Before the
COPYRIGHT ROYALTY BOARD
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 DSTRA

TESTIMONY OF

MICHAEL KUSHNER

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Atlantic Recording Corp.

PUBLIC VERSION

FINAL

October 2006

SX Trial Ex. 65

Public Version

DIRECT TESTIMONY OF MICHAEL KUSHNER

I. Qualifications

My name is Michael Kushner, and I am Senior Vice President, Business and Legal Affairs of Atlantic Recording Corp. ("Atlantic"). In my role at Atlantic, I am primarily responsible for directing the legal and deal making aspects of our business. In that regard, I work closely with all of the senior executives at our label, including the Chairmen, President, and heads of A&R (Artist & Repertoire, more fully described below) and Marketing. I have had various roles in the record business since 1987, and have been employed in my current position at Atlantic since 2001. A brief description of my educational and professional background is attached.

II. Summary

I understand that the Copyright Royalty Judges will determine the new rates and terms for the statutory licenses that permit satellite radio services ("SDARS") and other subscription services to make certain uses of sound recordings. I further understand that in making its determination the Board's objectives include, among other factors, reflecting the relative roles of the copyright owners (the record labels) and the copyright users (the SDARS) in the product made available to the public with respect to the relative creative contribution, and the risks associated with our business of producing sound recordings that the SDARS use to draw subscribers to their services.

The purpose of my testimony is to describe the creative process of a record label's operations and the inherent risks associated with our business. I start with a brief overview of Atlantic, and our parent company, Warner Music Group Corp. ("WMG"). I then explain the various creative contributions we make in identifying artists and creating, marketing and

distributing recordings. Finally, I discuss some of the inherent risks unique to the record industry, with a specific focus on the changing business dynamics of the industry as it evolves from a packaged goods industry into a digital business. As part of this discussion I present a case study on a specific Atlantic artist, Jewel, to demonstrate some of our current challenges.

As an initial notion, it is important to keep in mind that record labels are not passive conduits of talent, but active creative partners in the process that allows consumers to enjoy quality recordings. We play an integral role in the filtering process through which promising talent is identified, developed, and then brought to the public's attention. Of the thousands of artists we consider each year, we enter into a recording agreement with only a few. And out of those artists we do sign, the vast majority end up failing commercially. Ultimately, consumers vote with their dollars on which artists become successful, but without record companies artists' exposure to consumers would be limited and, equally importantly, consumers would be limited in their exposure to new and exciting music. Without record companies, artists would not have the benefit of the creative partnership we provide, or the financial resources this inherently risky business requires for a legitimate shot at success.

The process of identifying, developing, and then marketing musical talent has always been a risky business, but never more so than today. In addition to the inherent risks associated with any creative process, in recent years we have seen marketing expenses increase, the sales of our catalog titles decline, artists' careers shorten, and even established artists having their albums sell fractions of their prior sales history. Against the backdrop of rampant digital piracy and contracting physical sales, the record industry faces substantial challenges to be able to continue to provide the important function it serves for artists and music lovers. We remain confident that the digital era will ultimately be one of growing opportunities for the music business, but that

will depend in part on the industry's collective ability to ensure fair compensation from new digital sources such as satellite radio for the valuable sound recordings we produce.

III. Discussion

A. Overview of the Atlantic Records Group

Our parent company, WMG, is the only stand-alone music company that is publicly traded in the United States. The flagship labels of WMG, Atlantic and Warner Bros., are legends in the evolution of the record industry, each of which in their own right has made important contributions to American and international popular culture. In addition, WMG has significant smaller labels such as Nonesuch, Maverick, Rhino, East West, Asylum, Sire, and Word. Warner Music International, another subsidiary, is a leading company in national and international repertoire that operates through numerous international affiliates and licensees in more than fifty countries. Our domestic branch distribution company, Warner-Elektra-Atlantic Corporation ("WEA"), along with its related independent distribution company, Alternative Distribution Alliance ("ADA"), act not only as distributors for all of WMG's United States labels, but many independent labels as well. WMG also includes Warner/Chappell Music, one of the world's leading music publishers, with a catalog of more than one million copyrights worldwide.

WMG's business was part of Time Warner Inc. until it was sold to investors in March of 2004. The investment group, led by Edgar Bronfman Jr., emphasized that the opportunities for growth through digital distribution were a critical part of its decision to acquire the company. The company was privately held until its IPO in May of 2005.

Atlantic was started by industry legend Ahmet Ertegun in 1947. In its early history, it was known primarily as a rhythm & blues and jazz label, introducing such artists as The Drifters, Ray Charles, Aretha Franklin and Bobby Darin. In the late 1960s, the label emerged as one of

the leaders in the rock genre, with artists such as Led Zeppelin. In 2004, after the purchase of WMG from Time Warner, Elektra Records, which has a long and important history in its own right, was merged with Atlantic Records to form the Atlantic Records Group.

Some of the current artists on Atlantic include Phil Collins, matchbox twenty, Tracy Chapman, Missy Elliott, Jet, Kid Rock, Sean Paul, Staind, T.I., Simple Plan, Panic at the Disco, James Blunt, and Juvenile. Our artists represent a broad array of musical genres, including Pop, Rock, Rhythm & blues ("R&B"), Hip-Hop, Alternative, and a new Latin-oriented genre, Reggaeton. Our current catalog consists of about 2000 albums, and we release approximately 30-40 new albums each year.[1]

In fiscal year 2006, we sold [redacted] physical album units in the United States, including sales both of CDs and of other less popular configurations. According to recent data published by SoundScan (an independent company tracking record sales), Atlantic's share of all U.S. physical album sales was 5.8%. WMG's overall share was 19.2% (including Atlantic), while the remaining three major record companies had a 68.1% share. In addition, in 2006, we generated revenues of approximately [redacted] from all forms of digital exploitation, including downloads, up from approximately [redacted] in fiscal year 2005. It is important to note, however, that only a small fraction of that, [redacted], is attributable to downloads of albums; the remainder comes principally from single-track downloads, subscription services and cellular phone ringtones.

Atlantic is a well-managed record label with a solid artist roster and a strong catalog of popular, and even legendary, sound recordings. However, like our sister labels and our

[1] The information in this testimony that has been marked as restricted is proprietary and commercially sensitive information that is not generally known to the public.

competitors in the industry, we have had to confront and adapt to a changing business landscape. In addition to the normal challenges faced by any creatively-driven business, we face serious issues of physical and digital piracy, as well as competition and pricing pressures from other businesses (including video games and movies). And while we are experiencing growth of our digital businesses, we are now faced with maintaining an infrastructure to support our declining traditional physical business, while at the same time investing in new infrastructure to develop and support our digital business. If our investment in our digital business is to bear long-term fruit and offset the continuing decline in our physical business, we need to adequately monetize the various new digital uses of our copyrights, such as by the SDARS.

In all these respects, Atlantic's challenge as we enter these SDARS proceedings is the same challenge faced by the rest of our industry.

B. The Creative Contributions of a Record Label

1. The Artists & Repertoire Department

The first stage in the creative process within a label falls on the Artists & Repertoire ("A&R") Department, which is responsible for the discovery and selection of new artists, working with the artists on the recording process, and delivering a final sound recording to the label for release. The overhead cost attached to the company's A&R Department for fiscal year 2006 was approximately [[redacted]].

a. Finding Talent

The first stage in the process is the discovery of talent, which takes place in a number of different ways. Members of our A&R Department go to clubs and concerts, comb through thousands of demonstration recordings, scan the Internet, attend festivals, and perform market research. They use their instincts, knowledge of music, and understanding of trends to identify

artists with not only talent, but a certain uniqueness that can make them compelling to a wider audience. These factors are almost entirely subjective, and labels compete vigorously for A&R talent that has that "sixth sense" of spotting artists with potential. As finding talent is a highly creative process it is not surprising that many A&R professionals have a musical background.

Despite our A&R Department following the development of and having discussions with scores of promising artists, we sign recording agreements only with a small number of artists each year. The A&R scouts and managers first present interesting artist possibilities to the more senior A&R executives. Then, those artists whose potential is seen as the greatest are presented to the head of the A&R Department, and ultimately the senior executive team for the final decision. The process of selecting talent often includes special showcases set up for the artists to be seen by various company executives, as well as the production of demonstration recordings to help develop the artist and/or give us further insights into the potential. Once we decide to offer a recording contract to an artist, my department commences the process of negotiation with the artist's attorney and manager. This process can take days to months depending on how competitive and/or complex the deal is.

As the industry has evolved in recent years, both record companies and artist representatives have become much more focused on digital revenue streams, including downloads, subscription services, as well as satellite services. Although attorneys representing artists may differ with us on many aspects of the business arrangement, we are both equally concerned with ensuring that that our respective clients are fairly compensated for digital revenue streams. The music that is exploited by various for-profit businesses under the various compulsory licensing arrangements is a form of artistic expression in which the artists and labels have made substantial temporal, creative, and financial investments; and both the artists and the

labels want to ensure that their efforts and risk-taking are properly rewarded, in whatever form the music is consumed.

b. Pre-Production and Recording

Once the artist is signed, the process of making the album begins. Before the artist enters the recording studio the responsible A&R representative works with the artist to select and develop the material to be recorded. Depending on the type of music and the unique characteristics of the artist, this can mean in some cases literally finding suitable music for the artist to record. In other cases the artist may also be the songwriter, but even then our A&R Department has an important role in working with the artist to develop the material to be recorded. This process requires patience, focus, and creative skill -- all character traits possessed by the best A&R personnel.

As part of this pre-production process the A&R representative also works with the artist to select the studio, producer and engineer that the creative team believes is best capable of realizing the artist's potential. In the case of most Pop, Hip-Hop, and R&B recordings, the process involves sifting through hundreds of "tracks" by various producers to try to find the magic combination of artist, song and producer that makes for a hit record. Along with finding talent, managing this process is one of the key responsibilities of our A&R staff.

The A&R representative's substantial involvement continues when the artist records the material in the studio. Our A&R staff supervise the entire recording process, acting essentially in an executive producer role. The degree of our involvement in the creative process in the studio depends on the type of music in question and the dynamics of the people involved. The best A&R people will know when to get more involved and when to step back -- this in itself a trait requiring creative sensitivity.

c. Post-Production and New Digital Requirements

After completion of the basic recording process, there is still much work to do, and our A&R staff is integrally involved in all of it. The multi-track recordings have to be mixed to 2-track stereo and then mastered -- a final step where the frequency equalization and various sonic qualities are adjusted and the "master recording" is created. Often we will need numerous "re-mixes" of the same material, and even hire different producers to create versions for specific markets. We also often make various edits of the materials, i.e. longer and shorter versions, versions for specific uses (e.g. by eliminating any inappropriate lyrics), and 30-second clips.

In recent years, in light of the growing digital business (including the ringtone business), our A&R staff has had to be more focused on delivering a substantial amount of ancillary content that can help expand our ability to reach various new formats. A lot of creativity goes into planning and deciding exactly what types of ancillary content should be produced, and how the music that has been produced should be edited and configured for use in these important new markets.

2. Art Department

In parallel with material being recorded, creative work is being done in other departments. The design of artwork for the album -- an important aspect of the delivery of music to the marketplace -- is handled by our Art Department. In order to tailor the artwork for the digital marketplace, and to take advantage of the interactivity offered by computers, our Art Department, together with our New Media Department, is often involved in creating multimedia artwork, which may include animation and video. In addition to album artwork, our Art Department also designs a multitude of related publicity and marketing materials, each of which

has to convey the specific artistic nuances of the record and conform to a style consistent with the artist's imaging and what appeals to the target demographic.

In our fiscal 2006, Atlantic spent [[redacted]] in designing packaging for its new releases, excluding overhead costs attached to the company's Art Department. This overhead cost was an additional [[redacted]].

As part of the pre-release activities we also work on imaging the artist, and often hire stylists and consultants to work with the artist to cultivate the way the artist is presented to the public. We supervise photo shoots to capture this image for use on the album artwork and other materials. All of this creative effort is a key aspect of developing what is often promise of raw talent into a comprehensive presentation that facilitates capturing the artist's market potential.

3. Marketing Department

Once the album is complete, a number of departments at our label become involved simultaneously. These next steps are where most of the work and cost occur in the modern record business, and the creativity needed as part of this process is no less important than the quality of the music in ensuring that our artists are successful. The marketing function, and the many disciplines subsumed within its broad umbrella, is the part of a record label's operation that is least understood or appreciated by the general public.

While marketing in all businesses has a creative element, creativity plays an especially important role in record marketing. This is because in marketing artists and their music, the marketer must tailor a unique approach for the artist and his or her music, getting the message to consumers without compromising the artist's integrity. If the artist is new, there is the challenge of getting that artist's music heard through the din of hundreds of new artists introduced by

various labels each year; if the artist is established, there is the equally formidable challenge of marketing both to the artist's existing fan base and to expand that fan base. The latter is a greater challenge than ever, as the saturation of information, the competition from existing and new media, and the shortening of attention spans makes an established artist's fan base very difficult to retain.

The inherent creativity of record marketing is also demonstrated by the fact that there is no single template -- depending on the style of the music even the components of the marketing plan vary substantially. For example, for Rock acts touring is typically highly important where for a Rap act generating a "street buzz" may be the key. Whatever the focus, our marketing staff always has to be mindful of remaining consistent with the overall creative approach we have agreed to with the artist. It is not only the risk investment we make in marketing, but also the expertise and creative sensitivity that are important in the overall process. Without exception, for an artist to emerge from thousands of talented hopefuls to become a star on the national and international stages requires talent, experience, and the substantial investment brought by a record label to quarterback the effort.

In fiscal year 2006, Atlantic spent over [[redacted]] marketing its new releases, for an average of [[redacted]] per release. In the same year, the overhead cost of our company's Marketing Department (which also includes Artist Development, Video Production, Publicity, and New Media) was [[redacted]].

Some of the sub-departments and specific functions within the broader umbrella of marketing include the following:

a. Artist Development

As the record begins to near its release date the creative oversight for the project shifts from the A&R Department to the Artist Development Department. By helping to find the most suitable touring opportunities, and acting as the overall liaison between the various functions at the label, the Artist Development staff plays an integral role in ensuring the market positioning and "branding" of the artist. The Artist Development staff works closely with the artist to understand the artist's creative sensitivities and to help image the artist and find the most effective target demographics for the artist.

b. Video Production

Funding and overseeing the production of music videos is another important function in the record release process where our label has significant creative input. Similar to the recording process, our staff surveys and selects, together with the artist, the most appropriate production companies, directors, and other essential components for the video. We brainstorm with the artist on possible treatments and review proposed scripts for the video, and dedicate a significant amount of time to coordinating the effort. Especially with the extremely high costs of video productions, we take an active role in ensuring that the end product is consistent with the overall creative vision we are pursuing with the artist.

In our fiscal year 2006, our gross investment in the production of music videos was [ ].

c. Publicity

The task of the Publicity Department is to capture a larger "share of mind" for our artists. Our publicists, as well the subcontractors they hire, work with various media outlets making sure the artist's story gets as broad coverage as possible. Our goal is to educate the public about our

artists and records through features, interviews and reviews. The Publicity Department is also responsible for arranging for television appearances and organizing other events that help to promote our artists and their music.

While a significant part of a publicist's work is to "pitch" the story to media, especially with our better known artists there is also an important aspect of creative "brand management" associated with the task. Not all publicity is good publicity, and our staff members are experts in understanding the nuances and partnering with the artists to manage the coverage within the broader marketing and artist development objectives.

d. New Media

A major component of any label's marketing strategy for an artist in today's environment is New Media. This involves creating artist web sites, fan sites, "e-mail blasts" to the artist's fans, making sure that artists and their music are well represented on Internet portals, blogs, and social networking sites, setting up live Internet concerts, and otherwise utilizing the vast reach of the Internet to gain exposure for our artists and their music. Our New Media marketing team works closely with the other sub-departments under marketing to coordinate their efforts, and to ensure their programs fit in neatly within the total marketing strategy. As the Internet evolves constantly, so does the New Media marketing function -- the technological advances are consistently opening new creative ways for us to expose our artists to the public, and most importantly, earn revenues in new ways when we reach consumers, whether they are an artist's longtime fan, a new fan or a casual listener.

There has been a substantial amount of investment and deployment in the digital area. Where just a few years ago New Media was still a tiny fraction of the aggregate marketing spend, during fiscal year 2006 Atlantic spent [[redacted]] of its overall marketing budget on

New Media. In addition, [ ] of the Marketing Department's total overhead is allocated to the New Media Department.

C. The Risks of the Recording Industry

While all business has its risks, for an array of specific reasons germane to the record industry, ours has a number of elements that increase those risks in comparison to many other industries. In the following sections, I will discuss a few.

1. The Challenges of the Transition to a Digital Business Model

In recent years the record industry has undergone a major transition. From 2000 to 2005, sales of CDs in the United States have declined industry wide by 25.2%, and annual revenues from those sales have declined by 20%, SX Ex. 004 DP, and they continue to decline, SX Ex. 005 DP. Since WMG was sold by Time Warner, the payroll of the corporation has shrunk from about 9000 employees in 2000 to about 4000 employees, and the Atlantic and Elektra labels (now merged) have also cut their aggregate headcount over the same period. To the best of my knowledge, the staff reductions at our company are analogous to what has taken place at other labels. Over the past ten years, the six major recording companies have been reduced to four with the mergers of PolyGram into Universal, and more recently the combination of BMG Music and Sony Music Entertainment into Sony/BMG Music Entertainment. These companies have consolidated and, after consolidation, have made further reductions, in reaction to the decline of the physical record business. And now that they have done so, their ability to survive and prosper will depend on how well they are able to manage the shift from physical to digital distribution of music.

To that point, how the record industry will weather the transition from the old packaged goods industry into a digital service business will depend to a large degree on three factors: (i)

our ability to contain the presently rampant digital piracy; (ii) our ability to continue to manage costs in the declining, but still dominant, physical side of our business; and (iii) our ability to obtain fair compensation from new revenue opportunities, such as satellite services. Our investors have taken a risk in believing that the recording industry can turn the corner and create a healthy digital business model. We maintain our belief that after the current transitional period the record industry will re-emerge as a healthy industry, and our investors' commitment to WMG will continue to be rewarded. This view is based in part on our belief that these proceedings will yield a fair result for all parties, and will not require us to continue to subsidize the SDARS by providing content at royalty rates below the content's fair value in the market. Just as the SDARS have repeatedly shown their willingness to pay fair value for content that is not subject to compulsory licensing, so must they be required to pay fair value for our content, which makes up the core of their service. When distribution occurs through so many diverse channels, Atlantic must receive fair value from all of the platforms through which distribution occurs.

2. The Declining Physical Market: A Hit is Not What it Used to Be

It is a generally accepted industry truism that only about one out of every ten artists has measurable success. What distinguishes a good, healthy record label is, in large part, its ability to improve on that industry average. Fortunately, Atlantic at this time appears to be one of the labels that is beating the average, and of that we are very proud. But what we cannot do, and what no label can do no matter how great they may be at finding and marketing artists, is reverse the inexorable decline in physical sales. And while the mere attrition in physical sales is troubling in itself, an even bigger source of the industry's trouble is in the fact that a "hit" is not what it used to be.

The statistics are alarming. In 1997, the RIAA certified 281 albums Gold (selling over 500,000 units), 152 albums Platinum (selling over 1 million units), 68 albums Multi-Platinum (selling at least 2 million units), and 5 albums Diamond (selling over 10 million units). In stark contrast, in 2005, the RIAA certified 122 albums Gold, 57 albums Platinum, 10 albums Multi-Platinum, and no albums Diamond.

What do these statistics mean? If the average label has a "hit" with one out of ten albums, then it's fair to assume that labels need to have significant profits on the "hit" in order to make up for the more numerous misses. The A&R and marketing costs for most albums are sufficiently high that labels generally just start to make money when an album goes Gold; indeed, for many higher-profile releases (particularly in the Pop, R&B and Hip-Hop genres), albums may not be profitable until they approach Platinum. The more an album sells, the lower the percentage of revenues spent on marketing, and thus the higher the margin. For many years, labels relied on Multi-Platinum releases, hopefully selling far in excess of the minimum 2 million units required to garner that status, to make up for the losses they suffered on the majority of their releases. In 1997, with 68 albums certified Multi-Platinum, selling five million units or more of a release was not a fantasy; it happened with regularity. In 2005, with only ten albums certified Multi-Platinum, selling just over two million units of a record was a rarity. The trend continues in 2006 and is likely to continue from this point forward, and where it will settle is difficult to predict.

These statistics are far more disturbing than just looking at the year-on-year decline in physical sales, because they represent an even steeper decline in average profit margins for record labels. So how does the industry, faced with this steep drop in average profit margins, survive and transition to a model that can work in the new reality? We consolidate, we cut

overhead, we try to control A&R costs, and we definitely reduce marketing costs. We look for marketing partners to help defray costs. We sign fewer acts for less money, and we do what we can to improve our batting averages.

But like any business, we cannot make money solely through cost reductions. We innovate and, most crucially, we try to properly monetize those channels that are exploiting our music. That means we must increase our focus on digital customers, even as we must maintain our infrastructure to serve our physical customers, who at least for the near future still make up the largest share of revenues. And it means getting properly paid by businesses like the SDARS, who would not have subscribers but for the content we pay to create, often at a loss.

3. The Decline of Catalog Sales

Another major change in the business in the last ten years is the precipitous decline in catalog sales. By catalog sales, we mean the sales that happen after the big marketing push is over, usually starting about a year after release. Because catalog sales have little marketing spend attached to them, they should be very profitable. For years, major labels relied on their strong catalog sales to buoy them through the toughest times. But those days, too, may be over. SoundScan data shows that, in 2000, Atlantic's catalog sales had declined precipitously from historic highs to approximately [[redacted]] units. By 2005, that number had declined further to [[redacted]]. And this year, year-to-date data shows that the trend is continuing, with only [[redacted]] catalog units sold through October 15, 2006.

Again, the statistics only tell part of the story. Because fewer and fewer retail outlets are willing to devote the merchandising space to catalog selections, we are now having to take drastic, Herculean steps to get our catalog in those few remaining outlets. These outlets won't take catalog titles unless we slash our wholesale prices and/or offer extreme discounts, all of

which shrinks our precious catalog margins. We don't like it, but we have no choice if we want to maintain a competitive catalog business. (I note with sadness the recent liquidation of the esteemed record chain Tower Records, which was one of the few remaining outlets primarily devoted to music which also maintained deep catalog at their stores. This was a terrible blow to our business generally, but is particularly devastating to our catalog business.)

The combination of the decline in catalog sales, taken together with the downward pressure on catalog margins, is another source of difficulty for our industry. Gone is the buffer that catalog once offered.

Significantly, the music that makes up our deep catalog is alive and well and omnipresent on the SDARS. In my view, it is common sense: if you have narrowcasted, CD-quality, commercial-free access to your longtime favorite artists available on the SDARS, you will be less likely to be compelled to purchase the product in any form. After all, you already have access to the music you prefer on the narrowcasted SDARS. That distribution outlet has, to some extent, taken the place of previous sales.

4. Shortening of Careers and Failures of Established Artists

Another trend in the music industry has been the shortening of artist careers, and the sudden failures of artists that have established track records. Where in the past many of our artists had careers spanning decades during which they recorded ten or more commercially successful albums, today it is rare for an artist to have more than a few successful releases. This development substantially increases the level of risk in our business, because before we could count on an artist we "broke" (record industry jargon for making an unknown artist into a star) to continue generating healthy sales for a longer period of time. In other words, the risk investment that went into breaking a new artist would more often yield profits for an extended period. The

risks of releasing a new album from a big star used to be low, and labels could rely with a relative level of comfort that their flagship artists would deliver successful records well into the future.

All of this has changed in recent years. Breaking a new artist does not necessarily mean success beyond the release in question. Many artists of today have a hit album and quickly fall into obscurity thereafter. Not only does this deprive a label of a formerly reliable source of future income, but it compounds the risks because there is still an expectation that the follow-up album will be successful, and the marketing spend associated with it commensurately large. If that release fails, the losses are even worse than from a new artist release, where the initial expectations (and therefore the marketing budget) may have been more modest.

In addition to new artists having shorter careers, we have also had a growing number of instances where established artists with steady careers have unexplainable drops in their record sales. To illustrate this point I will next describe a case study of one of our highly respected artists, Jewel.

D. A Case Study

Jewel was originally signed to Atlantic in 1993. She released her first album, titled "Pieces of You," in 1995 (the "1995 Album"), and it achieved sales in the United States, as measured through SoundScan, of 7.3 million units (a unit volume which was very successful by the standards of the time, but is virtually unachievable today). Her second album, titled "Spirit," was released in 1998 (the "1998 Album") and achieved U.S. sales, as measured by SoundScan, of 3.7 million units. Three albums followed in 1999, 2001 and 2003, and scanned 1.1 million units, 1.6 million units and 762,000 units, respectively. Her most recent album, titled "Goodbye Alice in Wonderland," was released in 2006 (the "2006 Album") and has achieved sales in the

U.S. as measured by SoundScan, of 288,000 units. (While that album continues to sell in small amounts each week, it will in all likelihood never make it much past the 300,000 mark.)

For purposes of this exercise, I will be comparing the P&L of Jewel's 2006 Album against her 2003 Album titled "0304." It should be obvious that the financial results of Jewel's 2006 Album would be worse than her 2003 Album, given a drop in sales from approximately 762,000 units to 288,000 on the more recent release. What I believe may not be so obvious, and what may be somewhat surprising when examining the numbers more closely, is how the level of investment required to create, market and sell albums in the current marketplace needs such a high level of sales (or if not sales, other sources of revenue, of which satellite revenue is certainly one) in order to generate profit.

1. A&R Costs

In fiscal year 2006, Atlantic Records spent almost [[redacted]] in A&R investment. This amount encompasses recording costs for albums by both new and established artists, as well as advances to artists. This amount of A&R spend, while fluctuating to some degree year-to-year, has been typical. Significantly, though record sales are down and the upside potential for "hit" albums seems to drop each year, the cost of making records remains largely unchanged. With respect to Jewel, A&R costs, inclusive of all recording costs and advances to the artist, for the 2006 Album were approximately [[redacted]]. That number was [[redacted]] for the 2003 Album. The levels of spending for both albums are commensurate with what it typically costs to record a pop album by an established artist, with multiple producers and guest artists. While these costs are controllable to some degree, our experience is that certain types of albums tend to fall into a range, and the costs for both of these albums are within the "normal" range for this type of album.

2. Marketing Costs

In the modern record business, marketing costs remain the biggest variable of "controllable" spending. While we cannot ultimately determine how many units an album is going to sell, we must do our best to base our marketing spend on our unit projections. Looking at our approach to marketing the 2003 Album, we had what our A&R people believed was a very good album, and we had early indications from radio play in advance of release of the album that the album had great sales potential. These factors, taken together with the strong sales history of the artist, led us to design a marketing plan appropriate to the potential of the project. At the same time, when comparing the prospects of the 2006 Album to the results of the 2003 Album, we knew that we needed to control costs, because the marketplace in 2006 was simply not as robust as the marketplace in 2003; we were aware (and had personal experience with) artists whose relative popularity (measured by radio play and other factors) had not declined, but whose record sales nevertheless suffered from the effects of piracy and other factors.

A total of [[redacted]] was spent on marketing the 2003 Album, driven largely by the cost of music video production, radio promotion and cooperative advertising. For the 2006 Album, we were able to reduce those production, promotion, and advertising line items, resulting in a [[redacted]] reduction in marketing spending compared to the 2003 Album, for a total cost of [[redacted]]. We should note, however, that any attempt to further reduce those marketing costs, which might have been prudent in hindsight, would have resulted in less exposure or lower quality materials than an artist with Jewel's past success deserved. For example, while we were able to bring the cost of music videos down from [[redacted]] for the 2003 Album to [[redacted]] for the 2006 Album, attempting to cut that amount further might not have given the artist a video of the quality that her fans had come to expect.

We are faced with this dilemma in project after project; sales have slipped, yet in order to properly market our artists, we simply must provide a threshold level of support that gives our artists a fair chance to realize their potential. And our employees, who generally entered the music business because of their love of music and respect for artists, want nothing more than to provide this support. I am proud to say that I believe our company does an incredible job of stretching our marketing dollars, of finding alternate means of supporting our artists, and of trying to meet the challenges with ingenuity and hard work. It has become increasingly difficult to achieve sales levels that allow us to recapture even our threshold marketing investment and still turn a profit.

3. The Results

Jewel's 2006 Album "sold through" only 288,000 units in the U.S., as measured by SoundScan. (We shipped 419,000 units, but the excess units were largely returned by retailers for full credit because they were not selling, a standard practice when shipments exceed retail sales.) The 2003 Album had sales measured by SoundScan of 762,000 units, and that album earned over [[redacted]] in profit for the label. The 2006 Album lost Atlantic nearly [[redacted]]. While selling 288,000 units of an album remains no small feat in this marketplace, it was simply inadequate to cover the costs of making and appropriately marketing that album.

E. The Paradox: Sales Are Down, But Music is More Ubiquitous Than Ever

For those of us who have spent most of our careers in the record business, and who have seen the changes take place over the last few decades, there is a strange irony when we observe the current state of music "consumption." It is quite obvious that music is being consumed by more people, in more places, in more ways, than ever in our history. Although it is true that young people, who have always been our most important demographic, have lots of new ways to

spend their time, music remains a central focus of their life. There remains a thriving, even a growing, live music scene; it is *de rigueur* for high school and college students to have a social networking page on the Internet on which they include audio and video of their favorite artist (unlicensed, of course); and the music merchandising business selling t-shirts and other merchandise with artist's names and logos is stronger than ever. And other interactive and non-interactive outlets for our music, including the SDARS, grow and add subscribers day-by-day. So why is it harder than ever to make money in the record business?

We know that part of the answer is file sharing and physical piracy. We know that the popularity of single-track downloads on services like iTunes may be a factor, as some consumers may opt to purchase a single track instead of a physical album. But we also believe that the proliferation of new and better outlets for people to hear the music they like has to some degree supplanted the need for consumers to "own" their music. The SDARS are certainly one of the best and most accessible ways for people to do that. But if we have difficulty obtaining our fair share of their revenues both to compensate us fairly for their use, and for the cannibalizing effect they have on sales of records, we will be less able to continue to invest in and market artists and their music.

IV. Conclusion

Record labels make indispensable creative and financial contributions to the process that enables music consumers, including SDARS subscribers, to have quality recordings by talented artists available to them. In providing our service to the artists and the general public, we take significant risks in investing in creative endeavors in a business where commercial success eludes us the great majority of times. With the industry being in transition from a packaged goods industry to a digital one, in order for these risks to be manageable in the future we must have the ability to be fairly compensated for the use of our sound recordings in every channel of distribution.

While physical record sales have slipped, music is as popular as, if not more popular than, ever -- music can now be consumed almost ubiquitously, on demand, wherever, whenever. When music consumption is on the rise, but record industry sales are down, consumers must be finding other ways to quench their thirst for music. In the value chain of the creation and marketing of music, record companies take the biggest share of the risk. And while no company is entitled to be rewarded solely for its risk, the purpose of these proceedings is, in part, to examine the relative risk of all of the participants in the value chain and insure that no one gets a free ride (or an unfairly cheap ride). There is no justification for record labels and artists to continue subsidizing the major publicly held satellite services.

I declare under penalty of perjury that the foregoing testimony is true and correct to the best of my knowledge and belief.

Michael Kushner

Date: 10/24/02

SX Exhibit 004 DP

2005 Year-End Statistics

1330 Connecticut Avenue, NW, Suite 300, Washington, D.C. 20036
202-775-0101

Manufacturers' Unit Shipments and Retail Dollar Value
(In Millions, net after returns)

Physical

	1995	1996	1997	1998	1999	2000	2001	% CHANGE 2000-2001	2002	% CHANGE 2001-2002	2003	% CHANGE 2002-2003	2004	% CHANGE 2003-2004	2005	% CHANGE 2004-2005
(Units Shipped) CD[1]	722.9	778.9	753.1	847.0	936.9	942.5	881.9	-6.4%	803.3	-8.9%	746.0	-7.1%	767.0	2.8%	705.4	-8.0%
(Dollar Value) CD[1]	9,377.4	9,934.7	9,915.1	11,416.0	12,816.3	13,214.5	12,909.4	-2.3%	12,044.1	-6.7%	11,232.9	-6.7%	11446.5	1.9%	10,520.2	-8.1%
CD Single	21.5	43.2	66.7	56.0	55.9	34.2	17.3	-49.4%	4.5	-74.1%	8.3	84.5%	3.1	-62.2%	2.8	-12.1%
	110.9	184.1	272.7	213.2	222.4	142.7	79.4	-44.4%	19.6	-75.4%	36.0	83.6%	14.982	-58.4%	10.9	-27.0%
Cassette	272.6	225.3	172.6	158.5	123.6	76.0	45.0	-40.8%	31.1	-30.9%	17.2	-44.7%	5.2	-69.6%	2.5	-52.6%
	2,303.6	1,905.3	1,522.7	1,419.9	1,061.6	626.0	363.4	-41.9%	209.8	-42.3%	108.1	-48.5%	23.7	-78.1%	13.1	-44.9%
Cassette Single[2]	70.7	59.9	42.2	26.4	14.2	1.3	-1.5	-215.4%	-0.5	-68.0%	N/A	N/A	N/A	N/A	N/A	N/A
	236.3	189.3	133.5	94.4	48.0	4.6	-5.3	-215.2%	-1.6	-70.3%	N/A	N/A	N/A	N/A	N/A	N/A
LP/EP	2.2	2.9	2.7	3.4	2.9	2.2	2.3	4.5%	1.7	-23 7%	1.5	-11.5%	1.36	-11.9%	1.02	-25.0%
	25.1	36.8	33.3	34.0	31.8	27.7	27.4	-1.1%	20.5	-25.2%	21.7	6.0%	19.286	-11.3%	14.2	-26.2%
Vinyl Single	10.2	10.1	7.5	5.4	5.3	4.8	5.5	14.6%	4.4	-20.8%	3.8	-14.0%	3.5	-7.3%	2.3	-35.4%
	46.7	47.5	35.6	25.7	27.9	26.3	31.4	19.4%	24.9	-20.6%	21.5	-13.8%	19.9	-7.3%	13.2	-33.4%
Music Video	12.6	16.9	18.6	27.2	19.8	18.2	17.7	-2.7%	14.7	-17.2%	19.9	35.2%	32.8	65.0%	33.8	3.2%
	220.3	236.1	323.9	508.0	376.7	281.9	329.2	16.8%	288.4	-12.4%	399.9	38.7%	607.2	51.8%	602.2	-0.8%
DVD Audio	-	-	-	-	-	-	0.3	N/A	0.4	63.8%	0.4	1.2%	0.3	-20.5%	0.5	31.8%
	-	-	-	-	-	-	6.0	N/A	8.5	41.3%	8.0	-5.5%	6.5	-19.2%	11.2	72.2%
SACD	-	-	-	-	-	-	-	-	-	-	1.3	N/A	0.8	-39.7%	0.5	-40.5%
	-	-	-	-	-	-	-	-	-	-	26.3	N/A	16.6	-36.9%	10.0	-39.9%
DVD Video[3]	-	-	-	0.5	2.5	3.3	7.9	139.4%	10.7	34.8%	17.5	63.3%	29.0	66.0%	27.8	-4.1%
	-	-	-	12.2	66.3	80.3	190.7	137.5%	236.3	23.9%	369.6	56.4%	561.0	51.8%	539.8	-3.8%
Total Units	**1112.7**	**1137.2**	**1063.4**	**1123.9**	**1160.6**	**1079.2**	**968.5**	**-10.3%**	**859.7**	**-11.2%**	**798.4**	**-7.1%**	**814.1**	**2.0%**	**748.7**	**-8.0%**
Total Value	**12320.3**	**12533.8**	**12236.8**	**13711.2**	**14584.7**	**14323.7**	**13740.9**	**-4.1%**	**12614.2**	**-8.2%**	**11854.4**	**-6.0%**	**12154.7**	**2.5%**	**11195.0**	**-7.9%**
Total Retail Units		**817.5**	**850.0**	**869.7**	**788.6**	**733.1**	**-7.0%**	**675.7**	**-7.8%**	**658.2**	**-2.6%**	**687.0**	**4.4%**	**634.8**	**-7.6%**
Total Retail Value		**10.785.8**	**12,165.4**	**13,048.0**	**12,705.0**	**12,388.8**	**-2.5%**	**11,549.0**	**-6.8%**	**11,053.4**	**-4.3%**	**11,423.0**	**3.3%**	**10,477.5**	**-8.3%**

Digital

Download Single	-	-	-	-	-	-	-	-	-	-	-	-	139.4	N/A	366.9	163.3%
	-	-	-	-	-	-	-	-	-	-	-	-	138.0	N/A	363.3	163.3%
Download Album	-	-	-	-	-	-	-	-	-	-	-	-	4.6	N/A	13.6	198.5%
	-	-	-	-	-	-	-	-	-	-	-	-	45.5	N/A	135.7	198.5%
Kiosk[4]	-	-	-	-	-	-	-	-	-	-	-	-	-	-	0.7	N/A
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1.0	N/A
Music Video	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1.9	N/A
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3.7	N/A
Total Units	-	-	-	-	-	-	-	-	-	-	-		**143.9**	N/A	**383.1**	**166.2%**
Total Value	-	-	-	-	-	-	-	-	-	-	-		**183.4**	N/A	**503.6**	**174.5%**
Mobile[5]	-	-	-	-	-	-	-	-	-	-	-	-	-	-	170.0	N/A
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	421.6	N/A
Subscription[6]	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1.3	N/A
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	149.2	N/A

Total Digital & Physical

Total Units[7]	1,112.7	1,137.2	1,063.4	1,123.9	1,160.6	1,079.2	968.5	-10.3%	859.7	-11.2%	798.4	-7.1%	958.0	20.0%	1,301.8	35.9%
Total Value	12,320.3	12,533.8	12,236.8	13,711.2	14,584.7	14,323.7	13,740.9	-4.1%	12,614.2	-8.2%	11,854.4	-6.0%	12,338.1	4.1%	12,269.5	-0.6%

Retail value is value of shipments at recommended or estimated list price

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[1] Includes DualDisc
[2] RIAA's reports will no longer reflect shipments of cassette singles
[3] While broken out for this chart, DVD Video Product is included in the Music Video totals
[4] Includes Singles and Albums
[5] Includes Master Ringtunes, Ringbacks, Music Videos, Full Length Downloads, and Other Mobile
[6] Weighted Annual Average
[7] Units does not include subscriptions

2006 RIAA Mid-year Statistics

Phone: 202/775-0101

MANUFACTURERS' UNIT SHIPMENTS AND DOLLAR VALUE

(In millions at suggested retail list price, net after returns)

	Six Months Ended June 30											
	2006				2005				Percent Change			
Physical	Units to Retail	Dollars to Retail	Total Units*	Total Dollars	Units to Retail	Dollars to Retail	Total Units	Total Dollars	Retail Units	Retail Dollars	Total Units	Total Dollars
CD[1]	220.9	$3,559.2	264.8	$3,859.8	257.9	$4,189.3	307.7	$4,486.3	-14.3%	-15.0%	-13.9%	-14.0%
Vinyl Single	0.9	$5.1	0.9	$5.1	1.4	$7.7	1.4	$7.7	-36.2%	-33.7%	-36.2%	-33.7%
Music Video	0.3	$4.9	0.6	$6.1	4.3	$46.8	4.7	$50.0	-92.6%	-89.5%	-88.2%	-87.8%
SACD	0.1	$3.1	0.1	$3.1	0.3	$5.6	0.3	$5.6	-44.6%	-44.3%	-44.6%	-44.3%
DVD Video	9.2	$178.1	9.2	$178.1	11.6	$213.9	11.6	$213.9	-20.7%	-16.7%	-20.7%	-16.7%
DVD Audio	0.1	$1.4	0.1	$1.4	0.1	$1.7	0.1	$1.7	-35.1%	-17.0%	-35.1%	-17.0%
Other[2]	1.8	$11.6	2.0	$12.4	3.1	$19.2	3.7	$21.0	-42.4%	-39.6%	-47.2%	-41.0%
Total Albums[3]	**231.2**	**$3,753.5**	**275.5**	**$4,056.1**	**275.3**	**$4,469.1**	**326.1**	**$4,771.1**	**-16.0%**	**-16.0%**	**-15.5%**	**-15.0%**
Total Singles[4]	**2.0**	**$9.9**	**2.0**	**$9.9**	**3.3**	**$15.1**	**3.3**	**$15.1**	**-38.4%**	**-34.5%**	**-38.4%**	**-34.5%**
Total Physical	**233.2**	**$3,763.4**	**277.6**	**$4,066.0**	**278.6**	**$4,484.2**	**329.4**	**$4,786.2**	**-16.3%**	**-16.1%**	**-15.7%**	**-15.0%**
Digital												
Digital Single[5]	286.3	$283.4	286.3	$283.4	167.1	$165.4	167.1	$165.4	71.3%	71.3%	71.3%	71.3%
Digital Album	12.3	$122.7	12.3	$122.7	5.8	$57.9	5.8	$57.9	112.0%	112.0%	112.0%	112.0%
Kiosk	0.6	$0.8	0.6	$0.8	0.2	$0.3	0.2	$0.3	148.4%	155.2%	148.4%	155.2%
Digital Music Video	5.2	$10.3	5.2	$10.3	—	—	—	—	—	—	—	—
Total Digital	**304.3**	**$417.2**	**304.3**	**$417.2**	**173.1**	**$223.6**	**173.1**	**$223.6**	**75.8%**	**86.6%**	**75.8%**	**86.6%**
Mobile[6]	**144.3**	**$356.4**	**144.3**	**$356.4**	**73.1**	**$181.1**	**73.1**	**$181.1**	**97.5%**	**96.8%**	**97.5%**	**96.8%**
Subscription[7]	**1.9**	**$96.1**	**1.9**	**$96.1**	**1.3**	**$64.8**	**1.3**	**$64.8**	**45.1%**	**48.3%**	**45.1%**	**48.3%**
Total Digital & Physical[8]	**681.9**	**$4,633.1**	**726.2**	**$4,935.7**	**524.8**	**$4,953.7**	**575.6**	**$5,255.7**	**29.9%**	**-6.5%**	**26.2%**	**-6.1%**

** Total units includes shipments to retail, direct, and special markets*

[1] *Includes DualDisc*

[2] *Includes Cassette, Vinyl LP/EP, and CD Single*

[3] *Includes CD, Cassette, Vinyl LP/EP, Music Video, SACD, DVD Video, and DVD Audio*

[4] *Includes CD Single and Vinyl Single*

[5] *Digital Sales Based On Estimated Current Retail Prices of $0 99 per Single And $9.99 per Album*

[6] *Includes Master Ringtunes, Ringbacks, Music Videos, Full Length Downloads and Other Mobile*

[7] *Subscription units indicates average number of subscribers*

[8] *Units do not include subscriptions. Note 2005 figures updated for inclusion of new formats*