

**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)

WRITTEN REBUTTAL TESTIMONY OF

Jeff Walker

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Sony Music Entertainment**

February, 2017

Background and Overview

1. My name is Jeff Walker. I am the Executive Vice President & Head of Business & Legal Affairs for Global Digital Business for Sony Music Entertainment (“Sony Music”). I previously submitted written direct testimony concerning the authenticity of various Sony documents submitted as exhibits in this proceeding.

2. I have reviewed the public version of the testimony of George White. I understand that Mr. White alleges that Sirius XM has been unable to execute a more significant number of direct licenses because of “interference” from “the major labels and their trade organizations.” White WDT, ¶ 32. Mr. White does not make any specific allegations about possible interference by RIAA, any other major label trade organization, or any major label other than Sony. His broad-strokes allegation apparently rests on the claim that Sony “pressured” two of its wholly-owned subsidiaries – [REDACTED] – to terminate their direct licenses with Sirius XM. White WDT, ¶ 31.

3. Sony has not obstructed Sirius XM’s ability to negotiate direct licenses with major or independent record companies. Sony has not communicated with other record companies about executing a direct license with Sirius XM, other than its own wholly-owned subsidiaries, and certainly has not discouraged unaffiliated record companies from executing a direct license.¹ Mr. White’s suggestion to the contrary is incorrect and appears intended to manufacture an explanation for Sirius XM’s lack of success in persuading more companies (and any major record companies) to enter direct licenses.

¹ Moreover, I am not aware of any instance where RIAA or any other trade association or industry organization interfered with negotiations between Sirius XM and a record company.

4. To be clear, Sony does not in principle oppose direct licenses with Sirius XM, either for itself or for its wholly-owned subsidiaries.² Sony evaluates licensing opportunities and agreements as they arise. However, Sirius XM has never offered a direct license on terms that even approach the financial compensation that Sony obtains from other music streaming services and that Sony believes represent fair market rates. Contrary to Mr. White’s suggestions, we do not believe rejecting licenses that offer below-market rates constitutes “interference” – it is simply good business.

5. Sony now owns two companies, [REDACTED] (the “wholly-owned companies”), that had signed direct licenses with Sirius XM before Sony acquired them. After each acquisition was complete, Sony evaluated the executed agreements and concluded that they did not serve the interests of Sony or either wholly-owned company. Sony communicated its view to each of the wholly-owned companies, and they chose not to renew their direct licenses. Below, I explain why Sony reached these conclusions.

The Direct Licenses Created Long-Term Financial Problems

6. As the Judges know, in 2017, the statutory rate requires that Sirius XM pay 11% of its gross revenues as a statutory royalty (subject to various carve-outs in the definition of gross revenues and to exclusions for direct license and pre-1972 recordings). Sony views the current statutory rate as considerably below a fair market royalty rate. When Sony negotiates license agreements for digital streaming services, [REDACTED]

² Indeed, just a few weeks ago Sony entered into a blanket agreement authorizing Sirius XM to record live performances featuring Sony recording artists. Under the terms of that agreement, Sirius XM pays the costs of recording the performances and has the exclusive right to exploit the performances for one year. However, Sony owns the copyrights in the sound recordings, has all rights to exploit the performances after one year, and Sirius XM must pay Sony at the statutory rate for all broadcasts of the performances after the first live performance. *See SoundExchange Ex. 59.*

[REDACTED]. For example, Sony recently executed licenses with [REDACTED] and [REDACTED] for “mid-tier” services (that is, streaming services that offer functionality in excess of what is permissible under the statutory license, but that is well less than the functionality offered by on-demand services). Under the terms of [REDACTED] license, it will pay Sony [REDACTED] [REDACTED]. Similarly, in the first year of the [REDACTED] service, [REDACTED] will pay Sony [REDACTED] [REDACTED].³ These rates stand in stark contrast to the 11% rate that Sirius XM pays under the statutory license.⁴ The significant disparity between rates that digital music services ordinarily pay in the market and rates that Sirius XM pays under the statutory license is exacerbated by Sirius XM’s ability to monetize our content without granting other important rights and benefits typically negotiated in an arms-length transaction, including the right to hold back content and to receive valuable data that reflects how services and consumers use our content.

7. In Sony’s view, it is vital that Sirius XM’s royalty rate be increased to a fair market level, because streaming services like Sirius XM are quickly supplanting sales of digital and physical products as our most significant source of revenue. [REDACTED] [REDACTED]. As a result, it is imperative that use of our recordings by streaming services be well-monetized.

³ In the second year of service, [REDACTED] [REDACTED].

⁴ I appreciate that Sirius XM streams non-music content. Assuming that Sirius XM derives equal value from its music and non-music content, as I’m told SoundExchange’s experts have done in this proceeding, the rate that Sirius XM pays could be considered comparable to a rate of 22% for an all-music service. That rate is still far too low.

8. It is also imperative that Sirius XM's royalty rate align more closely with on-demand services. Although Sirius XM's SDARS service provides less functionality than an on-demand service, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

9. For these reasons, securing more competitive royalty rates for content on Sirius XM is a matter of significant strategic importance for Sony. In this regard, the direct licenses executed by the wholly-owned companies were, as a business matter, problematic. Both of the direct licenses fixed royalty obligations at well below statutory rates. In Sony's view, rates below the already too-low statutory rate confer on Sirius XM an even greater competitive advantage over other streaming services that pay higher royalties – an outcome obviously contrary to Sony's long term interests, and the long-term interests of its subsidiaries.

10. Moreover, Sony considered below-market rates in these direct licenses to be particularly problematic because of the possibility that, after Sony completed its acquisition of the wholly-owned companies, those rates might be viewed as somehow acceptable to Sony. It is no secret that Sirius XM has in past rate-setting proceedings used direct licenses as part of its litigation strategy to lower rates, and it did not require a crystal ball to predict that Sirius XM would do so again. We expected that Sirius XM might use licenses with companies owned by Sony to imply some acceptance of these rates by Sony itself. In reality, of course, Sony would

never willingly license its recordings at rates like those in the direct licenses previously signed by the now wholly-owned record companies.

**[REDACTED] Was Inclined Not To Renew
the Direct License Before it Spoke with Sony**

11. In January 2016, after Sony had acquired [REDACTED], I spoke with [REDACTED] [REDACTED]. [REDACTED] informed me that [REDACTED] had a direct license with Sirius XM. He indicated that [REDACTED] had evaluated the direct license and determined that the license provided no benefit. He further indicated that [REDACTED] had determined that doing direct deals did not benefit it in the long-run. As a result, he said, [REDACTED] had no interest in renewing its direct license with Sirius XM, but asked for my reaction to that conclusion. I agreed that the direct license between [REDACTED] and Sirius XM did not offer economic benefits. After my brief conversation with [REDACTED], I understand that [REDACTED] informed Sirius XM that it would not renew its direct license with Sirius XM.

[REDACTED] Direct License Incorrectly Was Perceived as Hurting Artists

12. [REDACTED] direct license presented another issue. When [REDACTED] signed its direct license, some people mistakenly assumed that [REDACTED] intended to help labels keep the featured and non-featured artist share of royalties. *See, e.g., SoundExchange Ex. 60.* Although that was not the case, Sony remained concerned about how artists perceived the deal. More specifically, Sony was concerned that any lingering mistrust might affect how artists perceived Sony because of its ownership interest in [REDACTED]. This is a matter of no small importance. Sony competes vigorously with other record companies to sign and retain talented recording artists. A suspicion by artists, founded or not, that Sony was facilitating the diversion

to record companies of the artist share of royalties paid by Sirius XM might have negatively affected Sony's artist relations.

13. After Sony completed its acquisition of [REDACTED], a Sony colleague and I met with personnel at [REDACTED] to discuss the direct license. During the meeting, I communicated that, in Sony's view, the direct license undermined the long-term economic interests of both Sony and [REDACTED]. I also communicated that Sony was concerned about how artists might perceive the direct license, however misguided that perception might be.

14. In response, personnel from [REDACTED] suggested that its primary motivation for executing the direct license was to get Sirius XM to accept a metadata feed from [REDACTED] and use the data to report its usage. [REDACTED] believed that (1) Sirius XM had historically done a poor job of reporting its usage to SoundExchange accurately; (2) it could improve the accuracy of Sirius XM's reporting by getting Sirius XM to report using metadata supplied by [REDACTED]; and (3) it could therefore increase the amount of revenue it derived from Sirius XM. I suggested that [REDACTED] explore whether it could continue providing a feed to Sirius XM if it elected to terminate its direct license.

15. I understand that [REDACTED] ultimately decided it would be best not to renew its direct license with Sirius XM. It is also my understanding that [REDACTED] has successfully negotiated an arrangement to continue providing metadata directly to Sirius XM, to facilitate accurate reporting and payment.

The Preexisting Subscription Services ("PSS")

16. I would also like to address briefly my perceptions of the PSS. I understand that Music Choice's direct case tries to position it as a service that is so promotional of sales that record companies should love to have it in operation regardless how poorly Music Choice might

monetize our recordings and how little it might pay us. That is not the way Sony views licensing in general or the PSS in particular, and I have never heard anyone at Sony express the view that Music Choice is an important promotional platform. In fact, in the absence of the statutory license, Sony probably would not be willing to grant licenses to the PSS with their current business model. It certainly would not do so at anything like the current statutory rate. To be an interesting business partner for Sony, a PSS would have to monetize our recordings more effectively and pay a higher royalty rate.

17. In our thinking about digital music service business partners, we place a high priority on making sure that a potential licensee has a sound monetization strategy and the potential to generate significant per-user revenues for us. These considerations are particularly critical where there is risk that the service will cannibalize use of other more profitable services. In the case of a service that is free to the user, we would want confidence that the licensee will have robust ad sales, and we would also want to see a migration path for users to a higher-revenue premium offering such as an ad-free mid-tier service. Even if those conditions were satisfied, [REDACTED]
[REDACTED]
[REDACTED].

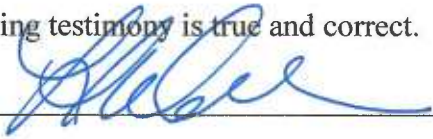
18. The PSS are similar to free, ad-supported services offered by Apple, Google, Spotify, and others, because they feel free to the user, in that the PSS come at no additional charge as a small part of a cable or satellite television package. However, we would much rather have users use the basic tier of a free, ad-supported digital radio service, rather than a PSS, because such services are more effective at monetizing our recordings and pay royalties at a

much higher rate. Even though they do not generate nearly as much per-user revenue for us as mid-tier or on-demand services, they generate much more per-user revenue for us than the PSS.

19. The problem with the PSS business model is that they are essentially giving away what we consider to be a premium product – 24x7 music with no in-stream advertising and little or no on-screen advertising. I understand that back in the 1990s, the PSS were originally positioned as a separately-priced premium product comparable to today’s mid-tier services. Unfortunately, they were ahead of their time. Because the statutory license rate structure did not require them to monetize our recordings effectively, they migrated to their current low-revenue model. Today, their product offerings are similar to the mid-tier services, but generate much less per-user revenue than any other type of royalty-paying service. And they offer no migration path for users to a higher-revenue offering. To be an attractive business partner for us today, the PSS would need to monetize our recordings more effectively and pay much higher royalties.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 2-7-17



Jeff Walker

Exhibits Sponsored by Jeff Walker

Exhibit No.	Description	Designation
SX Ex. 059	[Redacted]	Restricted
SX Ex. 060	[Redacted]	Restricted