

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

In the Matter of

**ADJUSTMENT OF RATES AND TERMS FOR
PREEXISTING SUBSCRIPTION SERVICES
AND SATELLITE DIGITAL AUDIO RADIO
SERVICES**

Docket No. 2006-1 CRB DSTR

**PROPOSED CONCLUSIONS OF LAW, JOINTLY SUBMITTED BY
SIRIUS SATELLITE RADIO INC. AND XM SATELLITE RADIO INC.**

R. Bruce Rich (N.Y. Bar No. 1304534)
Bruce S. Meyer (N.Y. Bar No. 2108447)
Ralph I. Miller (D.C. Bar No. 186510)
Jonathan Bloom (N.Y. Bar No. 2495810)
Mark J. Fiore (N.Y. Bar No. 4132395)
Todd Larson (N.Y. Bar No. 4358438)
William R. Cruse (N.Y. Bar No. 4315073)
WEIL, GOTSHAL & MANGES LLP
767 Fifth Avenue
New York, NY 10153
Tel: 212.310.8170
Fax: 212.310.8007
r.bruce.rich@weil.com,
bruce.ineyer@weil.com,
ralph.miller@weil.com, mark.fiore@weil.com,
todd.larson@weil.com,
william.cruse@weil.com

Bruce G. Joseph (D.C. Bar No. 338236)
Michael L. Sturm (D.C. Bar No. 422338)
Karyn K. Ablin (D.C. Bar No. 454473)
Benjamin B. Reed (D.C. Bar No. 461768)
Jennifer L. Elgin (D.C. Bar No. 432975)
Matthew J. Astle (D.C. Bar No. 488084)
WILEY REIN LLP
1776 K St NW
Washington, DC 20006
Tel: 202.719.7258
Fax: 202.719.7049
bjoseph@wileyrein.com,
msturm@wileyrein.com,
kablin@wileyrein.com, breed@wileyrein.com,
jelgin@wileyrein.com, mastle@wileyrein.com

Counsel for Sirius Satellite Radio Inc.

Counsel for XM Satellite Radio Inc.

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TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
PROPOSED CONCLUSIONS OF LAW	3..
I. BASIC PRINCIPLES OF COPYRIGHT APPLICABLE TO THIS PROCEEDING	3..
A. Public, Not Private, Purpose of Copyright Law	3
B. The Right at Issue	5..
II. HISTORY OF THE SOUND RECORDING PERFORMANCE RIGHT	9
A. Unlike Musical Works, Sound Recordings Were Not Subject to Federal Copyright Protection Prior to 1972.....	9
1. Congress' Eventual Grant of a Limited Sound Recording Reproduction Right.....	10
2. Congress' Repeated Refusal To Grant a Broad Sound Recording Performance Right	13
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.....	15
C. When Congress Modified the DPRA in 1998 To Include Certain Nonsubscription Transmissions, 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.	21
III. THE GOVERNING LEGAL STANDARD: RATES AND TERMS TO EFFECTUATE THE POLICY OBJECTIVES SET FORTH IN SECTION 801(B)(1) OF THE COPYRIGHT ACT.....	23
A. The Court Is Required To Follow Prior Interpretations of Section 801(b)(1).	24
B. Binding Precedent Demonstrates that "Reasonable" Rates Under Section 801(b)(1) Are Not the Equivalent of "Willing Buyer-Willing Seller" Rates.....	26
IV. APPLICATION OF THE SECTION 801(B)(1) POLICY OBJECTIVES: THE COURT MUST DETERMINE "REASONABLE RATES AND TERMS "CALCULATED TO ACHIEVE" THE STATUTORY OBJECTIVES DELINEATED IN SECTION 801(B)(1).	29
A. The Royalty Rate Must Maximize the Availability of Creative Works to the Public.	30

B.	The Royalty Rate Must Reflect the Relative Roles of the Copyright Owner and the Copyright User in the Product Made Available to the Public.....	36
1.	The "Product Made Available to the Public" Refers to the Overall Service, Not Merely Sound Recordings.....	37
2.	Creative Contribution.....	38
3.	Technological Contribution	42
4.	Capital Investment.....	43
5.	Cost and Risks.....	44
6.	Contribution to the Opening of New Markets for Creative Expression and Media for Their Communication.....	45
C.	The Royalty Rate Must Be Set So as To Minimize Any Disruptive Impact on the Industry.	46
D.	The Royalty Rate Must Afford the Copyright Owner a Fair Return and the Copyright User a Fair Income Under Existing Economic Conditions.	50
1.	Fair Return to the Copyright Owner	52
2.	Fair Income to the Copyright User Requires the Court To Set a Rate that Permits a Reasonable Risk-Adjusted Return on Investment, Including Past Investments in Starting and Developing the Business.	58
V.	LEGAL PRINCIPLES GOVERNING CONSIDERATION OF BENCHMARK AGREEMENTS.....	67
A.	The Statute Invites the Judges To Consider Sound Recording Performance Agreements with Preexisting SDARS and Preexisting Subscription Services as Benchmarks.....	67
B.	Past Rate-Setting Precedent Rejects the Use of Agreements Granting Exclusive Rights as Benchmarks for the Non-Exclusive Sound Recording Performance Right at Issue Here in Light of the Vastly Differing Nature and Value of the Rights Conveyed.	68
C.	Past Rate-Setting Precedent Has Relied on Musical Works Performance Royalties as an Appropriate Benchmark for the Performance Right at Issue Here.....	69
VI.	LEGAL PRINCIPLES GOVERNING EVALUATION OF SURVEY EVIDENCE.....	70

INTRODUCTION

Pursuant to 37 C.F.R. § 351.14, Sirius Satellite Radio Inc. and XM Satellite Radio Inc. (collectively, the "preexisting SDARS" (satellite digital audio radio services) or "SDARS") hereby submit these Joint Proposed Conclusions of Law. These proposed conclusions provide historical context on the origin of and rationale for copyright law in general, statutory licensing in particular, and the sound recording performance right at issue in this proceeding. They also discuss the requirement that the Copyright Royalty Judges ("Court" or "Judges") set a "reasonable" rate in this proceeding and analyze each of the statutory objectives set forth in section 801(b)(1) of the Copyright Act ("Act"), which the Judges are required to apply in setting such a "reasonable" rate. *See* 17 U.S.C. § 801(b)(1). The conclusions demonstrate that proper application of the statutory factors should lead to a rate designed to reflect the following principles:

- the interests of copyright owners, on one hand, and users of copyrighted works, on the other, should be balanced so as to achieve the overarching goal of the copyright laws to promote the public interest through broad public availability of works of creative expression;
- the copyright laws confer only a limited monopoly on copyright owners to exploit their works and, in appropriate settings, Congress has restrained that limited grant of authority even further by means of statutory license mechanisms;
- the copyright right here in issue – to publicly perform sound recordings by means of a digital audio transmission under section 106(6) of the Act – is a recent one under U.S. law and is intended to be of limited scope, to address specific, limited concerns, and not to “hamper[] the arrival of new technologies”;
- sections 114(f)(1)(A) and (B) of the Act, governing this rate-setting process, reflect the limited nature of the public performance right and afford the SDARS the benefits of their provisions;
- central to these statutory license provisions is the guarantee that the policies embodied in section 801(b)(1) of the Act will be applied to the record evidence in reaching a fee determination;

- those 801(b)(1) policies, as authoritatively construed by governing precedent, implement considerations that are separate and distinct from those that normally form the calculus of a marketplace rate, namely:
 - rewarding innovations such as those of the SDARS in "contributing to the opening of new markets for creative expression and media for their communications,"
 - in relation to new "product[s] made available to the public," such as satellite digital audio radio services, assaying the relative "creative contribution, technological contribution, capital investment, cost and risk" made and assumed by, in this setting, the SDARS and the recording industry,
 - assuring the interests, not simply in the "fair return" to which the copyright owner is entitled in this limited rate proceeding for performances of its works, but also in a "fair income" to the SDARS "under existing economic conditions," and
 - preventing disruption to the existing operations of the SDARS;
- section 114(f)(1)(B) specifically singles out, and encourages the Judges in a rate proceeding under that section to examine, prior agreements reached between the recording industry and licensees subject to section 114(f)(1) ratemaking, namely, preexisting subscription services and the SDARS themselves. The implicit logic of this prescriptive is that because only these licensees are entitled to section 114 statutory licenses reflecting the section 801(b)(1) objectives, prior agreements reached between such licensees and the recording industry are more likely to serve as useful fee-setting benchmarks (appropriately adjusted) than agreements (for sound recording performance rights, let alone for other copyright rights) that reflect instead the outcome of willing buyer/willing seller negotiations.

As discussed below, only a rate that furthers all of the foregoing goals can satisfy the Judges' statutory charge to set rates that are "reasonable" under sections 114(f)(1) and 801(b)(1) and in light of all the circumstances.

PROPOSED CONCLUSIONS OF LAW

I. BASIC PRINCIPLES OF COPYRIGHT APPLICABLE TO THIS PROCEEDING

A. Public, Not Private, Purpose of Copyright Law

1. Far from existing to grant to copyright owners unbounded property rights or to distribute rewards for owners' creative works, copyright is, at bottom, a set of rights designed to promote the public interest by fostering public access to such creative works.

2. Although the effect of granting copyright protection is to provide a limited monopoly in specifically enumerated circumstances, copyright law "is not based upon any natural right that the author has" and does not exist to protect private property rights in creative works. *Sony Corp. v. Universal City Studios, Inc.*, 464 U.S. 417, 429 n.10 (1984). "The primary objective of copyright is not to reward the labor of authors, but 'to promote the Progress of Science and useful Arts.'" *Feist Publ'ns, Inc. v. Rural Tel. Sew. Co.*, 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))).

3. The rights embodied in modern copyright law have their underpinnings in the Copyright Clause of the U.S. Constitution, where the public interest requirement that copyright law "promote the Progress of Science and useful Arts" is found. See U.S. Const. Art. I, § 8, cl. 8. The Copyright Clause "was written against the backdrop of the practices – eventually curtailed by the Statute of Monopolies – of the Crown in granting monopolies to court favorites in goods or businesses which had long before been enjoyed by the public." *Graham v. John Deere Co.*, 383 U.S. 1, 5 (1966). At the time the clause was written, Americans "had an

instinctive aversion to monopolies." *Id.* at 7. As Thomas Jefferson, the "moving spirit" of the clause, wrote, "'the benefit even of limited monopolies is too doubtful to be opposed to that of their general suppression.'" *Id.* at 8 (quoting *V Writings of Thomas Jefferson*, at 47 (Ford ed. 1895)).

4. Copyright law must be applied in light of this history of disfavoring monopolies and promoting free competition. The Supreme Court thus has explained that "[t]he monopoly privileges that Congress may authorize are neither unlimited nor primarily designed to provide a special private benefit. Rather, the limited grant is a means by which an important public purpose may be achieved." *Sony*, 464 U.S. at 429. That purpose, as noted, is 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); see also, *e.g.*, *Fogerty v. Fantasy, Inc.*, 510 U.S. 517, 527 (1994) ("[C]opyright law ultimately serves the purpose of enriching the general public through access to creative works."); *Sony*, 464 U.S. at 429 (observing that limited monopoly is granted to copyright holders "in order to give the public appropriate access to their work product"); *Eldred v. Ashcroft*, 537 U.S. 186, 219 (2003) ("[C]opyright supplies the economic incentive to create and disseminate ideas." (emphasis added) (internal quotation marks and citation omitted)).

5. The Supreme Court has further 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.

Twentieth Century Music Corp., 422 U.S. at 156. 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*, 464 U.S. at 429; *see, e.g., Stewart v. Abend*, 495 U.S. 207, 230 (1990) (referring to "the delicate balance Congress has labored to achieve").

6. Any application of copyright law necessarily must reflect this balance while guarding against any temptation to view copyright protection as conferring a broad form of competition-stifling monopoly. *See Sony*, 464 U.S. at 429 n.10 (describing the balance between stimulating the producer and "the evils of the temporary monopoly" (quoting H.R. Rep. No. 60-2222, at 7 (1909))); *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 146 (1989) (holding that Copyright Clause "reflects a balance between the need to encourage innovation and the avoidance of monopolies which stifle competition without any concomitant advance in the 'Progress of Science and useful Arts'").

B. The Right at Issue

7. Copyright is a creature of statute, and the protection granted is strictly limited to that which Congress has determined to be appropriate. *See Wheaton v. Peters*, 33 U.S. (8 Pet.) 591, 663 (1834) (holding that copyright "does not exist at common law – it originated, if at all, under the acts of congress"); *White-Smith Music Publ'g Co. v. Apollo Co.*, 209 U.S. 1, 15 (1908) ("[I]t is perfectly well settled that the protection given to copyrights in this country is wholly statutory.").

8. 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 rights, of reproduction. See 17 U.S.C. §§ 106(6), 106(1).¹ Section 106 confers a series of other exclusive rights beyond those described above. These entail the very distinct privileges to distribute copies or phonorecords of copyrighted works to the public in prescribed fashion (see *id.* § 106(3)) and to perform and display musical and other works publicly (see *id.* §§ 106(4) and (5)).

9. At the same time, Congress has created a number of mechanisms that limit the statutorily granted rights in copyrighted works. Thus, the "exclusive rights" that the Copyright Act grants to copyright owners are not exclusive in the ordinary sense of the term; in fact, they are subject to a range of statutory exceptions and limitations that are set forth in sections 107 through 121 of the Copyright Act.

10. One common limitation on copyrights is the fair use doctrine, which prevents copyright owners from blocking uses of their works that have important social benefits, such as criticism and parody. See 17 U.S.C. § 107. Another is the requirement that works be original and sufficiently creative to be entitled to copyright protection. See *Feist*, 499 U.S. at 345 (stating that "[t]he sine qua non of copyright is originality" and requiring that "original" works "possess[] at least some minimal degree of creativity"). Yet another restriction is the term limit; unlike other property rights, copyrights are limited in time – currently, generally to the life of authors plus 70 years. See 17 U.S.C. § 302(a).

11. A "statutory license," such as the section 114 license at issue in this proceeding, is yet another of the mechanisms that Congress has employed to limit the scope of copyrights, with the particular aim of ensuring the availability of copyrighted works to the public. See 17 U.S.C.

¹ In addition to setting the statutory fee for the sound recording performances here at issue, the Judges are required to set the statutory fee for ephemeral reproductions of sound recordings that are made to facilitate those performances. See 17 U.S.C. § 112(e).

§ 114(f)(1)(B).² As discussed in more detail below, the legislative history underlying the sound recording performance statutory license discusses the numerous consumer benefits of new digital transmission technologies and reveals a clear congressional intent that the statutory license should operate "without hampering the arrival of new technologies." S. Rep. No. 104-128, at 14-15 (1995) (hereinafter "1995 Senate Report").

12. Statutory licenses permit anyone who complies with their terms to make use of copyrighted content in the manner permitted under the license by paying the established royalties or, if they are not yet set, by agreeing to pay them when they are. For example, the statutory license at issue here provides:

Any person who wishes to perform a sound recording publicly by means of a transmission eligible for statutory licensing under this subsection may do so without infringing the exclusive right of the copyright owner of the sound recording –

(i) by complying with such notice requirements as the Copyright Royalty Judges shall prescribe by regulation and by paying royalty fees in accordance with this subsection; or

² 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 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. 94-1476, at 117 (1976) (section 118 statutory license exists in part because "encouragement and support of noncommercial broadcasting is in the public interest"); 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").

(ii) if such royalty fees have not been set, by agreeing to pay such royalty fees as shall be determined in accordance with this subsection.

17 U.S.C. § 114(f)(4)(B); see also 1995 Senate Report at 24 ("A 'statutory license' guarantees that every noninteractive subscription transmission service will receive a license to perform the sound recording by means of a digital transmission, provided that the transmission service pays the royalty and complies with the terms prescribed in accordance with subsection (f).").

13. 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. As discussed below, the form of regulation imposed here entails an application of the policy guidelines contained in section 801(b)(1) to the circumstances of the SDARS and record industry participants.

14. The limited right of public performance of sound recordings at issue here is closely allied to, but legally distinct from, the public performance right conferred upon copyright owners of musical works. The Copyright Act defines "sound recordings" as "works that result from the fixation of a series of musical, spoken, or other sounds, but not including the sounds accompanying a motion picture or other audiovisual work, regardless of the nature of the material objects, such as disks, tapes, or other phonorecords, in which they are embodied." 17

U.S.C. § 101. "Musical work," by contrast, is a term used to describe the song itself – *i.e.*, the underlying musical composition.

II. HISTORY OF THE SOUND RECORDING PERFORMANCE RIGHT

15. Valuing the statutory license at issue in this proceeding must be done with an eye toward Congress' objectives in creating a limited sound recording performance right. See, *e.g.*, *Dolan v. U.S. Postal Sew.*, 546 U.S. 481, 486 (2006) ("Interpretation of a word or phrase depends upon reading the whole statutory text, considering the purpose and context of the statute, and consulting any precedents or authorities that inform the analysis."); *Johnson v. United States*, 529 U.S. 694, 710 n.10 (2000) ("Our obligation is to give effect to congressional purpose so long as the congressional language does not itself bar that result."); *Crandon v. United States*, 494 U.S. 152, 158 (1990) ("In determining the meaning of the statute, we look not only to the particular statutory language, but to the design of the statute as a whole and to its object and policy.").

16. As discussed more fully below, while composers of musical compositions have long held rights of public performance and reproduction in their musical works, Congress was much more reluctant to accord copyright status to sound recordings. Indeed, Congress repeatedly refused to grant any copyright protection at all to sound recordings prior to 1972, and it refused to recognize any right of public performance in sound recordings until 1995. When Congress finally granted a public performance right, it made the right narrow in scope and tailored it to address specific concerns expressed by the record companies.

A. Unlike Musical Works, Sound Recordings Were Not Subject to Federal Copyright Protection Prior to 1972.

17. 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 prior to 1972. This circumstance stemmed, at least in part, from the longstanding view that sound recordings lacked the creativity that is an essential constitutional prerequisite to affording copyright protection and that the makers of sound recordings thus were not "authors" under the Constitution. See U.S. Const. Art. I, § 8, cl. 8 (permitting Congress to grant copyright protection to "Authors" for "Writings"); *Feist*, 499 U.S. at 346 ("Originality is a constitutional requirement."); *id.* (observing that it is "unmistakably clear" that the constitutional terms "authors" and "writings" "presuppose a degree of originality"); Barbara Ringer, "The Unauthorized Duplication of Sound Recordings," Study No. 26 in Copyright Revision, Studies Prepared for the Comm. on Patents, Trademarks and Copyrights of the Comm. on the Judiciary, U.S. Senate, 86th Congress, at 47 (Comm. Print 1961) (acknowledging that "[a]ttacks of the constitutionality of a statute granting copyright in sound recordings" involved arguments that "[r]ecord manufacturers cannot be regarded as 'authors' since their contributions do not amount to original intellectual creations" and that "[p]erformers cannot be regarded as 'authors'").

1. Congress' Eventual Grant of a Limited Sound Recording Reproduction Right

18. Congress eventually enacted a limited right in sound recordings in 1971 (effective in 1972), but it did so 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)).

19. Notably, neither the legislation that took effect in 1972 nor any of the subsequent amendments to the Copyright Act discussed below 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.").

20. 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. 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 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 different medium." *L. Batlin & Son v. Snyder*, 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 M. Nimmer § 20.2, at 93).

21. 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 ("The 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 should not qualify under this standard. See *L. Batlin & Son*, 536 F.2d at 491 ("[T]he mere reproduction of a work of art in a different medium should not constitute the required originality . . ."); *Bridgeman Art Library, Ltd. v. Corel Corp.*, 36 F. Supp. 2d 191,200 (S.D.N.Y. 1999) (holding documentary photographs of museum art objects not copyrightable for lack of significant new authorship). "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." *L. Batlin & Son*, 536 F.2d at 492.

22. The Copyright Office has endorsed these principles in the context of considering whether various alterations to sound recordings are sufficiently copyrightable to be eligible for registration. In a circular entitled "Copyright Registration of Sound Recordings," the Copyright Office stated: "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). The Copyright Office also has published a manual for staff use providing guidance on what does and does not constitute copyrightable material eligible for registration. In a section addressing the registrability of pre-1972 sound recordings that have been reissued after 1972, it identified several "noncopyrightable elements" – which, significantly, include "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").³

2. Congress' Repeated Refusal To Grant a Broad Sound Recording Performance Right

23. During the five decades leading up to Congress' grant of the limited sound recording reproduction right, the record companies repeatedly asked Congress to create a broad sound recording performance right. See "Performance Rights in Sound Recordings," Subcomm. on Courts, Civil Liberties, and the Admin. of Justice, House Comm. on the Judiciary, 95th Cong., 2d Session. (1978), at 28-58 (Comm. Print 1978) (hereinafter "1978 Register's Report"). Congress, however, consistently refused to do so. See 1995 Senate Report at 10-13; 1971 House Report at 3; 1971 Senate Report at 3.

24. Two related circumstances underlay Congress' 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

³ 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).

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 and thus as not needing additional compensation in the form of public performance royalties.

25. 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. 94-473, at 87-88 (1975); H.R. Rep. No. 94-1476, at 106 (1976). On September 9, 1974, the Senate took up S. 1361, a comprehensive revision bill that included a sound recording performance right subject to statutory licensing. Senator Ervin, however, offered an amendment to delete this provision that was debated and passed. *See* 120 Cong. Rec. 30,477-30,516 (Sept. 9, 1974). A number of senators supporting the amendment referred specifically in their statements to promotional value. Senator Hruska, for example, noted that “[o]ver many years the broadcasters and the recording companies have developed a fair system of exchange of goods and services. Each has contributed to the well-being of the other.” *Id.* at 30,479. Senator Gurney remarked that he opposed requiring “radio stations [and] broadcasters [] to pay an additional amount when they are broadcasting since it really increases the sale[s] of the record companies and the recording artists. . . . So it seems an absurd folly to have the very people who are benefiting these people pay them for doing the benefiting.” *Id.* at 30,480-81.

26. The rationale for Congress' repeated rejection of a sound recording performance right was aptly described by the minority views on the Senate Judiciary Committee in a report accompanying a bill proposing such a right (that ultimately failed):

Broadcasters and jukebox operators render a service to both performers and recording companies by playing new recordings; under S.1361, they would now be required to pay statutory fees to those who benefit from this arrangement. For years, record companies have gratuitously provided records to stations in hope of securing exposure by repeated play over the air. The financial success of recording companies and artists who contract with these companies is directly related to the volume of record sales, which, in turn, depends in great measure upon the promotion efforts of broadcasters.

S. Rep. No. 93-983, at 225-26 (1974) (minority views of Sens. Eastland, Ervin, Burdick, Hruska, Thurmond, and Gurney) (emphasis added).

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.

27. 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 the 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").

28. Congress enacted the DPRA to address a specific emergent potential concern, not to work a general redistribution of rights and obligations with respect to copyrighted sound recordings. The threat perceived by the record industry was 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 lost revenues, not to provide them a new revenue stream independent of that consideration.

29. The "certain types" of services to which the recording industry's concerns had the most direct application were of the so-called "interactive" variety,⁴ 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

⁴ The DPRA defines an "interactive service" as "one that enables a member of the public to receive, on request, a transmission of a particular sound recording chosen 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." Pub. L. No. 104-39, § 3 (codified as amended at 17 U.S.C. § 114(j)(7)); see *also* 1995 Senate Report at 33-34; 1995 House Report at 25-26.

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

30. With respect to the noninteractive digital subscription transmission services⁵ 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. Congress thus realized that unless it legislated cautiously, the promise of new technologies might not be realized. Observing that "consumers have embraced digital recordings because of their superior sound quality," the House and Senate reports noted:

Even 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 industry, suggest that digital transmissions of sound recordings is likely to become a very important outlet for performances 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 (emphasis added); 1995 House Report at 12. Congress was aware, however, 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. Thus, the House and Senate reports

⁵ The DPRA defines a "subscription" transmission as "a transmission that is controlled and limited to particular recipients, and for which consideration is required to be paid or otherwise given by or on behalf of the recipient to receive the transmission or a package of transmissions including the transmission." Pub. L. No. 104-39, § 3 (codified as amended at 17 U.S.C. § 114(j)(14)).

accompanying the DPRA recognized that although the DPRA aimed to "provide copyright holders of sound recordings with the ability to control the distribution of their product," that must be accomplished "without hampering the arrival of new technologies," from which consumers derived important benefits. 1995 Senate Report at 15; 1995 House Report at 14.

31. To account for the spectrum of risks posed by different business models to the displacement of record sales, Congress enacted a three-tiered system of protection for administering the new, narrowly tailored sound recording performance right. The top tier consisted of interactive services that posed potential risks of significantly displacing record companies' traditional sources of revenue. With respect to these services, Congress provided the record companies with a substantial potential substitute source of income by granting them exclusive rights in the public performance of their sound recordings by such services. The bottom tier included services, such as radio broadcasters, that were deemed to pose no significant threat to the traditional compensation systems, and Congress expressly exempted such services from the sound recording performance right. The middle tier consisted of noninteractive subscription services, such as Music Choice's subscription cable television service, that were considered potentially to pose, at most, a limited risk to the record industry's traditional sources of compensation. For these services, Congress gave the record companies a limited statutory license that would be set in accordance with the policy objectives outlined in section 801(b)(1) of the Copyright Act. Pub. L. No. 104-39, § 3, 109 Stat. 336,340-42 (1995); 1995 Senate Report at 16.

32. 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 sequentially⁶ 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], at 8-320.5 (footnotes omitted).

33. In subjecting noninteractive subscription services such as those at issue in this proceeding 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. With respect to radio broadcasting, which, like the preexisting SDARS, is noninteractive and exposes listeners to new sound recordings through airplay, the Senate report accompanying the DPRA

recognize[d] that the sale of many sound recordings and the careers of many performers have benefited considerably from airplay and other promotional activities provided by both noncommercial and advertiser-supported, free over-the-air broadcasting.

1995 Senate Report at 14-15, *see also* 1995 House Report at 13. Moreover, with respect to noninteractive subscription services, Congress acknowledged the testimony of Jerold Rubinstein, chairman of the Digital Music Express ("DMX") subscription audio service, who had stated "that certain digital subscription services effectively promote sales of sound recordings through the adoption of new identification technologies as well as by the exposure afforded to the performers

⁶ The "sound recording performance complement" was defined in 17 U.S.C. § 114(d)(2)(B) (1995). It is now codified at 17 U.S.C. § 114(d)(2)(B)(i).

and sound recordings." 1995 Senate Report at 15.⁷ 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)).

34. 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. S11, 945-49 (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 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 was a statutory license, to be set and periodically adjusted (in the absence of voluntary agreement) 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 III-IV.

⁷ This witness had pointed out that his company's studies "show what the U.S. Congress Office of Technology Assessment confirmed in 1989: those who are the most interested in new audio technologies are the heaviest purchasers of recorded music. Our research shows that DMX listeners generally increase their purchase of recorded music because of exposure to new artists on DMX channels. The DMX listener is the record industry's best customer." The Digital Performance Right in Sound Recordings Act of 1995: Hearing Before the House Subcomm. on Courts and Intellectual Property 104th Cong. 126, 132-33 (1995) (statement of Jerold H. Rubinstein).

C. When Congress Modified the DPRA in 1998 To Include Certain Nonsubscription Transmissions, 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.

35. Congress revised the DPRA in 1998, as part of the Digital Millennium Copyright Act ("DMCA"), to encompass certain eligible nonsubscription transmissions – most notably those made by webcasters over the Internet. See Pub. L. No. 105-304, § 405(a), 112 Stat. 2860, 2890 (1998); 17 U.S.C. § 114(d)(2) (1998); H.R. Rep. No. 105-796, at 80 (1998) (Conf. Rep.) ("The amendment to subsection (d)(2) extends the availability of a statutory license for subscription transmissions to cover certain eligible nonsubscription transmissions.") (hereinafter "DMCA Conference Report").

36. The DMCA retained the three-part structure adopted in the DPRA based on the perceived level of risk to the recording industry of substitution for sales of sound recordings. Thus, section 114 continues to distinguish among (i) exempt transmissions (terrestrial radio, including terrestrial digital radio), (ii) transmissions that are subject to a statutory license (noninteractive digital transmissions that meet certain conditions), and (iii) transmissions that require the permission of each sound recording copyright owner whose recordings are performed as part of the transmission (interactive transmissions). See Pub. L. No. 105-304, § 405(a), 112 Stat. 2860, 2890-97 (1998).

37. When Congress included eligible nonsubscription services within the scope of the statutory license, it applied a "willing buyer/willing seller" standard to the rates and terms established under the license – *i.e.*, "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." Pub. L. No. 105-304, § 405(a), 112 Stat. at 2896 (codified as amended at 17 U.S.C. § 114(f)(2)(B)). Significantly, however, Congress expressly chose not to apply that standard to

preexisting SDARS or to preexisting subscription services ("PSS"). Rather, Congress intentionally "grandfathered" those preexisting services under the 1995 provisions 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.

38. 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).

39. 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 81 (emphasis added); *see also* House Manager's Report at 54.

Thus, the decision reflected Congress' ongoing concern for the continued availability of these services to consumers, the reliance interests of the grandfathered services 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").

III. THE GOVERNING LEGAL STANDARD: RATES AND TERMS TO EFFECTUATE THE POLICY OBJECTIVES SET FORTH IN SECTION 801(B)(1) OF THE COPYRIGHT ACT

40. The Copyright Act directs the Copyright Royalty Judges to apply four statutory objectives to determine "reasonable" rates and terms for sound recording performance royalties payable by the preexisting SDARS under the section 114(f)(1)(B) statutory license at issue in this proceeding. Specifically, section 801(b)(1) requires that the rates and terms under section 114(f)(1)(B) "shall be calculated to achieve the following objectives":

- 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
- 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).

41. 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.*, *Recording Indus. Ass'n of Am. v. Librarian of Congress*, 176 F.3d 528, 533 (D.C. Cir. 1999) ("[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 Ass'n v. Copyright Royalty Tribunal*, 676 F.2d 1144, 1146 (7th Cir. 1982) (observing that Act "directed the Tribunal to establish a rate that best achieves" the statutory objectives); *Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords; Rates and Adjustment of Rates*, 46 Fed. Reg. 10,466, 10,479 (Feb. 3, 1981) ("Mechanical Royalty Determination") (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.").

42. In determining a reasonable rate under section 801(b)(1), the Judges must follow interpretations of section 801(b)(1) by prior rate-making bodies and reviewing tribunals. The Judges also must apply the specific policy objectives of section 801(b)(1) rather than a "willing buyer/willing seller" standard.

A. The Court Is Required To Follow Prior Interpretations of Section 801(b)(1).

43. In applying the section 801(b)(1) objectives, Congress enumerated specific types of past determinations that the Copyright Royalty Judges are required to follow. These include, *inter alia*:

- prior determinations and interpretations of the Copyright Royalty Tribunal;
- prior determinations and interpretations of the Librarian of Congress;
- prior determinations and interpretations of the Register of Copyrights;
- prior determinations and interpretations of the copyright arbitration royalty panels (to the extent those determinations are not inconsistent with a decision of the Librarian of Congress or the Register of Copyrights);
- prior determinations and interpretations of the Copyright Royalty Judges (to the extent those determinations are not inconsistent with certain decisions of the Register of Copyrights); and
- pertinent decisions of the courts of appeals.

17 U.S.C. § 803(a)(1).

44. There have been three prior copyright rate-setting determinations governed by the section 801(b)(1) factors. Most pertinent is 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"); *RIAA v. LOC*, 176 F.3d 528. In line with the present proceeding, this prior CARP proceeding involved determination of the value of the same copyright right (sound recording performance right) under the same statutory test – section 114(f)'s "reasonable" rate standard incorporating the same 801(b)(1) factors as are to be evaluated here. Thus, it is precedentially squarely on point.

45. Also informative and of precedential force here are the two other statutory proceedings conducted under section 801(b)(1):

- 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*, 676 F.2d 1144; 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 *Mechanical Royalty Determination*, 46 Fed. Reg. 10,466. 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).

B. Binding Precedent Demonstrates that "Reasonable" Rates Under Section 801(b)(1) Are Not the Equivalent of "Willing Buyer-Willing Seller" Rates.

46. Despite SoundExchange's contrary contention, the precedents on which the Judges must rely make clear that the determination of "reasonable" rates in accordance with the policy objectives articulated in section 801(b)(1) does not reduce itself to the equivalent of determining the rates that would prevail in an unregulated, competitive marketplace. Stated differently, the task of the Judges here is not to emulate the distinct inquiry established by section 114(f)(2)(B) of the Act (as applied, inter alia, to noninteractive webcasters) – the setting of rates "that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B). Rather, this proceeding requires an entirely different, policy-based inquiry.

47. The legal guidance provided for resolving this core dispute between the parties – whether, at bottom, the distinct legal standards for guiding rate-setting as set forth respectively in sections 114(f)(1)(B) and 114(f)(2)(B) are in reality distinctions without a difference – could not be plainer. 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.

48. The Librarian similarly observed 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 (emphasis added). 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)).

49. Outside of the context of proceedings governed by the section 801(b)(1) guidelines, representatives of the record industry themselves have acknowledged this reality. SoundExchange's principal economist in this proceeding, Michael Pelcovits, testified that rates set under section 801(b)(1) are "not established in the free market" and that the governing

standard under section 114(f)(1)(B) "is different than the willing buyer/willing seller standard" that pertains to section 114(f)(2)(B) proceedings. 7/9/07 Tr. 125:22-126:17, 129:11-21 (Pelcovits).

50. In this proceeding, Dr. Pelcovits likewise conceded that rate-setting under the section 801(b)(1) factors can lead to results different from those from voluntary marketplace negotiations. Specifically, discussing the effect of substitution on an appropriate license price, Dr. Pelcovits agreed that if applying the 801(b)(1) factors directly, the Judges should not take into account the effect of substitution from programming other than copyrighted sound recordings. 8/28/07 Tr. 230:14-231:3 (Pelcovits) (agreeing that "to the extent any substitution is due to performance of content[] that is not the subject of the statutory license, . . . the judges if they were looking or applying such an 801(b) directly should not and [he] would not expect them to take such substitution into account"). In a marketplace negotiation, by contrast, Dr. Pelcovits argued that sound recording copyright owners would take such substitution into account. *Id.*

51. Similarly, the Chief Executive Officer of Warner Music Group, Edgar Bronfman, testified in this proceeding, consistent with prior testimony given before the United States Congress, as to his understanding that the statutory rate-setting standard governing this proceeding "is not a willing buyer, willing seller standard." 6/20/07 Tr. 29:1-5, 54:9-55:7 (Bronfman).

52. In short, SoundExchange's position that section 801(b)(1) is satisfied by phased-in market rates is flatly wrong as a matter of law. This error is one of great consequence: the entirety of SoundExchange's economic case has been built around this erroneous premise.

53. 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'⁷ 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.

IV. APPLICATION OF THE SECTION 801(B)(1) POLICY OBJECTIVES: THE COURT MUST DETERMINE "REASONABLE" RATES AND TERMS "CALCULATED TO ACHIEVE" THE STATUTORY OBJECTIVES DELINEATED IN SECTION 801(B)(1).

54. The section 801(b)(1) factors embody particular policy goals that Congress concluded were necessary in order to ensure that "reasonable" royalty rates would be set. The specific criteria Congress adopted to guide the determination of the rates for statutory licenses – the section 801(b)(1) policy guidelines – encompass a range of technological, cultural, equitable, and commercial factors. As the Librarian of Congress explained, under section 801(b)(1), "reasonable rates are determined based on policy considerations." Librarian *PSS* Determination, 63 Fed. Reg. at 25,399.

55. In interpreting and effectuating those policy goals, past precedent emphasizes that "a reasonable adjustment of the statutory rate must look to the application and operation of the regulatory system of which it is an integral part." Mechanical Royalty Determination, 46 Fed.

Reg. at 10,479. In other words, the section 801(b)(1) policy objectives must be construed in light of the underlying policies of the section 114(f)(1) statutory license.

56. As discussed below and in the Proposed Findings of Fact ("PFF"), application of section 801(b)(1) in this proceeding dictates adoption of royalty rates within the range of fees proposed by the SDARS and, correspondingly, rejection of the exorbitant fees proposed by SoundExchange. The following sections analyze each of the section 801(b)(1) factors and provide the Court with guidance as to how they should be interpreted and applied to XM and Sirius. Because the second statutory factor – affording the copyright owner a fair return and the copyright user a fair income – is the most encompassing, it is addressed last.

A. The Royalty Rate Must Maximize the Availability of Creative Works to the Public.

57. 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).

58. The statute's focus on "availability," by its terms, implicates both the creation and the dissemination of copyrighted works. Any other reading of section 801(b)(1)(A), in particular one that focuses exclusively on creation, would contravene Supreme Court precedent as well as the underlying purpose of copyrights. Such a reading also would effectively render any analysis of this objective a nullity; it systematically would favor copyright owners over copyright users, which in turn would contravene the clear intent of both copyright law and the statutory license at issue here to balance the interests of copyright owners and users.⁸

⁸ A contrary reading of section 801(b)(1)(A) also would stand as an anomaly to all of the other section 801(b)(1) factors, each of which expressly recognizes the need to balance the interests of both copyright owners and users. *See* 17 U.S.C. § 801(b)(1)(B) (requiring Judges to balance need to provide "copyright owner a fair return" against need to provide "copyright user a fair

59. The proper starting point for analysis of section 801(b)(1)(A) is the plain English definition of the word "availability." Webster's Third New International Dictionary defines "available" as something "that is accessible or may be obtained." Webster's Third New International Dictionary of the English Language Unabridged 150 (1981). Likewise, Webster's II New College Dictionary defines "available" as "[a]ccessible for use: at hand." Webster's II New College Dictionary 77 (2001); accord The American Heritage Dictionary 144 (2d college ed. 1982). By definition, to make works "available" – that is, accessible – to the public, those works must be distributed, which is precisely what the SDARS do.

60. The Constitution's Copyright Clause similarly supports this reading. As discussed above, the Copyright Clause's overarching aim is "To promote the Progress of Science and useful Arts." U.S. Const. art. I, § 8, cl. 8; see also *supra* Part I.A. This public-interest purpose makes clear that creation of copyrighted works does not, by itself, fulfill the constitutional objective. Rather, the goals of copyright law can be achieved only when copyrighted works are both created and disseminated – that is, when fruits of creative activity are made available to the public.

61. A long line of Supreme Court precedent – including a decision issued after the PSS Determination – also emphasizes that both creation and dissemination of copyrighted works are objectives of copyright law. Most recently, in *Eldred*, 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). The Court further held that Congress "rationally credited projections that

income"); *id.* § 801(b)(1)(C) (requiring analysis of "relative roles of the copyright owner and the copyright user in the product made available to the public"); *id.* § 801(b)(1)(D) (requiring Judges to minimize "any disruptive impact on the structure of the industries involved," including industries of which both copyright owners and users are a part).

longer terms would encourage copyright holders to invest in the restoration and public distribution of their works." Id. at 206-07; 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.").⁹

62. As discussed above in Part I.A, prior Supreme Court decisions likewise recognize that the public benefit from incentivizing the creation of copyrighted works could not be achieved without public access to the works. See, e.g., *Fogerty*, 510 U.S. at 527 ("[C]opyright law ultimately serves the purpose of enriching the general public through access to creative works."); *Feist*, 499 U.S. at 349-50 ("[C]opyright assures authors the right to their original expression, but encourages others to build freely upon the ideas and information conveyed by a work."); *Sony*, 464 U.S. at 429 (noting that limited monopoly is granted to copyright holders "in order to give the public appropriate access to their work product"); *Twentieth Century Music Corp.*, 422 U.S. at 156 ("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.").

63. Other binding precedent makes clear that the Judges should consider both creation and dissemination of creative works under this factor. Specifically, the Copyright Royalty

⁹ In its filings in *Eldred*, the United States, advocating the perspective ultimately adopted by the Supreme Court, asserted that copyright law promotes the public interest in access to works of creativity by providing incentives to distribution as well as to creative production. See, e.g., Brief for the Respondent, *Eldred v. Ashcroft*, No. 01-618, 2002 WL 1836720, at *34-*37 (filed Aug. 5, 2002) (defending use of copyright protection to encourage restoration and dissemination of existing works). In a colloquy during the oral argument in the case, the Solicitor General expanded on this argument: "[T]he Copyright Clause . . . provides incentives not . . . just to the creators, but to the disseminators, the publishers, the broadcasters, the film companies." Transcript of Oral Argument at 30, *Eldred v. Ashcroft*, No. 01-618.

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).

64. Consistent with these judicial and administrative constructions of "availability" that embrace both creation and dissemination (and consistent with the plain meaning of the term "availability"), Congress has paid particular attention to ensuring that the consuming public has broad access to copyrighted works. For example, in enacting the DPRA statutory license provisions in 1995 and amending them in 1998 as part of the DMCA, Congress sought to ensure the development and ongoing existence of new technologies that expose consumers to an array of musical offerings not so broadly accessible previously. As noted above, the committee reports stressed:

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; 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. Accordingly, only a construction of this statutory factor that recognizes that both the creation and the dissemination of copyrighted works serve to "maximize the availability of creative works to the public" would further Congress' purpose of balancing the interests of both copyright owners and users.

65. Although SoundExchange may argue that the PSS Determination precludes consideration of dissemination of creative works under this factor, the decision does nothing of

the sort. In that determination, the Librarian based the conclusion as to section 801(b)(1)(A) on the fact 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. In light of the scant factual discussion and complete lack of any analysis of case law or other precedent, the Librarian found the Panel's discussion of this factor to be arbitrary.

66. In this proceeding, by contrast, the SDARS have discussed extensive judicial and other authority supporting the commonsense principle that section 801(b)(1)(A) encompasses both the creation and dissemination of copyrighted works. *See this Part & supra Part I.A.* Thus, there is ample justification for the Judges to construe the phrase "to maximize availability" to encompass both activities – 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.

67. In any event, any effort by SoundExchange to disavow the importance of dissemination in contributing to the availability of copyrighted works would be undercut by the fact that the record companies are 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.

68. In this proceeding, moreover, SoundExchange expert Professor Janus Ordoover has rested aspects of his testimony on the necessity of both creation and dissemination. Specifically, Professor Ordoover testified that "the [availability] objective is best interpreted as implying that license fees should promote creation of new content while maintaining the viability of various distribution channels that are attractive to the listening public." Ordoover WDT at 22-23.

69. Consistent with an economist's understanding of section 801(b)(1)(A) as being directed toward maximizing "the ability of consumers to consume creative works," Noll WRT at 7, Professor Noll testified that higher sound recording royalty rates for the SDARS would undermine the statutory objective, as it would lead to higher prices for consumers, fewer subscriptions, and, as a result, less availability of music to consumers. *Id.* at 42. He testified that, on the other hand, the availability of works to the public will be maximized if rates are as low as possible, as lower rates lead to lower prices to consumers, which will increase the penetration of satellite radio and thus the availability of music to consumers, within the limits imposed by the effect on inducing creative product and the other statutory factors. *Id.* at 41-42. Indeed, "[a]vailability is not served by a rate structure that creates no incentive for the SDARS to increase their number of subscribers." *Id.* at 44. And, of course, lower rates would maximize the availability not only of music, but also of the SDARS' non-music programming.

70. In addition, Dr. Woodbury testified that "'availability' can be interpreted in terms of music distribution – *i.e.*, transmitting more music and more types of music to more listeners – or in terms of the supply of music – *i.e.*, the creation of more music." Woodbury AWDT at 41.

He explained that an economist naturally would consider both aspects of availability, because they are interrelated. *Id.* In Dr. Woodbury's words, "distribution affects the production of sound recordings." *Id.* at 42. Thus, any consideration of one of the two aspects of availability necessarily must take into account the other as well.

71. The record abundantly demonstrates the manner in which the SDARS have expanded the availability of creative content over what can be heard on terrestrial radio both in terms of their uninterrupted nationwide coverage and the diversity of their news/talk/sports and music programming. The SDARS should be credited with creating satellite radio services that provide access to the full range of creative content they broadcast – not just sound recordings but also all the original and distinctive aspects of the music programming the SDARS offer (such as artist profiles, live and in-studio performances, interviews, creatively themed channels and shows, etc.) and news/talk/sports programming – much of it exclusive to XM or Sirius – which is an increasingly prominent component of the SDARS' content offerings. See PFF Parts IV, V.B, VII.C, VII.D.

72. A rate on the order of that proposed by SoundExchange would, by contrast, undermine the purpose of section 801(b)(1)(A) by reducing the availability of this diverse content to consumers.

B. The Royalty Rate Must Reflect the Relative Roles of the Copyright Owner and the Copyright User in the Product Made Available to the Public.

73. Section 801(b)(1)(C) requires the Court to set a royalty rate "[t]o 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." This objective requires examination of the "relative roles"

of the SDARS and the recording industry, respectively, with respect to each of the enumerated subfactors: (1) creative contribution; (2) technological contribution; (3) capital investment; (4) cost and risk; and (5) contribution to the opening of new markets for creative expression and media for their communication.

1. The "Product Made Available to the Public" Refers to the Overall Service, Not Merely Sound Recordings.

74. As a threshold matter, it bears noting that 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 sound recordings but, rather, Sirius⁷ and XM's overall satellite radio services, which include, but are not limited to, their performances of sound recordings. Only this construction harmonizes with the range of relative contributions – technological, financial, and otherwise – that the statute requires the Judges to consider.

75. 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. Thus, in determining the relative roles of the SDARS and recording industry, the Judges must consider the Sirius' and XM's services as a whole – their music and non-music content offerings,

technology, infrastructure, customer service, and so on – not merely sound recordings, which are but an input.

76. As discussed more fully below and in the accompanying Proposed Findings of Fact, weighing the relative roles of the SDARS and recording industry with respect to each of the subfactors compels the conclusion that the SDARS have made an overwhelmingly greater contribution to their services than has the recording industry. It is the SDARS that have made the enormous "technological contribution[s]" and "capital investment[s]" necessary to create the satellite radio systems and they that have borne all of the "cost[s]" and "risk[s]" associated with launching and operating the services. The SDARS alone are responsible for the "opening of new markets for creative expression and media for their communication," with no assistance from the record companies.

2. Creative Contribution

77. The record in this proceeding compels the conclusion that the SDARS have made significant creative contributions that exceed those of the recording industry. Unlike the PSS proceeding, where the "product made available to the public" was a digital service exclusively performing music, the product at issue here comprises a wide variety of creative offerings that are not confined to sound recordings. As discussed in the accompanying Proposed Findings of Fact, the SDARS offer extensive non-music creative content, including original talk, sports and entertainment shows hosted by SDARS on-air talent, sports programming that incorporates creative elements such as pit-to-driver conversations during NASCAR races, and a wide array of news programming covering national, international, financial, and local issues. *See* PFF Parts IV, V.D, VII.C, VII.D.

78. Even with respect to the SDARS' music programming, where the creative contributions by the record industry are more substantial, the SDARS have made significant creative contributions. The SDARS themselves have developed a substantial and growing amount of musical programming content that, in some cases, is exclusive to Sirius or XM. For example, the SDARS have developed exclusive branded artist channels, such as Jimmy Buffett's Margaritaville channel and the Elvis Presley and Siriously Sinatra channels on Sirius and the Bob Dylan and Willie's Place channels on XM, and have engaged on-air talent to conduct live artist and other interviews and to host music talk shows featuring particular types of musical genres. Moreover, even for programming that consists of recorded music, the satellite services have engaged on-air talent to present that programming in ways that appeal to subscribers. The SDARS also have engaged music programming talent to select and sequence the music in unique and creative ways to differentiate themselves from the music programming available without charge on terrestrial radio. **See** PFF Parts IV, V.D.

79. By contrast, the record companies have contributed nothing new to the SDARS' offerings. With respect to the SDARS' non-music programming, the record labels in fact have contributed nothing, or virtually nothing. **See** PFF Part V.D. And with respect to the SDARS' music programming, the record labels have expended no effort beyond what they would have expended regardless of the existence of the SDARS – all of the sound recordings at issue were created by the record companies for distribution through other channels. **See** Woodbury AWDT at 48 ("I am unaware of any evidence that the labels expend any incremental effort to create new music for XM and Sirius."); PFF Part V.D.

80. Recognition of the SDARS' substantial creative contributions to their music programming is consistent with the PSS Determination, where the Librarian acknowledged that

the services "enhanced the presentation of the final work through unique programming concepts." Librarian *PSS* Determination, 63 Fed. Reg. at 25,407. Given that the SDARS' creative contributions with respect to music programming are far greater than those recognized in the PSS Proceeding, which involved services whose content consisted of little more than performing sound recordings, and given the SDARS' far greater creative contributions with respect to non-music programming than any contributions made by the record industry, this subfactor of section 801(b)(1)(C) favors the SDARS.

81. The situation presented here is factually distinct from the minimal assessment of creative contributions afforded in proceedings under section 111(d) of the Copyright Act, the purpose of which is to determine how prescribed amounts of statutory license fees are to be distributed among various copyright owners. See 6/13/07 Tr. 93:8-94:4 (Woodbury) (Judge Roberts remarking as to arguments pertaining to "the value of the broadcast day" raised in proceedings under section 111(d)). The fact that the Copyright Royalty Tribunal in those proceedings refused to ascribe value to broadcasters' efforts in compiling and sequencing broadcast programming involving cable retransmissions has no bearing here. See *1983 Cable Royalty Distribution Proceeding*, 51 Fed. Reg. 12,792, 12,812 (1986) (rejecting "NAB's claim to any value for the local broadcasters' compilation of the broadcast day"); *1980 Cable Royalty Distribution Determination*, 48 Fed. Reg. 9,552, 9,565-66 (1983) ("We find that broadcast day compilation is of no value to a cable system.").

82. Central to the repudiation of the broadcasters' arguments in the section 111(d) proceedings were factual findings that the consumers of cable television services simply did not value the broadcasters' contributions to the programming at issue. In other words, the primary basis of each of the pertinent rulings was a judgment that the broadcasters' contentions that they

were contributing material that attracted cable customers lacked "evidentiary justification." *1980 Cable Royalty Distribution Determination*, 48 Fed. Reg. at 9,566 n.260. Notably, the contributions in question consisted of programming in the form of the "compilation of a broadcast day" and high-quality production. *Id.* at 9,565-66.

83. By contrast, the trial record in this proceeding – most notably, an Internet survey conducted by Professor Hauser – reveals that consumers (both subscribers and those considering subscribing) place significant value on the SDARS' creative contribution to their music programming, including the selection and sequencing of songs on their music channels, the SDARS' selection of on-air talent, and their inclusion of live concert programming. See Hauser WRT, Ex. M; PFF Part VII.A. In a constant sum survey question in which respondents allocated 100 points among eight features, respondents gave an average importance of 12.5% to "The selection and sequencing of the songs on the channels I listen to," 6.7% to "DJ's and celebrity hosts provide commentary and personality," and 6.6% to "I can hear live studio performance and live concerts," for a total of 25.8%. *Id.* The importance given to these music programming features overshadowed the importance that respondents assigned to "I can hear music from the 70's, 80's, 90's, and today," which was only 15.8%. *Id.*

84. Moreover, as noted above, the record has demonstrated far more extensive creative contributions made by the SDARS to the presentation of sound recordings than merely selection and arrangement as well as the creation of a significant amount of original music and non-music programming – all in order to attract and retain subscribers by differentiating themselves from terrestrial radio and from each other. For the SDARS, this creativity in programming is an essential aspect of their respective business models and brand identities.

3. Technological Contribution

85. 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.* Where, as here, the digital transmission services at issue make significant technological contributions of these sorts, compared to little or no technological contributions by the recording industry, this factor favors the services. See *id.* at 25,407-08.

86. As set forth in detail in the Proposed Findings of Fact, the SDARS each are responsible for numerous important technological developments associated with the design and development of the technology and infrastructure for their satellite systems, their transmission facilities, studio complexes, chipsets, and antennas. See PFF Parts IV, V.E. The technological challenges the SDARS had to surmount in creating the first nationwide satellite radio services is reflected in the fact that they collectively have received more than 50 patents for their technological developments. See *id.* Parts IV, V.E.

87. By contrast, as in the *PSS* proceeding, "the record companies made no contributions in th[is] area[]." Librarian *PSS* Determination, 63 Fed. Reg. at 25,407.

4. Capital Investment

88. Section 801(b)(1)(C) further requires weighing of the parties' "relative roles in making capital investments." Librarian PSS Determination, 63 Fed. Reg. at 25,407. 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 \$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. The Librarian's PSS Determination establishes that where such disparities in capital investments exist, this factor favors the services. See *id.* at 25,407-08.

89. The record in this proceeding similarly shows that the SDARS each have invested billions of dollars to create a new industry that has greatly expanded the availability of music and non-music content on a seamless nationwide basis. See PFF Parts IV, V.F. Indeed, all of the technological, business, and creative contributions and achievements of the SDARS have been funded by massive and ongoing multi-billion dollar infusions of capital on which neither company has yet generated a positive rate of return, let alone a risk-adjusted rate of return. See *id.* Parts IV, V.F.

90. The record industry, by contrast, has made no capital investment in satellite radio. See PFF Part V.F. As Dr. Woodbury testified, "the record companies have not incurred any incremental investment or any other costs with respect to the development and deployment of satellite radio service or programming on that service." Woodbury AWDT at 50. As against the record industry, therefore, the SDARS have made the greater contribution with respect to capital investment – a conclusion that was reached on a similar factual recording in the PSS proceeding.

See Librarian PSS Determination, 63 Fed. Reg. at 25,407 ("RIAA did not suggest that any capital investment was required on its part.").

5. Cost and Risks

91. Section 801(b)(1)(C) lists "cost" and "risks" (the next two statutory criteria) separately, though prior rate-making bodies have treated them together. See, *e.g.*, Librarian PSS Determination, 63 Fed. Reg. at 25,407-08. Whether treated jointly or individually, the same conclusion obtains: the SDARS have borne the greater cost and risks with respect to their services.

92. 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 costs and are currently undergoing a shift in how they market their services" 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.*

93. The SDARS' substantial costs include those associated with maintaining their transmission facilities and specialized technology – satellites, repeaters, antennae, chip sets, etc. – as well as programming, administrative, marketing, and advertising costs, among others. See PFF Parts IV, V.F. The Judges likewise must consider the panoply of technological, financial, and regulatory risks the SDARS have faced and, to some extent, continue to face in connection with their technologically innovative, never-before-attempted satellite radio services, which must

attempt to generate positive returns for investors in an increasingly competitive environment.

See PFF Parts IV, V.G.

94. By contrast, the trial record has revealed no significant expenses incurred or risks undertaken by the record companies in connection with the SDARS. **See** Woodbury AWDT at 50-51. Notwithstanding recent dips in physical sales, the record industry has a healthy history of profitability, is profitable today, and anticipates a bright future with exploding digital sales. Moreover, the record industry is able to minimize its risk by diversifying its portfolio across a wide variety of sound recordings and musical genres. **See** PFF Parts V.F, V.G.

95. In any event, the costs and risks incurred by the recording industry in connection with the creation of sound recordings have nothing to do with satellite radio. Indeed, with the exception of promotional expenditures undertaken to attain exposure via the SDARS, none of the costs incurred by the recording industry are directly related to the SDARS – the "product made available to the public." The record companies' risk that certain specific recordings may not appeal to the public was part of the industry's business structure before the SDARS existed, and the risk that unauthorized music file downloading will undercut sales likewise is wholly unrelated to the SDARS. **See** PFF Parts V.F, V.G. Finally, the Judges should take into account that to the extent XM and Sirius provide a nationwide avenue of exposure for sound recordings – as confirmed by the record companies' promotional efforts – they reduce the overall risk faced by the record companies.

6. Contribution to the Opening of New Markets for Creative Expression and Media for Their Communication

96. 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.

97. Pursuant to section 801(b)(1)(C), the SDARS must be credited for creating entirely new "end-to-end" mobile radio services with high-quality nationwide coverage; for offering a greater depth and diversity of both music and non-music programming than is available on terrestrial radio; and for generating a new revenue stream for record companies and artists, Woodbury AWDT at 43, 52 – all without any participation by the record companies. See PFF Parts IV, V.H. The SDARS also have significant promotional value for sound recordings. See id. Part V.H.

98. In sum, a factor-by-factor analysis of section 801(b)(1)(C) demonstrates that it heavily favors the SDARS.

C. The Royalty Rate Must Be Set So as To Minimize Any Disruptive Impact on the Industry.

99. 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; see also 17 U.S.C. § 801(b)(1)(D). As with each of the other statutory factors, this objective can be fulfilled only by a rate set at the lower end of the royalty 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").

100. Testimony from witnesses in this proceeding sheds light on the application of section 801(b)(1)(D) here. Professor Noll testified that disruption to an industry occurs when a proposed rate affects its long-term viability. Noll WRT at 9; see also Librarian PSS

Determination, 63 Fed. Reg. at 25,408 (endorsing Panel determination that the rate should be set at a level that would "allow the three companies currently doing business to continue to do so"). SoundExchange expert economist Dr. Herscovici framed the question similarly as "whether the increased expenses associated with the royalty will threaten the Services' longer-term ability to operate profitably." Herscovici WRT ¶ 92; 8130107 Tr. 31:21-32:13 (Herscovici).

101. Inability to raise cash would be one serious potential threat to viability. As SDARS expert Armand Musey testified:

A resulting decrease in the target prices for Sirius and XM . . . could make it more difficult for these companies to raise capital in the future and have a disruptive impact on their ability to compete with other audio services, maintain and improve their services and potentially even to survive.

Musey WDT ¶ 81. SoundExchange expert Sean Butson acknowledged that a rate that would affect the SDARS' liquidity or viability going forward would be disruptive. Butson WRT at 11 ("[A] royalty rate would be disruptive to the SDARS' business practices if the SDARS were not fully funded and the rate were so high that it threatened the SDARS' ability to generate free cash flow over the longer term.").

102. Experts for both sides agreed, moreover, that a royalty rate that would cause one or both of the SDARS to fundamentally change its business, such as by no longer offering sound recordings, would be disruptive. Herscovici WRT ¶ 92; id. ¶ 111 ("[T]he rate should not be set so high that the rate itself will cause the Services to cease operating or fundamentally change their business over the long term."); 8116/07 Tr. 72:1-13 (Noll) (testifying that a disruptive outcome would be one that "allows satellite radio to continue to exist but that cause it dramatically to change the nature of its product, to have a dramatically different number of subscribers, to have a completely different business model"); id. at 75:4-76:7 (testifying that one

test for disruption is whether the company “change[s] fundamentally its business model in a way that has an effect on consumers that is detrimental”).

103. A rate that did not permit a copyright user to recover a reasonable return on start-up investments would be disruptive because if potential investors know they will never recover start-up costs such as those required, in the case of the SDARS, to obtain a license, building the system, and developing a marketing strategy, "there will never be another technology introduced that makes use of sound recordings involving digital technology." 8/16/07 Tr. 76:8-77:19 (Noll). Similarly, a rate is disruptive if it diminishes earnings to such an extent that a company can no longer recover its forward-looking costs. Noll WRT at 72-73; 8/16/07 Tr. 84:2-84:20 (Noll).

104. Professor Noll, who testified as to the satellite radio industry that "you don't want to kill it off in the beginning when its viable in the long run," 8/16/07 Tr. 70:6-71:22 (Noll), stated in his written rebuttal testimony that disruption is a far more serious concern in relation to the potential royalty rate for the SDARS than for the record companies:

To the extent that the outcome of this proceeding can disrupt an industry, disruption is much more likely to occur in satellite radio than in sound recordings. The reason is that SoundExchange's proposed rate would be a substantial part of costs – indeed, enough to prevent satellite radio from recovering its investments – whereas the potential revenues to the record companies are a much smaller proportion of revenues. Dr. Pelcovits explicitly ignores all unrecovered sunk investments, and Mr. Butson concludes that the proposed rates will cause the cumulative deficit of the SDARS to increase. If the methods used by the SoundExchange experts were replicated in each license determination in the future, the resulting rates would prevent satellite radio services from ever recovering their start-up losses and most of their past investments. Moreover, to the extent that the next generation of satellites, which is planned to be launched during the license period, fails to recover its annual depreciation and earn a competitive return in the initial years after its launch, the method proposed by Dr. Pelcovits would guarantee that the SDARS would never be able to recover those investments either. Hence, under plausible conditions, the adoption of the proposed rates would cause the SDARS not to launch these satellites and to withdraw from the industry when the current satellites fail. This outcome is far more disruptive than the effect of even a zero rate on the record industry. I therefore conclude that the disruption factor favors the SDARS.

Noll WRT at 72-73.

105. In this regard, Professor Noll testified, with respect to SoundExchange's Amended Rate Proposal, that even at rates substantially below those proposed by SoundExchange, the SDARS "would not be financially viable over the term of the license," Noll WRT at 9, as it would prevent them from recovering start-up losses and past investments, much less forward-looking costs. *Id.* at 37-38; see also *id.* at 22 ("[I]f the SoundExchange proposal were adopted, SDARS would likely be put out of business before the compulsory license expires."); PFF Part V.I.

106. In applying section 801(b)(1)(D), the Court should decline to credit SoundExchange's predictions that the SDARS will become profitable in years beyond the license term. Aside from the inherently unreliable nature of such long-term predictions, there is no legal basis for royalty rates predicated on the projected financial condition of the SDARS in years beyond the license term. Indeed, the Copyright Act states that the Judges are to set rates and terms only for the specific period at issue – from 2007 to 2012 – not to set fees for all time. *See* 17 U.S.C. § 804(b)(3)(B) (specifying that rates and terms set for "preexisting satellite digital audio radio services" are "to be effective during the period beginning on January 1, 2007, and ending on December 31, 2012"). Moreover, the Librarian, suggesting a cautious approach to relying on future market conditions in an anticipatory fashion, observed that the Copyright Act had established "regularly scheduled rate-setting proceeding[s]" and that "as the market conditions change and the industry shows significant growth and profitability, another Panel will have an opportunity to make adjustments to the rate, and may well find that the changed circumstances favor an upward adjustment." Librarian *PSS* Determination, 63 Fed. Reg. at 25,409.

107. Even assuming its accuracy, the projection model that SoundExchange has offered in support of its rate proposal makes plain that its proposed rates would be disruptive to the industry and prevailing industry practices. The reason, Professor Noll explains, is that SoundExchange's proposed rates would not only prevent the SDARS from recovering their investments, Noll WRT at 72, but the "SDARS would likely be put out of business before the compulsory license expires," *id.* at 22.

108. Even at rates substantially below those proposed by SoundExchange, Professor Noll testified, the SDARS "would not be financially viable over the term of the license," Noll WRT at 9, as those rates would prevent them from recovering start-up losses and past investments, much less forward-looking costs. *Id.* at 37-38. Applying Professor Noll's calculation to Mr. Butson's rebuttal projections and SoundExchange's Third Amended Rate Proposal, the SDARS will not cover even their forward-looking cost of physical capital during this license term with a zero royalty. *See* PFF Part V.I.

109. On the other hand, the potential revenues to the record companies from SDARS royalties are a much smaller proportion of their revenues. *See* Noll WRT at 72 ("[T]he potential revenues to the record companies are a much smaller proportion of revenues."). There is "no evidence that record companies will not remain viable over the term of the license even if the SDARS rate were zero." *Id.*, at 9.

D. The Royalty Rate Must Afford the Copyright Owner a Fair Return and the Copyright User a Fair Income Under Existing Economic Conditions.

110. Section 801(b)(1)(B) 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). This is the most encompassing of the guidelines applicable to this proceeding, implicating the widest range of considerations.

111. As the use of the normative term "fair" indicates, section 801(b)(1)(B) does not implicate solely what parties may negotiate in the marketplace, as SoundExchange posits, but also separate policy considerations. As noted above, the Librarian, in concluding that section 801(b)(1)(B) weighed in favor of setting a low royalty rate, explained that the rate "need not mirror a freely negotiated marketplace rate – and rarely does – because it is a mechanism 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 also emphasized the importance in analyzing this factor of taking into account the considerations underlying the enactment of the section 114(f)(1)(B) sound recording performance right, which "balances the owners' right to compensation against the users' need for access to the works at a price that would not hamper their growth." Librarian *PSS* Determination, 63 Fed. Reg. at 25,409.

112. A significant dimension of fairness, reflected in section 810(b)(1)(C), is that parties should be rewarded in a manner commensurate with effort. As a matter of economics, Professor Noll refers to this as the "just desserts" theory, pursuant to which income is deserved, and therefore fair, if it arises from effort and sacrifice. See Noll WRT at 51. Conversely, "Ricardian rents" – returns to superior productivity that arise without the necessity for sacrifice – are not fair. *Id.*; see also PFF Part V.C.

113. "A fair royalty is at most the competitive price" Noll WRT at 53 (emphasis added). As demonstrated by Professor Noll, however, the assertedly competitive market-based rate proposed by SoundExchange is far too high to allow the SDARS to earn any net income, let alone a fair income, at any time during the license term. See *id.* at 22-25; see also 8/16/07 Tr. 97:4-98:4 (although SoundExchange's experts "pay lip-service" to the competitive market rate,

their proposed rates are "divorced from whether it's a competitive market"). As Professor Noll explained, even in a competitive market, the prices for inputs may be higher than is necessary to induce supply, and the income received from the returns on the market price in excess of the competitive rate of return are Ricardian rents and under the "difference principle" "are not part of a fair return." Noll WRT 50-51. This is also true for "Monopoly rents" because they too "include returns that exceed the competitive rate of return." *Id.*, at 50.

114. The contours and legislative history of the sound recording performance right also bear upon the proper calibration of fair return/fair income. The Librarian observed with respect to the digital performance right subject to the statutory license that while "afford[ing] copyright owners some control over the distribution of their creative works through digital transmissions, [it] then balances the owners' right to compensation against the users' need for access to the works at a price that will not hamper their growth." Librarian *PSS Determination*, 63 Fed. Reg. at 25,409.

115. This statement, coupled with the Librarian's recognition that the statutory rate is not tantamount to a market rate and the other section 801(b)(1) objectives, discussed above, leads to the conclusions that (i) "fairness" is not necessarily congruent with competitive market outcomes; (ii) "fair return" to the copyright owner must be assessed in accordance with the limited nature of the public performance right in sound recordings; and (iii) "fair income" to the copyright user must be assessed in light of the rate of return on investment necessary to allow the user to earn a risk-adjusted competitive return on investments, including past investments.

1. Fair Return to the Copyright Owner

116. In addition to the "just desserts" principle noted above, Professor Noll testified to several other dimensions of "fairness" as a normative concept that should inform the Judges'

consideration of the concept of a "fair return" to the copyright owner in the context of this proceeding. Specifically, Professor Noll testified that:

- (i) in industrial organization economics, "fair return" is understood to be the risk-adjusted competitive return on investment;
- (ii) a "fair return" to a copyright owner is not necessarily commensurate with, but never exceeds, the competitive price and may be subject to adjustment based on principles of distributive justice;
- (iii) income derived from market power and pure Ricardian rents lacks fairness, such that an economically valid analysis of fairness must distinguish between income that is necessary to induce supply and that which is some sort of rent;
- (iv) rates should be prices that fairly reflect the rewards necessary to induce supply from record companies (which are no more than the competitive price);
- (v) a fair return requires consideration of whether a copyright user's service affects copyright owners' other sources of revenue – that is, if the SDARS do not substitute significantly for other uses that generate revenue for record companies, and if record companies earn a competitive return on investment, the "fair return" standard does not support increasing the rate over time just because the SDARS and their customers have an increased willingness to pay; and
- (vi) if increased rates cause the record companies to earn more than the competitive return while the SDARS earn less than the competitive return, then the higher rates are unfair.

See Noll WRT at 48-56; *see also* PFF Part V.C.

117. As Professor Noll testified, the regulated rate should be no lower than the record companies' marginal costs and no higher than the rate at which the profitability of record companies is above the return that they would realize if they behaved competitively and unilaterally. Noll WRT at 19. In this regard, there is no evidence that the record companies do not earn a competitive return on investment. *Id.* at 55. "Fairness . . . implies that prices should be no greater than is necessary to induce supply." *Id.* at 8. Professor Noll concludes that "correct application of the appropriate economic model of competition in the market for sound

recording rights leads to the conclusion that competitive rates for SDARS would be at or near zero." *Id.* at 17. Indeed, in this framework, it follows that the fair rate will likely be less than the competitive price if a price less than the price they currently receive would induce artists and labels to continue creating sound recordings. *Id.* at 53.

118. The absence of evidence that the record companies are not earning a competitive return sufficient to induce the supply of sound recordings, coupled with the fact that the record companies have not incurred any incremental investment or costs in connection with the development of satellite radio or programming on the SDARS, Woodbury AWDT at 50-51, suggests that fair return in this context should turn largely on evidence relating to the rationale for Congress' recognition of a limited sound recording performance right: the potential for sales displacement by digital audio services.

119. As discussed in detail in Part II.B above, the impetus for the grant of the new performance right in 1995 was the stated concern of the record industry that the advent of digital technology threatened record sales as never before – that a user's ability to access high-quality digital sound recordings "might adversely affect sales of sound recordings and erode copyright owners' ability to control and be paid for their work." 1995 House Report at 13.

120. As shown above, Congress recognized that "interactive services are most likely to have a significant impact on traditional record sales," 1995 House Report at 14, 1995 Senate Report at 16, and that the concern was attenuated with respect to noninteractive services. But the statutory license scheme was established, along with the "complement rule" and the ban on publishing advance schedules, to accommodate the possibility of some "leakage" in terms of substitution, *see* 2 Nimmer on Copyright, § 8.22[C][1][c] (2000) at 8-317, while protecting the societal interest in new technological platforms for enhancing the availability of music to the

public. See, *e.g.*, 1995 Senate Report at 14 (stating intention "to provide copyright holders of sound recordings with the ability to control the distribution of their product by digital transmissions, without hampering the arrival of new technologies").

121. On the other hand, as also noted, Congress recognized the potential promotional benefits of airplay, see 1995 Senate Report at 14-15, and sought to enhance the promotional effect of digital services by requiring, for example, that they include digitally encoded information about the titles of recordings and the names of performers when they transmit sound recordings to listeners. See 17 U.S.C. § 114(d)(2)(A)(iii).

122. Against the backdrop of this legislative history, it follows that in assessing a "reasonable" fee and "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.

123. In the PSS proceeding, 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." Librarian *PSS Determination*, 63 Fed. Reg. at 25,408. The record here is replete with similar evidence regarding promotional efforts on the part of record companies, agents, and artists with respect to the SDARS, including providing free copies of CD releases, undertaken with the understanding that exposure via

airplay promotes sales. See, *e.g.*, 6/21/07 Tr. 40:8-41:9 (Renshaw); 6/25/07 Tr. 46:7-50:2 (Navarro); 6/20/07 Tr. 83:18-85:16 (Bronfinan); 6/26/07 Tr. 36:4-40:4 (Chemelewski); 6/12/07 Tr. 329:8-331:1 (Woodbury); Noll WRT at 65; 6/5/07 Tr. 209:16-21 (Logan); 6/11/07 Tr. 68:10-73:7 (Blatter); Logan WDT ¶ 73 and Logan WDT Exs. 22, 23; *see also* PFF Part V.C.

124. In evaluating the evidence regarding the promotional effect of the SDARS, Professor Noll explained that a determination of promotional or substitutional effect of SDARS airplay is in essence a determination of opportunity cost to the copyright holder. 8/16/07 Tr. 43:11-20 (Noll). Professor Noll testified that the proper focus is on individual record companies, not on the record industry as a whole. Noll WRT at 20, 66-67. In the competitive marketplace, the individual record companies make decisions based solely upon unilateral self-interest, not based upon how these decisions might affect their competitors. *Id.* at 66. In turn, an individual record company would only consider the effect upon its own sales when negotiating a license fee for use of its copyrights. *Id.* Under section 801(b)(1), the promotional and substitutional analysis must take into account "the specific effect on that copyright owner" of selling its rights as opposed to the industry-wide effect. 8/16/07 Tr. 44:10-14 (Noll). Thus, because individual record companies compete with each other, to put the focus on the record industry as a whole is to assume that the record companies are acting as a cartel to prevent competition with one another. *Id.* at 43:11-44:14 (Noll). In view of the evidence of promotional costs incurred by record companies, agents, and artists with respect to the SDARS, Professor Noll concluded that "[u]nilateral competitive behavior by record companies (as opposed to cartel behavior by the industry) would cause rights fees to reflect the promotional value of radio on sales of recorded music," which implies a rate at or near zero in this proceeding. *Id.*

125. On the other hand, as demonstrated in Part V.C of the Proposed Findings of Fact, SoundExchange has presented no probative evidence of the displacement of CD and download sales caused by the playing of post-1971 sound recordings on the SDARS. In this connection, Professor Noll noted that the recording industry is not entitled to be compensated in this proceeding for the substitution effect of anything other than performances on the SDARS of post-1971 sound recordings. *See* Noll WRT at 57 ("To the extent that older sound recordings, live performances, and content other than music are sources of substitution for revenue-generating distribution channels for sound recordings, the record companies have nothing to complain about, just as they had nothing to complain about concerning the invention of television. In this case, recorded music is just being replaced by other content that consumers value more highly.").

126. All of these considerations relating to "fair return" to the copyright owner point to compensation to the record companies on the lower end of the range of proposed royalty rates.

As Professor Noll stated:

I conclude that there is no basis for assuming that for an individual record company the opportunity cost of providing sound recordings to any form of radio is positive, and every reason to believe that individual record companies face a market environment in which the promotional effect for their own recordings outweighs the substitution effect, in which case the rate that would arise from competitive unilateral decisions among record companies is negative.

Noll WRT at 66-67; *see also* id. at 6-7 ("Because the net cost to record companies of licensing their sound recordings to the SDARS is negative, the competitive market price of license fees to the SDARS is very close to zero.").

2. Fair Income to the Copyright User Requires the Court To Set a Rate that Permits a Reasonable Risk-Adjusted Return on Investment, Including Past Investments in Starting and Developing the Business.

127. A royalty rate on the lower end of the spectrum 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). Currently, XM and Sirius are generating no net income, let alone "fair income." *See* Noll WRT at 22 ("[N]either service is anywhere near showing a profit, let alone a competitive return on investment."); Butson WRT Apps. A, B; Vendetti WRT ¶ 12; PFF Part V.C.

128. In this regard, it bears noting that section 801(b)(1)(B) requires consideration of fair return and fair income "under existing economic conditions." As observed above with respect to disruption, the explicit temporal limitation on this statutory objective counsels against relying on SoundExchange's projections as to the financial conditions of the SDARS many years from now – particularly when those years fall well outside of the term of the license.

129. As a matter of economic theory, income to the SDARS is fair "to the extent that it is a competitive reward to effort and sacrifice, including sacrifices in the past as well as sacrifices that are incorporated into an estimate of forward-looking costs." Noll WRT at 53. The remuneration to the SDARS "should be sufficient to enable the firm to earn a competitive return on investment." *Id.*

130. Fair income means income sufficient to generate a competitive risk-adjusted return on past as well as on future investments. "The appropriate standard is whether a rate allows an SDARS to earn a competitive return on all of its investments, including the paid-in capital that has financed its early cash flow losses." Noll WRT at 6 (emphasis in original); *see also* 8/16/07 Tr. 36:6-37:9 (Noll).

131. Even Professor Ordovery agreed that under a fair income standard, the copyright users should be able to obtain a reasonable risk-adjusted return on investments. "Otherwise, [the firm] simply will not come into the market and offer the service." 6/21/07 Tr. 321:13-322:19 (Ordovery). Likewise, from a "financial perspective," Mr. Musey said that a "fair income" is "one that compensates investors for what they've invested in." 6/13/07 Tr. 209:1-10 (Musey). This is because, "[i]f the goal is to encourage additional investment in the industry, it's going to be very hard to get additional investment in the industry if investor expectations have been consistently frustrated." 6/13/07 Tr. 210:6-11 (Musey).

132. In the context of how prices would be established in a competitive market, Professor Noll testified that he was referring to a competitive return on "[t]he total investment by . . . all of the investors in the company, whether through debt or through equity, in creating the company. It's whatever they have put into the company valued at opportunity cost. That is to say, if they have financed start-up losses, they're valued at the cost of the start-up losses brought forward at the opportunity cost of capital, which is the competitive return." 8/16/07 Tr. 99:6-22 (Noll).

133. Further elucidating the concept of risk-adjusted rate of return on investment in a competitive market as it applies to the SDARS, Professor Noll testified that

[t]he break-even profit rate for a SDARS operator includes a competitive return on the paid-in financial investments of SDARS investors since it was initiated. The true economic cost of these losses is not just the actual negative cash flow. Instead, the loss in any year is the operating loss plus foregone earnings on financial investments in the company that have financed these losses. The latter is the opportunity cost of financial capital, which is the return that investors could have earned on an alternative investment. Thus, for each year in the history of each SDARS operator, the operating loss in that year should be brought forward to the next year by increasing it by the real return on investments having the same risk. Likewise, in each future forecast year, the total cumulated loss should be increased in the same manner.

Noll WRT at 23-24 (emphasis added).

134. Professor Noll testified that such a result is the expected outcome of the competitive market

[b]ecause no one would ever enter an industry unless they expected in the long run to earn at least the competitive return on investment. . . . [E]veryone knows that a startup loses money for years, and so that fact that they lose money in the short run isn't the big fact. The big fact is you believe that the losses you're suffering in the short run are a valuable investment in building a business that will then earn a competitive return on those investments in the long run. You would never enter if you didn't believe that.

8/16/07 Tr. 100:1-15 (Noll).

135. Thus, setting a rate that will not effectively preclude the SDARS' investors from realizing a competitive return on all of their investments, including good will, is critical in order to avoid undermining the incentive to invest in innovative technologies that section 801(b)(1) is designed to protect. A "profitability" standard of fairness that inquires whether a firm earns "a competitive return on the actual financial investments of its owners," Noll WRT at 27, "allows investors to earn a return on all their investments, which preserves the incentive of investors to create other companies that will need to pay royalties for sound recording performance rights and who might otherwise fear that statutory rates will be set so high that they can never recover their investments," *id.*

136. Looking only to the return on current and future investments (the "forward-looking investment standard" or the "forward-looking cost standard"), as Dr. Pelcovits and Mr. Butson urge, "does not address whether investors will ever receive a competitive return on their past investments. In so doing, this analysis implicitly assumes that whether future investors have an incentive to create new technologies for distributing and using sound recordings is irrelevant. For this reason, adopting the forward-looking investment standard for setting rates would be very bad public policy." Noll WRT at 26.

137. "The forward-looking cost standard is inappropriate for a start-up company," Professor Noll testified, "because start-ups typically experience cash flow losses early in their lives." Noll WRT at 5. Indeed, Professor Ordover agreed that investors "must expect to earn a competitive return on start-up losses or they will not be willing to finance these losses," *id.* at 5-6 (citing 6/21/07 Tr. 320:18-322:19 (Ordover)), and he made clear that, as an economist, he regarded a reasonable return on investment to be part of costs, "as much as paying the worker to work or paying for electricity," 6/21/07 Tr. 319:22-321:3 (Ordover). He stated that the reasonable return would need to take account of the expected value of the return, with the return discounted by the probability of failure. *Id.* 321:13-322:19 (Ordover) ("Otherwise, [the firm] simply will not come into the market and offer the service."). He also acknowledged that "[o]bviously, the SDARS have incurred risks associated with the 'launch' of the service, including the launch of the satellites and the marketing expenditures undertaken at a time when the success of satellite radio was not assured. Accordingly, the SDARS should be compensated for these costs and risks, as well as for all the costs they incur on a recurring basis to deliver programming to subscribers." Ordover WDT at 30.

138. There appears to be no dispute that losses in early years "are a form of investment that firms make because they expect later on to recoup those losses as their business grows." Noll WRT at 28; *see also* Herscovici WRT ¶ 76 ("All businesses make investments with the expectation of reaping a return over the useful life of those investments; otherwise they would not make the investment".); 7/9/07 Tr. 212:20-213:16 (Pelcovits) (agreeing that "the investors of capital in the business that was used to fund building brand equity, gaining subscribers and covering operating losses would have invested that capital expecting a return on that capital"). As Mr. Frear, Sirius' Chief Financial Officer, testified with respect to the importance of

generating a return on start-up investments: "If you went to investors with the proposition that we're going to blow three billion dollars of your money and we're not going to give you a nickel back, I don't think you would get any. . . . You wouldn't raise the money." 6/12/07 Tr. 54:10-17 (Frear).

139. Put succinctly, "[t]he income of an SDARS operator is fair to the extent that it is a competitive reward to effort and sacrifice, including sacrifices in the past as well as sacrifices that are incorporated into an estimate of forward looking costs." Noll WRT at 53.

140. Dr. Pelcovits admitted on cross examination that "the investments needed to finance that building of the business including the financing, the accumulated losses, is no different than the investment needed to buy satellites from the standpoint of those providing the capital." 7/9/07 Tr. 213:17-214:2 (Pelcovits). But his dismissal of the SDARS' historical investment as a meaningful factor is wrong. Dr. Pelcovits did not include as a cost in his surplus analysis the financial capital that the SDARS have borrowed and spent in building their businesses. 7/9/07 Tr. 207:10-208:4 (Pelcovits). While he did include the costs he believed were necessary to rent the SDARS' systems, he did not include past operating losses or the SDARS' total accumulated deficits. 7/9/07 Tr. 208:6-19 (Pelcovits). "I do not and did not in the surplus analysis try to determine whether the investors in the company, the stockholder, would be receiving a particular return." 7/9/07 Tr. 209:7-11. Dr. Pelcovits refused to include costs the SDARS have incurred by investing in their businesses, such as payments made for exclusive content that drives subscribership numbers, 7/9/07 Tr. 210:18-212:19 (Pelcovits), costs which are certainly considered investments in the SDARS' businesses that are directly related to business growth and for which investors deserve a "fair income."

141. The asset on the firm's balance sheet that represents the investment in building the business is "good will" or "going-concern value." Noll WRT at 28. If a firm "does not expect eventually to earn a competitive return on investments in good will, it will never enter the business in the first place." *Id.* A firm is a failure if, at the end of the start-up period, it is worth "nothing more than the sum of the market value of its assets." *Id.* at 29. Hence, a regulatory procedure that "ignores the going-concern value of a firm by recognizing only the sum of the market value of its assets guarantees that no firm will ever recover any of its start-up costs and so will never receive any reward for creating a successful going concern." *Id.* (emphasis in original).

142. Investments in R&D, programming, subscriber acquisition, regulatory proceedings to obtain a license to operate, and initial physical capital investments – all of which must precede actual sales – are among the necessary capital investments to which the forward-looking cost standard does not include any return. Noll WRT at 6; *see also* Pelcovits WDT at 17 (describing costs taken into account in his "surplus analysis" as including "the fixed and sunk costs of launching the satellite system, and a risk-adjusted return on that investment").

143. At bottom, the condition of a competitive input market that both buyer and seller earn a competitive return on investment (if such rates are feasible), Noll WRT at 4, is not satisfied by rates that amount to expropriation of the SDARS' investments by the record companies, *id.* at 5. Far from disputing this, Professor Ordoover agreed that the SDARS should not be "subject to expropriation of what economists refer[] to as quasi-rents" and that quasi-rents include the difference between "the risk-adjusted normal rate of return on the capital invested by the SDARS in order to bring their services to where they are today" and "what the firm needs in the short run." 6/21/07 Tr. 322:20-324:7 (Ordoover).

144. In sum, the concept of fair income to the SDARS should allow the provision of returns to investors commensurate with the risks those investors assume. People and firms that invest money in high-risk enterprises customarily expect returns much larger than those that invest in well-established enterprises. That practice is both efficient and fair. Over the long haul – taking into account the larger proportion of risky ventures that, by definition, fail – it provides the investors reasonable rates of return. Attention to this dimension of fairness should prompt the Judges to select a rate that will enable investors in the SDARS to reap returns commensurate with the high risks they undertook when they made their investments. See Noll WRT at 9 ("The SDARS operators bear the financial risks of satellite radio and at present the cumulated losses of the SDARS run to billions of dollars; the record companies, by contrast, cannot lose a penny from satellite radio."); Woodbury AWDT at 50-51.

145. Other, related considerations relevant to evaluation of fair income include (i) rewarding pioneers; and (ii) protecting reasonable reliance interests.

146. Rewarding pioneers. Latent in many aspects of the American legal system, including copyright and patent law, and consistent with the theory of "just desserts" discussed by Professor Noll, see Noll WRT at 52-53, is the principle that pioneers – people and firms that develop truly novel, socially valuable products and services – deserve rewards larger than ordinary businessmen and craftsmen. See, *e.g.*, *In re Horgan*, 559 F.2d 595,606 (C.C.P.A. 1977) (acknowledging that "pioneers" deserve broad patent claims to their inventions); Lawrence Becker, *Deserving to Own Intellectual Property*, 68 CHICAGO-KENT L. REV. 609 (1993) (contending that persons who engage in "creative" work deserve larger rewards than persons who engage in less creative work). Attention to this dimension of fairness should lead

the Judges to take into account the vision and determination of the SDARS by ensuring that they reap an appropriate financial reward.

147. This dimension of fairness would be undermined by the rates proposed by SoundExchange, which, Professor Noll demonstrates, "offer a chilling prospect for the future of new digital technologies for delivering streaming sound recordings," thus making future innovations in digital technologies that make use of sound recordings by anyone other than the record companies unlikely. Noll WRT at 38.

148. Reasonable reliance interests. Fairness also should protect reasonable reliance interests. Many aspects of the American legal system are designed to ensure that persons who reasonably rely upon the representations of others are protected against injury resulting from the repudiation of those representations. Examples of rules that express and enforce this principle are the doctrine of promissory estoppel in contracts, the doctrine of easements by estoppel in property law, and the constitutional prohibition upon the retraction of governmental promises exemplified by the Kaiser-Aetna case in constitutional law."¹⁰

149. The legislative history of the DMCA suggests that Congress had in mind the principle of reasonable reliance when in 1998 it decided to continue to give the SDARS the

¹⁰ See RESTATEMENT SECOND OF CONTRACTS § 90 (1981) ("A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise."); RESTATEMENT OF PROPERTY § 519(4) (1944) ("A licensee under [an otherwise revocable license] who has made expenditures of capital or labor in the exercise of his license in reasonable reliance upon representations by the licensor as to the duration of the license, is privileged to continue the use permitted by the license to the extent reasonably necessary to realize upon his expenditures."); Kaiser-Aetna v. United States, 444 U.S. 164, 179-80 (1979) ("While the consent of individual officials representing the United States cannot 'estop' the United States, it can lead to the fruition of a number of expectancies embodied in the concept of 'property' – expectancies that, if sufficiently important, the Government must condemn and pay for before it takes over the management of the landowner's property." (citations omitted)).

benefit of section 801(b)(1), rather than subject them to the willing buyer/willing seller standard now embodied in section 114(f)(2)(B), on the ground that “[t]he 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 81. The most plausible reading of this statement is that Congress recognized the unfairness of changing the rules of the game after the SDARS had entered into contracts and made investments in reliance upon the prior statutory standard. Applying the general principle underlying this recognition to the present proceeding, it suggests that the Judges should avoid adopting a rate that – as SoundExchange urges – is tantamount to a market rate (the “willing buyer/willing seller” standard expressly rejected in 1998 when Congress grandfathered the SDARS), unless such a rate is consistent with the statutory policy objectives embedded in section 801(b)(1), including fairness.

150. As discussed above, a royalty at or near zero is necessary to allow Sirius and XM to earn a reasonable return on even the forward looking cost of their physical assets. It is essential to permit the prospect of a reasonable return on the investment they have made in building their businesses.

151. By contrast, SoundExchange’s fee proposal would cause the SDARS each to earn no net income over more than the next decade. *See* PFF Part V.C. There is no circumstance under which that can be considered fair.

V. LEGAL PRINCIPLES GOVERNING CONSIDERATION OF BENCHMARK AGREEMENTS

A. The Statute Invites the Judges To Consider Sound Recording Performance Agreements with Preexisting SDARS and Preexisting Subscription Services as Benchmarks.

152. In addition to the mandated application of the four 801(b)(1) objectives, section 114 expressly identifies one other type of information that the Judges are invited to consider: "rates and terms for comparable types of subscription digital audio transmission services and comparable circumstances under voluntary license agreements described in subparagraph (A)." *See* 17 U.S.C. § 114(f)(1)(B) (emphasis added). The referenced subparagraph A defines a limited set of agreements:

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.

Id. § 114(f)(1)(A).

153. 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 who, had they litigated, would have been subject to the application of those factors could well serve as probative rate-setting benchmarks. The SDARS' principal benchmark in this proceeding – the 2003 PSS rate – suitably adjusted, falls directly within this category of presumptively relevant agreements. *See* Woodbury AWDT at 12-14; *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings by Preexisting Subscription Services*, 68 Fed. Reg. 39,837 (July 3, 2003).

B. Past Rate-Setting Precedent Rejects the Use of Agreements Granting Exclusive Rights as Benchmarks for the Non-Exclusive Sound Recording Performance Right at Issue Here in Light of the Vastly Differing Nature and Value of the Rights Conveyed.

154. Past rate-setting precedent establishes that agreements granting exclusive rights are not appropriate benchmarks for the non-exclusive sound recording performance right at issue here. In its PSS determination, the CARP rejected a benchmark proffered by RIAA that conveyed exclusive rights to perform movies on cable television, finding that the “[e]conomic value of [e]xclusivity [r]enders the analogy inappropriate.” *CARP PSS Determination* at 40-42.

The CARP reasoned:

Copyright purchasers will value exclusivity for a number of reasons. Exclusivity allows a programmer to define its identity in the marketplace. In addition, exclusivity facilitates promotion and marketing and alerts consumers to the attractiveness of the offered service. Exclusivity also enhances the diversity of available programming.

Id. ¶ 138; see also *Librarian PSS Determination*, 63 Fed. Reg. at 25,397 (“Exclusive rights are highly prized, and consequently, command a premium price, but they are not implicated in the market for digital audio transmissions.”).

155. Based on the fundamental differences between exclusive and non-exclusive rights, the CARP found that “comparing movie license fees, which reflect the value of exclusivity, to sound recording performance fees, which will not convey exclusivity, would be misleading.” *CARP PSS Determination* at 40. It observed that “[b]y ignoring the value of exclusivity, RIAA grossly misstated the value of program acquisition costs in its analogy” and concluded that “RIAA’s failure to account for exclusivity in movie licensing demonstrates the complete irrelevance of the cable movie analogy.” *Id.* at 42.

156. In light of the foregoing precedent, agreements conveying exclusive rights in copyrighted subject matter are not appropriate benchmarks for the non-exclusive sound

recording performance right at issue here unless the significant additional value conveyed by the grant of exclusivity is taken into account.

C. Past Rate-Setting Precedent Has Relied on Musical Works Performance Royalties as an Appropriate Benchmark for the Performance Right at Issue Here.

157. In the most pertinent prior determination under section 801(b)(1) – the PSS Determination – the Librarian of Congress relied heavily on license fees paid for musical works public performance rights as an appropriate benchmark for setting digital sound recording public performance rights. See Librarian PSS Determination, 63 Fed. Reg. at 25,404. The Librarian reasoned that the performance rates in musical compositions "represent an actual marketplace value for a public performance rate in the digital arena, albeit not the digital performance rate in sound recordings" and that these fees are "useful at least in circumscribing the possible range of values under consideration for the statutory performance license in sound recordings." *Id.* at 25,404, 25,409. It concluded that "the values of the performance rights embodied in these licenses figure prominently in the determination of the value for the digital performance right in sound recordings. In fact, the sum of these license fees establishes the outer boundary of the 'zone of reasonableness' for this proceeding." *Id.* at 25,409 n.33.

158. In reaching this determination, the Librarian made clear that it is inappropriate to rely on evidence concerning the relative pricing of sound recordings and musical works as an indication that the marketplace values sound recordings more highly than musical works if the musical works rights at issue are subject to a statutory license whereas the sound recording rights are negotiated in an unconstrained marketplace. See Librarian PSS Determination, 63 Fed. Reg. at 25,405. RIAA had submitted precisely such evidence that purported to show that the sound recording rights at issue with respect to a particular commercial product were priced more highly than the corresponding musical works right. *Id.* The Librarian found that the evidence RIAA

had submitted in support of that argument concerning the relative pricing of musical works and sound recordings in the same commercial products was useless because the musical works rights at issue were established pursuant to the section 115 statutory license whereas the corresponding sound recording rights were set in an unfettered marketplace. *Id.* The Librarian reasoned:

Hence, RIAA's contention that the data supports its assertion that the marketplace places a higher value on the contributions of the record companies and the recording artists in the creation of the phonorecord fails, because it does not discuss the constraining effect the mechanical license has on the copyright owners in setting a value on their reproduction and distribution right. Record companies pay the copyright owners of the musical compositions no more than the statutory rate for the right to reproduce and distribute the musical composition in a phonorecord. The record company then, in **turn**, sells the phonorecord at a fair market price. Because both groups do not share equal power to set rates in an unfettered marketplace, it is unreasonable to compare the value of the reproduction and distribution right of musical compositions – a rate set by the government at a level to achieve certain statutory goals – with the revenues flowing to record companies from a price set in the marketplace according to the laws of supply and demand, and then to declare that the marketplace values the sound recording more than the underlying musical composition. Consequently, RIAA's evidence sheds no light on the relative value of the sound recording performance right and the musical works performance right.

Id.

VI. LEGAL PRINCIPLES GOVERNING EVALUATION OF SURVEY EVIDENCE

159. As discussed in the accompanying Proposed Findings of Fact, SoundExchange has presented survey evidence purporting to demonstrate the "value" of music to the SDARS and the "substitution" effect of the SDARS on CD sales and downloads. *See* PFF Parts V.C, VII.A. As part of its direct case, SoundExchange presented a consumer survey conducted by Professor Yoram Wind in an effort to assess the value of music to the SDARS. In addition, as part of its rebuttal case, SoundExchange presented two consumer surveys, one by Professor Wind and one by George Mantis, seeking to establish a substitution effect of satellite radio.

160. The Proposed Findings discuss the specific factual errors in those surveys that render them wholly unreliable; the discussion below provides the legal framework pertinent to

evaluation of the probative value of the surveys. In this regard, it is noteworthy that the Judges excluded from evidence the Wind substitution survey, as well as testimony related thereto.

161. Consumer surveys conducted for litigation purposes must meet a number of requirements in order to be considered reliable by the courts to which they are presented. Surveys deemed unreliable are to be accorded little or no evidentiary weight. See *Ramdass v. Angelone*, 530 U.S. 156, 173 (2000). For a survey to be reliable, it "must have been fairly prepared and its results directed to the relevant issues." *Universal City Studios, Inc. v. Nintendo Co., Ltd.*, 746 F.2d 112, 118 (2d Cir. 1984) (internal quotation marks and citation omitted). In one of the leading cases addressing the factors to be considered in determining the reliability of surveys, the court in *Toys R Us, Inc. v. Canarsie Kiddie Shop, Inc.*, 559 F. Supp. 1189 (E.D.N.Y. 1983), observed that "trustworthiness" depends on findings that:

- (1) the "universe" was properly defined,
- (2) a representative sample of that universe was selected,
- (3) the questions to be asked of interviewees were framed in a clear, precise and non-leading manner,
- (4) sound interview procedures were followed by competent interviewers who had no knowledge of the litigation or the purpose for which the survey was conducted,
- (5) the data gathered was accurately reported,
- (6) the data was analyzed in accordance with accepted statistical principles, and
- (7) objectivity of the entire process was assured.

See *id.* at 1205.

162. The Supreme Court and numerous federal appellate courts have relied on criteria similar to those articulated in *Toys R Us* in evaluating the reliability of surveys. In *Ramdass*, the Supreme Court focused on unreliable sampling techniques, inadequate survey universes, samples drawn from incorrect areas, failure to ask relevant follow-up questions, improperly drafted

questions, and other methodological errors. See *Ramdass*, 530 U.S. at 173. The Court of Appeals for the Third Circuit explained similarly:

In the context of polls and surveys, the circumstantial guarantees of trustworthiness are for the most part satisfied if the poll is conducted in accordance with generally accepted survey principles, and if the results are used in a statistically correct way, since proper survey and statistical methods are intended to assure a poll's reliability. . . . [S]urveys, since they involve hearsay, must be conducted with proper safeguards to insure accuracy and reliability. . . . A proper universe must be examined and a [r]epresentative sample must be chosen; the persons conducting the survey must be experts; the data must be properly gathered and accurately reported. It is essential that the sample design, the questionnaires and the manner of interviewing meet the standards of objective surveying and statistical techniques. Just as important, the survey must be conducted independently of the attorneys involved in the litigation. The interviewers or sample designers should, of course, be trained, and ideally should be unaware of the purposes of the survey or the litigation. A fortiori, the Respondents should be similarly unaware.

Pittsburgh Press Club v. U.S., 579 F.2d 751, 758 (3d Cir. 1978).¹¹

163. Failure to meet even one of the reliability criteria can result in the survey being discredited. See *Toys R Us*, 559 F. Supp. at 1205. Here, the existence of numerous flaws in the surveys conducted by Professor Wind and Mr. Mantis compels the conclusion that the surveys are untrustworthy and should, along with their testimony and all other testimony relying on their conclusions, be given no evidentiary weight.

¹¹ See also, e.g., *Lutheran Mut. Life Ins. Co. v. US.*, 816 F.2d 376, 378 (8th Cir. 1987) ("To establish the trustworthiness of a survey, it must be shown (1) that a proper 'universe' was examined and a representative sample was chosen; (2) that the persons conducting the survey were experts; (3) that the data were properly gathered and accurately reported; (4) that the sample design, the questionnaires, and the manner of interviewing met the standards of objective surveying statistical techniques; and (5) that the interviewers, as well as the respondents, were unaware of the purpose of the survey."); *Johnson & Johnson * Merck Consumer Pharms. Co. v. Smithkline Beecham Corp.*, 960 F.2d 294, 300 (2d Cir. 1992) ("The evidentiary value of a survey's results rests upon the underlying objectivity of the survey itself. This objectivity, in turn, depends upon many factors, such as whether [the survey] is properly 'filtered' to screen out those who got no message from the advertisement, whether the questions are directed to the real issues, and whether the questions are leading or suggestive." (citations and internal quotation marks omitted)).

164. The principal errors that infect the Wind and Mantis surveys are: questions that are vague, ambiguous, or off-point; leading, suggestive, or biased questions; errors in coding survey responses and inadequate procedures to validate the responses; over-reliance on counsel in the preparation and execution of the surveys; reliance on third-party surveys not conducted by the experts themselves; improper universes of survey respondents and unrepresentative samples of respondents from those universes; and the lack of adequate controls to demonstrate causation. See PFF Parts V.C, VII.A. As noted, any one of these flaws, each discussed below – and there are many others as well, see *id.* – suffices to render a survey unreliable.

165. Courts have emphasized that survey questions must be clear, unambiguous, and related to the issues being addressed by the expert. See *Johnson & Johnson v. Smithkline Beecham*, 960 F.2d at 300 (requiring questions to be "directed to the real issues"); *Simon & Schuster, Inc. v. Dove Audio, Inc.*, 970 F. Supp. 279,290-91 (S.D.N.Y. 1997) (assigning "significantly reduced weight" to survey because its key question was ambiguous, making it impossible to determine how each respondent understood the question); *Toys R Us*, 559 F. Supp. at 1205 (survey questions must be framed in a "clear" and "precise" manner). The surveys conducted by both Professor Wind and Mr. Mantis fail to meet this criterion of reliability. See PFF Parts V.C, VII.A.

166. Questions also must not be leading or suggestive. Indeed, courts routinely have deemed surveys unreliable where the surveys included one or more such questions – as is the case with the surveys of both Professor Wind and Mr. Mantis here. See, *e.g.*, *Scott Fetzer Co. v. House of Vacuums Inc.*, 381 F.3d 477,488 (5th Cir. 2004) (refusing to rely on "survey question that begs its answer"); *Johnson & Johnson-Merck Consumer Pharms. Co. v. Rhone-Poulenc Rorer Pharms., Inc.*, 19 F.3d 125, 134 (3d Cir. 1994) ("A survey is not credible if it relies on

leading questions."); *Universal City Studios*, 746 F.2d at 118 (finding survey "so badly flawed" that it was accorded no weight; among survey's flaws were "an obvious leading question [that] suggested its own answer"); *Hutchinson v. Essence Communications, Inc.*, 769 F. Supp. 541, 564 (S.D.N.Y. 1991) ("To be reliable, a survey should not contain leading questions. This proposition is undisputed." (internal citations omitted)); *Wells Fargo & Co. v. WhenU.com, Inc.*, 293 F. Supp. 2d 734,753 (E.D. Mich. 2003) (refusing to consider surveys on several grounds, including that they were "unreliable because [the expert] used leading questions that may have skewed the survey results").

167. Equally damaging to the credibility of surveys are errors in categorizing, or "coding," the survey responses to open-ended questions, as well as inadequate "validation" procedures to ensure the accuracy of the responses. See *Toys R Us*, 559 F. Supp. at 1205 (requiring that "data gathered" be "accurately reported"). The court in *Revlon Consumer Products Corp. v. Jennifer Leather Broadway, Inc.*, 858 F. Supp. 1268 (S.D.N.Y. 1994), *aff'd*, mem., 57 F.3d 1062 (2d Cir. 1995), found a survey "so unreliable that it is entitled to no weight" where, among other flaws, there were "flagrant example[s] of mis-scoring" of responses, including instances of coding that were "too subjective." *Id.* at 1275-76. Relatedly, the absence of proper validations renders surveys unreliable. See 6 J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition* § 32:170 (2007) (urging use of "[s]tandard procedures" such as "validation checks" to ensure that, inter alia, "responses accurately reflect actual interviews" and that "the survey was administered in such a manner as to minimize error and bias"); Shari Diamond, *Reference Guide on Survey Research*, in FEDERAL JUDICIAL CENTER REFERENCE MANUAL ON SCIENTIFIC EVIDENCE 267 (2d ed. 2000) (verification process is necessary "to ensure that the survey instrument was implemented in an unbiased fashion and

according to instructions" and is used to "detect gross failures in the administration of the survey").¹²

168. Professor Wind's survey as to the value of music suffers from both of these methodological flaws with respect to coding and validation. *See* PFF Part VII.A. Notably, insufficient involvement by the expert in the design, implementation and analysis of surveys can result in such flaws, and in past cases, Professor Wind has been criticized for such a lack of involvement. *See United States v. Dentsply Int'l, Inc.*, 277 F. Supp. 2d. 387,435-36 (D. Del. 2003) (finding that Professor Wind "relied on [others] as the principal questionnaire designers"; that he "was not involved in the collection of survey data"; that he "did not train interviewers, create training materials or review written materials used for training"; that he "was not involved in monitoring the interview process"; that he "did not review any completed questionnaires during the survey process, and performed no interview valuation"; that he "was not involved with creating or analyzing the data set"; and that he "did not analyze the response data, nor did he analyze the survey data"); *G. Heileman Brewing Co., Inc. v. Anheuser-Busch Inc.*, 676 F. Supp. 1436, 1437 (E.D. Wis. 1987) ("Wind's own testimony established that he exercised little supervision over the collection or interpretation of data for either survey"). That appears to have been the case here as well.

169. Nor can survey experts rely on counsel in the preparation and execution of surveys. To ensure accuracy and reliability, courts have required that surveys be "conducted

¹² In addition, survey experts that themselves code responses to open-ended questions, as Mr. Mantis did – thereby negating the "blind" aspect of the survey process – risk tainting their findings. *See, e.g., 24 Hour Fitness USA, Inc. v. 24/7 Tribeca Fitness, LLC*, 447 F. Supp. 2d 266,280-81 (S.D.N.Y. 2006) (criticizing survey expert's methods for coding responses to open-ended questions himself and noting that expert's "biases could be reflected in the coding of the responses").

independently of attorneys involved in the litigation." *Allstates Air Cargo, Inc. v. U.S.*, 42 Fed.Cl. 118 (Fed. Cl. 1998); see also *Pittsburgh Press Club*, 579 F.2d at 758 (holding that "[i]t is essential that the sample design, the questionnaires and the manner of interviewing meet the standards of objective surveying and statistical techniques. Just as important, the survey must be conducted independently of the attorneys involved in the litigation."). Professor Wind violated this crucial principle in numerous respects. See PFF Part VII.A.

170. The reliance by survey experts on third-party surveys (*i.e.*, ones not conducted by the experts themselves) fares no better. Such surveys – such as the "NARM" survey relied upon by Professor Wind regarding a purported substitution effect of the SDARS, see PFF Part V.C – have been accorded no weight because crucial information needed to assess their reliability and accuracy typically is missing. In *Merisant Co. v. McNeil Nutritionals, LLC*, 242 F.R.D. 315, 327-28 (E.D. Pa. 2007), the court refused to consider three surveys conducted not by experts but by third parties because the court was presented with "practically no information about the details" of the polls. With respect to one of the rejected surveys, the court explained: "[T]he Court does not know exactly when this poll was conducted, the context in which the poll was conducted, what 'universe' of respondents was selected, whether the respondents were aware of this current litigation before they responded, [and] whether the resulting data was properly gathered and accurately reported." *Id.* at 328. Such a complete lack of context in the record exists with respect to the NARM study as well.

171. Courts also have emphasized the need for proper survey universes and representative samples of respondents from those universes, both of which requirements Professor Wind failed to satisfy with respect to his survey attempting to value music on the SDARS. See, *e.g.*, *Toys R Us*, 559 F. Supp. at 1205 (requiring use of "properly defined"

universe and "representative sample"); Pittsburgh Press Club, 579 F.2d at 758 (noting need for "proper universe" and "[r]epresentative sample").

172. Finally, the lack of an adequate control as part of a survey – as is the case with Mr. Mantis's survey – is a serious methodological flaw that justifies refusals to consider the survey.¹³ The court in *Wells Fargo*, 293 F. Supp. 2d at 754, explained the need for a control group as follows: "[U]nless a control group is used to account for the effects of 'noise,' *i.e.*, extrinsic factors such as pre-existing beliefs other than the stimulus at issue that could contribute to a survey's results, the survey's results are uninterpretable." The court added that the absence of a control group in that case made it impossible to determine causation: "Had [the expert] used a control group, he might have been able to make a 'causal inference' that was 'clear and unambiguous.'" *Id.* at 769. That the expert "failed to employ an experimental design that established causation" thus rendered the surveys unreliable. *Id.* Mr. Mantis's survey similarly lacks any means by which to establish causation reliably. See PFF Part V.C.

173. Numerous other courts have not hesitated to discredit surveys where causation could not be established because of the absence of controls. See, *e.g.*, *In re Three Mile Island Alert, Inc.*, 771 F.2d 720, 737 (3d Cir. 1985) (holding that government agency did not act arbitrarily in refusing to consider study that had "serious methodological flaws," including that it

¹³ In survey research, a controlled design – using a "control group" as a comparison to the group being tested – is generally favored, particularly where the expert is attempting to establish causality. See *Haggerty v. Upjohn Co.*, 950 F. Supp. 1160, 1163-64 (S.D. Fla. 1996) (rejecting anecdotal reports as inadmissible to establish causation, and finding that cause and effect determinations must rely on a controlled clinical trial); David H. Kaye & David A. Freedman, Reference Guide on Statistics, in Federal Judicial Center, Reference Manual on *Scientific Evidence*, at 91 (2d ed. 2000) ("Controlled experiments are ideal for ascertaining causation"); *id.* at 92 ("Typically, a well designed study will compare outcomes for subjects who are exposed to some factor – the treatment group – and other subjects who are not so exposed – the control group."); *id.* at 95 ("Was there a control group? If not, the study has little to say about causation.").


"failed to compare [the study's] findings to a control group"); *Hand A Land Corp. v. City of Kennedale*, Tex., No. Civ. A. 4:02-CV-458-Y, 2005 WL 723690, at *7 (N.D. Tex. Mar. 29, 2005) (holding that court "could not reasonably rely upon [a] survey's results" where, among other flaws, "no control group was formed"); *Hernandez v. Attention, LLC*, 429 F. Supp. 2d 912, 917 (N.D. Ill. 2005) ("The survey's fatal flaw is that it did not make use of a control group."); *Revlon*, 858 F. Supp. at 1268 (S.D.N.Y. 1994) (finding that survey that gave no indication that "controls were properly used" was "so poorly executed" as to be accorded no weight); *Pharmacia Corp. v. GlaxoSmithKline Consumer Healthcare, L.P.*, 292 F. Supp. 2d 594,601 (D.N.J. 2003) ("Controls are an essential feature of reliable survey evidence."); *Greenpoint Financial Corp. v. Sperry & Hutchinson Co., Inc.*, 116 F. Supp. 2d 405,409 S.D.N.Y. 2000) (holding that "flaws in [a] survey," including "lack of a control group," "cast serious doubts on the value of the survey and any conclusion the Plaintiff seeks to draw therefrom").

174. In sum, the multiple flaws in the surveys conducted by Professor Wind and Mr. Mantis render the surveys entirely unreliable. Accordingly, the surveys and related testimony of Professor Wind and Mr. Mantis, as well as all other testimony relying upon those surveys, should be accorded no weight.

* * *

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

Respectfully submitted,


R. Bruce Rich (N.Y. Bar No. 1304534)
Bruce S. Meyer (N.Y. Bar No. 2108447)
Ralph I. Miller (D.C. Bar No. 186510)
Jonathan Bloom (N.Y. Bar No. 2495810)
Mark J. Fiore (N.Y. Bar No. 4132395)
Todd Larson (N.Y. Bar No. 4358438)
William R. Cruse (N.Y. Bar No. 4315073)
WEIL, GOTSHAL & MANGES LLP
767 Fifth Avenue
New York, NY 10153
Tel: 212.310.8170
Fax: 212.310.8007
r.bruce.rich@weil.com,
bruce.meyer@weil.com,
ralph.miller@weil.com, mark.fiore@weil.com,
todd.larson@weil.com,
william.cruse@weil.com

Counsel for XM Satellite Radio Inc.


Bruce G. Joseph (D.C. Bar No. 338236)
Michael L. Sturm (D.C. Bar No. 422338)
Karyn K. Ablin (D.C. Bar No. 454473)
Benjamin B. Reed (D.C. Bar No. 461768)
Jennifer L. Elgin (D.C. Bar No. 432975)
Matthew J. Astle (D.C. Bar No. 488084)
WILEY REIN LLP
1776 K St NW
Washington, DC 20006
Tel: 202.719.7258
Fax: 202.719.7049
bjoseph@wileyrein.com,
msturm@wileyrein.com,
kablin@wileyrein.com, breed@wileyrein.com,
jelgin@wileyrein.com, mastle@wileyrein.com

Counsel for Sirius Satellite Radio Inc.

October 1, 2007

CERTIFICATE OF SERVICE

I hereby certify that the foregoing Proposed Conclusions of Law, Jointly Submitted by
Sirius Satellite Radio Inc. and XM Satellite Radio Inc., was served on October 1, 2007 via
overnight courier on the following party:

Michael DeSanctis
Jenner & Block LLP
601 Thirteenth Street, NW,
Suite 1200 South
Washington, DC 20005
mdesantis@jenner.com

Counsel for SoundExchange, Inc.

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