Before the
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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

CHARLES CIONGOLI

Executive Vice President and Chief Financial Officer
Universal Music Group North America

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SX Trial Ex. 67

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DIRECT TESTIMONY OF CHARLES CIONGOLI

INTRODUCTION

A. Background and Qualifications

I am Executive Vice President and Chief Financial Officer for Universal Music Group North America ("UMG"), a position I have held since 2003. I ultimately am responsible for all the finance activities of UMG's North American operations, which includes nine United States record label groups, as well as music publishing, distribution, and manufacturing operations. In my capacity as Executive Vice President and Chief Financial Officer, I have personal knowledge of, and regularly review, the finances of UMG's record label operations in the United States.

I was previously Senior Vice President of Finance for UMG. Prior to that, I was employed as Vice President of Finance for MCA Records, and also served as Vice President and Group Controller for both MCA Records and MCA Music Publishing. I began my employment with MCA in 1990 as the Group Controller for the MCA Music Entertainment Group, which became UMG in 1996. Prior to joining MCA in 1990, I was a Senior Manager with the international accounting and consulting firm Price Waterhouse where, for ten years, I provided a variety of audit, accounting and special services for Mergers and Acquisitions.

I received a Bachelor's degree in Finance and Auditing from California State University at Northridge. I am a Certified Public Accountant (CPA) in the State of California, and I am a member of the American Institute of Certified Public Accountants and the California State Society of CPAs.

B. Universal Music Group

UMG is the largest record company in the world and had a 31.7% share of the domestic recorded music market in 2005; it consists of numerous acclaimed and popular record labels, including Motown Records, Universal Records, Geffen Records, Interscope Records, MCA Nashville, and Island Records and Def Jam Records. Our artist roster is a lineup of many of the biggest stars in almost all styles of music, including artists such as Luciano Pavarotti, Shania Twain, Bon Jovi, Mariah Carey, Eminem, and Kanye West.

Our history dates back to the Music Corporation of America ("MCA"), which was founded in 1924. We have been a major force in the recording industry since the 1960's, when MCA acquired Decca Records and several other labels and formed MCA Records in 1971. Our growth in the record industry has been steady since those days. After adding several legendary labels to its fold, including Interscope Records and Geffen Records in the 1990's, MCA was renamed Universal Music Group in 1996. A major addition to our company came in 1998 when we acquired the PolyGram group from Phillips N.V. We are headquartered in New York, New York.

OVERVIEW

In the following discussion, I explain some of the main cost categories in our income statement and cash investments related to our business. The UMG income statement is attached to my testimony as an exhibit. *See* SX Ex. 106 DR. The discussion is not intended to be a comprehensive listing of all of our cost line items, but rather an overview of the most important costs necessary for our business.

It is important to note that virtually all of the costs that I discuss are directly or indirectly necessary for the satellite radio services ("SDARS") and pre-existing services ("PES")

(collectively, "Services") to have the sound recordings they use to attract subscribers to their services. Even costs associated with our physical sales fall in this category: without the revenues from physical sales, we would not be able to finance the production of new sound recordings or the associated marketing needed to create new popular music.

One final introductory note is that the distinct and interrelated finance and accounting concepts of costs, expenses, investments and cash expenditures are often conflated in general discussion. For present purposes, the technical distinctions among these terms are not instructive. Accordingly, my testimony uses the term "cost" broadly to give the Board an instructive sense of the financial scope of UMG's business -- the business of making and exploiting sound recordings.

TESTIMONY

Though any "total cost" figure can be somewhat malleable around the edges, it is safely stated that UMG's total costs in 2005 were approximately [[redacted]].[1] I will spend the rest of this statement explaining that figure and breaking it down into its component parts. I start by describing the key variable cost categories of our business. These are costs that, broadly speaking, we incur as a function of our sales. I then discuss marketing and recording costs as a separate section because these costs do not comfortably fit in a discussion of either variable or overhead costs. Finally, the third section of the discussion describes the key overhead costs of our operations.

[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.

A. Variable Costs

1. Royalties and Other Contractual Payments

In fiscal year 2005, the total external direct costs of sales for UMG were over [ ]. Of our [ ] total variable costs, over [ ] related to amounts associated with artists and other participants, including a growing amount for various forms of digital exploitation, such as [ ] for on-line and [ ] in mobile-related royalties. These amounts include payments to various different types of contributors in the music making process, including our recording artists, producers, music publishers, licensors of sound recordings that we distribute, various types of production companies, and joint venturers.

The substantial costs we incur under this line item represent the life blood that ensures that musical creativity continues to flourish. The royalties and other payments we make are imperative in maintaining an economic incentive (and often the very financial ability) for the creative talent to continue their craft. In this respect, our over [ ] per year direct expenses relating to royalties resulting from creativity is particularly significant in maximizing the availability of creative works to the public.

2. Manufacturing and Other Variable Costs

Even as physical sales decline and our business is shifting increasingly to digital distribution, the costs associated with our physical operations remain significant. In 2005, we recognized [ ] in manufacturing and related expenses, and [ ] in other variable distribution costs.

The costs described in this subsection, totaling over [ ], are costs of selling sound recordings, physical or digital. In addition, we have funds in our inventories in the amount of [ ] as of the ending balance sheet for 2005. As already explained, these

costs are relevant to the present proceedings because it is the sales of our sound recordings that create the financial ability for us to produce new music. Consequently, without us incurring these costs, the new production of sound recordings would be disrupted, and the Services would soon find themselves without new and exciting musical content to offer their subscribers.

B. Marketing and Recording Costs

Marketing and recording costs form another major cost that record labels incur in ensuring a continuous flow of new artists and recordings to the marketplace for the public to enjoy. These expenditures -- if successful -- benefit both record companies and the Services, who count on the recording industry constantly to deliver new popular artists and new music from already established artists. In fiscal year 2005, UMG's income statement denoted [ ] as our marketing expense and recognized [ ] in non-recoupable artists and repertoire ("A&R") costs or write-offs for advances that are likely never to be recouped.

1. Marketing Costs

In the recording industry, "marketing" does not refer simply to the marketing of our CDs and other physical products. Rather, it is a much broader concept that is best thought of as "marketing" our artists to their target audiences, turning new songs and albums into "hits," and turning new recording artists into "stars." The investment in marketing includes the cost of making music videos, consumer advertisements, publicity and promotional tours, promotional merchandise, and a host of other expenses. Most of these marketing costs are incurred up front, before the record company is able to generate any revenue from the music that is being marketed.

In 2005, our gross marketing cost commitments were [ ]. Of this amount, the two biggest line items, video production at [ ] and consumer advertising at

[redacted] account for well over a third of all marketing costs. Music videos, which often resemble short movies, are a substantial creative output from our business in their own right, and remain one of the most powerful tools to generate awareness of new artists as well as new music from established artists. In today's world, videos create a critical visual connection to the music. Music videos and consumer advertising allow record labels to use these traits to project the overall image of the artist to the public.

The five next most significant line items in our marketing costs include publicity and promotional tours [redacted], independent services [redacted], packaging [redacted], promotional merchandising [redacted], and co-operative advertising [redacted].

Publicity and promotional tours include the costs we incur in sending our artists for TV and other media appearances, and promotional tours where our artists perform for industry tastemakers or early fans without being separately compensated for the performance. Appearances on national and key regional media are obviously an important part of our efforts to create awareness for the artist, and promotional appearances give us the ability to introduce the artist live and in person to key industry figures and fans. Independent marketing services encompass a variety of costs paid to individuals and companies who operate in effect as an extension of our in-house marketing staff.

The marketing spend on packaging represents the cost of designing attractive packaging for our products and the related collateral materials. Notably, 'packaging' is not limited to physical sales. Many of the images used by various digital distributors are results of our investment in the design efforts under this line item. The merchandising line item incorporates the costs of various materials we manufacture primarily for point-of-sale promotions, such as

posters, various cardboard stand-ups and window display flats, and customized bins for products, as well as other promotional items such as t-shirts and other fan materials.

Other marketing expenses include items such as deficit funding of commercial tours, Internet marketing and website development, and publicity materials.

2. Recording Costs

In theory, recording costs are recoupable from royalties otherwise payable to artists or production companies and, in that sense, they constitute de facto royalty advances. In the event of a successful recording, the recoupable recording costs are later offset against royalty earnings as part of that accounting process.

While a part of our gross recording costs are later reclassified as royalty expenses, the majority of recordings end up not being successful and, despite our contractual right to recoup these costs, as a practical matter there are insufficient royalty earnings to allow for recoupment. Additionally, while most A&R-related costs are recoupable, some are not, and such costs represent an additional investment our company makes directly into the creation of sound recordings.

In 2005, the income statement impact of non-recoupable costs and write-offs from costs deemed unlikely to be recouped was [[redacted]]. Additionally, our ending balance sheet for the year includes [[redacted]] of capitalized recording costs and advances.

C. Overhead

In fiscal year 2005, our total overhead was [[redacted]]. This includes general and administrative overhead, as well as marketing, A&R, and sales and distribution overhead.

1. General & Administrative Overhead

The costs associated with our general and administrative ("G&A") functions were [redacted] in fiscal year 2005. Our G&A costs include the costs associated with our executive, legal, finance, copyright and royalties, information technology, human resources, corporate development, and administrative departments. The activities that fall under the responsibilities of the departments accounted for under G&A are critical to the functioning of the company, and are essential for the production of the sound recordings used by the Services.

2. Marketing Overhead

In addition to the [redacted] of third-party marketing expenses, our 2005 income statement also includes [redacted] as the cost of our in-house marketing staff. The marketing department is also divided into several sub-departments, including artist development, publicity, promotion, video and new media. The video department is one of the most important marketing departments, because it is responsible for making sure that an artist's videos align with the artist's vision and image.

The artist development department works closely with the artists and artist management to identify touring opportunities and to coordinate the various marketing efforts associated with a particular artist. Our in-house publicity staff consists of a group of professionals who work with various media outlets and supervise the work of outside publicists we engage for specific projects. The promotion staff is responsible for generating awareness of and excitement about our records at radio stations and with various music video channels. The new media department, which only emerged a few years ago, is now one of the most important marketing departments and is responsible for various Internet-based promotion and marketing efforts.

3. A&R Overhead

The overhead costs associated with our A&R department were [ ] in fiscal year 2005. This department consists of the staff responsible for searching for and identifying the talent we sign to recording agreements, and it is critical to our ability to record the best talent available. The involvement of the A&R department, however, goes far beyond simply finding talent -- after artists are signed to one of our labels, the A&R staff works closely with them in developing and finding the best possible material for their records, as well as overseeing their recording sessions.

4. Selling and Distribution Overhead

Our selling and distribution overhead in 2005 was [ ]. This cost comprises the departments responsible for retail interaction, customer service, credit and collection, and supply chain fulfillment with both physical and digital retailers, as well as the departments responsible for the production of our inventories and various logistical operations necessary for the business.

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

Charles Ciongoli

Date: 10/29/2006

Exhibit Sponsored by Charles Ciongoli

Exhibit No.	Description
SX Ex. 106 DR	UMG (US Only) Income Statement, 1999-2005

This portion of this exhibit is restricted in its entirety and is therefore omitted from the public version of the exhibit binders.