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 CONCLUSIONS OF LAW

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PROPOSED CONCLUSIONS OF LAW

1. The purpose of this proceeding is to determine reasonable rates and terms of royalty payments by preexisting satellite digital audio radio services (SDARS) for the public performance of sound recordings pursuant to 17 U.S.C. § 114(d)(2), and the making of any number of ephemeral phonorecords to facilitate such performances pursuant to 17 U.S.C. § 112(e), during the period January 1, 2013, through December 31, 2017. *See* 17 U.S.C. § 804(3)(B); 17 U.S.C. § 114(j)(10).

2. In 2007, the Copyright Royalty Judges set the statutory royalty rate for Sirius Satellite Radio Inc. and XM Satellite Radio Holdings, Inc. at a rate beginning at 6% in 2007 and increasing to 8% by 2012. *See Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 73 Fed. Reg. 4080 (Jan. 24, 2008) ("*Satellite I Determination*"), *aff'd in part by SoundExchange, Inc. v. Librarian of Congress*, 571 F.3d 1220, 1225 (D.C. Cir. 2009).

3. Sirius XM Satellite Radio Inc. ("Sirius XM" or "the Company") filed a Petition to Participate in the current proceeding in January 2011. Sirius XM provides a satellite digital audio radio service ("SDARS") which offers both non-music and music content to its subscribers. On November 29, 2011, Sirius XM filed its written direct statement, pursuant to 37 C.F.R. § 351.4, requesting that the Copyright Royalty Judges set the SDARS monthly royalty rate in the range of 5% to 7% of Sirius XM's monthly U.S. Gross Revenues (as currently defined in 37 C.F.R. § 382.11), with the rate for ephemeral recordings to be included within, and constituting 5% of, the Section 114 payment.

4. SoundExchange, Inc. ("SoundExchange") also filed a Petition to Participate in January 2011. SoundExchange is an organization established to collect and distribute royalties

to recording artist and sound recording copyright owners for the performance of sound recordings over various media, including satellite radio. Pursuant to 17 U.S.C. § 114(e), SoundExchange is the agent designated, on a non-exclusive basis, to negotiate the royalty rate for the public performance of sound recordings. On November 29, 2011, SoundExchange filed its written direct statement, pursuant to 37 C.F.R. § 351.4, requesting that the Copyright Royalty Judges set the SDARS monthly royalty rate at 12% of Sirius XM's Gross Revenues (as defined in SoundExchange's proposed rates and terms) for 2013, increasing 2% each year to reach 20% in 2017.

I. BASIC PRINCIPLES OF COPYRIGHT APPLICABLE TO THIS PROCEEDING

5. Copyright protection provides a limited monopoly in specifically enumerated circumstances, "not to reward the labor of authors, but 'to promote the Progress of Science and useful Arts.'" *Feist Publ'ns, Inc. v. Rural Tel. Serv. Co., Inc.*, 499 U.S. 340, 349 (1991) (quoting U.S. Const. art. I, § 8, cl. 8); *see also* H.R. Rep. No. 100-887(I), at 10 (1988) ("As this [House Judiciary] Committee observed during the 1909 revision of the copyright law, "[n]ot primarily for the benefit of the author, but primarily for the benefit of the public, such rights are given.'" (quoting H.R. Rep. No. 60-2222, at 7 (1909))).

6. In keeping with this constitutional mandate, copyright law is intended not only to provide an incentive "to stimulate artistic creativity for the general public good," but also to foster *access* to creative works. *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975). The Supreme Court has observed that the goal of promoting public access to creative works is best served when copyright protection is circumscribed:

> The limited scope of the copyright holder's statutory monopoly . . . reflects a balance of competing claims upon the public interest: Creative work is to be encouraged and rewarded, but private

> motivation must ultimately serve the cause of promoting broad public availability of literature, music, and the other arts.

Id. Accomplishing the goal of promoting public access to creative works requires balancing "the interests of authors and inventors in the control and exploitation of their writings and discoveries on the one hand, and society's competing interest in the free flow of ideas, information, and commerce on the other hand." *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 429 (1984).

7. In delineating copyright protection, Congress has granted a number of specifically enumerated "exclusive rights" to owners of various types of works of authorship. These include the two at issue here – the right of public performance of sound recordings and, with respect to ephemeral copies, the right of reproduction. *See* 17 U.S.C. §§ 106(6), 106(1). Section 106 of the Copyright Act confers a series of other exclusive rights beyond those described above, including the right to distribute copies or phonorecords of copyrighted works to the public. *Id.* § 106(3).

8. At the same time, consistent with the overriding purpose of copyright law to facilitate public access to copyrighted works, Congress has created a number of mechanisms that limit the statutorily granted rights in copyrighted works. Thus, these "exclusive rights" are not absolutely exclusive but, in fact, are subject to a range of statutory exceptions and limitations that are set forth in sections 107 through 122 of the Copyright Act.

9. One such exception is a statutory license, such as the section 114 license at issue in this proceeding, which aims to ensure the availability of copyrighted works to the public. *See* 17 U.S.C. § 114(f)(1)(B).[1] Statutory licenses permit anyone who complies with their terms to

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[1] The legislative history accompanying other statutory licenses, like the history of section 114, discussed in the text, repeatedly emphasizes the importance of preventing monopolies and ensuring broad public availability to copyrighted works. *See, e.g.*, H.R. Rep. No. 60-2222, at 7 (1909) (section 115 mechanical

make use of copyrighted content in the manner permitted under the license by paying the established royalties. Statutory royalties are set either through agreements resulting from voluntary negotiations or, in the absence of such agreements, by the Copyright Royalty Judges – the latter procedure serving as a check on the level of economic returns from the exploitation of copyright by taking out of the hands of copyright owners the power to set these rates unilaterally. *See, e.g.*, 17 U.S.C. §§ 114(f), 801(b). Congress thus has made clear that by subjecting the statutory license fee-setting process to governmental regulation when copyright owners and users are unable to agree, the broad dissemination of copyrighted works, especially by means of new media, is likely to be better served than by allowing those amounts to be determined in the unregulated market.

II. HISTORY OF THE SOUND RECORDING PERFORMANCE RIGHT

10. Valuing the statutory license at issue in this proceeding must be done with an eye toward Congress's objectives in creating a limited sound recording performance right. The copyright status of sound recordings under federal law is of much more recent – and more limited – vintage than that of other works of authorship, including musical works. Although musical works had long been protected under federal copyright law, sound recordings received no federal copyright protection at all prior to 1972, and it was not until 1995 that Congress finally granted a circumscribed public performance right in sound recordings (as distinct from the reproduction right).

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royalty license has "the double purpose of securing to the composer an adequate return for all use made of his composition and at the same time prevent the formation of oppressive monopolies, which might be founded upon the very rights granted to the composer for the purpose of protecting his interests"); H.R. Rep. No. 100-887(I), at 15 (1988) (stating that while section 119 statutory license remained in place, "an exciting new communications technology – satellite earth stations – will be allowed to develop and flourish" and that law "will not only benefit copyright owners, distributors, and earth station manufacturers; it also will benefit rural America, where significant numbers of farm families are inadequately served by broadcast stations licensed by the Federal Communications Commission").

A. Unlike Musical Works, There Is No Federal Copyright Protection For Sound Recordings Made Prior To 1972

11. Congress enacted a limited right in sound recordings effective in 1972 in response to a specific crisis unrelated to the issue of performance rights: "the widespread unauthorized reproduction of phonograph records and tapes," which was a threat to the industry's core business – *i.e.*, selling copies of sound recordings – and which state law had been ineffective in combating. *See* S. Rep. No. 92-72, at 3-4 (1971) (hereinafter "1971 Senate Report"); H.R. Rep. No. 92-487, at 2-3, 5 (1971) (hereinafter "1971 House Report"). The Sound Recording Amendment of 1971 thus granted a limited right to (and only to) prevent the manufacture and distribution of commercial copies that were literal duplicates of protected sound recordings – *i.e.*, that "directly or indirectly recapture[] the actual sounds fixed in the recording." *See* Pub. L. No. 92-140, § (a), 85 Stat. 391, 391 (1971) (codified as amended at 17 U.S.C. § 114(b)).

12. Neither the legislation that took effect in 1972 nor any of the subsequent amendments to the Copyright Act extend federal protection to sound recordings made in the United States before February 15, 1972. *See* 17 U.S.C. § 301 ("[N]o sound recording fixed before February 15, 1972, shall be subject to copyright under this title before, on, or after February 15, 2067."). Rather, rights in these recordings are governed exclusively by state law. *See id.* ("With respect to sound recordings fixed before February 15, 1972, any rights or remedies under the common law or statutes of any State shall not be annulled or limited by this title until February 15, 2067."). Because they lack federal copyright, they are not subject to the Section 114 statutory license.

13. Notably, the process of converting pre-1972 sound recordings from their original analog formats to new digital ones does not confer new eligibility for protection under the

Copyright Act. As the Copyright Office has explained: "This new material must result from creative new authorship rather than mere mechanical processes; if only a few slight variations or purely mechanical changes (such as declicking or remastering) have been made, registration is not possible." U.S. Copyright Office, Library of Congress, Circular 56, *Copyright Registration of Sound Recordings* (rev. 2006). In a manual for staff use, the Copyright Office identified several "noncopyrightable elements" of reissued, pre-1972 sound recordings including "remastering" and stated that "[c]laims based solely on [these] elements will be refused." U.S. Copyright Office, Library of Congress, *Compendium II: Copyright Office Practices*, § 496.03(b)(2) (1984) (hereinafter "Compendium II").[2]

14. Case law regarding derivative works more generally supports these conclusions. To qualify for copyright protection, a new (or "derivative") version of an existing work must display some modicum of "originality" and "creativity." *See Feist*, 499 U.S. at 346. In the context of musical composition arrangements, the Court of Appeals for the Second Circuit has held that "there must be something of substance added making the piece to some extent a new work with the old song embedded in it but from which the new has developed. . . . It is, in short, the addition of such new material as would entitle the creator to a copyright on the new material." *Woods v. Bourne Co.*, 60 F.3d 978, 991-92 (2d Cir. 1995) (holding a piano-vocal arrangement of musical composition lead sheet not separately copyrightable). In the context of art reproductions, the Second Circuit likewise has endorsed "the school of cases in this circuit and elsewhere supporting the proposition that to support a copyright there must be at least some substantial variation, not merely a trivial variation such as might occur in the translation to a

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[2] Other noncopyrightable elements include, *inter alia*, "[n]ew master cut[s]," "[e]nhanced stereo," "[r]eprocessing," and electronic enhancements. Compendium II, § 496.03(b)(2).

different medium." *L. Batlin & Son v. Snyder, Inc.*, 536 F.2d 486, 491 (2d Cir. 1976). The court further held that "the reproduction must contain 'an original contribution not present in the underlying work of art' and be 'more than a mere copy'" to obtain derivative-work recognition. *Id.* (quoting 1 Nimmer, The Law of Copyright § 20.2, at 93 (1975)).

15. Absent such creative contribution, the investment of mere effort or expense, even if significant in amount, cannot confer copyright protection. *See Feist*, 499 U.S. at 346; *see also Woods*, 60 F.3d at 991 ("[T]he demonstration of 'physical skill' or 'special training' is insufficient to satisfy the requirement of originality." (citation omitted)). Thus, a routine change of medium or format (*e.g.*, vinyl to CD) "should not constitute the required originality." *See L. Batlin & Son*, 536 F.2d at 491. "To extend copyright to minuscule variations would simply put a weapon for harassment in the hands of mischievous copiers intent on appropriating and monopolizing public domain work." *Id.* at 492.

B. Congress Refused To Grant A Public Performance Right In Sound Recordings Until 1995; Even Then, The Right Was Carefully Limited To Guard Against Impeding The Development Of New Technologies Such As The SDARS

16. Despite five decades of requests by the record companies to do so, Congress refused to create a broad sound recording performance right in 1971. *See* Subcomm. on Courts, Civil Liberties, and the Admin. of Justice, House Comm. on the Judiciary, 95th Cong., 2d Session "Performance Rights in Sound Recordings," at 28-58 (Comm. Print 1978) (hereinafter "1978 Register's Report"); *see also* S. Rep. No. 104-128, at 10-13 (1995) (hereinafter "1995 Senate Report"); 1971 House Report at 3; 1971 Senate Report at 3.

17. Two related circumstances underlay Congress's refusal. First, public performances of sound recordings were a key means by which the public came to know, like, and

decide to purchase sound recordings, and Congress recognized that granting a performance right would disrupt the mutually beneficial relationship between record companies and the radio broadcasters that provided these public performances in their broadcasts. 1978 Register's Report, at 54-55; 120 Cong. Rec. 30,479 (Remarks of Sen. Hruska) (Sept. 9, 1974); *id.* at 30,480-81 (Remarks of Sen. Gurney); 1995 Senate Report at 14-15. Second, the record companies earn a larger share of the revenues generated by those increased sales than do composers/publishers, whose royalties are statutorily limited to those set pursuant to 17 U.S.C. § 115. The record companies (and, indirectly, the recording artists) thus were considered to be adequately compensated by their share of the proceeds from increased sales without the need for additional compensation in the form of public performance royalties.

18. During the comprehensive revision of the Copyright Act in 1976, Congress again considered, and again rejected, creation of a sound recording performance right. *See* S. Rep. No. 94-473, at 87-88 (1975); H.R. Rep. No. 94-1476, at 106 (1976).

19. Not until the Digital Performance Rights in Sound Recordings Act of 1995 ("DPRA") – nearly a quarter century after Congress first granted a sound recording reproduction right – did Congress create a narrow performance right in sound recordings encompassing a limited category of digital audio transmissions. *See* Pub. L. No. 104-39, 109 Stat. 336 (1995). In doing so, Congress rejected efforts by the recording industry to secure a more expansive right:

> [T]he Committee has sought to address the concerns of record producers and performers regarding the effects that new digital technology and distribution systems might have on their core business without upsetting the longstanding business and contractual relationships among record producers and performers, music composers and publishers and broadcasters that have served all of these industries well for decades. *Accordingly, the Committee has chosen to create a carefully crafted and narrow*

> *performance right, applicable only to certain digital transmissions of sound recordings.*

1995 Senate Report at 13 (emphasis added); *id.* at 3-4, 7; *accord* H.R. Rep. No. 104-274, at 2-5, 12 (1995) (hereinafter "1995 House Report").

20. The DPRA was not intended to work a general redistribution of rights and obligations with respect to copyrighted sound recordings; rather, it responded to the specific threat perceived by the record industry that certain types of emerging high-quality digital audio transmission services – including, in particular, "interactive services that enable a member of the public to receive, on request, a digital transmission of the particular recording that person wants to hear" – might directly displace record sales. 1995 Senate Report at 14. In the words of the Senate committee report, the DPRA was

> a narrowly crafted response to one of the concerns expressed by representatives of the music community, namely that certain types of subscription and interactive audio services might adversely affect sales of sound recordings and erode copyright owners' ability to control and be paid for use of their work.

1995 Senate Report at 15; *accord* 1995 House Report at 13. In other words, Congress sought to compensate copyright owners for potential lost revenues, not to provide them an entirely new and independent source of revenue.

21. The "certain types" of services about which the recording industry was concerned were of the so-called "interactive" variety,[3] which were thought potentially to lead to direct substitution of "on-demand" listening for CD purchases. As the Senate and House reports accompanying the DPRA concluded, "[o]f all the new forms of digital transmission services,

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[3] An "interactive service" is "one that enables a member of the public to receive . . . on request, a transmission of a particular sound recording . . . which is selected by or on behalf of the recipient. The ability of individuals to request that particular sound recordings be performed for reception by the public at large . . . does not make a service interactive." 17 U.S.C. § 114(j)(7).

interactive services are most likely to have a significant impact on traditional record sales." 1995 House Report at 14; 1995 Senate Report at 16.

22. With respect to the noninteractive digital subscription transmission services also addressed by the DPRA, by contrast, Congress was concerned with preserving the benefits to consumers from the development of new transmission technologies and ensuring that the copyright protection it granted did not impede the development of these technologies. Observing that "consumers have embraced digital recordings because of their superior sound quality," the House and Senate reports noted:

> [e]ven more recently, a small number of services have begun to make digital transmissions of recordings to subscribers. Trends within the music industry, as well as the telecommunications and information services industries, suggest that digital transmission of sound recordings is likely to become a very important outlet for the performance of recorded music in the near future. . . .
>
> These new digital transmission technologies may permit consumers to enjoy performances of a broader range of higher-quality recordings than has ever before been possible.

1995 Senate Report at 14; 1995 House Report at 12. Congress was aware that granting a broad performance right might interfere with the development of these new services, thereby impeding consumer access to these new technologies. *See* 1995 House Report at 14 ("[C]oncern was expressed that granting a performance right in sound recordings would make it economically infeasible for some transmitters to continue certain uses of sound recordings."); *accord* 1995 Senate Report at 16.

23. In an effort to "provide copyright holders of sound recordings with the ability to control the distribution of their product . . . without hampering the arrival of new technologies," 1995 Senate Report at 15; 1995 House Report at 14, Congress enacted a tiered system of

protection for administering the new, narrowly tailored sound recording performance right. The first tier included interactive services (SoundExchange's proffered benchmark in this proceeding), which, in Congress's view, posed the risk of significantly displacing record companies' traditional sources of revenue; accordingly, Congress provided the record companies with exclusive rights in the public performance of their sound recordings by such services. The second tier consisted of noninteractive digital streaming services that were considered potentially to pose, at most, a limited risk to the record industry's traditional sources of compensation. For these services, Congress limited the performance right granted to the companies by making that right subject to a statutory license, the rates for which would be set through arbitration.[4] Pub. L. No. 104-39, § 3, 109 Stat. at 340-42; 1995 Senate Report at 24.

24. The DPRA incorporated further provisions designed to reduce still further the risk that noninteractive subscription services (such as those involved in this proceeding) might substantially displace sales of sound recordings if they were subject to a statutory license. In particular, the legislation limited the number of related recordings that services could transmit sequentially[5] and barred services from publishing advance schedules of the particular recordings they would transmit. *See* Pub. L. No. 104-39, § 3, 109 Stat. at 338 (codified as amended at 17 U.S.C. § 114(d)(2)(B), (C)). As one authority on the DPRA has commented, these requirements were "geared to prevent [noninteractive] subscription services from effectively diminishing sales of pre-recorded music by virtue of the statutory license." 2 Nimmer on Copyright§ 8.22[C][1][c] (2012) (footnotes omitted).

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[4] Radio broadcasters were deemed to pose no significant threat to the traditional compensation systems and were exempted from the sound recording performance right altogether.

[5] The "sound recording performance complement" is defined at 17 U.S.C. § 114(j)(13).

25. In subjecting noninteractive subscription services such as Sirius XM to a limited, policy-based statutory license rather than granting a broader exclusive right subject to voluntary licensing, Congress was aware not only of the limited risk of displaced sales presented by such services, but also that such services might even affirmatively *promote* the sale of sound recordings. To enhance this promotional effect, Congress incorporated into the DPRA a requirement that when digital services transmit sound recordings to subscribers, they include digitally encoded information about, *inter alia*, the titles of the sound recordings transmitted as well as the featured performing artists. *See* Pub. L. No. 104-39, § 3, 109 Stat. at 338 (codified as amended at 17 U.S.C. § 114(d)(2)(A)(iii)).

26. Congress thus viewed the DPRA as a carefully-calibrated compromise through which, in the words of Senator Hatch, "the legitimate interests of everyone involved in the music licensing, distribution, and performance systems" could be accommodated. 141 Cong. Rec. S11945-04 (1995) (statement of Sen. Hatch); *see also* 1995 Senate Report at 30 (section-by-section analysis). The 1995 legislation reflected a Congressional determination that although the recording industry deserved safeguards against the risk that various new, digital audio services might, to varying degrees, displace sales of music on prerecorded media, this new protection should not impinge unnecessarily on the interests of the listening public or of the services themselves. The mechanism chosen to strike the proper balance as to, among other preexisting services, the SDARS was a statutory license, to be set and periodically adjusted (in the absence of voluntary agreement, *see infra* Part III) by a governmental rate-setting process. That process, in turn, was made subject to the general provisions of section 801(b)(1). *See infra* Parts IV-V.

III. DIRECT LICENSES ARE A FAVORED BENCHMARK IN FEDERAL COPYRIGHT RATE-SETTING PROCEEDINGS

A. Sections 114 And 803 Demonstrate Congress's Clear Preference For Voluntary Licenses Over Statutory Rate-Setting

27. Both the structure and explicit language of sections 114 and 803 of the Copyright Act demonstrate Congress's preference for voluntary licenses over statutory licenses, the latter being clearly intended as a fallback or default in the event services and rightsholders are not able to reach voluntary agreements.

28. To start, Section 114 provides that voluntary licenses entered between parties "at any time" "shall be given effect in lieu of any decision by the Librarian of Congress or determination by the Copyright Royalty Judges." *Id.* at § 114(f)(3). Where no such license agreements exist, and the parties petition the Judges to initiate a rate-setting proceeding, that proceeding starts with a statutorily imposed "voluntary negotiation period" intended to give the parties a chance to negotiate a voluntary arrangement. 17 U.S.C. § 803(b)(3)(A)(i). Only "if further proceedings . . . are necessary" after the voluntary negotiation period ends (that is, if no voluntary agreement was made) will the Copyright Royalty Judges commence the proceeding. *Id.* § 803(b)(3)(C); *see also* 1995 Senate Report at 29 (noting Committee's "hope" that the voluntary negotiation proceeding would lead to negotiated agreements).

29. Although the statute grants SoundExchange an antitrust exemption to negotiate the rates and terms of statutory licenses, *see* 17 U.S.C. § 114(e)(1), that exemption requires such negotiations to be nonexclusive, again to foster direct licensing. The legislative history explains that

> the requirement of nonexclusivity is intended to preserve the possibility of direct licensing negotiations *between individual copyright owners and operators of digital services*, rather than

> merely between their common agents. For example, *nonexclusivity should help prevent copyright owners from using a common agent to demand supracompetitive rates, because such demands might be avoided by direct negotiations with individual copyright owners.* In such negotiations an individual copyright owner would exercise independent judgment on whether to contract on particular terms.

1995 Senate Report at 28 (emphasis added).

B. Section 114 Explicitly Invites Consideration Of Direct Licenses To Set Rates In This Proceeding

30. Even when the Judges do go on to conduct formal proceedings, Section 114 provides that in establishing a rate in a proceeding such as this one, the Judges may consider the "rates and terms for comparable types of subscription digital audio transmission services and comparable circumstances under voluntary license agreements described in subparagraph (A)," as well as the four section 801(b)(1) policy objectives (discussed in Section IV below). 17 U.S.C. § 114(f)(1)(B).

31. The logic of such a provision is evident. Insofar as the Judges are tasked with arriving at rates under section 114(f)(1)(B) that take account of the section 801(b)(1) factors, it makes sense that prior "comparable" agreements entered into by parties that, had they litigated, would have been subject to the application of those factors could well serve as probative rate-setting benchmarks. Indeed, section 114(f)(1)(A) actually invites participants to present such agreements to the Judges to use as rate-setting benchmarks. *See id.* § 114(f)(1)(A) ("Any copyright owners of sound recordings, preexisting subscription services, or preexisting satellite digital audio radio services may submit to the Copyright Royalty Judges licenses covering such subscription transmissions with respect to such sound recordings.").[6]

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[6] SoundExchange has criticized the Direct Licenses as unsuitable benchmarks because they provide for payment of royalties directly to the record labels, who would in turn pay their artists pursuant to their

32. Here, for the first time, Sirius XM radio has presented actual market evidence not only of "comparable" agreements, but of marketplace agreements that involve the *identical* buyer (Sirius XM), sellers (record labels) and rights (performances on SDARS) as are at issue in this proceeding. These agreements (the "Direct Licenses") 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. *See* Noll RAWDT pp. 9-10, 33-40.[7]

C. Recent Federal Rate-Setting Precedent Establishes Direct Licenses As The Preferred Benchmark For Setting Industry-Wide Performance Rights

33. In circumstances strikingly similar to those presented in this proceeding, the two federal courts that oversee rate-setting for ASCAP and BMI (the organizational analogues to SoundExchange with respect to musical work licensing) recently adopted the royalty rates found in direct licenses between the licensee service and individual rightsholders as the appropriate benchmark for industry-wide rates. *See Broadcast Music, Inc. v. DMX, Inc.*, 726 F. Supp. 2d 355, 361 (S.D.N.Y. 2010) ("*BMI v. DMX*") (BMI rate-court decision authored by Judge Louis

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artist agreements. Ordover AWRT ¶¶ 47-48. However, as demonstrated in the text, Section 114 establishes not only that voluntary licenses "shall be given effect in lieu of" statutory rates, and not only that the parties should submit such licenses for the Judges' consideration in the proceeding, but that where such direct licenses are in effect, the record companies' artists are to be paid "in accordance with the terms of the artist's contract" with the record label. 17 U.S.C. § 114(f)(1)(B), (f)(3), (g)(1)(A). Given these express provisions, it would violate the letter and spirit of the statute if the very voluntary licenses that the statute encourages the parties to enter and submit to the Judges – and royalties pursuant to which the statute directs should be allocated according to the artists' contracts with the signing labels – were nonetheless diminished as benchmarks because the labels followed the statutory prescription to pay artists according to their contracts and not the 50/50 payout that exists under the statutory license.

[7] As discussed in Section V below, application of the 801(b) factors suggests that the willing-buyer willing-seller rate if anything overstates the appropriate rate to be set here.

Stanton); *In re THP Capstar*, 756 F. Supp. 2d 516, 552 (S.D.N.Y. 2010) (ASCAP rate-court decision authored by Judge Denise Cote), *affirmed in tandem by BMI v. DMX*, 683 F.3d 32, 46 (2d Cir. 2012).

34. These two decisions involved DMX, a leading business establishment service that had secured direct licenses with music publishers for the same rights available under the BMI and ASCAP blanket licenses. *See BMI v. DMX*, 726 F. Supp. 2d at 359; *In re THP Capstar*, 756 F. Supp. 2d at 528. DMX proffered the direct licenses as the best evidence of competitive marketplace rates for musical work performance rights, and argued that the fee for BMI and ASCAP blanket licenses should be set based on the direct license evidence rather than prior agreements between ASCAP or BMI and other business establishment services. *See BMI v. DMX*, 726 F. Supp. 2d at 359; *In re THP Capstar*, 756 F. Supp. 2d at 528.

35. Each Judge agreed. Finding the DMX direct licenses to be the appropriate benchmark, and rejecting the benchmark agreements proffered by ASCAP, Judge Cote concluded that the DMX direct licenses presented an especially useful measure of how the market valued the precise rights at issue in the case, finding the agreements entered into between DMX and music publishers "provide[d] compelling evidence of the valuation of the right to publicly perform musical compositions within the [background/foreground] music service industry." *In re THP Capstar*, 756 F. Supp. 2d at 550; *see also BMI v. DMX*, 726 F. Supp. 2d at 361 (finding the DMX direct licenses to be "useful benchmarks" for the industry-wide BMI blanket license).

36. The Second Circuit affirmed both decisions and explicitly endorsed the use of direct licenses as the appropriate benchmark for rate setting proceedings, holding "that rate courts can take direct licenses into account in setting rates between commercial music service

providers and PROs." *BMI v. DMX*, 683 F.3d at 46. "That the rates set by the ASCAP and BMI rate courts were comparatively lower than those historically obtained by ASCAP and BMI is of no moment," the Court explained, "given ASCAP and BMI's longstanding market power and the industry's changing economic landscape." *Id.* at 48. The Court further explained that the royalty rate found in the DMX direct licenses

> reflected the competitive market, was an appropriate valuation of the right to publicly perform the licensed musical works, and was consistent with the four factors that guide the selection of a benchmark (a comparable right, similar parties, similar economic circumstances, and whether the rate would be set in a sufficiently competitive market). . . . [T]he ASCAP rate court did not err in finding that the "collective decisions [of publishers and administrators] to execute direct licenses [were] comparable to the decision [a PRO] makes in entering a license."

Id.

37. Notably, both Judge Cote and Judge Stanton concluded that the fact that certain rightsholders declined DMX's direct-license overture did not undercut the probative value of the licenses that *were* signed in revealing competitive market rates. "[T]hat some publishers chose not to [] enter a direct license," Judge Stanton wrote, "[was] not a reason to disregard the direct licenses as benchmarks. There [was] no credible evidence that those publishers' decisions were based on the direct licenses undervaluing their music." *BMI v. DMX*, 726 F. Supp. 2d at 361. Judge Stanton also noted that "[r]ejections of the direct licenses [by publishers] also may have resulted simply from the blanket license practice being so well-established in the industry." *Id.*

38. This was especially the case, each judge held, because both BMI and ASCAP (not unlike SoundExchange here) went out of their way to interfere with DMX's direct licensing effort and convince rightsholders not to enter into direct licenses, lest those licenses undercut the rates that BMI and ASCAP were seeking to establish in the rate court. Judge Cote thus described

how ASCAP and BMI "tried their best to prevent the major music publishers from entering direct licenses" with DMX, how ASCAP's CEO "actively tried to discourage the CEOs of Universal and Sony from entering into ... [direct license] agreements," and the fact that "BMI offered Universal a substantial guaranteed advance payment if it refrained from signing" a direct license with DMX.[8] *In re THP Capstar,* 756 F. Supp. 2d at 535.

39. In extolling the virtues of direct licensing as increasing competition in the market for music rights, Judge Cote commented that "a vibrant direct licensing program increases competition within" the music licensing industry. *Id.* at 549. While "[t]he economic circumstances of the direct licensors and . . . [the PROs] are considerably different," she explained, "that difference is more than balanced by the degree of competition that the direct licenses inject into [the] marketplace." *Id.* at 550.

40. Similarly, the Second Circuit found that "direct licenses inject ... [a degree of competition] into the marketplace. Accordingly, in both cases, the district court did not err in finding that ... direct licenses were more reflective of rates that would be set in a competitive market than blanket fees imposed by PROs on [background/foreground] music providers." *BMI v. DMX*, 683 F.3d at 48. The court continued:

> Direct licenses, and their incorporation into licensing fee structures, foster fair pricing and competition within the music licensing market, thereby advancing the very purpose of the [ASCAP Consent Decree] and the BMI Decree. The rates set by the district court, as the ASCAP court found, "allow[] the

[8] As Judge Cote pointed out, ASCAP's activities violated the express terms of its Consent Decree, under which ASCAP is "restrained from limiting, restricting, or interfering with the right of any member to issue, directly or through an agent other than a performance rights organization, non-exclusive licenses to music users for rights of public performance." *In re THP Capstar*, 756 F. Supp. 2d at 539. This is analogous to the antitrust exemption at 17 U.S.C. 114(e), which as noted above limits SoundExchange to negotiating statutory licenses on a nonexclusive basis and forbids any sort of interference with the direct licensing efforts of services like Sirius XM.

> appropriate incentives for DMX to continue and to expand its direct licensing program." . . . We have already noted that if the ASCAP and BMI rate courts had not taken DMX's direct licenses into account, DMX would have had to pay twice to use the same musical works, and, more substantially, direct licensing within the commercial music industry would be discouraged.

Id. (internal citations omitted).

41. Acknowledging the importance of instilling competition into the music performance marketplace, the Department of Justice ("DOJ") submitted *Amicus Curiae* briefs to the Second Circuit in support of DMX on ASCAP's and BMI's appeals of the lower court rate determinations.[9] *See* Brief of the United States as Amicus Curiae, *In re THP Capstar Acquisition Corp.*, No. 11-127, 2011 WL 1836821, at *16 (2d Cir. May 6, 2011) (hereinafter "DOJ ASCAP Brief"); Brief of the United States as Amicus Curiae in *Broadcast Music, Inc. v. DMX Inc.*, No. 10-3429, 2011 WL 1462242, at *10-12 (2d Cir. Apr. 11, 2011) (hereinafter "DOJ DMX Brief"). In its ASCAP brief, the DOJ claimed that direct licenses "enhanced competition" by virtue of the fact that, as the record demonstrates here, the direct licensors agreed "to lower per play fees in the hope of a higher number of plays." DOJ ASCAP Brief at *16.

42. The DOJ DMX brief additionally noted that "fundamental to the concept of reasonableness is a determination of what an applicant would pay in a competitive market." DOJ DMX Brief at *11 (quoting *United States v. ASCAP*, 627 F.3d 64, 76 (2d Cir. 2010)). The value of direct licenses, the DOJ pointed out, cannot be understated, as they provide an alternative to blanket statutory rates and relevant evidence to rate courts, who need "not simply . . . rubber

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[9] Because the antitrust consent decrees governing ASCAP and BMI grew out of antitrust litigation with the U.S. government as plaintiff, the DOJ plays an ongoing oversight role with respect to the activities of the two organizations, including, where merited, intervening as *amicus* in rate-court litigation.

stamp whatever rate . . . [a PRO] secured from other licensees in the past without considering whether it was a product of market power." *Id.* at 10.

43. As the record in this case makes clear, the Direct Licenses entered into by Sirius XM, like those adopted by Judges Cote and Stanton, meet the four criteria identified by the Second Circuit for selecting a benchmark. As Professor Noll testified, they were entered into between "sellers and the record companies that are represented by SoundExchange" that "could have chosen to have their rates set in . . . [a rate setting proceeding], but instead freely chose to sign a separate license with Sirius XM." Noll RAWDT p. 35. Because they feature the same buyer, seller, and rights, Professor Noll observed, "the direct licenses between Sirius XM and record companies provide unprecedented, compelling evidence about competitive market rates for sound recording performance rights and constitute the best available benchmarks for setting a statutory rate." *Id.* at p. 36. Moreover, like the direct licenses at issue in *BMI v. DMX* and *In re THP Capstar*, Sirius XM's Direct Licenses are competition-enhancing, as they provide the first-ever opportunity for record labels to compete for airplay on Sirius XM's satellite radio service on the basis of a competitively-negotiated royalty rate. *See generally* Sirius XM Radio Inc.'s Proposed Findings of Fact ("Sirius XM PFF") Section II.

44. That the Direct Licenses are a powerful tool for the Judges' rate determination in this proceeding is confirmed by the record industry's response to Sirius XM's efforts to execute them. *See generally* Sirius XM PFF Section I.C.5. Like BMI and ASCAP with DMX, the record here is replete with evidence of SoundExchange's efforts, in the words of its own president, Michael Huppe, [redacted] Noll RWRT Ex. 39. Numerous Sirius XM witnesses testified to "the coordinated effort by the record industry, led by SoundExchange, A2IM, the National Academy

of Recording Arts and Sciences, the Future of Music Coalition, and various musicians' unions, to publicly discredit the [Sirius XM Direct License] offer and encourage labels not to accept it." Gertz CWDT ¶ 17; *see also* Sirius XM PFF Section I.C.5.

45. Mr. Gertz, chairman of MRI, which assisted the Direct License negotiations, explained that his staff heard repeatedly from labels they approached on behalf of Sirius XM that the labels were interested in doing a deal, but were under tremendous pressure from industry groups not to sign. That is, labels were given to understand that their signing a deal with Sirius XM at a lesser, competitive rate, would have the impact of setting a bad precedent in this proceeding and risked undercutting SoundExchange's anticipated request for substantially higher royalties. *Id.* As SoundExchange board member [redacted] Noll RWRT Ex. 40. This behavior, as Professor Noll testified, is consistent with what one would expect from a collective interested in stemming the tide of competition to the collectively determined, industry-wide statutory rate: if no reliable voluntary licensing is undertaken, then no comparable licenses exist that can be used as benchmarks other than agreements for non-comparable services. Sirius XM PFF Section II.B.1.

46. Accordingly, for all of the reasons discussed above and in Sirius XM's Proposed Findings of Fact, and consistent with established precedent favoring direct licenses as benchmarks in rate-setting proceedings, Sirius XM's Direct Licenses are precisely the "comparable type" of agreement on which the Judges' determination of a reasonable rate should be based in this proceeding. In addition, Professor Noll has presented evidence that the rates in the Direct Licenses are corroborated by an additional set of voluntary marketplace agreements

between the major record companies and "custom" noninteractive webcasters; properly adjusted, those agreements suggest rates for Sirius XM between 6.5% and 7.25% of revenue.

D. SoundExchange Has Failed To Sustain Its Burden Of Proof As To Its Proposed Benchmark For Setting Rates In This Proceeding

47. Unlike Sirius XM, which has placed its Direct Licenses in evidence as proof supporting the reasonableness of its rate proposal in this proceeding, *see* Sirius XM's PFF Section II, SoundExchange has failed similarly to place in evidence the industry license agreements on which its rate case is founded. The sole support for the rates SoundExchange proposes came from Professor Ordover, who created several overlapping models said to be derived from license agreements between the major record labels and certain interactive Internet music services. *See generally* Ordover CAWDT. But Professor Ordover did not annex a single one of those agreements to his testimony, nor did SoundExchange otherwise offer any of them into evidence.[10] We are thus left with a record consisting solely of a single expert's description of the rates, terms and rights conveyed by what he regards to be dispositively significant agreements, without the benefit of the agreements themselves being in evidence. Especially given what the trial record demonstrated to be Professor Ordover's unfamiliarity with those documents, 6/14/12 Tr. 2318:21-2321:1 (Ordover) – evidently having delegated review of them to others supporting him in preparing his testimony – it would be inappropriate to credit facially Professor Ordover's modeling based upon them.

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[10] The record does contain two agreements – between Slacker and EMI and between Slacker and Warner Music Group – referred to by Professor Ordover. *See* Sirius XM Dir. Trial Exs. 27-28; Noll RAWDT Appendix J. Although these agreements do contain certain provisions concerning Slacker's recently launched interactive service, the agreements were entered into evidence by *Sirius XM* in support of Professor Noll's review of the non-interactive benchmarks: specifically, they reveal that EMI and Warner charge Slacker royalty rates for its non-interactive service tier that are less than half the rates they charge for its interactive service tier, and thus support Sirius XM's – and not SoundExchange's – rate proposal.

48. It is a fundamental precept of the law of evidence that, while experts may certainly rely on documents or other materials outside of the evidentiary record to form their opinions, *see* Fed. R. Evid. 703, the offering of expert testimony does not, as a result, bring those relied-upon documents into evidence. *See, e.g.*, *Estate of Noble v. C.I.R.*, No. 12606-01, 2005 WL 23303, at *4 (T.C. Jan. 6, 2005) ("Although an expert need not rely upon admissible evidence in forming his or her opinion, . . . we must rely upon admitted evidence in forming our opinion. . . . The mere fact that the Court admits an expert's opinion into evidence does not mean that the underlying facts upon which the expert relied are also admitted into evidence.") (citing *Anchor Co. v. Comm'r*, 42 F.2d 99 (4th Cir. 1930)); *Haffner's Serv. Stations, Inc. v. C.I.R.*, 83 T.C.M. (CCH) 1211, at *11 (2002), *aff'd*, 326 F.3d 1(1st Cir. 2003) (same); *see also United States v. Scheffer*, 523 U.S. 303, 317 n.13 (1998) (noting that, whereas expert opinion is considered evidence, the facts upon which such an expert relies in forming that opinion are not considered evidence until introduced at trial by a fact witness).[11] Here, SoundExchange is not asking the Judges simply to accept Professor Ordover's *opinions*; it is also asking them to accept the *calculations* he claims to have derived from documents not in evidence.[12]

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[11] For this reason, numerous courts have found a failure of proof when a litigant fails to enter into evidence the very document on which it bases its claims. *See, e.g.*, *Warden v. PHH Mortgage Corp.*, 799 F. Supp. 2d 635, 641-42 (N.D. W.Va. 2011) (plaintiff failed to raise genuine issue of material fact to defeat summary judgment on breach of contract claim where he failed to put forward letter in which he claimed agreement was established; noting "[i]nsofar as [plaintiff] seeks to 'prove the content' of the letter, [he] must produce the original letter unless he can establish an exception to the 'original document rule'"); *In re Shekerjian*, No. 09-14708, 2010 U.S. Dist. LEXIS 33037, at *18-21 (E.D. Mich. Apr. 5, 2010) (affirming holding that party failed to establish it was a creditor of debtor's estate where it failed to offer sales agreement under which it claimed to have been assigned debt into evidence and thus "failed to establish with any evidence that it received an assignment of the debt owing by the debtor").

[12] In contrast to this proceeding, in the *Satellite I* proceeding, in addition to Professor Ordover's economic analysis of the proffered interactive services benchmark agreements, SoundExchange placed in evidence the agreements themselves through the testimony of sponsoring record-industry witnesses. *See, e.g.*, SX

49. In short, having failed to put the underlying agreements supporting Professor Ordover's testimony into evidence, SoundExchange has not met its burden of proof with respect to establishing the economic predicates of its expert's fee modeling. Accordingly, that modeling is entitled to little, if any, weight.

IV. THE GOVERNING 801(B)(1) POLICY OBJECTIVES

50. 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 from agreements between interactive services and those same major record companies that are not in evidence. 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 five-to-seven-percent-of-revenue range proposed by Sirius XM. The propriety of that conclusion is only reinforced by the recognition that this proceeding does *not* entail merely determining fair market value but, instead, requires application of the four section 801(b) policy factors to arrive at a "reasonable" SDARS fee:

- To maximize the availability of creative works to the public;
- To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions;
- To reflect the relative roles of the copyright owner and the copyright user in the product made 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; and

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Trial Exs. 403, 412 (*Satellite I* designated testimony of Mark Eisenberg (Sony) and Lawrence Kenswil (UMG)).

- To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

17 U.S.C. § 801(b)(1).

51. The governing jurisprudence instructs that, while evidence of market rates (especially rates governing "comparable" services) properly informs that determination, it is not conclusive. To the contrary, the protections afforded the SDARS as pre-existing services entitled to have fees set pursuant to these 801(b) factors means, in practice, that evidence as to market rates serves to place an upper bound on the fee to be set by the Judges. 17 U.S.C. § 114(f)(3); 17 U.S.C. § 801(b).

52. As discussed in detail in Section V below, Sirius XM has made a strong record in this proceeding as to each of the four 801(b) factors. It has shown, among other considerations:

- <u>under Factor A ("Availability")</u>, that its music service is highly promotional of sales of sound recordings and that it disseminates diverse genres of music to audiences to which such sound recordings would not otherwise be available, while the record industry's inducement to make additional creative works available is unaffected by royalty rates it earns from Sirius XM for performances of sound recordings on its satellite radio service;

- <u>under Factor B ("Fair Return")</u>, that the record industry earns a fair return on its investment in sound recordings and will continue to do so – indeed, will be aided by the promotional value of Sirius XM in doing so – irrespective of the license fees established in this case, while, in contrast, Sirius XM has yet to recoup its multi-billion-dollar investment and will be further delayed in doing so by rate increases of any kind, let alone of the magnitude sought by SoundExchange;

- <u>under Factor C ("Relative Contribution")</u>, that Sirius XM has made, and continues to make, extraordinary investments in technology and infrastructure, among other critical areas of its business, to enable and maintain its unique service, while, for its part, the record industry has not made any satellite-radio-industry-specific investment; and

- <u>Under Factor D ("Disruption")</u>, that Sirius continues to face an uncertain future in the face of an intensified competitive environment, accumulated debt in the billions of dollars, and continued economic uncertainty – and that the rates set here can disrupt the balance of competition in audio entertainment between Sirius XM and its free-to-the-consumer competitors.

53. The implications of the foregoing legal framework and record evidence for this proceeding are the following:

- Sirius XM's formal rate proposal, calling for rates between 5% and 7% of Sirius XM's gross revenues derived from marketplace benchmarks, is a conservative estimate of a "reasonable" fee under the governing 801(b) standard.

- To the extent the Judges find plausible a range of fees based on marketplace benchmarks, the weight of 801(b) considerations would counsel selecting fees in the lower end of that range.

- The theoretical possibility (although unproven) that the Direct License royalty range may understate by a small margin the rate that the record labels that did not sign might have demanded, or that a given direct licensor might have perceived, by virtue of its artist contracts, that it was effectively earning a slightly higher rate than the nominal royalty rate in its Direct License agreement are of little moment. The ultimate inquiry here is not what constitutes the prevailing market rate for SDARS sound recording performance rights but, instead, the rate that is dictated by application of the 801(b) factors. Insofar as the rate proposed by Sirius XM conservatively makes no downward adjustment to account for this potentially meaningful distinction – and insofar as the section 801(b) analysis suggests selecting fees in the lower end of the range of marketplace rates – it would be inappropriate to elevate the 5% to 7% Direct License rate based solely on its asserted understatement of rates for certain market participants.

- Beyond the purely economic rationale for adjusting webcaster benchmarks offered by both parties to account for the costs of Sirius XM's distribution platform, Factor C mandates such an adjustment in recognition of Sirius XM's investments in that platform and supporting technology, in contrast to the benchmark services.

The following sections elucidate the general policy considerations that motivate the 801(b) analysis and provide the legal and factual basis for the foregoing conclusions.

A. When Congress Modified The DPRA In 1998, It Expressly Grandfathered Preexisting SDARS Under The Section 801(b)(1) Policy-Based Analysis Instead Of Subjecting Them To A Willing Buyer/Willing Seller Standard

54. When Congress revised the DPRA in 1998 as part of the Digital Millennium Copyright Act ("DMCA"), it established different rate-setting standards for preexisting services

like Sirius XM and new Internet webcasters. *See* Pub. L. No. 105-304, § 405(a), 112 Stat. 2860, 2890 (1998); 17 U.S.C. § 114(d)(2); H.R. Rep. No. 105-796, at 80 (1998) (Conf. Rep.) (describing amendment to extend the statutory license to cover nonsubscription as well as subscription services) (hereinafter "DMCA Conference Report"). The rates and terms of statutory licenses for webcasting services were to be set at levels that "most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." Pub. L. No. 105-304, § 405(a), 112 Stat. at 2896 (codified as amended at 17 U.S.C. § 114(f)(2)(B)).

55. Significantly, however, Congress expressly chose not to apply the willing buyer/willing seller standard to preexisting SDARS or to preexisting subscription services ("PSS"). Rather, Congress intentionally "grandfathered" the satellite radio services so that the 1995 provisions governed with respect to both the policy-based section 801(b) rate-setting standard and the conditions under which such a statutory license would be available. The legislative history of the DMCA makes clear that "Section (f)(1)(B) . . . continues to provide that [the rate-setting body] should consider the objectives set forth in section 801(b)(1) as well as rates and terms for comparable types of subscription services." *See* DMCA Conference Report at 85; *accord* Staff of the House Comm. on the Judiciary, 105th Cong., "Section-by-Section Analysis of H.R. 2281 as Passed by the United States House of Representatives on August 4, 1998," at 57 (Comm. Print 1998) (hereinafter "House Manager's Report"). The effect thus was to preserve a multi-factored, policy-based approach to rate-setting for preexisting services as against one based exclusively on the ascertainment of competitive market forces. *See* 144 Cong. Rec. S9935 (Sept. 3, 1998) (remarks of Sen. Ashcroft).

56. The legislative history accompanying the DMCA articulates the rationale for "grandfathering" preexisting services as follows:

> The purpose of distinguishing preexisting subscription services . . . was to prevent disruption of the existing operations by such services. . . . The purpose of distinguishing the preexisting satellite digital audio radio services is similar. The two preexisting satellite digital audio radio services. . . have purchased licenses at auction from the FCC and have begun developing their satellite systems.

DMCA Conference Report at 80-81; *see also* House Manager's Report at 54. Thus, the decision reflected Congress's ongoing concern for the continued availability of these services to consumers, their reliance interest in not being subjected to excessive copyright royalties that would undermine their provision of service to consumers, and – more broadly – the continued viability of the accommodation among competing interests that had been struck in 1995. *See, e.g.*, DMCA Conference Report at 81; 1995 Senate Report at 14 (observing that DPRA is "intended to strike a balance among all of the interests affected thereby").

B. Precedent In Rate-Setting Case Law Demonstrates That Reasonable Rates Under Section 801(b) Are Not Simply Market Rates

57. There have been four prior copyright rate-setting determinations governed by the section 801(b)(1) factors – most recently the *Satellite I* decision. *See Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4080. The three prior determinations were:

- the 1997 determination by the Copyright Arbitration Royalty Panel ("CARP") of rates and terms pursuant to 17 U.S.C. § 114 for the digital performance of sound recordings by preexisting subscription services, as thereafter reviewed by the Librarian of Congress and the Court of Appeals for the D.C. Circuit. *See* Report of the Copyright Arbitration Royalty Panel, Docket No. 96-5 CARP DSTRA (Nov. 28, 1997) ("*CARP PSS Determination*"); *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25,394 (May 8, 1998) ("*Librarian PSS Determination*"); *Recording Indus. Ass'n of Am. v. Librarian of Congress*, 176 F.3d 528 (D.C. Cir. 1999) ("*RIAA v. LOC*");

- the Copyright Royalty Tribunal's determination of rates and terms pursuant to 17 U.S.C. § 116 for the public performance of nondramatic musical works by jukeboxes. *See 1980 Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players*, 46 Fed. Reg. 884 (Jan. 5, 1981). This determination was reviewed by the Court of Appeals for the Seventh Circuit in *Amusement & Music Operators Ass'n v. Copyright Royalty Tribunal*, 676 F.2d 1144 (7th Cir. 1982); and

- the Copyright Royalty Tribunal's determination of rates and terms pursuant to 17 U.S.C. § 115 for mechanical licenses for making and distributing phonorecords embodying nondramatic musical works. *See Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords; Rates and Adjustment of Rates*, 46 Fed. Reg. 10,466 (Feb. 3, 1981) ("*Mechanical Royalty Determination*"). This determination was reviewed by the Court of Appeals for the D.C. Circuit in *Recording Industry Association of America v. Copyright Royalty Tribunal*, 662 F.2d 1 (D.C. Cir. 1981) ("*RIAA v. CRT*").

58. Courts reviewing section 801(b)(1) rate-setting determinations, and predecessor rate-setting bodies, have emphasized the centrality of the four statutory objectives. *See, e.g.*, *RIAA v. LOC*, 176 F.3d at 533 ("[T]he Librarian determined that 'reasonable rates' are those that are calculated with reference to the four statutory criteria. This interpretation is not only permissible but, given that § 114 rates are to 'be calculated to achieve' the four objectives of § 801(b)(1), it is the most natural reading of the statute."); *Amusement & Music Operators*, 676 F.2d at 1146 (observing that Copyright Act "directed the Tribunal to establish a rate that best achieves" the statutory objectives); *Mechanical Royalty Determination*, 46 Fed. Reg. at 10,479 (noting "Congressional mandate, that this Tribunal's adjustment must set a 'reasonable' mechanical royalty rate designed to achieve four objectives, set forth in Section 801 of the Act.").

59. Notably, binding precedent is clear that the determination of "reasonable" rates in accordance with the policy objectives articulated in section 801(b)(1) cannot be reduced to determining the rates that would prevail in an unregulated, competitive marketplace. In the PSS

Proceeding, which involved the identical rate-setting standard at issue here, the CARP, the Librarian of Congress, and the Court of Appeals for the D.C. Circuit all unequivocally concluded that "reasonable" rates under section 801(b)(1) did not signify market rates. Specifically, the D.C. Circuit ruled:

> RIAA's claim that the statute clearly *requires* the use of "market rates" is simply wrong. Section 801(b)(1) requires only that arbitration panels set "reasonable copyright royalty rates." The statute does not use the term "market rates," nor does it require that the term "reasonable rates" be defined as market rates. Moreover, there is no reason to think that the two terms are coterminous, for it is obvious that a "market rate" may not be "reasonable," and vice versa.

RIAA v. LOC, 176 F.3d at 533 (internal citation omitted) (emphasis in original). The court went on to observe that when Congress wanted to mandate market rates, it did so expressly:

> Furthermore, when Congress sought to require market rates in the Act, it used the term "market rate" or its equivalent. . . . Most strikingly, in the recent amendments to 114(f), the Librarian is directed to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller" for the new categories of services. Pub. L. No. 105-304, 112 Stat. at 2896 (codified as 17 U.S.C. § 114(f)(2)(B)). Notably, the statutory criteria for establishing rates for preexisting services, such as those at issue here, remain unchanged, even though both subsections (f)(1) and (f)(2) were revised by the 1998 legislation and are virtually identical in all other aspects.

Id.

60. In so holding, the D.C. Circuit affirmed the Librarian's observation that the DPRA "instructs the CARP to set reasonable rates, which need not be the same as rates set in a marketplace unconstrained by a compulsory license." *See Librarian PSS Determination*, 63 Fed. Reg. at 25,396. Thus, the Librarian ruled that "[t]he standard for setting the royalty rate for the performance of a sound recording by a digital audio subscription service is not fair market value"

and that "[u]nlike a marketplace rate which represents the negotiated price a willing buyer will pay a willing seller, reasonable rates are determined based on policy considerations." *Id.* at 25,399 (citation omitted). The Librarian further made clear that a statutory rate set under section 801(b)(1) "rarely" will "mirror a freely negotiated marketplace rate . . . because it is a mechanism whereby Congress implements policy considerations which are not normally part of the calculus of a marketplace rate." *Id.* at 25,409; *accord CARP PSS Determination* at 36 (rejecting argument that "reasonable" rates signify fair market rates and stating that "reasonable compensation *is not synonymous* with fair market rate" (emphasis added)). Instead, the Librarian found that rate-setting "requires evaluating the marketplace points of reference *and tempering the choice of any proposed rate with the policy considerations underpinning the objectives of Congress in creating the license*." *Librarian PSS Determination*, 63 Fed. Reg. at 25,409 (emphasis added).

61. As the Judges confirmed most recently in *Satellite I*, "the Copyright Act requires that the Copyright Royalty Judges establish rates for the Section 114 license that are reasonable and calculated to achieve the . . . four specific policy objectives identified in Section 801(b)." *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. at 4088. The D.C. Circuit affirmed, finding that that the Judges were "under no obligation to choose a rate derived from a market-based approach" and that it had previously "held in no uncertain terms the 'claim that [§801] clearly *requires* the use of market rates is simply wrong.'" *SoundExchange*, 571 F.3d at 1224 (emphasis in original).

62. At the same time, it is equally clear that a rate *above* that which would prevail in a competitive marketplace by definition cannot be a "reasonable" rate under section 801(b)(1) – a position in which RIAA itself has concurred. In a proceeding governed by the same 801(b)(1)

standard applicable here, RIAA argued that "[a] rate that is deliberately fixed *above* the level that the market can bear . . . cannot be 'reasonable.' Such a rate would yield more than the 'fair return' to copyright owners mandated by the statute." *Mechanical Royalty Determination*, 46 Fed. Reg. at 10,478 (quotations and footnote omitted) (quoting RIAA's Proposed Findings of Fact and Conclusions of Law). The Copyright Royalty Tribunal ("CRT"), a predecessor decisionmaker to the Judges, expressly "adopt[ed] the view of RIAA." *Id.* The Court of Appeals for the D.C. Circuit affirmed the CRT's finding and held that "[t]he Tribunal's decision that the royalty rate must be reasonable as set, and must not yield an unfairly large return, is based on a reasonable interpretation of the statutory language and is entitled to the deference of this court." *RIAA v. CRT*, 662 F.2d at 12-13.

V. APPLICATION OF THE SECTION 801(B)(1) POLICY OBJECTIVES IN THIS PROCEEDING

A. The Royalty Rate Must Maximize The Availability Of Creative Works To The Public

63. The first of the section 801(b)(1) statutory objectives requires the Court to establish a royalty rate that "maximize[s] the availability of creative works to the public." 17 U.S.C. § 801(b)(1)(A). To further Congress's purpose of balancing the interests of both copyright owners and users, this statutory factor must be construed so as to recognize that both the creation and the dissemination of copyrighted works serve to "maximize the availability of creative works to the public." Congress enacted the DPRA statutory license provisions in 1995 (and amended them in 1998 as part of the DMCA) in an effort to ensure the development and ongoing existence of new technologies that expose consumers to a broader array of musical offerings than previously accessible:

> These new digital transmission technologies may permit consumers to enjoy performances of a broader range of higher-quality recordings than has ever before been possible. . . . Such systems could increase the selection of recordings *available to* consumers, and make it more convenient for consumers to acquire authorized phonorecords.

1995 Senate Report at 14 (emphasis added); 1995 House Report at 12. In light of these clear consumer benefits from the developing services, the committee reports expressly provided that the section 114 statutory license should operate in a manner that encourages, rather than thwarts, the development of these new technologies. *See* 1995 Senate Report at 14.

64. Any other reading of section 801(b)(1)(A) – particularly one that focuses exclusively on creation – would contravene Supreme Court precedent as well as the underlying purpose of copyrights. A long line of Supreme Court precedent emphasizes that both creation and dissemination of copyrighted works are objectives of copyright law. Most recently, in *Eldred v. Ashcroft*, 537 U.S. 186 (2003), the Supreme Court upheld the 1998 Copyright Term Extension Act in part because a longer term for copyright protection could "provide greater incentive for . . . authors to create *and disseminate* their work." 537 U.S. at 206 (emphasis added); *see also id.* at 241 (Stevens, J., dissenting) ("[A]s our cases repeatedly and consistently emphasize, ultimate public access is the overriding purpose of the constitutional provision."); *id.* at 244 (Breyer, J., dissenting) ("The Copyright Clause and the First Amendment seek related objectives – the creation and dissemination of information.").

65. Other binding precedent makes clear that the Judges should consider both creation and dissemination of creative works under Section 801(b)(1)'s availability factor. Specifically, the Copyright Royalty Tribunal in the Mechanical Royalty Determination held that "the adjustment of the statutory rate payable under Section 115 of the Act is intended to encourage

the creation *and dissemination* of musical compositions." *Mechanical Royalty Determination*, 46 Fed. Reg. at 10,479 (emphasis added).[13]

66. Though this common-sense principle has been given scant treatment by the parties in previous proceedings, the extensive authority cited above supports a finding that section 801(b)(1)(A) encompasses both the creation and dissemination of copyrighted works. In addition, Sirius XM has adduced significant economic and factual testimony attesting both to that principle and Sirius XM's role in exposing music to a broader audience. Professor Noll, for example, testified at length that economic analysis of the availability factor must consider both the impact of statutory royalties on the creation of new recordings (the "inducement effect"), as well as Sirius XM's unique contributions to disseminating sound recordings to a nationwide audience in a fashion that would not otherwise occur. Noll RAWDT 18-20; 6/5/12 Tr. 222:6-225:5 (Noll); Sirius XM PFF Section IV.A.1-2.

67. The factual record amply demonstrates that Sirius XM has created, and continues to provide, an uninterrupted national broadcast of unparalleled breadth and depth – and does so to audiences who would not otherwise have access to the types and range of programming offered by Sirius XM. *See* Sirius XM PFF Section IV.A.1. Moreover, Sirius XM's 70-plus

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[13] The Judges in *Satellite I* did not address the interpretation of the factor explicitly, holding essentially that the parties had failed to adduce evidence as to "whether the net substitution/promotion effect of the SDARS is different from the net substitution/promotion effect of the interactive subscription service benchmark." *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4095. Moreover, although certain language in the PSS Determination may appear to preclude consideration of dissemination of creative works under this factor, those statements were premised on the unique record (or lack thereof) in that case. The Librarian concluded that the CARP's analysis of this factor was arbitrary because it "failed to discuss any relevant case law or past precedent construing the statutory objective before rendering its determination." *Librarian PSS Determination*, 63 Fed. Reg. at 25,406. Indeed, the Panel's entire discussion of this factor consisted of two brief paragraphs, with no discussion of the record industry's role in creating copyrighted works. *See CARP PSS Determination* at 35.

music channels provide access to new tracks, deep playlists, and even entire genres of programming unavailable on terrestrial radio in most markets. *Id.*

68. Sirius XM listeners not only are exposed to music they wouldn't otherwise hear – they are motivated to *purchase* it: for the first time in a proceeding like this, Sirius XM has presented hard evidence that airplay on Sirius XM's satellite radio service leads directly to increased record sales, providing additional revenue to the record companies to fund new recordings – a showing SoundExchange has failed to rebut and in fact that is corroborated by record industry witnesses and internal record-company documents in evidence. *Id.* By contrast, the evidence makes clear that statutory royalties represent a trivial share of record company income – and that any change in the rates charged therefore would have a negligible impact on stimulating the creation of new recordings. *Id.* As the efforts of artists and record company promotional staff make clear, the promotional benefits of getting exposure to Sirius XM's 22 million subscribers is far more important than the royalty streams that result. *Id.*

69. In sum, the phrase "to maximize availability" encompasses both creation and dissemination of sound recordings. Both are necessary in order to maximize public access to creative works, and both are specifically identified by judicial, legislative, and copyright rate-setting authority as activities that are important to copyright law in general and to statutory licenses subject to the section 801(b)(1) standard in particular.[14] The record of the proceeding

[14] The record companies are repeatedly on record as agreeing with the conclusion that section 801(b)(1)(A) involves consideration of both creation and dissemination of creative works. In the 1981 section 115 proceeding, RIAA, as the copyright user, emphasized the "vital contribution" of the record companies in making music available to the consuming public through the production of recordings and "packaging, graphics, marketing and promotion," as well as "contributions to the opening of new markets through record clubs, mail order sales and television advertising campaigns." *Mechanical Royalty Determination*, 46 Fed. Reg. at 10,479-81. In the more recent Section 115 proceeding, Docket No. 2006-3 CRB DPRA, RIAA's expert economist David Teece cited the 1981 proceeding and likewise argued that

shows that Sirius XM contributes much more to achieving that objective than SoundExchange, and therefore, when considered in connection with the other Section 801(b) factors, a rate at the lower end of the range of reasonable rates is most appropriate.

B. The Royalty Rate Must Afford The Copyright Owner A Fair Return And The Copyright User A Fair Income Under Existing Economic Conditions

70. The second section 801(b) 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).

71. As the use of the normative term "fair" indicates, section 801(b)(1)(B) implicated policy considerations beyond solely what parties may negotiate in the marketplace. Thus, for example, while the Judges in *Satellite I* concluded that this factor did not give reason to diverge from the range of rates suggested by marketplace benchmarks, they reached that conclusion only after analyzing a variety of evidence offered by the parties as to their respective returns on investment, market power, and – in the context of what constitutes a "fair return" for the copyright owners – the promotional and substitutional impact of the licensee service. *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4096 (holding SoundExchange's claims that SDARS substituted for music sales were "neither adequately supported nor quantified in the record").

72. This approach is consistent with prior 801(b) jurisprudence. The Librarian concluded that section 801(b)(1)(B) weighed in favor of setting a low royalty rate that "need not mirror a freely negotiated marketplace rate – and rarely does – because it is a mechanism

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the availability factor "will not be achieved without recognizing record companies' critical contributions . . . which, in the end, enable[] the *dissemination* of music to the public." Testimony of Professor David J. Teece at 82 (emphasis added), *available at* http://www.loc.gov/crb/proceedings/2006-3/riaa-teece-amended.pdf.

whereby Congress implements policy considerations which are not normally part of the calculus of a marketplace rate." *Librarian PSS Determination*, 63 Fed. Reg. at 25,409 (citations omitted). The Librarian found that the fact that the record companies provided promotional copies of sound recordings to the services there at issue undermined RIAA's contention that the services did not promote sales, and it cited the acknowledgement by RIAA's expert that there are "promotional benefits to recording companies from having their music played on radio stations or the digital music services." *Id.* at 25,408.

1. Fair Return To The Copyright Owner

73. The point of the prior Determinations is simple: to afford a "fair return" to the copyright owner, the fee should be higher, relatively speaking, in circumstances where there is some reason to believe that the services involved provide little in the way of promotional benefits and cause lost sales of sound recordings and, conversely, that the fee should be relatively lower where the opposite is likely to be the case: that the services are likely to provide promotional benefits to the record industry and there is no probative evidence of actual or likely displacement of sales.

74. As discussed at length in the sections of Sirius XM's Proposed Findings of Fact, the record here is clear that Sirius XM airplay promotes CD and download sales – and that both artists and record companies believe that to be the case and therefore devote extraordinary resources to obtaining such airplay. Sirius XM PFF Section IV.A.3. Most notably in this regard, Sirius XM has, for the first time, presented specific evidence of airplay on Sirius XM's

satellite radio service driving immediate and dramatic increases in sales in the days following exclusive plays of various tracks.[15] Sirius XM PFF Section IV.A.3.d.

75. SoundExchange, by contrast, has presented no probative evidence of the displacement of CD and download sales caused by the playing of sound recordings on the Sirius XM's satellite radio service. Nor has SoundExchange presented any evidence that record companies are failing to earn a fair return on their investments in creating sound recordings; to the contrary, the record reveals that even in the face of diminished sales from prior years, the record companies continue to be highly profitable. Sirius XM PFF Section IV.B. What *has* been shown is the substitutional impact of the SoundExchange's own benchmark, interactive services. *Id.* at IV.A.4.

2. Fair Income To The Copyright User

76. A royalty rate in the range suggested by Sirius XM's benchmarks also is in keeping with the requirement that the rate be set so as "[t]o afford . . . the copyright user a fair income under existing economic conditions." 17 U.S.C. § 801(b)(1)(B). As Professor Noll testified, "in regulatory economics a 'fair return' is understood to mean the returns that arise if rates recover total costs, including a competitive return on investment." Noll RWRT p. 53. "Here the fair return standard is whether a rate allows both Sirius XM and record companies to remain financially viable in the long run," he continued. *Id.* at p. 54 "By this criterion, a rate is not reasonable if it expropriates the investments of Sirius XM while allowing record companies

[15] As noted in the text, prior 801(b) determinations have addressed evidence of promotion/substitution variously under the Availability and Fair Return factors. In its Proposed Findings of Fact in this proceeding, Sirius XM has presented such evidence in the "Availability" section. *See* Sirius XM PFF Section IV.A.3-4. That placement does not impact the importance or relevance of the evidence to the Fair Return factor as well.

to earn profits in excess of the return that is necessary to be profitable."[16] *Id.* This insight supports Professor Noll's calculation of the costs of the Sirius XM delivery infrastructure that are necessary to induce its continued investment in obtaining new subscribers. *See* Sirius XM PFF Section III.E (describing Noll's third methodology for determining the implicit retail price of Sirius XM music channels); Noll RWRT p. 54.

77. Professor Salinger likewise explained that in order for a rate to be considered fair, it must be one that each party would enter voluntarily "even in the long run." CWRT ¶ 37. "In other words, any party that has incurred sunk costs might voluntarily accept interactions in the short run that it would not have agreed to in the long run had it been aware of the terms prior to incurring sunk costs, and it would be "unfair" to set the rate for the music input at a level that necessarily would have *prevented* such investment in the first instance." *Id.* His testimony is thus consistent with the Judges' holding in *Satellite I* that the rate need not "guarantee" users "a profit *in excess of* fair expectations." *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4095 (emphasis added). As Professor Salinger explained, setting the rate in a fashion that allows for some portion of the subscriber fee to cover Sirius XM's investment in its delivery infrastructure (and preventing the copyright holders from expropriating that portion, which Professor Ordover condones) is not "guaranteeing" a profit in excess of expectations – but merely recognizing and preserving those expectations. Salinger CWRT ¶ 37.

78. Taken together, these "fair return" considerations, when considered in conjunction with the other Section 801(b) factors, point to compensation to the record companies at the lower end of the range of reasonable rates – and certainly well less than rates implied by

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[16] This insight also supports Professor Noll's conclusion that "Universal would be viable if it received no royalties from Sirius XM." Noll RWRT p. 54.

the (much more substitutional) interactive services. *See Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, pp. 4094-95 (explaining that "only the relative difference between the benchmark market and the hypothetical target market would necessitate an adjustment" from the benchmark rates).

C. The Royalty Rate Must Reflect The Relative Roles Of The Copyright Owner And The Copyright User In The Product Made Available To The Public

79. The third section 801(b) policy objective requires that the royalty rate "reflect the relative roles of the copyright owner and the copyright user in the product made 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).

1. The "Product Made Available To The Public" Refers To The Service Offered, Not Merely The Performance Of Sound Recordings.

80. Section 801(b)(1)(C) focuses explicitly on the relative roles of copyright owners and users "in the product made available to the public." *Id.* Binding precedent confirms that the "product" contemplated by this language is not merely the transmission of sound recordings, but the satellite radio service that offers those sound recording performances, including service features and attributes that extend beyond the mere transmission of sound recording performances.

81. In the PSS proceeding, the Librarian rejected the definition of "product" advocated by the recording industry – sound recordings – instead agreeing with the services that the relevant "product" consisted of the digital music service being offered, of which sound recordings were an element. *See Librarian PSS Determination*, 63 Fed. Reg. at 25,408 (holding that CARP's finding that "'product made available to the public' applied to both the sound

recordings and the entire digital music service" "is consistent with the 1980 rate adjustment proceeding for the mechanical license"). The Librarian further recognized that this construction of "product" was consistent with the determination in the 1981 mechanical royalty proceeding. *See id.*; *see also Mechanical Royalty Determination*, 46 Fed. Reg. at 10,480-81.

82. As the SDARS argued in *Satellite I*, only this construction harmonizes with the range of relative contributions – technological, financial, and otherwise – that the statute requires the Judges to consider. In their Determination, the Judges responded by pointing out that the service at issue in the *Librarian PSS Determination* was a music-only service, and that the SDARS therefore could not rely on that Determination to claim credit under the relative contribution factor for its contributions to the non-music aspects of its service. *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4096. The Judges acknowledged, however, that it would be appropriate to consider Sirius XM's "creative contributions to music channels." *Id.*

83. Given that SoundExchange's fee model adopts the principle that an adjustment to benchmark rates of 50% is necessary to account for the fact that Sirius XM offers non-music programming, there does not appear to be any dispute between the parties that Sirius XM's contribution of separately licensed non-music programming merits an adjustment at least in that respect – *i.e.*, to reflect revenue earned by Sirius XM on account of such programming that is not earned by the benchmark services.

2. Creative Contribution

84. Although the PSS Proceeding involved services whose content consisted of little more than performing sound recordings, the Librarian nonetheless acknowledged that the services "enhanced the presentation of the final work through unique programming concepts." *Librarian PSS Determination*, 63 Fed. Reg. at 25,407. The record reveals that Sirius XM's

creative contributions with respect to its music programming are far greater. Not only does Sirius XM provide much broader music offerings in genres and formats not otherwise available on terrestrial radio, but it also invests substantial resources in its music programming to further distinguish it from any other service. *See* Sirius XM PFF Section I.B.5. Such investments include the procurement of quality on-air talent and expert music programmers who employ their considerable expertise in the sequencing and packaging of music content to create a "style or identity" for each music channel available on Sirius XM's satellite radio service. *See* Sirius XM PFF Section I.B.5. Sirius XM also goes to great lengths to provide unique promotional opportunities for artists and their representatives, including the development of dedicated artist channels and shorter-term pop-up channels, live performances and other special appearances, and nationwide promotions, publicity and contests to promote an artist's music or events. *See* Sirius XM PFF Section IV.A.3. Sirius XM's unique ability to offer diverse and rich music content, combined with its additional promotional activities, have led the record industry to acknowledge expressly the powerful promotional impact Sirius XM's satellite radio airplay has on the sale of sound recordings – a fact that is borne out by industry data as well. *See* Sirius XM PFF Section IV.A.3. This promotional effect stands in stark contrast to SoundExchange's preferred interactive services, which all evidence indicates in fact substitute for the sale of sound recordings. *See* Sirius XM PFF Section IV.A.4.

85. By contrast, the record companies have contributed nothing new to Sirius XM's offerings, and expended no effort beyond what they would have expended regardless of the

existence of Sirius XM: the sound recordings at issue were created by the record companies for distribution through other channels.[17] *See* Sirius XM PFF Section IV.A.2.

3. Technological Contribution And Capital Investment

86. Section 801(b)(1)(C) requires consideration of the parties' relative roles with respect to "technological contribution." This factor encompasses "the technological developments made by the Services in opening a new avenue for transmitting sound recordings to a larger and more diverse audience." *Librarian PSS Determination*, 63 Fed. Reg. at 25,407. Some relevant types of technological contributions that should be credited include "the creation of technology to uplink the signals to satellites and transmit them via cable; technology to identify the name of the sound recording and the artist during the performance; and technology for programming, encryption, and transmission of the sound recording." *Id.*

87. Along the same lines, Section 801(b)(1)(C) further requires weighing of the parties' "relative roles in making capital investments." *Id.* Thus, in the PSS proceeding, the Librarian found that "the evidence reveals a large investment of capital by the Services to create a new industry that expands the offerings of the types of music beyond that which one receives over the radio, through live performances, and other traditional means of public performance." *Id.* at 25,408. The Librarian further found that "the Services made a substantial showing of their

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[17] In the *Satellite I* Determination, the Judges took issue with this contention on the grounds that record companies receive compensation from all digital services even where their recordings were not created exclusively for those services. *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4096 n.38. Respectfully, Sirius XM's argument is not that the record companies should not receive compensation for plays on Sirius XM, and is not meant to "preclude intellectual property owners from ever being compensated for their creative efforts in this market." *Id.* The point, rather, is merely that the record companies have not made any *additional* contributions that they would not otherwise have made (absent satellite radio existing) to tip this sub-factor in their favor (and thus in favor of a higher royalty rate). The record reveals quite clearly that the record companies do not make any such additional contributions, and is clear that there is *no* risk that if Sirius XM's position is adopted that the labels' "incentive to create and supply" sound recordings, *id.*, will be impacted in any way. *See* Sirius XM PFF Section IV.A.2.

$10 million investment in equipment and technology . . . whereas RIAA did not suggest that any capital investment was required on its part." *Id.* at 25,407.

88. Likewise, in *Satellite I*, the Judges concluded that the "relative contribution" factor "may weigh in favor of a discount from the market rate because of the SDARS' demonstrated need to continue to make substantial new investments to support the satellite technology necessary to continue to provide this specific service during the relevant license period." *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4096.

89. As detailed in the Proposed Findings of Fact, the same conclusion still holds. Sirius XM continues to invest hundreds of millions of dollars to maintain, monitor, and update its satellite systems; to improve its repeater networks; and to improve its chipsets and radios. *See* Sirius XM PFF Section IV.C.2. In total, Sirius XM anticipates that it will invest more than [redacted] during the coming license term just to maintain, upgrade and, where necessary, replace its technological infrastructure. Karmazin WDT ¶ 10. In addition, Sirius XM anticipates that it will continue to make substantial incentive payments to OEMs to ensure that its radios are installed in new cars. Sirius XM PFF Section IV.C.2. Based on contractual terms for 2009 through 2012, these incentive payments have amounted to an annual average expenditure of more than [redacted] and Sirius XM anticipates that these annual payments will only increase in the coming license term. Meyer WDT ¶ 43. These continued investments are on top of the more than $10 billion that Sirius XM has already spent creating and supporting its service. Karmazin WDT ¶¶ 8-9.[18]

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[18] In the *Satellite I* Determination, the Judges expressed the view that the SDARS were attempting to "take credit" for technological contributions of others. *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4096 (citing testimony of SoundExchange witness Elbert). The more important inquiry, however, is not whether the Sirius XM should get "credit" for conceiving and designing its system, or whether it

90. The Judges recognized precisely this point when they explained that "the primary type of expenditure incurred by the SDARS that does distinguish them from other digital distributors of music is their expenditure for satellite technology." *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4096. Professor Noll's testimony with respect to the non-interactive service benchmark provides the methodology for recognizing and crediting this expenditure through a simple adjustment to Sirius XM's per-subscriber retail price. *See* Sirius XM PFF Section III.E. Importantly, Professor Noll's testimony clarifies that it is not just the expenditure for satellites alone that distinguishes Sirius XM from other digital distributors, but its investment in its delivery network more broadly, including its repeaters and receivers. As Professor Noll explains, Sirius XM, unlike its Internet-based rivals, invests hundreds of millions of dollars each year to install Sirius XM receivers in vehicles. See Sirius XM PFF Section III.E; Noll RAWDT p. 24 and Appendix. D. If that investment is not credited, then – no different than the satellites that deliver the service – Sirius XM will be unable to continue investing in one of the key aspects of its delivery system. Sirius XM PFF Section III.G.6; Noll RWRT p. 54; 6/5/12 Tr. 232:6-234:3 (Noll) (describing Sirius XM as "basically gone if they have no incentive to make these additional investments" in subsidizing car radios).

91. Thus, when the Judges opined in *Satellite I* that "nothing in the record . . . indicates that the SDARS can continue to make their current product available to the public in the license period at issue in this proceeding without making new expenditures related to their

built off of the insights of prior satellite pioneers. Rather, the issue is that Sirius XM invested literally billions of dollars converting those insights into practice in the form of a new, dependable satellite network that, until that time, had not existed; while the services offered as a benchmark by SoundExchange have *not* made such investments – those services instead piggyback off Internet service and computer hardware funded separately by other entities, and paid for separately through consumer payments to other providers. Thus, whoever gets the credit, Sirius XM's massive expenditures in developing the technology and putting it into practice – expenditures that the benchmark services have not made – cannot be ignored.

satellite technology," and that "new satellite investment, unlike other costs, cannot be postponed without a serious threat of disruption to the service," *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, pp. 4096-97, that insight applies equally as well to Sirius XM's ongoing investment in installing radios in vehicles, without which the Company would quickly cease to exist. Sirius XM PFF Section III.G.6; Noll RAWDT pp. 24-25; Noll RWRT p. 54.

92. Notably, the approach advocated by Professor Noll (and supported by Professor Salinger) is premised on the difference in the "relative contributions" of Sirius XM and benchmark services delivered via the Internet rather than through a proprietary satellite network; the approach does *not* rest on the conclusion that the record companies have not themselves made significant investments in developing talent. *See Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4096 (noting that the record companies should receive revenue from each distribution channel that reflects the value of their investments in creating new recordings). The reward for record company investments, however, is built into the benchmark rates, and the adjustments proposed by Professor Noll to the benchmark rates do not diminish that reward – in fact the result of his methodology is to roughly equate, on a per-subscriber level, the monthly fee paid by Sirius XM and the benchmark non-interactive services. This approach simply recognizes that a certain portion of Sirius XM's revenue is earned on account of unique contributions to delivering the service that the benchmark services do not make (and thus do not get paid for).

4. Cost And Risks

93. Section 801(b)(1)(C) lists "cost" and "risks" (the next two statutory sub-criteria) separately, though prior rate-making bodies have treated them together. *See, e.g., Librarian PSS Determination*, 63 Fed. Reg. at 25,407-08. This factor requires "balanc[ing] the costs and risks involved in producing the sound recordings against the cost and risks associated with bringing

the creative product to market in a new and novel way." *Id.* at 25,407. Where "the Services have invested significant start-up" and "face new competition from the internet and digital radio," this factor will favor the services. *Id.* at 25,407-08. This remains true even where "record companies incur significant costs and risks in their business" if "the record companies [do] not incur additional risk from lost sales due to the Services' activities." *Id.*

94. Much more so than in *Satellite I*, the record in this proceeding reveals the risks that Sirius XM has encountered over the preceding license term and is expected to face during the next license – not the least of which is "new competition from the internet and digital radio." 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 and are capable of being easily incorporated into automobiles. Sirius XM PFF Section I.B.4, Meyer WDT ¶ 11.

95. This trend is expected to continue as even more significant competitors in providing digital streams of audio content – the likes of Apple, Google and Microsoft – are expected to compete with Sirius XM in the near future. Meyer WDT ¶ 21; Stowell WRT ¶ 3. Moreover, OEMs are responding to these marketplace developments with technological innovations that enable consumers to access online music and other content in the vehicle with increasing safety and seamlessness. Sirius XM PFF Section I.B.4; *see generally* Rosenblatt WDT at 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"). This competitive reality, combined with Sirius XM's overwhelming reliance on the OEM market and the ongoing uncertain economic climate, lead to the conclusion 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." Stowell WDT ¶¶ 24, 42; Sirius XM PFF Section IV.D.2.

96. By contrast, the trial record has revealed no significant expenses incurred or risks undertaken by the record companies in connection with Sirius XM. While SoundExchange presented evidence from one major record company – UMG – regarding the types of costs that are incurred in its recording business, the vast majority of those costs are wholly unrelated to Sirius XM and are incurred for the purpose of promoting and selling records generally, not for the purpose of having sound recordings performed on satellite radio. *See* Sirius XM PFF Section IV.B. Indeed, as UMG's Chief Financial Officer for North America testified, there is no additional or incremental cost to UMG in connection with the performance of digital sound recordings on Sirius XM's satellite radio service. *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.").

97. Moreover, the performance of sound recordings on satellite radio poses no risk to the record industry, as all available evidence (including concessions from the record industry itself) indicates that such performances promote the sale of sound recordings, and the record does not contain any evidence of any potential substitutional effect on sales. *See* Sirius XM PFF Section IV.A.3. Finally, though SoundExchange bemoans the costs and risks of the record industry, it has collected more than [redacted] in royalties from Sirius XM over the last license term on behalf of its constituency, even though Sirius XM's cumulative free cash flow during this same period was negative, its cumulative loss to date is approximately $8 billion, and it still faces considerable risks from its satellite infrastructure. *See* Sirius XM PFF Section IV.B. In sum, the marginal cost to the record companies of performances of sound recordings on Sirius

XM's satellite radio service is zero, and the promotional value of the performances in fact *reduces* their overall risk.

5. Contribution To The Opening Of New Markets For Creative Expression And Media For Their Communication

98. The Court also must consider the extent to which the SDARS and the record industry "contribut[e] to the opening of new markets for creative expression and media for their communication." 17 U.S.C. § 801(b)(1)(C). Where, as here, the digital services at issue "expose the public to a broader range of music than does traditional over-the-air radio" and, "[u]nlike traditional radio, . . . offer multiple channels for classical, jazz, traditional, alternative, and ethnic formats," this factor favors the services. *Librarian PSS Determination*, 63 Fed. Reg. at 25,407.

99. This sub-factor tips decidedly in Sirius XM's favor. Sirius XM has invested billions of dollars to create, from scratch, a new service in the market – nationwide satellite radio – that literally did not exist before, and that offers a depth and breadth of both music and non-music programming unavailable through previously existing offerings, such as terrestrial radio. This has not only exposed tens of millions of consumers to sound recordings they might not otherwise have discovered, but has generated a new revenue stream for record companies and artists that did not previously exist – all without any additional investment or effort by the record companies. *See* Karmazin WDT ¶¶ 20-25; Noll RAWDT pp. 24-26; Noll RWRT p. 55; Salinger CWRT ¶¶ 32-34; 08/14/12 Tr. 3463:7-3464:22 (Noll); 08/16/12 Tr. 3808:4-3810:12 (Salinger); PFF Section IV.C.

6. Relevant Precedent In Rate-Setting Case Law Supports Subtracting Revenue Earned On Account Of Service Delivery to Account for the Relative Contribution of the Licensee Service

100. In the course of presenting his alternative non-interactive benchmark, Professor Noll explains that the appropriate implicit price of the Sirius XM music channels for benchmarking purposes is one that deducts the costs that Sirius XM invests in its unique satellite delivery infrastructure – its "relative contribution" to the service – prior to applying the benchmark royalty rate. *See* Noll RAWDT pp. 81-83, 85-88. Recent case law in the ASCAP rate-setting context, affirmed by the Second Circuit, confirms that the revenues Sirius XM receives as a result of its investment in providing the platform and distribution service should not be considered to be part of the revenue base against which the benchmark royalty rate will be applied. *See In re Application of MobiTV, Inc.*, 712 F. Supp. 2d 206 (S.D.N.Y. 2010), *aff'd*, *ASCAP v. MobiTV, Inc.*, 681 F.3d 76 (2d Cir. 2012).

101. MobiTV ("Mobi") is a company that aggregates audiovisual content (television programs, music videos, news, etc.) and digital radio (40 non-interactive music channels) from various content providers into a package of programming that wireless carriers such as Cingular and Sprint then offer to their mobile phone subscribers, often as part of a mobile bundle providing wireless phone service and access to Mobi programming, among other content, for a single price. In a proceeding to determine a reasonable royalty rate for the public performance of musical works contained in each type of programming Mobi offered to mobile subscribers, the court set a benchmark royalty rate of 2.5% (the rate ASCAP charges Music Choice, as well as Internet-based streaming providers such as AOL and Yahoo!) for Mobi's streaming music channels. *In re Application of MobiTV, Inc.*, 712 F. Supp. 2d at 255.

102. The question arose as to the proper revenue base against which the benchmark royalty rate would be applied: the retail revenue earned by the mobile provider, including wireless data charges for delivery of the music (as ASCAP argued), or the lesser "wholesale" revenue earned by Mobi for providing the music content to the mobile provider (as Mobi, through the expert testimony of Professor Noll, argued). The court agreed with Mobi, holding that the proper revenue base was the wholesale revenue paid by the wireless carriers to Mobi for its content, not the wholesale revenue collected by the wireless carriers, which "reflects so many inputs that bear little or no relation" to the music content. *Id.* at 246.

103. In support of its holding, the Court cited favorably the contention of Professor Noll that wholesale revenue earned by Mobi properly excluded "compensation that the program distributor receives for aggregating content, providing technical services that enable distribution, or for bundled services such as high-speed data and telephone services."[19] *Id.* at 245. The wireless carriers' retail revenues, by contrast, "embod[ied] the value contributed by many inputs, including investments in wireless technology, wireless networks, and the handsets themselves." *Id.*; *see also id.* at 234 ("'If it were demonstrated that retail purchasers were motivated to pay more because of advantages that resulted from a particular mode of delivery, such as better quality, better accessibility [sic] or whatever' . . . then it may be preferable to base a rate on wholesale revenue.") (quoting *In re Music Choice*, 316 F.3d 189, 196 n.3 (2d Cir. 2003)). Importantly, the court also noted that the wholesale revenue base to which the rate would be applied was consistent with the royalty base from the benchmark service (wholesale revenues paid to Music Choice by cable providers). *Id.* at 248.

[19] The Court also praised Professor Noll's "unquestioned expertise as an economist and his deep engagement with the industries at issue." *Id.*

104. The Second Circuit affirmed, citing Professor Noll's conclusions at length and concluding that ASCAP "failed to provide the District Court with any basis for discounting, much less rejecting, his analysis." *ASCAP v. MobiTV*, 681 F.3d at 85. In upholding the District Court's decision to exclude the wireless carriers' retail revenues from the rate base, the Second Circuit gave as an example a consumer that pays $12 for a CD as opposed to a vinyl record of the same recording that sells for much less:

> True, the purchaser [of the CD] was not motivated to pay the salaries of all the personnel whose efforts made possible the production and delivery of the CD (or the vinyl record), but preference for a CD would have resulted in payment of a higher price than for a record, even though both contained the same music. The retail price of the CD was reflecting not just the value the purchaser assigned to the music but also the value assigned *to the mode of delivery of that music*. . . . The District Court . . . did not err in concluding that the retail price paid by customers for a service that delivers video and audio channels containing music to their handsets is not a good measure of the value of the music itself."

Id. at 87 (emphasis added).

105. Professor Noll has applied the same reasoning to his methodology in the current proceeding. Just has he argued that it was appropriate to apply the streaming audio benchmark rate solely to the revenue received by Mobi for providing content to the wireless carriers – effectively weeding out the additional revenue earned by the carriers for *delivering* Mobi's content – his methodology here deducts the revenues earned by Sirius XM on account of delivering music content before applying the benchmark rate. (That rate is taken from the non-interactive Internet-based services who, like Music Choice and Mobi, provide content but not delivery of the content). Judge Cote and the Second Circuit's conclusions apply squarely to the facts before the Judges here.

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106. Taken together, the "relative contribution" sub-factors lead to the conclusion (a) that applying Internet-based benchmarks to Sirius XM requires an adjustment to account for Sirius XM's unique contributions – namely, its provision of a satellite delivery network and in-vehicle receivers that are reflected in its per-subscriber revenue; and (b) that, when considered in conjunction with the other Section 801(b) factors, a rate at the lower end of the range of reasonable rates is warranted.

D. The Royalty Rate Must Be Set So As To Minimize Any Disruptive Impact On The Industry

107. Section 801(b)(1)(D) requires the setting of "a reasonable rate that minimizes the disruptive impact on the industry" and that does not "hamper the arrival of new technologies." *Librarian PSS Determination*, 63 Fed. Reg. at 25,408. In *Satellite I*, the Judges stated that a royalty rate could have a disruptive impact "if it directly produce[d] an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for either the SDARS or the copyright owners to adequately adapt to the changed circumstances produced by the rate change." *Satellite I Determination*, Fed. Reg. Vol. 73, No. 16, p. 4097. When it came time to set the rate, however, the Judges focused more closely on the basic financial measures of Sirius and XM – namely, to be sure the rate would not "significantly delay[] the attainment and amounts of EBITDA profitability and positive free cash flow for the SDARS," and to take account of testimony that a rate starting at 8% would "impact[] the amount of cash the company has to run its operation." *Id.* at 4097-98.

108. The Judges clearly did *not* rule that disruption would not occur until the companies were driven into bankruptcy, much less forced to shut down, and there is no support

for the contention, pressed by various SoundExchange witnesses, that the disruption inquiry is satisfied as long as the Company can continue operating. *See, e.g.*, Sidak ACWDT ¶ 68 (opining that Sirius XM would not "cease operations," and thus not be disrupted, so long as its subscription price remains greater than its average variable costs, which would be the case unless the royalty rate exceeded 57.8%); 8/20/12 Tr. 4042:8-4043:1 (Lys) (distinguishing bankruptcy as mere "change of control" of company and not of same concern as full liquidation). Nor does the Determination suggest that the rate should be set solely to ensure that Sirius XM does not drop back into a negative free-cash-flow position – *i.e.*, that SoundExchange should be able to expropriate every dollar of positive free cash flow earned by Sirius XM. 8/20/12 Tr. 4077:4-8 (Lys) (no disruption to Sirius XM as long as the Company has free cash flow). Finally, it should go without saying that the Company's ability to pay some higher percentage of its revenue than the current rate without disruption does not necessarily tip this factor in SoundExchange's favor or suggest that the rate therefore necessarily should be raised; if neither SoundExchange nor Sirius XM will be disrupted by keeping the royalty at or below the current level, then there is no reason, subject to the other 801(b) sub-factors, to raise it.

109. With these cautions in mind, the record in the proceeding shows that Sirius XM faces a high risk of disruption in the upcoming license period if the rate is increased above the current rate, and certainly if it is raised to levels proposed by SoundExchange. Having operated at a continuous loss for most of its 20 years, Sirius XM achieved net positive annual income for the first time only in 2010. The Company's near-bankruptcy in 2009 dramatically illustrates how royalty rates, in a crisis situation, or even a no-growth scenario, can threaten the continued viability of the business. It further illustrates that a company that is inextricably linked to the

volatile auto industry and has no ability to hedge its exposure to this industry is particularly vulnerable to economic downturns. *See* Sirius XM PFF Section IV.D.

110. While Sirius XM's management has publicly expressed optimism about its prospects for future growth, such growth is by no means assured.[20] In light of its near-bankruptcy experience in the last rate term, and its $3 billion of debt – not to mention uncertainty over whether the recent uptick in new auto sales will be sustained in an increasing volatile economic climate – the Company will need to maintain significantly more cash than it has in the past. *See* 6/7/12 Tr. 663:17-665:2 (Frear) (stating his view that the Company needs cash reserves of at least $750 million); Sirius XM PFF Section IV.D. The rapid growth of new low-cost competitive alternatives that are increasingly available in vehicles presents another looming threat that counsels caution in rate setting – not only because it threatens Sirius XM's ability to add subscribers over the next license term, but also because, as Professors Noll and Salinger testified, Sirius XM's prospects could be disrupted by a royalty rate that disadvantages Sirius XM relative to its Internet-based competitors. Sirius XM PFF Sections IV.C and IV.D.2. In short, whereas the Judges held in the *Satellite I Determination* that "over the period of time marked by the license period, the potential for disruption will diminish," *id.* at p 4097, the

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[20] Optimistic statements by management on earnings calls about the Company's future prospects and continued growth are not a basis for finding that the Company's recent growth will be sustained; such statements lack concrete financial predictions and are regularly deemed too vague, in the context of securities litigation, to be actionable. For instance, securities fraud claims against XM Satellite Radio and its CEO, challenging similar forward looking statements about subscriber growth and lower subscriber acquisition costs, were dismissed on this ground in *In re XM Satellite Radio Holdings Sec. Litig.*, 479 F. Supp. 2d 165 (D.D.C. 2007). *Id.* at 176-177 ("[I]t is well-established under the "puffery" doctrine that 'generalized statements of optimism that are not capable of objective verification' are not actionable 'because reasonable investors do not rely on them in making investment decisions.'") (quoting *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1119 (10th Cir.1997)).

potential for disruption in the forthcoming license term will actually *increase* over time, a situation that will only be exacerbated by any rate increase.

111. By comparison, the record reveals no risk of disruption for the record companies at the rates proposed by Sirius XM. As detailed in Sirius XM's Proposed Findings of Fact, record company earnings from Sirius XM performances comprise a trivial portion of their revenue – much too small a portion to suggest that the loss of such royalties (much less enduring a modest decrease of the kind proposed by Sirius XM) would be disruptive. While the record companies no doubt would like to see their Sirius XM royalties increase, it cannot be argued that a failure to do so would be disruptive.

112. In sum, when considered in conjunction with each of the other statutory factors, this objective is best fulfilled by a rate set at the lower end of the reasonable range. *See Librarian PSS Determination*, 63 Fed. Reg. at 25,409 (affirming "Panel's determination that the best way to minimize the disruptive impact on the structure of the industries is to adopt a rate from the low range of possibilities").

CONCLUSION

For the reasons set forth herein, and in the Sirius XM's Proposed Findings of Fact, the Copyright Royalty Judges should adopt the Proposed Rates and Terms submitted by Sirius XM.

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CERTIFICATE OF SERVICE

I, Sabrina A. Perelman, hereby certify that a copy of the public version of Sirius XM Radio Inc.'s Proposed Conclusions of Law was served on October 1, 2012 via email and overnight mail on the following parties:

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