
  - the extensive investment that Sirius has been required to make to create from scratch a new transmission system, literally from the ground up (and from space down)—from its broadcast facilities, to satellites in outer space, to its terrestrial repeater network, and to specially designed antennas and radios;
  - the significant, ongoing financial risks and funding requirements facing Sirius as a result of this substantial investment;

  - o the huge costs of building distribution partnerships, establishing Sirius as a mass consumer brand and acquiring subscribers; and
  - o the costs we incur to create compelling, exclusive and branded talk, entertainment and sports programming; and the extensive value we add to music programming through our experienced on-air hosts and music format managers, branding our music channels, securing limited run features with legendary musical talent, and live performances in our studios. These costs are incurred in order to convince subscribers who have multiple music listening choices, including free alternatives like terrestrial radio, to buy a new technology radio and to pay $12.95 a month to receive our audio entertainment.

- To provide detailed financial information about Sirius, including information about the costs used by Dr. John Woodbury in his analysis of an appropriate license fee; and
- To offer Sirius' view on the appropriate fee for the sound recording performance right, specifically why Sirius believes that the appropriate fee is at the low end of the range described by Dr. Woodbury in light of the many highly conservative assumptions used by Dr. Woodbury.

3. I have held my current position since June 2003, when I joined Sirius. My responsibilities include (i) managing the financial and accounting aspects of all areas of Sirius' business including the satellite and terrestrial transmission infrastructure; the development and manufacture of Sirius chipsets and radios; the costs of subscriber acquisition, customer care, sales and marketing; as well as the costs of program acquisition, creation and branding; (ii) oversight for the company's information technology (IT) function, including our subscriber management system described in the testimony of Michael Moore; (iii) audit and tax functions, including compliance with public financial disclosures and securities regulations; (iv) the planning and procurement for our next-generation satellite program and (v) supervision of our treasury and investor relations functions, which include balance sheet management and relationships with the Wall Street community.

4. Prior to joining Sirius, I was Executive Vice President and CFO for SAVVIS Communications, a global managed network services provider with operations in 44 countries.

Prior to joining SAVVIS, I was Senior Vice President and CFO for Orion Network Systems, an international satellite services company, where I assisted Orion in raising over $850 million to fund the construction of the company's global satellite system. Prior to joining Orion Network Systems, I was the Chief Financial Officer of Millicom, a leading worldwide developer and operator of cellular telephone and telecommunications services. I previously held various management positions at Bear, Stearns & Company, Credit Suisse, Transway International and Deloitte & Touche. I hold a Master of Business Administration degree from University of Michigan Graduate School of Business Administration, as well as a Bachelor of Arts degree also from University of Michigan.

The Risks of the Satellite Radio Business

5. Satellite businesses are extremely risky. I know this first hand from my work at Sirius and Orion Network Systems. Further, I have followed the satellite radio industry closely since its inception in the early 1990s. I first met and began a dialog with Sirius in 1993. I was offered the Chief Financial Officer position in 1997 but declined given the overwhelming technological, business and funding risks that the industry faced during its pre-launch phase, and the potentially insurmountable competitive position of terrestrial radio which obtains its sound recordings for free and does not have to design and distribute radios in order to allow listeners to hear its service. I am also familiar with the testimony of satellite industry expert Roger Rusch, our Chief Executive Officer, Mel Karmazin, and our Senior Vice President, Engineering, Terrence Smith, which accurately describes these risks. First, Sirius was required to obtain the requisite regulatory authorizations. Then, the satellites themselves had to be designed, constructed, launched into orbit, and tested. This required an enormous up-front investment before commercial operation could begin and revenues could be generated. As further explained

by Terrence Smith, limits on satellite reception in certain areas required Sirius also to invest in a network of terrestrial repeaters to fill potential coverage gaps.

6. In Sirius' case, this satellite-related investment risk was further exacerbated because Sirius offered a wholly new consumer service utilizing innovative technologies, requiring it to simultaneously fund the design and development of compatible customer equipment to permit subscribers to receive its service, as detailed in the testimony of John Douglas Wilsterman and Robert Law. In the beginning, Sirius had to rely on third parties to design equipment. These third parties did not have experience in designing satellite radios and, given the relatively small impact satellite radio would have on their businesses, were not always motivated to devote adequate resources to the development tasks; hence Sirius was required to establish its own internal research and development program to develop radios and chipsets for its equipment. In fact, Sirius faced an enormous challenge in 2001 when critical problems surfaced with the chipsets being developed and manufactured for Sirius by Agere Systems, Inc. (the successor to the micro-electronics group of Lucent Technologies, Inc.). These chipsets were the core component of the radios that receive our broadcasts. With our planned operational launch not far away and XM Satellite Radio approaching its operational launch, Sirius did not have working radios. This setback delayed Sirius' commercial launch, pushed back our automotive OEM programs by several years, helped XM Satellite Radio get to market before us with more advanced chipsets and radios (creating a meaningful early competitive lead for XM in both number of subscribers and brand awareness), and ultimately forced Sirius to recapitalize its balance sheet and exchange approximately 91% of its debt for equity, considerably diluting the then existing shareholder base.

7. Moreover, Sirius was required to enter a market to compete against a terrestrial radio industry with a combined $20 billion in revenue and $11 billion in free cash flow, which among other things, obtains its musical recordings for free. In short, we were required to develop a compelling programming offering that would convince consumers to pay for a service analogous to one they already received for free. We learned early on that simply having the right to perform music and sound recordings did not mean that consumers would pay for our service. Performances of music are available, for free to the listener, from multiple sources, most notably terrestrial radio, but increasingly a plethora of internet radio stations and podcasts. In order to drive sufficient subscription demand and earn a reasonable return on capital for our shareholders, we found that we needed to invest heavily in non-music programming, such as name-brand sports programming from the NFL, NBA, NHL and NASCAR and well known personalities like Howard Stern, Barbara Walters and Martha Stewart. We have also had to invest in brand name news programming like CNN, Bloomberg, and Fox News. Further, as Steve Blatter testifies, we needed to "do music better" than our free terrestrial radio and Internet radio competitors. In order to provide a meaningfully superior music service, we had to offer deeper playlists and a broader spectrum of music genres programmed by format managers with considerable knowledge of their formats. In order to further drive listener loyalty to our music channels, the channels needed branding and personality which we achieved by featuring best-in-class on-air hosts and a strong celebrity presence. We invested in a leading edge programming software platform to allow our on-air hosts to create and record programming and to manage our entire multichannel programming service. Further, our sound quality had to be better than the competition while we still needed to extract as much capacity as possible from our allocated

spectrum to broadcast all this content. This required additional and ongoing investment in compression and multiplexing technologies.

8. Meeting these funding needs required Sirius to make capital expenditures for property, plant and equipment totaling almost $1.3 billion through June 30, 2006 with an uncertain ultimate return on investment. As discussed below, Sirius has also incurred and continues to incur substantial and increasing operating costs.

9. Although Sirius began to invest in its business as early as 1990, and had invested more than $1 billion prior to commercial launch, Sirius could not begin to provide service until 2002. Subscriber growth has been steady, but slower than projections at the time when we reached our initial agreement with SoundExchange. In a forecast prepared at the time of the initial agreement with SoundExchange and publicly filed in connection with the company's 2003 recapitalization, the company expected to generate [[ ]] in revenues, incur net losses of [[ ]] and require, [[ ]] in cash flow for its operations through 2006. In fact, through 2006 Sirius is expected to generate approximately [[ ]] less revenue, losses are expected to be [[ ]] higher and the company's operations are anticipated to require [[ ]] more cash than expected.

10. Sirius has suffered and continues to suffer substantial losses. Sirius' accumulated deficit totaled $3.4 billion through June 30, 2006. Net losses are expected to continue to accumulate until 2009. [[

]] Further, Sirius will not even erase its aggregate net losses within the time horizon generally forecast by Wall Street analysts. As financial expert Armand Musey testifies, increasing sound recording performance fees may further delay these dates, which will likely have an adverse effect on Sirius' investors and the company's ability to obtain any additional financing.

11. As is clear from my testimony, projections are uncertain estimates that often are not realized. In the projections noted above, Sirius expected to be cash flow break-even by 2005. It is now late 2006 and we have still not achieved that goal. Reaching the goals described above depends on continued growth of customer demand in the face of an uncertain market for subscription SDARS service, Sirius' competitive positioning vis-à-vis terrestrial radio, the possible growth of new technologies, and the potential for technical and operational problems with our novel technology as well as our satellites and repeater network. At the time of the original royalty agreement with Sound Exchange, industry forecasts for subscriber, revenue and free cash flow growth were far more bullish than where we stand today, further evidence that commercial-free music was not enough to drive demand for satellite radio and to turn it into a viable long term business.

The Costs of the Sirius Service

12. The costs to authorize, design, deploy and operate a SDARS system are vastly different from, and many times greater than, those faced by a traditional radio broadcaster or programmer. Sirius has developed an innovative technology that permits the nationwide broadcast of digital quality radio services to fixed and mobile radios. The costs of bringing this new technology to the market are enormous. To get its radios into vehicles and into the hands of consumers, Sirius must operate a consumer electronics business and an automotive electronics business. We must also sell the Sirius service directly to subscribers, pay subsidies and other costs to acquire those subscribers, and then bear the expenses of servicing and billing those

subscribers. Sirius must also, of course, provide quality programming that is sufficient to induce potential subscribers to pay for the service and to retain our existing subscribers.

Satellite and Terrestrial Transmission System and License Costs

13. License: As one of two winning bidders in the FCC license auction of 1997, Sirius paid $83.3 million to acquire its license from the Federal Communications Commission ("FCC") to operate a national satellite radio system.

14. Satellites: Sirius has invested approximately $950 million in its first generation satellite infrastructure. Sirius invested approximately $800 million to design, construct, and deploy its three in-orbit satellites in order to deliver its radio offerings to subscribers. Our three orbiting satellites and one ground spare satellite were designed and built by Space Systems/Loral with an intended useful life of 15 years. The capital costs of Sirius' three orbiting satellites, including the costs associated with satellite launches, ranged from approximately $259 million to approximately $273 million each. The fourth satellite, currently on the ground as a spare, cost approximately $130 million, and long-lead time parts for a potential fifth first generation satellite cost approximately $15 million. Sirius has invested an additional $18 million in the tracking, telemetry and control ("TT&C") system which is used to control operation of the satellites. Sirius performs TT&C for our orbiting satellites by an earth station in New Jersey and additional stations in Panama and Ecuador, as described in the testimony of Terrence Smith. Sirius TT&C equipment has a useful life of 3 or 15 years and depreciation of the TT&C equipment is included in Sirius' reported satellite depreciation. Satellite, launch vehicle and TT&C depreciation expenses for fiscal years 2004 and 2005 and the first half of 2006 totaled **[[**

]], respectively.

15. Next Generation Satellites: Sirius expects to replace its existing in-orbit, three satellite constellation by the end of 2012. We recently adjusted the useful lives of two of the in-orbit satellites to 13 years (from 15 years) to reflect how we intend to operate the constellation. In June 2006, Sirius entered into an agreement with Space Systems/Loral for the design and construction of a new satellite, the first satellite in the planned new constellation. Sirius expects the total cost of this new satellite—including the launch vehicle, launch insurance and manufacture of the satellite—to be approximately $260 million, and the total cost of the next generation satellite program to be approximately $1 billion.

16. Terrestrial Repeaters: Sirius' network of approximately 140 terrestrial repeaters rebroadcasts its signals in areas where satellite reception may be impaired as explained by Terrence Smith. Sirius has invested approximately [[ ]] million in its repeater network through June 30, 2006. Sirius has also budgeted to begin an expansion of our terrestrial repeater network and, beginning in 2006, to replace equipment at our existing terrestrial repeater sites. The expected useful life for repeater equipment ranges is 5 or 15 years. Terrestrial repeater depreciation expenses for fiscal years 2004 and 2005 and the first half of 2006 totaled [[ ]], respectively.

Non-Satellite System Capital Costs

17. Sirius has made the following major capital investments that are not directly related to its satellite distribution system or reception of its transmissions:

- Sirius has invested approximately [[ ]] million to date in its custom subscriber management system ("SMS") to integrate customer service, subscriber management and billing operations. As discussed in the testimony of Michael Moore, the SMS establishes an electronic interface for information exchanged with automobile manufacturers, automobile dealers, consumer electronics retailers and radio manufactures and facilitates subscriber interaction through the Internet. It also permits remote activation and deactivation of Sirius radios as well as parental controls to block adult content. In addition, representatives of Sirius' customer care service provider are permitted online access to its billing and account system. The expected useful life of SMS-related assets ranges between 3 and 7 years. Depreciation expenses related to customer care and billing for fiscal years 2004 and 2005 and the first half of 2006 totaled [[ ]], respectively.

- Sirius has invested approximately [[ ]] million in leasehold improvements, primarily to its premises in New York City, and [[ ]] million in equipment for its National Broadcast Studio. The expected useful life for these investments ranges between 2 and 15 years. Depreciation expenses related to leasehold improvements for fiscal years 2004 and 2005 and the first half of 2006 totaled [[ ]], respectively. Depreciation expenses related to the broadcast studios for fiscal years 2004 and 2005 and the first half of 2006 totaled [[ ]], respectively.
- Sirius has invested [[ ]] million in furniture, fixtures, vehicles, and other property, plant and equipment. The expected useful life for these assets ranges from 2 to 7 years. Depreciation expenses related to furniture, fixtures and other PP&E for fiscal years 2004 and 2005 and the first half of 2006 totaled approximately [[ ]], respectively.

Operating Expenses:[1]

18. Operating Expenses Related to Satellite Distribution System and Service Transmission: Total operating expenses for the satellite distribution system and service transmission were approximately $33.2 million in 2004, $29.8 million in 2005 and $26.7 million in the first half of 2006. These expenses consisted primarily of service transmission costs, personnel costs, broadcast engineering, and costs associated with the engineering, operation and maintenance of the satellites, repeaters and TT&C system. Additional breakdown of Satellite & Transmission costs is provided in the following chart (dollars in thousands).

Dollars in thousands

Satellite and Transmission Operating Expense	**2004**	**2005**	**First Half 2006**
[[			
			]]
Total	**$33,198**	**$29,798**	**$26,699**

The uplink expense includes the expense of third-party transponder leases to serve the terrestrial repeater network. This expense is comparable to the expense we would incur if we were delivering the Sirius service using leased transponders on an existing commercial satellite to

[1] Sirius has granted equity incentives, often in the form of stock options, warrants, or restricted stock units ("RSUs"), to certain employees and third parties. Many of these grants were to third parties such as car manufacturers and an exclusive retailer to encourage them to partner with SIRIUS and to install and/or sell Sirius products. Major non-music content providers also received equity grants in order to encourage them to sign exclusive contracts with SIRIUS early on, including the NFL and Howard Stern. These rights are expensed in accordance with Generally Accepted Accounting Principles and the expenses are included in the individual operating expenses outlined in the following pages.

cable head ends and other fixed distribution systems and it is my understanding that it is comparable to the expense incurred by a digital cable radio service for that purpose. The 2004 satellite expense includes in-orbit insurance, discontinued in August, 2004. The 2006 satellite expense includes an $11 million loss on the disposal of satellite parts. These long-lead parts had been acquired as a precautionary measure in case Sirius ever needed to procure a fifth first generation satellite. In 2006, Sirius determined that these parts were obsolete and wrote off the net book value of these parts. The telecom transmission costs include transmission to the uplink facility and transmission of programming originated outside of the New York studios. The broadcast engineering expenses highlight the value that Sirius brings to its programming. The expenses include a department that works 24 hours a day, 7 days a week, with live studio operations, the operation of master control systems, studio maintenance engineering and support for the Sirius digital audio software system that is used to create and manage our more than 125 channels and is accessed by about 300 users around the country including format managers, on-air hosts and broadcast coordinators.

19. Consumer Equipment Development Costs: As explained in the testimony of Terrence Smith, John Douglas Wilsterman and Robert Law, subscribers receive Sirius' service through a choice of specialized radios and antennas. Sirius began by contracting out chipset and product design and development but quickly learned that if it wanted the work done right, it had to do it itself. Thus, we were required to establish our own chipset and product design departments. In essence, we found that we needed to enter the consumer electronics and automotive electronics businesses. FM modulated receivers enable the Sirius service to be received through existing FM radios. New three-band radios installed in vehicles permit reception of AM, FM or satellite broadcast with the push of a button. Sirius has recently

introduced two portable radios, the Sirius S50 (introduced in October 2005) which offers portable listening of recorded Sirius content and MP3s anywhere; and the Sirius Stiletto 100 (introduced in September 2006) which offers truly live listening of SIRIUS Satellite Radio and was designed to incorporate a "buy button" which allows subscribers to bookmark songs they like for later purchase on line. Sirius continues to refine and improve the dedicated integrated circuits used in its radios and its radio, themselves. Because Sirius uses a new and previously untested technology, the company has been required to incur substantial portions of the equipment design and manufacturing costs to ensure that compatible radios will be available to meet customer demand. Our expenses for engineering design and development in 2004, 2005 and the first six months of 2006 totaled $35.5 million, $66.3 million and $35.2 million, respectively.

20. Sirius has incurred approximately [[ ]] for its chipsets since inception. In the future, Sirius will continue to incur additional chipset and product development costs associated with advanced generation products. In addition, as I explain below, Sirius provides substantial equipment subsidies and other funding to encourage sales of its equipment by various types of vendors.

21. Customer Service Center and Billing: Customer care and billing expenses include costs associated with our contractor's full time operation of Sirius' customer service center and subscriber management system, including personnel. This system is described in the testimony of Michael Moore. The total expenses included in customer care and billing in 2004, 2005 and the first half of 2006 equaled $22.8 million, $47.2 million and $29.9 million, respectively.

22. Programming: Sirius' programming and content expenses for 2004, 2005 and the first half of 2006 totaled $87.3 million, $118.1 million, and $383.0 million[2], respectively. These expenses include license fees to third parties that provide non-music content, costs associated with production of Sirius' music and non-music programming, costs of on-air talent and live performances, advertising revenue shares for non-music programming, and the cost of programming personnel.

- The programming expense data also include musical work and sound recording performance license fees. The ASCAP, SESAC and SoundExchange fees are actual fees paid. Our existing license with ASCAP remains in effect until December 31, 2006 and we are currently negotiating a new agreement with ASCAP. As I discuss below, these numbers are very conservative. Sirius has not accepted ASCAP's existing offer, because Sirius believes that the offer significantly over-states the value of the musical work public performance right. We have an interim license with BMI and accrue BMI fees equal to ASCAP. The sound recording fees are those actually paid to SoundExchange under our agreement that expires in 2006. In each case, there is a timing difference each year between the amount of royalty expenses accrued (for accounting purposes) and the amount of cash payments made for musical work and sound recording license fees.
- The programming cost data reflect a continued increase in the costs for non-music programming. Much of this is exclusive satellite radio content, which we have found is essential to drive subscriptions. As I discuss below, management concluded that it was essential to our business to acquire exclusive and other brand-name programming to differentiate Sirius from the many other sources of audio entertainment available, mostly

[2] Programming and Content expense for the first six months of 2006 included approximately $226 million of equity expense related to 34.4 million shares of Sirius Common Stock granted to Howard Stern and his agent in January 2006.

for free, to consumers. As a result, Sirius has entered into agreements with Howard Stern, Martha Stewart, the National Football League, NASCAR, the National Basketball Association, the National Hockey League, and many others, to provide talk, entertainment and sports programming. We have also entered into agreements with Eminem, the Metropolitan Opera, Lance Armstrong and other "action sports" stars, Elvis Presley's estate, Jimmy Buffett, The Who, and the Rolling Stones, among others, to enhance and add value to our music programming.

Dollars in thousands

Programming Expenses	**2004**	**2005**	**6 mo. 2006**
[[			
			]]
Total	**$87,252**	**$118,076**	**$382,979**

The "other" category includes primarily programming costs related to our non-satellite services.

23. Sales and Marketing and Subscriber Acquisition: A large share of Sirius' expenses relate to the acquisition of subscribers. Our activities include direct sales and marketing, conducted by our in-house sales and marketing personnel, advertising, sponsorships, consumer promotions, brand building activities, commission payments to distributors and retailers, and other payments to distributors and retailers to reimburse them for marketing and promotional activities. These activities are further described in the testimony of Michael Moore, John Douglas Wilsterman and Robert Law. Among other items, a large share of these expenses include direct subscriber acquisition costs, which include hardware subsidies, certain sales and activation commissions, and hardware-related incentives paid to manufacturers, automobile dealers and others to provide incentives for the marketing and installation of Sirius subscriber

equipment. Unlike terrestrial radio listening which simply requires a broadly available AM/FM radio, in order to listen to our service Sirius subscribers must purchase a new radio from a retailer or as a factory installed option in a new car. Sirius must subsidize the cost of these radios in order to encourage the purchase and installation of our radios.

Dollars in thousands

Sales and Marketing and SAC Expenses	**2004**	**2005**	**6 mo. 2006**
Sales and Marketing	$202,848	$212,741	$103,174
Subscriber Acquisition Costs	$206,851	$399,350	$249,606

If we were a business that simply provided our programming to third-party distributors to handle distribution to subscribers as well as all of the subscriber based functions, I would expect our total sales and marketing expense would be substantially less than $5 million.

25. General and Administrative and Other Expenses: General and administrative expenses, include rent and occupancy costs, information technology expenses, corporate overhead, and the cost of general and administrative personnel. Our G & A expense also includes allowance for bad debts, which we expect to increase as a direct percentage of our revenue. Sirius' G & A expenses for 2004, 2005 and the first half of 2006 totaled $57.9 million, $87.6 million, and $68.2 million, respectively. A significant portion of our G&A expense results from IT infrastructure and the corporate finance and accounting resources required to serve the multiple functional areas of our business including customer care & billing, as well as relationships with our radio manufacturers and distribution partners (retail and automotive OEM). In the future, bad debt expense will represent an increasing portion of our G&A expense as our subscriber base and subscription revenues increase.

Revenues

26. The Sirius subscription fee is $12.95 per month, however, we offer discounts to subscribers who pre-pay for a period of one year or longer, discounts to subscribers who have more than one subscription, and mail-in rebates to attract subscribers. Advertising is only offered on our non-music channels (our music channels are commercial free) and is a relatively small part of our business. In addition, we receive some revenue from the direct sale of Sirius equipment.

Dollars in thousands

Revenue	**2004**	**2005**	**6 mo. 2006**
Subscription Revenue	$62,881	$223,615	$252,817
Advertising Revenue	906	6,131	15,463
Equipment Revenue	2,898	12,271	6,788
Other Revenue	169	228	1,674
Total Revenue	**$66,854**	**$242,245**	**$276,742**

At the time of Sirius' 2003 recapitalization and at the time of the initial agreement with SoundExchange, the company expected total revenues of $819 million in 2006, as compared to our current guidance for total 2006 revenue of $615 million.

Sirius' Fee Proposal

27. Sirius proposes a sound recording performance and ephemeral recording fee equal to .88% of its gross revenues from subscriptions and from advertisements on music and comedy formatted channels.

28. Sirius' proposal is based on the bottom end of the range described in Dr. Woodbury's testimony. The PSS benchmark on which the Sirius fee proposal is based includes both the public performance and ephemeral recording rights at issue in this proceeding. Accordingly, the Sirius fee proposal covers both rights.[3] In fact, Sirius believes that the many

[3] In any event, to the extent the server copies are used only to facilitate the public performances licensed in this proceeding, those copies have no value apart from the performances and there is reason to charge an additional fee

significant conservative assumptions in Dr. Woodbury's testimony and the application of the applicable statutory factors in this case more than justify a fee at or below the low end of the range described by Dr. Woodbury. It is worth noting again that the comparable fee paid by terrestrial radio (a principal competitor to Sirius) for the right to perform sound recordings is zero. I have also reviewed Sirius' proposal for the payment and audit terms applicable to this proceeding and believe they are reasonable and should be adopted. Sirius has systems in place to comply with the proposed notice and recordkeeping terms and requiring different obligations would work a significant hardship on Sirius.

Application of the Digital Cable Radio ("Music Choice") Benchmark

29. The first benchmark used by Dr. Woodbury is the digital cable radio rate set by the Librarian of Congress in 1998 following the first "pre-existing services" CARP as revised by agreement of the parties in 2003.

30. Dr. Woodbury clearly explains that analysis of a benchmark in rate setting requires careful adjustments to account for differences between the benchmark and the rate being set. This is particularly true when translating a rate based on a percentage of revenue, for the simple reason that revenues must cover all of the costs and inputs of a business, and it is not reasonable to compensate one input for revenue attributable to other inputs. To use a simple phrase, not all revenue is created equal.

31. Of course, just because the applicable digital cable radio percentage of revenue rate must be translated to a lower rate to account for the enormous additional costs incurred by satellite radio doesn't mean that the record companies and artists are paid less, as Dr. Woodbury's example explains. Given Sirius' substantially larger revenues, the proposal being

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(Continued . . .)
for those copies.

made by Sirius will provide much greater compensation to SoundExchange than the compensation paid by the digital cable services under the 7.25% rate.

32. In performing his translation from the digital cable radio rate to a reasonable rate for Sirius and XM, Dr. Woodbury has used many highly conservative assumptions to be sure that he can have great confidence that the range he presents does not understate the appropriate fee that should be set. In fact, these assumptions provide compelling reasons to set the SDARS fee at the low end of Dr. Woodbury's range. I discuss below several of the most significant conservative assumptions used by Dr. Woodbury:

- Dr. Woodbury's analysis does not include any allowance for a return on the investment made by Sirius and XM in their transmission infrastructure. In light of the risk involved, these investments would be expected to generate a significant return, and return on investment is generally recognized by economists as a "cost" in economic analysis. Sirius has made much greater investment in its transmission infrastructure than the digital cable radio services, which are distributed by third parties using excess capacity in pre-existing infrastructures that have been developed for other purposes.
- Dr. Woodbury recognizes that Sirius incurs sizable costs to provide high quality, exclusive and brand name talk, sports and entertainment programming. These costs have been incurred because management, in its business judgment, concluded that such programming was essential to draw subscribers needed to ensure the survival of Sirius and allow it to succeed. Sirius could neither succeed nor survive solely as a music programming service. The benchmark cable radio services do not incur these costs. Under the principle that "all revenue is not

created equal," the revenues attributable to these costs should not be assessed to generate fees payable for the sound recording performance right, except to the extent that these costs cause a greater use of that right, which will be a small fraction of the total expenditure. Although Dr. Woodbury calculated the adjustment merited by these costs, he did not incorporate the adjusted rate in his range of rates. The substantial investments Sirius has made in bringing unique, compelling programming to subscribers in association with well-known brand names like the NFL, NHL, NBA, Howard Stern and many more is what drives subscriptions and subscription revenues. By not including an adjustment for these essential costs in his range of rates, Dr Woodbury's range is very conservative.

- Dr. Woodbury recognizes the sizable costs incurred by Sirius to enhance and add substantial value to its music programming. These include the costs paid to operate branded channels based on the music of a single, well-known band or artist (such as Eminem's Shade45, and the special feature Rolling Stones Radio and The Who channels), the costs paid for well-known personalities who host programs on our music channels (such as Tony Hawk), the costs paid for our first-rate on air talent, who engage the audience, and the high production costs and technology that contribute to the sound of our channels. These costs have been incurred because management, in its business judgment, concluded that subscribers would not pay a subscription fee for the kind of music programming available on digital cable radio services. There is no better evidence of that than the digital cable radio services themselves, which originally attempted to sell their programming as a premium paid add-on to cable television service. They quickly discovered that the market would not support that business model and now offer their service to cable and satellite systems to offer their subscribers for no added cost as part of the basic package of television programming. The benchmark digital cable radio services do not incur these costs. Under the principle that "all revenue is not created equal," the revenues attributable to these costs should not be assessed to generate fees payable for the sound recording performance right, except to the extent that these costs cause a greater use of that right, which will be a fraction of the total expenditure. Again, as in the case of our costs for exclusive talk, news and sports programming, Dr. Woodbury does not adjust his range of fees for this difference between Sirius and the benchmark, adding further to the conservative nature of his range.

- Dr. Woodbury counts all music channels and the Sirius comedy channels as having 100% compensable programming. In fact, many of the channels contain a great deal of programming that is not subject to the sound recording performance fee. This includes talk, discussion and interview features on the branded channels (such as Faction, with its action sports personalities; limited special feature channels that include interviews, backstage content and the music of legendary musicians and bands). It also includes channels like Metropolitan Opera Radio, which features live performances and archival recordings owned and directly licensed by the Metropolitan Opera to Sirius, and other channels that feature live performances (like Margaritaville and Rolling Stones Radio). It is my understanding that the benchmark digital cable radio services lack such non-compensable programming, or if they include it, they do not include nearly as much as Sirius.[4] Moreover, because the digital cable radio services lack on-air talent such as the hosts used by Sirius, they likely perform more music in any given period of time on any given channel than Sirius does. The assumption that all music and comedy channels are 100% compensable is a very conservative assumption.

Application of the Musical Work Benchmark

33. Dr. Woodbury offers as an upper end for his fee range an agreement between XM and ASCAP for the musical work performance right for compositions licensed by ASCAP. Although I do not know XM's financial details, I know from Sirius' experience with its ASCAP agreement that the ASCAP-XM agreement charges about **[[ ]]** of gross revenue.[5] The ASCAP-XM agreement significantly over-states the value of the musical work performance right, and as such is properly viewed only as an upper bound for any range to be considered by this Court and not as the rate that should be adopted.

- Sirius entered into a similar agreement with ASCAP for a period ending in 2006. We did so in 2002, at a time when Sirius expected music to constitute a much greater part of the Sirius service than it now does.
- The early ASCAP agreement was based on the then existing ASCAP agreements with terrestrial radio stations. Those agreements charged music stations 1.615% of adjusted gross revenue and talk stations .24% of adjusted gross revenue for "incidental" performances. It is easy to see that the calculus would be different

[4] I also understand that sound recordings recorded prior to 1972 are not protected by copyright law and are not subject to the statutory license or the fee to be set in this proceeding. However, I understand that the digital cable radio services also perform such recordings.

[5] The ASCAP-XM agreement nominally charges 1.44% of a defined "adjusted gross revenue" but the adjustments lead to a lower percentage (about **[[ ]]**) of overall gross revenue.

for a service with relatively more music channels than for a service with relatively fewer music channels. With a 50%-50% music-talk split, those rates would result in a fee of about .93% of adjusted gross revenue, or about [[ ]] of overall gross revenue.[6] Of course, it is worth noting that the comparable fee paid by terrestrial radio (a primary competitor of Sirius) for the right to perform sound recordings is zero.

- The principle that "not all revenue is equal" is not properly taken into account in either the old agreement Sirius made with ASCAP or the XM-ASCAP agreement. While the economic validity of that principle is undeniable, Sirius recognized that establishing that principle would require litigation, and Sirius was not in a position to litigate with ASCAP in 2002. Sirius had just launched its service, was trying to complete its recapitalization, and it needed to attend to its business. It could not afford the distractions and costs of music license litigation.
- I do not know what prompted XM to extend its agreement with ASCAP. However, I can only assume that it did not want to conduct litigation on multiple fronts with the record companies and with ASCAP. It was clear from statements made in the press by the record companies that they would seek far more extreme fees than the agreement offered by ASCAP.

34. In any event, Dr. Woodbury explains why the musical work benchmark likely overstates substantially the fee that should be charged for a sound recording performance right. I note in particular that although musical works copyright owners are entitled to compensation for pre-1972 recordings and live performances, sound recording copyright owners are not.

[6] Applying the same ratio between adjusted gross revenue and gross revenue that we encountered under our ASCAP agreement.

Conclusion

35. As I have described, Sirius has invested a tremendous amount of money, effort and creative resources in its satellite and terrestrial distribution system, radio and chipset development, development of a new distribution chain, marketing efforts and program offerings. To bring this new service to the public, Sirius has incurred accumulated deficit of $3.4 billion and to date has raised over $3.8 billion in capital from investors. Yet, Sirius has yet to earn a profit or even turn EBITDA positive. It has incurred and continues to incur substantial losses. Any "break even" point for its investors is well in the future and subject to continuing significant regulatory, technical and marketplace risks. The imposition of excessive licensing fees as a result of this proceeding will exacerbate the financial challenges facing Sirius. Sirius respectfully urges the Court to adopt Sirius' fee proposal.

Before the
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LIBRARY OF CONGRESS
Washington, D.C.

In the Matter of	)	
	)	**Docket No. 2006-1 CRB DSTRA**
Adjustment of Rates and Terms for Preexisting Subscription and Satellite Digital Audio Radio Services	)	

DECLARATION OF DAVID J. FREAR

I, David J. Frear, declare under penalty of perjury that the statements contained in my Written Direct Testimony in the above-captioned matter are true and correct to the best of my knowledge, information and belief. Executed this 30 day of October 2006 at New York, New York.

David J. Frear