

**Before the  
UNITED STATES COPYRIGHT ROYALTY JUDGES  
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms  
for Transmission of Sound Recordings by  
Satellite Radio and “Preexisting”  
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR  
(2018-2022)

**INTRODUCTORY MEMORANDUM TO THE  
WRITTEN REBUTTAL STATEMENT OF SOUNDEXCHANGE, INC.,  
AND COPYRIGHT OWNER AND ARTIST PARTICIPANTS**

SoundExchange, Inc., the Recording Industry Association of America (“RIAA”), Sony Music Entertainment (“Sony”), Universal Music Group (“UMG”), Warner Music Group (“WMG”), the American Association of Independent Music (“A2IM”), the American Federation of Musicians of the United States and Canada (“AFM”), and the Screen Actors Guild and American Federation of Television and Radio Artists (“SAG-AFTRA”) (collectively, “SoundExchange”), through their undersigned counsel, respectfully submit this Introductory Memorandum to SoundExchange’s written rebuttal statement in accordance with 37 C.F.R. § 351.4. This memorandum describes the contents of SoundExchange’s written rebuttal statement and briefly summarizes the testimony of its witnesses.

**CONTENTS OF SOUNDEXCHANGE’S WRITTEN REBUTTAL STATEMENT**

Volume 1 contains (A) this Introductory Memorandum; (B) an index of SoundExchange’s witness testimony; (C) an index of SoundExchange’s exhibits; (D) a declaration regarding Protected Material and an accompanying redaction log; and, (E) a certificate of service;

Volume 2 contains the written rebuttal testimony of SoundExchange's eight expert and four fact witnesses; and

Volumes 3 and 4 contain exhibits to the written rebuttal testimony of SoundExchange's expert and fact witnesses, and the designated testimony of Michael Powers from the *SDARS II* proceeding.

Pursuant to 37 C.F.R. § 350.4(a), § 351.4(a), and the Court's Orders of March 14, 2016 and June 28, 2016, SoundExchange is filing an original, five copies, and an electronic copy of the materials in Volumes 1-4.

The written rebuttal testimony of some of SoundExchange's witnesses and some of SoundExchange's exhibits contain information that SoundExchange has marked as Restricted, as that term is defined in Part III of the Protective Order entered by this Court on June 15, 2016 (the "Protective Order"). Pursuant to Part IV(A) of the Protective Order, SoundExchange has marked Restricted limited portions of its written rebuttal statement that contain confidential information and has also submitted a declaration listing a description of the Restricted material. Pursuant to Part IV(C) of the Protective Order, SoundExchange has submitted a redaction log identifying for every item claimed as Restricted: (1) an identification of the document or source by title, page number and producing participant; (2) the basis or bases for the redaction; and, (3) a description of the redacted material sufficient to enable a reviewing participant or party to challenge the designation.

## **SUMMARY OF THE WRITTEN REBUTTAL TESTIMONY OF SOUNDEXCHANGE'S WITNESSES**

SoundExchange's written rebuttal statement includes the written testimony of the following expert and fact witnesses:

### **A. Expert Witnesses**

David Blackburn, Ph.D., is a Director for NERA Economic Consulting and is based in NERA's Washington, DC office. His testimony explains that in order to assess the applicability of candidate benchmark agreements, it is necessary to assess the bargaining positions and leverage of both sides to the agreements. He explains that Sirius XM's dismissal of the applicability of the interactive-streaming benchmarks is the result of a focus only on the bargaining position of the record companies. As Dr. Blackburn explains, the evidence shows that the services themselves have substantial leverage in their negotiations with record labels. Dr. Blackburn then analyzes the marketplace evidence surrounding these negotiations in more detail and finds no evidence that the rates in the interactive-streaming licenses are the result of excessive bargaining leverage from the record companies. Instead, the evidence suggests that the rates in these benchmarks fairly represent the value of the sound recording copyrights licensed by the record companies to the interactive services.

Ravi Dhar, Ph.D., is the George Rogers Clark Professor of Management and Marketing at the Yale School of Management, and the Director of the Yale Center for Customer Insights at the School of Management at Yale University. He previously submitted written direct testimony in this proceeding. Dr. Dhar critiques the testimony of Joe Lenski, who conducted a survey on behalf of Sirius XM. The Lenski Survey purported to measure which audio services respondents would listen to if Sirius XM (or Pandora) were not available, and how they would allocate their listening time across alternative audio options in this hypothetical circumstance. Dr. Dhar concludes that the Lenski Survey did not achieve this purpose. He finds it replete with significant methodological flaws that render any conclusions drawn from the survey to be completely unreliable. Among other things, he shows that the survey methodology fails to follow accepted survey practices by presenting respondents with questions that suffer from order effects, response options that are incomplete and ambiguous, and questions that require respondents to perform complex mental calculations. These flaws lead him to conclude that the survey is of no scientific value. Because the written direct testimony of Sirius XM's expert witness Carl Shapiro relied on the Lenski Survey results, Dr. Dhar's critique of the Lenski Survey also bears on the validity of Dr. Shapiro's conclusions.

George S. Ford, Ph.D., is the President of Applied Economic Studies, a private consulting firm specializing in economic and econometric analysis. He is also the Chief Economist of the Phoenix Center for Advanced Legal & Economic Policy Studies, a 501(c)(3) research organization that specializes in the legal and economic analysis of public policy issues involving the communications and technology industries. Dr. Ford is an Adjunct Professor at Samford University and Auburn University. He previously submitted written direct testimony in this proceeding.

Dr. Ford's written rebuttal testimony responds to the discussion of promotion and substitution effects in Sirius XM's and Music Choice's direct cases. First, he examines the testimony of fact witnesses Steven Blatter (Sirius XM) and Damon Williams (Music Choice), and discusses flaws in the anecdotal evidence these witnesses present. Dr. Ford shows that anecdotes about promotion are not helpful, as the Judges have found in past proceedings; and, even if it showed a promotional effect, such a demonstration would not justify a promotional discount. Second, Dr. Ford rebuts several of the specific examples discussed in Mr. Blatter's and Mr. Williams' testimony. He shows that the services' anecdotes themselves are flawed and likely overstate the services' promotional effects. Third, Dr. Ford explains that neither of the services' economic experts (Dr. Shapiro or Dr. Crawford) even relied on the anecdotes presented by Mr. Blatter or Mr. Williams. In fact, the services do not request a downward adjustment in their rate proposals on the basis of purported promotional effects, or explain how such an adjustment could be calculated. This omission comports with Dr. Ford's view that any purported promotional effect does not warrant an adjustment to the statutory rate. He concludes that nothing in the services' cases alters the conclusions in his written direct statement.

Thomas Z. Lys, Ph.D., is the Eric L. Kohler Professor Emeritus at the Kellogg School of Management, Northwestern University. He has reviewed the expert reports and fact testimony of the Sirius XM witnesses, as well as an extensive number of documents concerning the negotiation history between Sirius XM and its direct licensors. He previously submitted written direct testimony in this proceeding.

First, Professor Lys examines the model put forward by Sirius XM's expert witness Professor Shapiro, which purports to analyze the relationship between the direct license rates and the statutory rate. Professor Lys concludes that this model is fundamentally flawed. In

particular, Professor Shapiro assumes the conclusion that his model purports to prove—that the statutory rate is set above the royalty rate that would be negotiated between a willing buyer and willing seller absent the statutory environment. When this exogenous assumption is removed, Professor Shapiro’s model could lead to the opposite conclusion and is therefore not insightful.

Second, Professor Lys rebuts Professor Shapiro’s contention that the direct license agreements that Sirius XM has executed with independent record companies are indicative of the market value of royalty rights that would have been negotiated absent the statutory license. He explains that the vast majority of economic activity attributable to direct licenses can be traced to only thirty labels. He then explores the factors that motivated these thirty companies to enter into direct licenses, based on a detailed review of Sirius XM’s “pitches” and based on representations by the labels themselves. He concludes that “steering” was a minor and potentially nonexistent factor driving these licenses. The hope of “steering” was a substantially less important deal point than a variety of other factors including: (1) avoiding the SoundExchange administrative fee; (2) receiving 100 percent of the royalty payment, versus the 50 percent share paid to record companies under the statutory license; (3) obtaining an agreement from Sirius XM to pay for pre-1972 sound recordings; (4) receiving the benefit of Sirius XM’s methodology for calculating royalties, which differs from the methodology required by the statutory license; (5) royalty advances; (6) distribution fees; and (7) idiosyncratic reasons based on special circumstances.

Third, Professor Lys analyzes Professor Shapiro's computation of royalties as a percentage of revenue and finds that Professor Shapiro used inappropriate inputs that render his conclusion invalid.

Fourth, Professor Lys analyzes Professor Shapiro's argument that Sirius XM deserves special consideration because of upcoming satellite investments and concludes that this argument is unfounded. The most recent analyst forecast consensus demonstrates that Sirius XM will continue to enjoy extraordinary levels of financial success, which will permit Sirius XM to remain extremely profitable even if the Judges adopt SoundExchange's proposed revenue rate. Furthermore, those analyst predictions already incorporate capital expenditure investment levels (including satellite expenses) consistent with the needs articulated by Sirius XM's witnesses in this proceeding. And Sirius XM's expected per satellite expense in the upcoming rate period has not materially changed from the past. Finally, no new concessions are warranted given that, over the last two rate periods, concessions on the 801(b) objectives have cumulatively contributed one third to Sirius XM's market capitalization.

Jonathan Orszag is a Senior Managing Director and member of the Executive Committee of the economic consulting firm of Compass Lexecon, LLC. He holds a M.Sc. from Oxford University, which he attended as a Marshall Scholar, and an undergraduate degree, *summa cum laude*, from Princeton University. He previously submitted written direct testimony in this proceeding. In his rebuttal testimony, Mr. Orszag responds to the written direct testimony and deposition testimony of Sirius XM's expert witness, Professor Carl Shapiro. Specifically, Mr. Orszag explains the problems with Professor Shapiro's reasons for dismissing as possible benchmarks the licensing rates voluntarily negotiated between interactive subscription services and record labels. He also explains that the three benchmark methodologies that Professor Shapiro offers instead are flawed because, among other things, they are not based on rates negotiated between willing buyers and willing sellers in the absence of a compulsory license. Mr. Orszag concludes his testimony by affirming his position that interactive

subscription services represent the most appropriate benchmark for purposes of setting a rate in this proceeding.

Itamar Simonson, Ph.D., is the Sebastian S. Kresge Chair of Marketing in the Graduate School of Business at Stanford University. Dr. Simonson was asked to evaluate the survey conducted by Mr. Lenski on behalf of Sirius XM, and, if he found that the survey suffered from serious flaws, to conduct a new survey that corrects those flaws and provides a reliable estimate of consumers' music-source choices if Sirius XM service were no longer available. Dr. Simonson concludes that the Lenski survey was systematically biased. Dr. Simonson explains that the Lenski survey largely predetermined its findings by asking unreliable and biasing questions, and by relying on a data collection methodology that was unsuitable for this type of survey.

Dr. Simonson then discusses basic survey principles and applies these principles to create a valid and accurate measure of subscriber preferences while still retaining the basic construct of the Lenski survey. Dr. Simonson corrects key flaws of the Lenski Survey (for example, the elimination of biasing questions and addition of important information Mr. Lenski omitted such as the price and key features of alternative services, and popular services Mr. Lenski omitted), in order to provide a reliable estimate of what music-source choices consumers would make if Sirius XM were no longer available. His findings report, among other things, that the Lenski survey systematically under-reported the percentage of Sirius XM subscribers with paid subscriptions who would subscribe to new paid streaming services if Sirius XM were no longer available. Dr. Simonson's findings bear on the testimony of Dr. Willig (discussed below) with regard to the opportunity cost of Sirius XM's cannibalization of higher paying streaming



services. Dr. Simonson's findings also undermine the validity of the testimony of Sirius XM's economic expert, Carl Shapiro, who relied on the Lenski Survey.

C. Paul Wazzan, Ph.D., is a Managing Director with Berkeley Research Group ("BRG"), a firm that provides analyses and consulting in matters involving economics, finance, and statistics. He previously submitted written direct testimony in this proceeding. Dr. Wazzan's testimony rebuts Music Choice's royalty rate proposal for the PSS. He begins by observing that he and Dr. Gregory S. Crawford, Music Choice's expert witness, are in substantial agreement as to the basic methodology to be used in setting royalty rates for the PSS. But Dr. Wazzan refutes Dr. Crawford's suggestion that the best possible benchmark for the PSS royalty rate is the musical works rate, which the Copyright Royalty Judges previously rejected and which Dr. Crawford does not attempt to rehabilitate. Dr. Wazzan also critiques Dr. Crawford's application of a model based on the Nash Bargaining Framework that Dr. Crawford proposed using to determine a PSS royalty rate in lieu of a benchmark. In particular, Dr. Wazzan explains that it is not appropriate to use the Nash Framework in the context of the PSS, and that Dr. Crawford used inappropriate inputs to his model. Correcting for those errors, Dr. Crawford's model would indicate a rate broadly in the range of SoundExchange's proposal (if it was appropriate to use the model in the context of the PSS). Finally, Dr. Wazzan explains why Dr. Crawford's application of the Section 801(b)(1) factors was improper, and why it would be most reasonable to set PSS rates to match the CABSAT rates.

Robert Willig, Ph.D., is a Professor Emeritus of Economics and Public Affairs at Princeton University, where he held a joint appointment in the Economics Department and at the Woodrow Wilson School of Public and International since 1978. He previously submitted written direct testimony in this proceeding. His rebuttal testimony responds to the written direct

testimony of Sirius XM's expert witness Carl Shapiro. Specifically, Dr. Willig's testimony rebuts Professor Shapiro's use of the *Web IV* statutory rate to determine the rate for Sirius XM in this proceeding, and rebuts Professor Shapiro's claim that the SDARS statutory rate for 2017 can be considered the upper-bound of the reasonable royalty rate for the upcoming licensing period.

Dr. Willig first concludes that Professor Shapiro's use of the *Web IV* statutory rate to determine the rate for Sirius XM in *SDARS III* suffers from structural and empirical flaws that render the analysis unreliable. Dr. Willig identifies several disqualifying deficiencies in Professor Shapiro's analysis, including deficiencies related to Professor Shapiro's selection of a benchmark service, his examination of differences between the benchmark service and Sirius XM, and his methodology for translating the benchmark service's rate into a proposed rate for Sirius XM's SDARS service.

Dr. Willig next concludes that, contrary to Professor Shapiro's testimony, the 2017 statutory rate for Sirius XM's SDARS service is not an appropriate upper bound for the licensing period at issue in *SDARS III*. Dr. Willig discusses market trends that, when properly considered, necessitate an upward adjustment to the 2017 statutory rate. His analysis illustrates that Professor Shapiro made several methodological errors in evaluating the dynamic market for sound recordings and, as a result, failed to account for the manner in which the explosive growth of streaming has cannibalized creator compensation. Indeed, having reviewed Professor Shapiro's assertions about how properly to set the rates at issue in this proceeding, as well as other testimony that Sirius XM submitted in support of its rate proposal, Dr. Willig reaffirms his conclusion that the appropriate rate for Sirius XM during the next licensing period is a rate of \$2.55 to \$3.94 per subscriber-month.

## **B. Fact Witnesses**

Glen Barros is the President and CEO of Concord Music Group, Inc. (“Concord”), the recording arm of Concord Bicycle Music, one of the world’s leading independent music companies. His rebuttal testimony responds to George White’s testimony about the reasons Concord signed direct licenses with Sirius XM. Mr. Barros explains Concord’s primary motivation. Mr. Barros also responds to some of the claims about promotion made by Mr. White and Steven Blatter. He explains that while Concord values plays on Sirius XM, a recording, album or artist’s success can rarely be attributed to a single outlet.

Jonathan Bender is the Chief Operating Officer of SoundExchange. He previously submitted written direct testimony in this proceeding. His rebuttal testimony primarily addresses the terms and other regulatory language proposed by Sirius XM and Music Choice. First, he addresses the structure of the regulations to be adopted by the Judges in this proceeding. He explains that Sirius XM and Music Choice both proposed retaining separate, repetitive subparts addressing their respective types of service, and each worked from the current regulations in its subpart. By contrast, SoundExchange supports the goals of the Judges’ project in *Web IV* to reduce repetition, use plain language and otherwise clean up the drafting of the regulations. To advance those goals and achieve operational efficiencies, SoundExchange believes that the SDARS and PSS regulations should be conformed to the *Web IV* regulations unless, as to any particular provision, there is good reason not to do so.

Mr. Bender then addresses numerous specific issues raised by the regulations proposed by Sirius XM and Music Choice. Among other things, he explains why use of actual satellite listenership data generated by 360L radios would be the best way to address the possible issues Sirius XM identified in the methodology used to calculate the pre-1972 and direct license

exclusions from SDARS royalty payments, and why it would be inappropriate for the Judges to reverse the decision they made in *SDARS II* that those exclusions should be based on listenership rather than plays. As a further example, Mr. Bender also addresses Sirius XM's proposal concerning late fees for underpayments discovered in audits, explaining that it would effectively allow Sirius XM to borrow money from artists and record companies at an interest rate much more advantageous than those applicable to its other sources of credit.

Aaron Harrison is the Senior Vice President of Digital Business and Legal Affairs of UMG Recordings, Inc. He previously submitted written direct testimony in this proceeding. His rebuttal testimony addresses assertions that the upstream market for on-demand or interactive services is not workably competitive. Mr. Harrison explains why the rates in UMG's agreements with interactive service providers represent fair market, rather than "supra-competitive," rates. He also describes the substantial bargaining power that interactive services providers can and do exercise in their negotiations with UMG.

Jeff Walker is the Executive Vice President & Head of Business & Legal Affairs for Global Digital Business at Sony Music Entertainment. He previously submitted brief written direct testimony in this proceeding. His rebuttal testimony rebuts Sirius XM's allegations that Sony has somehow interfered with Sirius XM's direct license campaign. Mr. Walker first makes clear that Sony has not discouraged unaffiliated record companies from signing direct licenses with Sirius XM. He then discusses direct licenses that Sirius XM executed with companies that Sony subsequently acquired, describing how Sony evaluated the direct licenses after completing each acquisition. Mr. Walker explains that Sony determined that the direct licenses did not serve the long-term interests of Sony or its wholly-owned subsidiaries. Both direct licenses contained discounts from the rate available under the statutory license, which Sony already viewed as

considerably lower than the rates it could obtain through arms-length negotiation in a free market. As a result, Sony concluded that the direct licenses risked under-monetizing content on Sirius XM, and provided Sirius XM with a competitive advantage over digital music services that yield significantly higher royalties on a per-user basis.

Mr. Walker also responds to Music Choice's direct case, explaining why Sony does not view the PSS as an important promotional platform and why Sony would not be willing to license the PSS at anything like the current statutory rate.

**C. Designated Testimony**

SoundExchange is designating the testimony of Michael Powers, who was a SoundExchange rebuttal witness in the *SDARS II* proceeding. Mr. Powers is the President of an independent record company that previously signed a direct license with Sirius XM. In his *SDARS II* testimony, Mr. Powers discussed his label's experience with the direct license.

Respectfully submitted,

By 

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