UNITED STATES COPYRIGHT ROYALTY JUDGES

WASHINGTON, D.C.

In the Matter of:	Docket No. 2011-1 CRB PSS/Satellite II
Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services	Volume I
	Pgs. 1 - 298

Washington, D.C.

Tuesday, June 5, 2012

The following pages constitute the proceedings held in the above-captioned matter, held at the Library of Congress, Madison Building, 101 Independence Avenue, Southeast, Washington, D.C., before Cindy L. Sebo, RMR/CRR/CSR/RPR/CCR/RSA of Capital Reporting Company, a Notary Public in and for the District of Columbia, beginning at approximately 9:32 a.m.

2

1 APPEARANCES
2 Copyright Royalty Tribunal:
3 CHIEF JUDGE SUZANNE M. BARNETT
JUDGE WILLIAM ROBERTS
4 JUDGE STANLEY C. WISNIEWSKI
5
6 On behalf of SiriusXM:
7 R. BRUCE RICH, ESQUIRE
8 TODD LARSON, ESQUIRE
9 MIRANDA S. SCHILLER, ESQUIRE
10 RANDI W. SINGER, ESQUIRE
11 SABRINA A. PERELMAN, ESQUIRE
12 Weil, Gotshal & Manges LLP
13 757 Fifth Avenue
14 New York, New York 10153-0119
15 212.310.8170
16 bruce.rich@weil.com
17 todd.larson@weil.com
18 miranda.schiller@weil.com
19 randi.singer@weil.com
20 sabrina.perelman@weil.com
21
22

3

1 APPEARANCES (Continued):
2 On behalf of Music Choice:
3 PAUL M. FAKLER, ESQUIRE
4 MATTHEW TROKENHEIM, ESQUIRE
5 Arent Fox LLP
6 1675 Broadway
7 New York, New York 10019
8 212.457.5445
9 fakler.paul@arentfox.com
10 trokenheim.matthew@arentfox.com
11 - and -
12 MARTIN F. CUNNIFF, ESQUIRE
13 Arent Fox LLP
14 1050 Connecticut Avenue, Northwest
15 Washington, D.C. 20036-5339
16 202.715.8465
17 cunniff.martin@arentfox.com
18
19
20
21
22

4

1 APPEARANCES (Continued):
2
3 On behalf of SoundExchange:
4 DAVID A. HANDZO, ESQUIRE
5 JARED O. FREEDMAN, ESQUIRE
6 GARRETT A. LEVIN, ESQUIRE
7 1099 New York Avenue, Northwest
8 Suite 900
9 Washington, D.C. 20001-4412
10 202.639.6085
11 dhandzo@jenner.com
12 jfreedman@jenner.com
13 glevin@jenner.com
14
15
16
17
18
19
20
21
22

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1 PROCEEDINGS
2 CHIEF JUDGE BARNETT: Good morning.
3 Please be seated.
4 Good morning. Welcome all.
5 This is the date and time set for
6 hearings in the direct case or the direct phase of
7 Copyright Royalty Board Docket Number 2011-1 in the
8 Determination of Rates and Terms for Preexisting
9 Subscription Services, or PSS, and Satellite Digital
10 Audio Radio Services.
11 I am Judge Suzanne Barnett. Seated to
12 my left is Judge William Roberts. Seated to my
13 right is Judge Stanley Wisniewski.
14 We preside as a three-judge panel and
15 shall do so throughout these proceedings.
16 Our court reporter this week is
17 Ms. Cindy Sebo.
18 I understand Ms. Sebo is providing
19 realtime reporting for counsel, and I also have
20 realtime hooked up here on the bench.
21 I might, from time to time, highlight a
22 portion of the record. I hope -- and I take notes

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1 at the keyboard. I hope my note taking or
2 highlighting is not distracting to counsel.
3 Please don't draw any conclusions about
4 when I do or do not take notes or highlight the
5 transcript.
6 The hearings on the direct case will
7 proceed in accordance with the -- this Board's
8 earlier order: for four days this week, counting
9 today; Monday through Friday of next week, the week
10 of June 11; and for the first two days of the
11 following week, the week of the 18th.
12 Each hearing day will begin at 9:30. We
13 will break for lunch at or around noon each day. We
14 will reconvene at 1 p.m. and continue with hearings
15 until approximately 4:30.
16 I say approximately because you know as
17 well as I do that we don't want to cut off a witness
18 in midsentence.
19 As you're no doubt aware, these hearings
20 are subject to the procedural rules set forth in
21 Subchapter B, Chapter 3, Title 37 of the Code of
22 Federal Regulations.

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1 We are also going forward in accordance
2 with prior orders of the Copyright Royalty Panel and
3 in accordance with stipulations of the parties
4 regarding scheduling, allocation and utilization of
5 allotted time and the order of presentation of
6 witnesses.
7 Just as a reminder, which is, I'm
8 certain, not necessary given the caliber of the --
9 of the parties assembled here, these hearings will
10 proceed with all of the decorum afforded a court
11 proceeding.
12 The Panel expects that you will remember
13 to speak clearly and distinctly to assure a clear
14 record and to spare the life of our trusty court
15 reporter to whom you may want to turn for production
16 of an accurate record of these proceedings.
17 The Panel further expects that you will
18 maintain the respect due all participants in these
19 proceedings, counsel, parties and witnesses.
20 It is our expectation that all
21 participants will address one another by last name
22 and courtesy titles.

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1 In the interest of full disclosure to
2 the company assembled, all participants should know
3 that from mid-1986 until late 1989, I was affiliated
4 as a senior associate with the firm of Weil, Gotshal
5 & Manges in their Houston office.
6 I had no equity interest in the firm. I
7 had no involvement with the intellectual property or
8 technology lawyers of the firm. I had minimal
9 contact with the Washington, D.C. office, although I
10 did spend a fair amount of time in the New York
11 office in the waning years of Eastern Airlines. You
12 might remember them.
13 I can conceive of no scenario that might
14 give rise to a conflict of interest, but I think
15 disclosure is the better part of valor.
16 If anyone has any heartburn about my
17 continuing to preside, speak now or forever hold
18 your peace.
19 Okay.
20 We received the stipulation of all the
21 remaining parties relating to the royalty and
22 minimum fee payment for ephemeral recordings under

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1 17 USC Section 112. Thank you for that. We will
2 proceed accordingly.
3 We have one preliminary motion to deal
4 with this morning, a motion by SiriusXM relating to
5 revision and amendment of the testimony of
6 Dr. Roger Noll. We received the motion, the
7 response in opposition from SoundExchange and a
8 reply from SiriusXM.
9 We will hear brief argument of counsel
10 on the remaining issues raised by this motion. My
11 fellow jurists and I will rule on this motion before
12 Dr. Noll testifies, which I understand will be
13 today.
14 We will hear opening statements today
15 and, as I said, we anticipate beginning Dr. Noll's
16 testimony today.
17 The court reporter tells me you have all
18 reported in, so we don't need to have appearances
19 for the record, thank goodness. It will take us
20 half the morning to do that, I think.
21 Any other business for the day that I
22 failed to mention, Judge Roberts?

11

1 JUDGE ROBERTS: No.
2 CHIEF JUDGE BARNETT: Judge Wisniewski?
3 JUDGE WISNIEWSKI: No.
4 CHIEF JUDGE BARNETT: On the motion,
5 I've asked my colleagues to take the laboring oars,
6 as that was -- what's left is based on an order that
7 was entered before I came onboard. And I think it's
8 better for me just to not insert myself into
9 something that is ongoing.
10 So who will be making the presentation
11 for --
12 MR. RICH: Good morning, Your Honor.
13 Bruce Rich from Weil, Gotshal. I will make the
14 presentation on behalf of SiriusXM.
15 CHIEF JUDGE BARNETT: Thank you,
16 Mr. Rich.
17 MR. RICH: If I may approach
18 Your Honors. I have redlined -- or bluelined and
19 redlined copies of the proposed amended testimony.
20 JUDGE WISNIEWSKI: Is that different
21 from your filing, Mr. Rich?
22 MR. RICH: Yes.

12

1 JUDGE WISNIEWSKI: Did you say that's
2 the same or different?
3 MR. RICH: The same.
4 Good morning, Your Honors. Straight
5 forwardly, I think the briefing is quite
6 comprehensive. On -- in a timely fashion, we
7 submitted a proposed amended written direct
8 testimony of Dr. Noll which was objected to on a
9 variety of grounds.
10 And Your Honors denied the motion in
11 substantial part based on an interpretation of what
12 was appropriate subject for amended testimony based
13 on materials learned during the discovery process.
14 And in accordance with that -- and
15 certain of the proposed amended testimony, indeed,
16 fell within that category, specifically and
17 prominently -- most prominently relating to
18 additional information relating to the direct
19 licenses in which our clients have entered and, as
20 well, a public filing relating to Pandora.
21 Notwithstanding that, there were other
22 aspects of the proposed amended testimony which fell

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1 within both the letter and the spirit of proposed --
2 of the -- of amended direct testimony; namely,
3 updating Dr. Noll's testimony and benchmarking to
4 accommodate materials that were produced in the
5 discovery process.
6 And the order, without prejudice,
7 indicated that we could represent that portion of
8 the proposed amended testimony during the proceeding
9 for Your Honors' consideration. And before you is
10 a -- is that proposed revised amended written direct
11 testimony.
12 And what I handed up this morning is a
13 blueline of the proposed additions which faithfully
14 adhere to the standards set forth in the ruling of
15 Your Honors: namely, limiting any proposed amended
16 testimony to materials produced in discovery.
17 We think it shouldn't be controversial.
18 It's well within the spirit and the letter of it
19 that, precisely, this is the contemplated scope of
20 amended testimony taking advantage of materials
21 produced by one's adversary.
22 This was incorporated in the prior

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1 proposed amended testimony by March 26th, which was
2 the due date. And so we are seeking to move into
3 evidence today the revised amended testimony, which
4 is identical in that portion of the prior proposed
5 amended testimony, which relates solely to materials
6 which the prior order indicated was the appropriate
7 subject of an amendment.
8 JUDGE ROBERTS: Mr. Rich, perhaps we can
9 go right to the heart of your motion.
10 In looking over the testimony of
11 Professor Noll, I see, in essence, five portions
12 that seem to be the most substantial ones. And I
13 just wanted to see if you agree with me that -- that
14 this is the gravamen of your motion: the testimony
15 on Page 8; the testimony that begins on the bottom
16 of Page 13, goes through 14 and 15; the testimony on
17 the bottom -- starting on the bottom of Page 74
18 going to 75, 76, 77, 78, 79, 80, 81, 82 and ends on
19 the top of 83; then the testimony starting on the
20 bottom of Page 83 that goes over to Page 84; and
21 then, finally, the testimony that begins on Page 92,
22 93 and ends on the top of 94.

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1 Are those the five essential sections?
2 MR. RICH: That's correct, Your Honor.
3 JUDGE ROBERTS: Thank you.
4 Perhaps you might be interested in going
5 through each of those and let us know why those five
6 portions are permissible under our rules.
7 MR. RICH: Surely.
8 In all or virtually all of those cases,
9 Dr. Noll has amended his testimony to incorporate
10 into his analysis of the marketplace and the
11 potential benchmarks discovery which came out of the
12 files of SoundExchange and which is largely
13 incorporated in proposed further appendices relating
14 to certain agreements principally involving other
15 noninteractive active custom radio services, which
16 he finds corroborative of the analysis which was in
17 the original direct testimony.
18 In each of the cases you cite,
19 Judge Roberts, all that Dr. Noll is doing is
20 incorporating the benefit of his examination of
21 those agreements, certain surrounding information
22 necessary to put those agreements in context, which

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1 is, for example, going to the Web sites of one or
2 more of these other entities; and, again, within the
3 structure of his direct testimony in each case,
4 performing the analysis and updating the analysis
5 consistently with his original testimony, but with
6 the benefit of additional marketplace agreements to
7 which we and Dr. Noll had no access prior to the
8 discovery process, which, had Dr. Noll had access to
9 those, publicly or otherwise, he would have
10 considered sooner and, again, entirely consistently
11 with the rules of this Tribunal, having gotten the
12 benefit of those within the 15-day window, rapidly
13 integrated those into his testimony.
14 With respect to -- I should add,
15 Judge Roberts, with respect to 83 and 84 of the
16 testimony, there is, in addition, a discussion of a
17 mobile services agreement which helps to emphasize a
18 very important part of Dr. Noll's testimony which
19 relates to how one deals with bundled services in
20 terms of how one thinks and goes about the
21 benchmarking process.
22 And the particular agreement which he

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1 discusses there, which, again, came out of the
2 discovery process, explicates and supports his
3 underlying economic framework of analysis.
4 JUDGE ROBERTS: It would seem that the
5 potential objection lies with the fact that
6 Dr. Noll, while certainly looking at agreements that
7 were produced in discovery -- there's little doubt
8 of that -- but then he went on to do additional
9 research, as you just mentioned. You described it
10 as putting it in context, but perhaps going to the
11 Web site of these different services, Slacker or
12 turntable.fm or Tier 4 service.
13 And then, also, he looked into any
14 publications that might discuss those agreements or
15 might have some bearing on what he wanted to say
16 about them.
17 Isn't that additional material and
18 additional research that was not really the product
19 of discovery?
20 MR. RICH: Well, it was -- it was the
21 fruits of the discovery, Your Honor. Had -- had
22 Dr. Noll had access to these materials prior to

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1 discovery, it's reasonable to assume he would have
2 used those same research tools to flesh out,
3 contextualize and present in a coherent fashion the
4 implications of these agreements.
5 The only reason he supplemented in the
6 fashion you describe was with the benefit of that
7 discovery in order to present a coherent analysis.
8 It seems, to us at least, that it would
9 be a bit artificial to allow the physical documents
10 in without being able to round the testimony in a
11 meaningful way, in a coherent way with a very
12 limited amount of supplemental information designed
13 simply to contextualize it.
14 This is not a massive supplementation of
15 what's there; it's really to put it in its proper
16 context within the framework of an existing, you
17 know, comprehensive piece of testimony.
18 So it was -- it was literally the --
19 what you cite was not the fruits of discovery, but
20 it wasn't extraneous to it, it wasn't independent of
21 it, it wasn't gratuitously added; it was simply to
22 take what was the benefit of that discovery and put

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1 it into a format and shape and context that would
2 make it meaningful for Your Honors.
3 JUDGE ROBERTS: So you're asking for
4 some flexibility of the rules?
5 MR. RICH: A little bit.
6 JUDGE WISNIEWSKI: Thank you.
7 MR. RICH: Thank you.
8 CHIEF JUDGE BARNETT: Who will be
9 responding?
10 MR. HANDZO: Good morning. For the
11 record, I'm David Handzo on behalf of SoundExchange.
12 And to Judge Roberts and
13 Judge Wisniewski, it's good to be here again.
14 And to Judge Barnett, welcome to our
15 world.
16 CHIEF JUDGE BARNETT: Thank you.
17 JUDGE ROBERTS: You still lead the
18 league, Mr. Handzo.
19 MR. HANDZO: I am compelled to say
20 Mr. Freedman, who's with me, is tied.
21 I think I can narrow this dispute a
22 little bit. There are particular portions of the

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1 testimony that we do still object to, and let me
2 start on Page 14.
3 There you have a further description not
4 from discovery, but from Internet research about
5 Slacker.
6 It is not correct to say that that's
7 research that couldn't have been done prior to
8 discovery because there was information about
9 Slacker in the original testimony. So this is all
10 something that could have been done before.
11 There was knowledge about Slacker in the
12 original testimony. They just supplemented it by
13 doing some Internet research that could have been
14 done much earlier.
15 JUDGE ROBERTS: Mr. Handzo, why wouldn't
16 you want to, however, as Mr. Rich pointed out, put
17 this into context? You get these agreements in
18 discovery and, while it would be nice to just simply
19 confine your testimony solely to the agreements, it
20 could be helpful to give a little explication on, in
21 this instance, Slacker.
22 MR. HANDZO: Well, let me just

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1 distinguish between two different things. On 14
2 and 15, we've got Slacker and then we've got
3 turntable.
4 Now, in the case of turntable, that was
5 an agreement that was disclosed in discovery. They
6 didn't know about it before. So, there, Mr. Rich's
7 argument is I just found out about turntable for the
8 first time in discovery, so I ought to be able to go
9 a little bit further and do some Internet research.
10 My point with respect to Slacker is they
11 didn't discover that one in discovery; they already
12 knew about it at the time they filed their testimony
13 the first time.
14 So, there, there's no reason to be
15 giving latitude to go write things in the amended
16 testimony that you kind of wish you'd written in the
17 original testimony, but you just didn't.
18 JUDGE ROBERTS: Maybe they knew it, but
19 did they have it?
20 MR. HANDZO: I'd have to go back and
21 look at exactly what agreement they had, but I don't
22 think it influences the fact that they talked about

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1 Slacker in the first place and could have said
2 whatever they wanted to say about Slacker in the
3 original testimony.
4 Let me go also to Page 76.
5 It's the same sort of thing here. This
6 is information that they could have -- I'm referring
7 now, I'm sorry, to not the first paragraph about
8 turntable, but to the second paragraph, blueline
9 paragraph, about Last.fm. There, they did have the
10 Last.fm agreement -- a Last.fm agreement with Warner
11 and certainly could have done whatever they needed
12 to do with that.
13 This is just adding new information that
14 they could have added in the first pace.
15 That carries over, then, as well, to
16 Page 77 at the top. All this discussion there about
17 Last.fm includes a social networking feature and
18 chat rooms and so on; again, they discussed the last
19 agreement between Warner and Last in the original
20 testimony. This all could have been in the original
21 testimony.
22 The same point with respect to the

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1 bottom of 77 and the top of 78, again, with respect
2 to Slacker, they knew about Slacker, they could have
3 addressed that information in the original
4 testimony.
5 So I guess my point is I think the
6 Court's point is well taken, that there is an issue
7 here with respect to if you get discovery and you
8 learn of some new agreements, do you get to just
9 talk about those agreements or can you go further,
10 and is the Court going to provide that latitude.
11 And it seems to me that is a matter within the
12 Court's discretion.
13 But where they already had the discovery
14 on Slacker, they already had the Last.fm deal,
15 there, I think there is a line to be drawn that --
16 that just going back and adding new information that
17 you wish you had in the first place is not
18 permissible.
19 JUDGE ROBERTS: Okay.
20 MR. HANDZO: If the Court has no other
21 questions, I think that's my presentation.
22 MR. RICH: May I respond very briefly?

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1 CHIEF JUDGE BARNETT: Brief rebuttal.
2 MR. RICH: Mr. Handzo confuses two
3 separate concepts, the physical ability to get on a
4 Web site and identify more current information and
5 its relevance.
6 At the time, the only documents
7 available to Dr. Noll dated back to 2007, and,
8 therefore, he was required essentially to confine
9 his analysis to the context and circumstances for
10 the duration of those agreements.
11 The agreements that were produced,
12 however, in discovery are more contemporaneous, and
13 it would have been neglectful on his part and
14 certainly incomplete and, I would argue, subject to
15 cross-examination and impeachment if he had simply
16 offered those later-in-time agreements without
17 updating for Your Honors the later evolution of
18 these services and how those agreements fit within
19 the functionality offered by services, like Last.fm
20 and Slacker.
21 All he did and the only reason it became
22 relevant to look and add the information to which

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1 Mr. Handzo adverts is because we had later, more
2 contemporaneous agreements which made exactly that
3 contextualizing relevant.
4 CHIEF JUDGE BARNETT: Thank you.
5 MR. RICH: Thank you.
6 CHIEF JUDGE BARNETT: Do you want to
7 confer?
8 We're going to confer for a few minutes.
9 We will return.
10 (The Judges confer.)
11 CHIEF JUDGE BARNETT: Good morning.
12 Please be seated.
13 The Judges have conferred. We have
14 concluded that we will grant the motion of SiriusXM
15 to amend the testimony of Professor Noll. And his
16 testimony will be based upon the revised amended
17 written direct testimony that we received
18 recently --
19 MR. RICH: Thank you.
20 CHIEF JUDGE BARNETT: -- and another
21 copy this morning.
22 MR. RICH: Thank you, Your Honor.

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1 CHIEF JUDGE BARNETT: Thank you.
2 We will now have opening statements for
3 the directed case.
4 Mr. Rich, you again?
5 MR. RICH: Yes, thank you.
6
7 OPENING STATEMENT ON BEHALF OF SIRIUSXM
8
9 MR. RICH: With Your Honors' permission,
10 we have a few demonstratives we'd like to hand up.
11 CHIEF JUDGE BARNETT: Thank you.
12 MR. RICH: A formal good morning to you,
13 Chief Barnett, and add welcome.
14 CHIEF JUDGE BARNETT: Thank you.
15 MR. RICH: And Judge Roberts and
16 Judge Wisniewski, the same.
17 May it please Your Honors, this
18 proceeding, as it relates to SiriusXM, involves a
19 determination of rates that SiriusXM will pay to
20 publicly perform sound recordings during the 2013 to
21 2017 license period pursuant to statutory license
22 provisions of Section 114(f)(1) of the

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1 Copyright Act.
2 This proceeding also encompasses
3 Section 112(e), ephemeral licenses.
4 As Her Honor indicated, the parties have
5 submitted a stipulation as to the disposition of
6 fees as they relate to the 112(e) license rates.
7 Pursuant to that stipulation are to be encompassed
8 within the rates determined for the Section 114
9 license and valued at 5 percent of the total
10 license.
11 And, therefore, what's before
12 Your Honors in this proceeding, formally, is the
13 determination of that encompassing rate for the
14 sound recording performance right under Section 114.
15 This is, as you're aware, the second
16 such proceeding between these parties, the first
17 conducted during 2006 and 2007 covering the period,
18 2007 through this year, 2012. That proceeding
19 resulted in rates for the current period beginning
20 at 6 percent of defined revenues as of 2007, rising
21 to 8 percent of defined revenues for 2012.
22 Those rates reflected three to four

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1 times higher rates than the effective level of prior
2 fees that had been negotiated between the parties.
3 These fees and the current fee structure
4 has generated some $600 million in license fees over
5 the term through the date, roughly, of the direct
6 case filing or, actually, more technically, through
7 the end of the third quarter of 2011.
8 And in our testimony is an estimate that
9 by the end of 2012, more than $200 million in
10 additional fees will have been paid pursuant to this
11 license structure, meaning something in the
12 neighborhood of $830 million in license fees will be
13 paid through SoundExchange to the record industry
14 over the course of the current license term.
15 Now, for SoundExchange, the great thing
16 about a revenue-based license is that the record
17 companies really become SiriusXM's top-line partner.
18 They share proportionally in SiriusXM's revenue
19 growth irrespective of the actual drivers of that
20 growth.
21 So whether the success of SiriusXM is
22 driven by music programming or nonmusic programming

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1 or improved delivery systems or upgraded receivers
2 or whatever, the record industry, by definition,
3 gets its stated share of those revenues.
4 Looking at the first demonstrative,
5 Your Honor, at the red bars, you'll see that
6 SoundExchange royalties under the current fee
7 structure have steadily grown year by year in line
8 with our client's own revenue growth.
9 Now, in practice, during this same 2007
10 to third quarter 2011 period, during which SiriusXM
11 paid continually increasing yearly fees cumulating
12 approximately $600 million, the company experienced
13 cumulative cash flow losses during the same period
14 of some $437 million.
15 If you look at the blue bars heading in
16 the other direction on the first demonstrative, you
17 see the contrast between those two sets of data.
18 Now, along those lines, you'll hear from
19 SiriusXM's chief financial officer, David Frear,
20 that while the company's financial performance has
21 improved, it's going to take years to recoup nearly
22 20 years of losses experienced by the company.

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1 As of the time of the direct case
2 filing, those losses stood at $5.5 billion in
3 negative free cash flow and $8 billion -- $8 billion
4 in net operating losses.
5 We've not seen a proposal from
6 SoundExchange either in this case or in the previous
7 case offering to partner on that side of the
8 financial ledger. Nor can SoundExchange complain
9 that SiriusXM hasn't paid its fair share of
10 statutory royalties.
11 From 2007 to 2011, SoundExchange
12 collected an estimated $1.15 billion from all manner
13 of statutory licenses combined, subscription and
14 nonsubscription services, business establishments
15 services on ephemerals, preexisting; you name it.
16 And if you do the simple math, our client paid well
17 over half of the entire amount of that
18 $1.15 billion.
19 Viewed from a slightly different
20 perspective, as you will have read, SiriusXM's
21 principal competitor remains terrestrial radio.
22 Now, because of its statutory exemption,

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1 radio stations pay no sound recording royalties
2 whatsoever. They do, however, pay music performing
3 rights organizations, ASCAP, BMI, royalties to
4 perform the musical works which are embedded in
5 these sound recordings.
6 In 2012, broadcast radio -- the
7 broadcast radio industry combined with reported
8 revenues in the $17 billion range, give or take, are
9 estimated to pay about $300 million annually in
10 music performing rights royalties to the music
11 performing rights organizations.
12 So compare that to the $200 million
13 estimated to be paid by SiriusXM alone to
14 SoundExchange despite, despite, SiriusXM have
15 scarcely 1/5 the revenues of its terrestrial radio
16 competitors.
17 Now, the point of these comparisons, to
18 being clear, is not, per se, to suggest that
19 payments for diverse music copyright licenses should
20 all be equivalent; but, rather, it's to establish
21 that SiriusXM, by any rational measure, is making
22 extraordinary payments for the use of the record

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1 industry's intellectual property and that, at
2 prevailing royalty levels, the record industry is
3 benefiting handsomely by the signs that SiriusXM may
4 have turned the financial corner.
5 Remarkably, in our view, the record
6 industry professes that it's still being
7 significantly undercompensated at the prevailing
8 royalty levels and notwithstanding ever escalating
9 royalty payments made by SiriusXM.
10 For all of its window dressing,
11 SoundExchange's case really distills down to the
12 propositions that since SiriusXM is increasingly
13 financially stable, because it is no longer
14 hemorrhaging massive annual losses, because its
15 management has expressed optimism concerning its
16 future prospects even in the face of a fiercely
17 competitive marketplace, that this somehow entitles
18 the record industry not merely to share in whatever
19 future success the company may attain by continuing
20 to receive their current share of any increased
21 revenues, but, instead, to receive an ever largely,
22 indeed, immensely larger share of those revenues.

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1 Now, you can scour the entire
2 SoundExchange filing for evidence that the record
3 industry's relative contribution to our client's
4 business has grown since the prior license period so
5 as to validate such a demand, but I submit you won't
6 find it.
7 Boiled down to its essence, the record
8 industry's position is that SiriusXM's recent
9 success and short-term continued prospects for
10 success, by definition, entitle the record industry
11 to a larger partnership share in SiriusXM.
12 This position is most clearly evidenced
13 by the written direct testimony of one of its
14 experts, Gregory Sidak. Now, he posits that
15 SiriusXM could afford to pay statutory license fees
16 as high as 57.8 percent of revenue, computed by
17 taking the dollar difference between SiriusXM's
18 total revenue collections and deducting all of its
19 other costs of service and awarding every remaining
20 dollar to SoundExchange.
21 So, in other words, Mr. Sidak's
22 testimony invites Your Honors to think of this case

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1 not through the prism of what a reasonable fee is
2 under the governing standard, but, rather, in terms
3 of what he terms the "shut down royalty rate" --
4 those are his words, "shut down royalty rate" --
5 would be for the record industry to take every last
6 dollar of revenue remaining after SiriusXM covered
7 its other costs.
8 Now, even SoundExchange must have
9 blushed a bit at pressing that assertion as to the
10 actual basis for its proposed rates. So it cut that
11 proposal roughly in half.
12 Instead, the record industry, quote,
13 merely seeks a rate increase beginning with a
14 50 percent rate hike in the first year of the new
15 license, bringing it to 12 percent of revenue,
16 increasing each year such that by 2017, SiriusXM
17 would be paying fully 20 percent of its revenue or
18 fully two-and-a-half times the current 8 percent
19 rate.
20 Now, in actuality, Your Honors, the rate
21 increase sought is larger than that, given
22 SoundExchange's attempt to redefine the governing

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1 revenue base under -- to which those percent of
2 royalty rates would be applied. I'll mention a bit
3 more about that later.
4 Now, as I discuss also in greater detail
5 in just a bit, the basis for SoundExchange's
6 proposal, as testified to by Professor Ordover, is a
7 dated reliance on agreements reached between the
8 major record companies and so-called interactive
9 music services.
10 This is the same group of benchmark
11 services relied on by SoundExchange and Dr. Ordover
12 in the prior proceeding. These agreements, if you'd
13 flip to your next demonstrative, please, the second
14 column, implicate different users engaged in
15 different businesses and in need of different
16 rights.
17 Accordingly, for such agreements to
18 serve as potential benchmarks for the fees to be
19 paid by SiriusXM necessarily requires a series of
20 imprecise adjustments by nature even to try to get
21 to the point of viability.
22 Now, whatever its merit five years ago,

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1 this choice of benchmark, in light of a
2 significantly altered competitive landscape and the
3 availability now of far better benchmarks, will be
4 shown during this hearing to be deeply flawed in its
5 attempted application to SiriusXM.
6 Our client, in contrast, will rely on
7 far more probative benchmarks. There are two of
8 these: first, the direct licenses SiriusXM has
9 entered into with individual record labels which
10 require no extrapolations at all -- back to
11 Demonstrative 2, if you don't mind, the last
12 column -- since those licenses involve the same
13 buyer, the same sellers, the same service and the
14 same rights conveyance.
15 That first ever, first ever direct
16 evidence of fair market value for the very rights in
17 issue here, indeed, including an even broad scope of
18 rights, demonstrates that in actual competitive
19 bargaining between and among record companies to
20 secure airplay on SiriusXM, the rate that has
21 emerged is between 5 and 7 percent of defined
22 SiriusXM revenue.

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1 Dr. Noll's testimony establishes that
2 the average of the 62 agreements executed as of
3 November of '11 is 6.06 percent.
4 The second corroborating benchmark,
5 which Dr. Noll will testify to in detail, involves
6 the majors' agreements with noninteractive, as
7 opposed to interactive, Internet music services.
8 These, you will learn, are head-to-head
9 competitors with our client in the car who offer
10 user experiences and music listening options far
11 more comparable and compatible with SiriusXM's
12 offerings than do the interactive services.
13 These far more apposite agreements were
14 readily available to SoundExchange and its experts,
15 but they avoided them like the plague, and that's
16 for good reason. Making the basic needed
17 adjustments to these far more relevant agreements
18 yields fees in a range corroborative of the direct
19 licenses, 6.6 to 8.3 percent of revenue.
20 Now, it's useful to examine the
21 respective economic consequences of the parties'
22 positions.

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1 If you turn to the next series of
2 demonstratives, please.
3 Under our client's primary proposal,
4 taking an average of 6.06 percent of revenue, and
5 based on revenue projections used by one of their
6 experts, Mr. Lys, L-Y-S, and him self-relying on
7 revenue projections by Morgan Stanley, you would see
8 that SoundExchange's five-year receipts for the
9 period 2013 to 2017 would increase from the prior
10 five-year period, 2008 to 2012, by about
11 $250 million to a cumulative total of just under
12 $1 billion for the license term.
13 That's assuming a rate of 6.06 percent
14 were established and that those revenue targets were
15 actually reached.
16 If you turn to the next demonstrative,
17 the same analysis, but, this time, plugging the
18 current statutory rate at 8 percent and
19 hypothesizing that that rate were to stay in place
20 over the term. And what you see is that, here,
21 SoundExchange would receive more than half a billion
22 dollars more than they will have received in the

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1 prior eight-year period.
2 Turning to the next demonstrative, you
3 see a depiction of the SoundExchange rate proposal
4 escalating as it does from 8 percent to 20 percent.
5 And you'll notice that by 2017, its impact for that
6 year alone would be an annual payment close to a
7 billion dollars one year alone on that estimate.
8 And if you flip to the next
9 demonstrative, please, you will see that the full
10 import of that proposal would be to generate an
11 estimated $3.4 billion over the term of the next
12 license or about $2.4 billion more that our own
13 clients' proposal at 6 percent -- and if you turn to
14 the next demonstrative, please -- more than
15 $2 billion more than maintaining the status quo. A
16 $2 billion rate increase over the next five-year
17 period.
18 Now, if you'll put in front of you the
19 next demonstrative please, you're all familiar with
20 the so-called 801(b) factors. The presentation of
21 our case, Your Honors, will also demonstrate that
22 the rates implied by the foregoing benchmarks are,

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1 if anything, conservative; that is, they overstate
2 the reasonable fee called for here.
3 Why is this? Because, as Your Honors
4 are aware, this proceeding is not focused simply on
5 what a willing buyer or a willing seller would have
6 agreed to in a workably competitive market; it,
7 instead, entails a determination of reasonable fees
8 based on an evaluation of the statutory 801(b)
9 factors which are set forth on this -- on this slide
10 for you.
11 Now, as it attempted to do in the prior
12 proceeding, SoundExchange and its experts try to
13 avoid this legal reality, urging Your Honors simply
14 to ignore the various 801(b) criteria and assume
15 instead that the rate in this proceeding ought to be
16 determined as if the governing standard were willing
17 buyer/willing seller.
18 Now, of course, you can't do that. When
19 SoundExchange appealed this Tribunal's ruling in
20 2007 to the D.C. Circuit, based in part on the
21 assertion that the Judges erred in failing simply to
22 adopt a purely market-based rate, the D.C. Circuit

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1 held that the argument, quote, ignores relevant
2 precedent. Quote, The agency -- meaning you-all --
3 were under no obligation, said the Court, to choose
4 a rate derived from a market-based approached,
5 unquote.
6 For support for that, the Court cited to
7 its early 1999 decision in RIAA versus Librarian of
8 Congress, where it held, quote, In no uncertain
9 terms, the claim that 801 clearly requires the use
10 of market rates is simply wrong, unquote.
11 And just a brief reference to that
12 earlier decision itself, which was the Librarian's
13 decision in that proceeding, there, the Librarian
14 addressed the argument made by SoundExchange's
15 originating parent, the Recording Industry
16 Association of America, RIAA, that the predecessor
17 CARP's responsibility in determining rates under
18 801(b) was, quote -- this is now quoting the RIAA --
19 to determine the royalty that would be produced
20 through free market negotiations absent the
21 compulsory license, unquote.
22 The Librarian -- this is the opinion

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1 that was cited favorably in the D.C. Circuit --
2 squarely rejected this approach, concluding that
3 reasonable rates under Section 801(b) are to be
4 determined based on policy considerations and that,
5 quote, the standard for setting the royalty rate for
6 the performance of a sound recording under an 801(b)
7 analysis is not fair market value, unquote; and,
8 importantly here, observed that the governing policy
9 consideration should, quote, temper, unquote,
10 marketplace points of reference, temper, marketplace
11 points of reference.
12 Now, the reason that SoundExchange runs
13 from this standard, I would submit, is evident.
14 Application of the 801(b) factors to the record
15 facts inexorably leads to the need to, quote, temper
16 the marketplace points of reference that will be
17 submitted before Your Honors for your consideration
18 and drive rates lower, rather than higher, in
19 relation to such benchmarks.
20 Now, I want to turn for a few minutes to
21 an explication of our direct case. Dr. Roger Noll,
22 emeritus professor of economics at Stanford

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1 University and deeply experienced in the economics
2 of the entertainment industry, of intellectual
3 property and in the valuation of music rights, will
4 present testimony establishing the economic basis
5 for our client's rate proposal.
6 Dr. Noll's testimony explains that the
7 analytic path for setting appropriate fees here is
8 far simpler than it was in the prior proceeding.
9 As of the date of filing of the direct
10 cases, November of last year, SiriusXM had
11 successfully negotiated 62 direct licenses with
12 record labels, the fees for which incorporate the
13 grant of performance rights that would otherwise be
14 determined by the outcome of this proceeding.
15 Taken together, those agreements cover
16 more than 7,000 artists, 9,000 albums, and 110,000
17 sound recordings, or tracks, as we call them.
18 These agreements reflect voluntary
19 decisions, voluntary decisions by numerous
20 individual record labels to compete for airplay on a
21 major platform that they recognize is promotional of
22 sales of their sound recordings, precisely the sort

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1 of agreements contemplated as probative of
2 reasonable fees in a proceeding such as this by
3 statute.
4 And I refer you here to the provision of
5 114(f)(1)(B) of the statute, which, in interest of
6 time, I won't read in full text.
7 The fees agreed to range between 5
8 and 7 percent of specified SiriusXM revenue and
9 encompass grants of rights that are actually broader
10 than those at issue here.
11 Accordingly, as I've already noted, we
12 have agreements that represent the same buyer
13 dealing with the same body of sellers for even more
14 expansive rights in relation to what is being
15 adjudicated here.
16 This is a breakthrough from prior
17 proceedings. We no longer have to look to imperfect
18 surrogates for the market value of performances of
19 sound recordings by SiriusXM.
20 There's no need, for example, to
21 determine the comparability of different buyers to
22 SiriusXM. There's no need to determine the

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1 comparability of the rights granted, such as between
2 on-demand interactivity for nonstatutory licenses
3 versus the more circumscribed grants of rights under
4 this statutory license.
5 You avoid the need to make complicated
6 adjustments to account for characteristics that
7 distinguish these other claimed benchmarks services
8 from SiriusXM.
9 In prior proceedings, those adjustments
10 included so-called interactivity adjustments. In
11 this proceeding, as you'll hear, it would entail, in
12 addition, adjustments to account for different music
13 intensity of the respective services, as well as the
14 different relative contributions made in offering
15 their products to consumers, most notably here, the
16 fact that SiriusXM uniquely provides not only
17 content, but the platform to deliver the content, in
18 contradistinction to any benchmark service. It's
19 absolutely imperative that adjustments be made to
20 account for that major reality.
21 Now, while SoundExchange can be expected
22 to attack these agreements as nonrepresentative

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1 outliers and as reflecting fees well below fair
2 market value, they really suffer neither
3 shortcoming.
4 The quality and breadth of the music
5 catalogs directly licensed can't be seriously
6 disputed.
7 You'll hear from Mr. Gertz of an
8 organization called Media Reports, Inc., who was
9 associated with the effort to secure these licenses
10 and who is, himself, deeply experienced in the -- in
11 the business, indicating that -- if you turn to the
12 next two demos, please -- that these agreements
13 cover all genres of music from jazz to punk, from
14 children's music to metal, from Broadway show tunes
15 to hip-hop; and next demo, cover GRAMMY nominated
16 and other award-winning artists and works of which a
17 sample are set forth on your demonstrative; cover
18 works regularly featured on SiriusXM service; and
19 are with some of the most sophisticated and
20 important independent record labels.
21 As for the assertion that the royalty
22 levels in these agreements are below previously

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1 prevailing levels and, therefore, must not reflect
2 fair market value of these rights, that's the funny
3 thing about actual competition; it drives prices
4 down to competitive levels.
5 Now, this is obviously an uncomfortable
6 reality for our friends at SoundExchange and its
7 members, which have really never had to confront
8 competition nor deal with evidence of this caliber.
9 Directly contrary to SoundExchange's
10 supposition, Dr. Noll's testimony describes how
11 SoundExchange's presence in the market, the tendency
12 of otherwise competing record labels to band
13 together to license only through that collective or
14 only at license fees that result from a proceeding
15 such as this distorts the competitive process in a
16 way that leads to fees above competitive norms.
17 Now, this fear of competition and
18 concern over the highly probative value that such
19 direct licenses would have in this proceeding led
20 SoundExchange to decide not simply to challenge
21 these direct licenses in this hearing room, but,
22 instead, to mount a feverish campaign within the

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1 record industry to limit the success of these direct
2 licensing efforts.
3 As Messrs. Frear and Gertz will testify,
4 beginning days after the launch of the direct
5 license initiative, first, SoundExchange, then a
6 series of other record industry trade groups began
7 an orchestrated campaign aimed at discouraging
8 record labels from entering into such agreements.
9 This messaging is apparent from candid
10 communications between and among SoundExchange
11 employees, board members of SoundExchange and
12 third-party record company executives. But a sample
13 of these is set forth on the next demonstrative.
14 Because these reflect information
15 produced in restricted documents, I'll let
16 Your Honors read these privately. I'm not going to
17 read them in the open hearing room, but they speak
18 volumes as to the mindset.
19 And, incidentally, the reference in the
20 first of these to MRI, as I mentioned, is a
21 shorthand for Mr. Gertz' Media Reports, Inc.
22 organization.

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1 Now, in addition to these private
2 communications, SoundExchange also went public with
3 its disdain for the direct licenses. In a statement
4 released on August 11th of 2011, which appears as
5 Exhibit 10 to Mr. Frear's written direct
6 testimony -- that's just days after the initial
7 mailing starting the direct licensing program --
8 SoundExchange advised these potential licensees that
9 it was, quote, planning to seek a substantial
10 increase in the statutory rate; in other words, we
11 plan to seek rates well in excess of the 2012 rate
12 of 8 percent, closed quote.
13 The statement went on to assure the
14 industry that, quote, it should expect to see a
15 significantly increased statutory rate and hammering
16 home the importance of not breaking ranks by signing
17 the direct licenses.
18 The statement concluded by pointedly
19 observing, quote, Privately negotiated licenses in
20 the marketplace may play a very significant role in
21 the outcome, unquote, of this proceeding.
22 Now, SoundExchange continues to resist

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1 discovery into their communications on this topic
2 with other industry groups for good reason. A
3 barrage of obviously coordinated communications on
4 message with SoundExchange's exhortations soon
5 followed. Five occurred in one 24-hour period by
6 five different organizations.
7 Their messaging included, quote, It is
8 in your interest to refrain from direct licensing,
9 unquote, from the Recording Academy; quote, We are
10 more powerful collectively than we are separately,
11 unquote, from the Future of Music Coalition.
12 I offer this summary at this point,
13 Your Honors, to suggest that the foregoing conduct
14 should give Your Honors more than a bit of pause as
15 you consider what surely will be SoundExchange's and
16 its expert's efforts here and in the rebuttal phase
17 to denigrate and knock down the probative value of
18 the direct license benchmark.
19 In the interest of time, I'm going to
20 skip, except make passing reference to the fact that
21 there is interesting precedent in parallel with the
22 evidence that we are proffering as to direct

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1 licenses here.
2 I simply refer Your Honors to several
3 litigations in which a company called DMX litigated
4 in the ASCAP and BMI so-called rate courts, where
5 the standard, similarly, is reasonable fees and
6 used, there, similar evidence of their going into
7 the marketplace, in that case, dealing directly with
8 music publishing companies rather than with the
9 collectives for the music performing rights.
10 And two District Court opinions, one by
11 Judge Cote in Southern District New York, another by
12 Judge Stanton in Southern District New York,
13 affirmed the strong probative value of that direct
14 license evidence in formulating what was an
15 appropriate blanket fee. And we would urge that
16 parallel consideration here on the facts in this
17 record will be warranted.
18 Now, a few more words about Dr. Noll's
19 corroborating benchmark --
20 JUDGE WISNIEWSKI: Before you get to
21 that, Mr. Rich, if I can interrupt with a question.
22 I'm not quite following the flow of your

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1 argument here with respect to this interference with
2 the direct license initiative.
3 As I understand it, your position is
4 that the direct licenses that you're offering are,
5 in fact, representative.
6 MR. RICH: Yes.
7 JUDGE WISNIEWSKI: If that is so, then
8 why do we care about this interference? The
9 argument there would be that they are not
10 representative.
11 MR. RICH: We're certainly arguing
12 they're representative. And you'll hear at length
13 from Dr. Noll and you've read from Dr. Noll why we
14 believe they are.
15 We also fully anticipate from the other
16 side, however, the argument that they're two few,
17 they're too small, they're outliers, they're just a
18 handful, they're a small percent of the market. And
19 what we're suggesting very strongly is that while we
20 don't think, to your point, that should affect
21 this -- Your Honors' judgments about the adequacy of
22 the group we have, we think it's self-evident that

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1 there would have been significantly more such
2 licenses for Your Honors' consideration, but for the
3 activity here.
4 JUDGE WISNIEWSKI: If we had so many
5 more licenses, would they be more representative?
6 That's the question that I'm asking.
7 MR. RICH: Without seeing them, it would
8 be very difficult -- that's a hypothetical I have
9 trouble responding --
10 JUDGE WISNIEWSKI: So do I.
11 MR. RICH: But that's the
12 straightforward answer to your question.
13 JUDGE WISNIEWSKI: Thank you.
14 MR. RICH: Now, while the direct
15 licenses constitute the best evidence of competitive
16 market rates for rights being priced in this
17 proceeding, Dr. Noll will describe another set of
18 agreements negotiated in the marketplace that we
19 submit are corroborative of the direct license
20 evidence and provide further support for our
21 client's rate proposal.
22 And these are agreements between the

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1 major record companies and noninteractive customized
2 Internet radio services.
3 It's important that Your Honors
4 understand the nature of these services, as well as
5 a second category of services, so-called interactive
6 services, which I adverted to earlier, which is the
7 category of services from which SoundExchange, once
8 again, has constructed its own benchmarking
9 analysis.
10 You'll hear from a variety of our
11 witnesses, including Dr. Rosenblatt and Mr. Meyer,
12 about the nature and development and competitive
13 impact of these various services in brief.
14 But let me just describe the essential
15 attributes and distinctions between these two
16 categories, which is very central to your
17 consideration of the competing rate proposals.
18 Noninteractive radio services, similarly
19 to SiriusXM and to traditional radio, do not allow a
20 user to choose the music tracks that he or she hears
21 beyond, perhaps, identifying the particular genre of
22 music or a decade of music.

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1 In some cases, such as the popular
2 Pandora, the user may be able to identify a favorite
3 artist or a favorite song or indicate likes or
4 dislikes, and the service will build a
5 noninteractive playlist of songs reflecting that
6 user input. But the service will not allow the user
7 to listen to the specific referenced artist or
8 tracks on demand, that is to say, whenever and as
9 often as the user wants to listen to those tracks.
10 These services, other examples of which
11 Last.fm and Slacker, are sometimes referred to as
12 lean back services to distinguish them from lean
13 forward interactive services, a term that captures
14 the fact that users of those services actively
15 choose the tracks that they wish to listen to.
16 As various of our witnesses will
17 describe, these lean back services, that is, the
18 noninteractive services, are direct competitors to
19 our client in the car in a way that was not the case
20 five years ago when the record in the prior
21 proceeding was established.
22 In the Satellite One proceedings the

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1 terrestrial radio, the chief competition, came from
2 so-called lean forward playback options. CDs, MP3s
3 downloaded to iPods and plugged into a car's audio
4 jack, tracks from portable subscription services
5 ported to devices and plugged into car stereo.
6 Now, in contrast, webcasting services,
7 like Pandora, Slacker, Last.fm, are all available
8 streamed to smartphones over 3G and 4G networks,
9 including in cars, where they can be connected
10 directly to the audio system. Pandora, for example,
11 is already seamlessly integrated into the dash in
12 systems offered by Toyota and Ford.
13 Over the period of this license term,
14 you will hear, automobile manufacturers will be
15 making huge strides in so-called connected car
16 technology with the result that SiriusXM
17 increasingly will be faced with low-cost competitive
18 offerings of both music and nonmusic programming in
19 vehicles either for free or at very low and,
20 therefore, very highly competitive to SiriusXM
21 prices.
22 Now, to the extent that such

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1 noninteractive services otherwise observe
2 Section 114's limitations to qualify for statutory
3 licenses, they are, no differently than our client,
4 entitled to operate under such licenses, and a
5 number do so.
6 Some such services, however, also
7 include features that exceed what is allowed under
8 the 114 license, such as unlimited skipping,
9 preannouncement of songs, and even caching of
10 channels. And because of these features, the
11 services have negotiated voluntary licenses with the
12 record companies.
13 Let me pause. I know a lot of these
14 terminology, even for me, are inside baseball. You
15 will have ample time, I would hope and expect, with
16 some our witnesses if you have any specific
17 questions about the technology.
18 I'm probably the wrong person to ask,
19 but we have some right people you can ask on the
20 stand, such as Mr. Rosenblatt.
21 Now, what about the interactive
22 services? The so-called interactive services, a

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1 category familiar to Your Honors from the prior
2 proceedings, include services like Rhapsody,
3 Napster, Spotify, MOG, Rdio, and they offer
4 significantly different functionality.
5 Most important, they're fully on demand,
6 meaning a user can listen to any song he or she
7 wishes whenever he or she wants and as many times as
8 he or she wants to listen.
9 In this sense, they stand as a total
10 substitute for the need to purchase the CD or
11 download a track, particularly when on-demand
12 streaming is now available on Internet-connected
13 portable devices, like smartphones.
14 The labels recognize this. Dr. Noll
15 discusses major label digital strategy documents
16 that recognize the high level of, quote,
17 cannibalization, unquote, caused by such interactive
18 services for the sales of albums and tracks.
19 SiriusXM, by contrast, is acknowledged
20 in other research conducted among others by the RIAA
21 to stimulate music purchases.
22 Now, Dr. Noll will describe why the

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1 voluntary agreements between noninteractive Internet
2 radio services, such as Last.fm, provide a good test
3 for the reasonableness of the rates of the SiriusXM
4 direct licenses and why these proxies serve as a far
5 better alternative benchmark than do the agreements
6 entered into by interactive services, however
7 adjusted.
8 Very simply, these noninteractive
9 services, while still providing the user certain
10 features that allow more user input than does our
11 client's service, are still much closer in
12 functionality to the noninteractive genre- and
13 decade-based music channels found on SiriusXM than
14 are the fully on-demand services offered as
15 benchmarks by SoundExchange.
16 Given, in addition, that they are now
17 direct competitors in the car with SiriusXM, the
18 agreements entered into between such services and
19 individual record labels are informative, we submit,
20 of the ratemaking process.
21 As Dr. Noll explains, once properly
22 adjusted, there should be rate parity between these

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1 other licenses and any rate payable by SiriusXM,
2 less SiriusXM itself be competitively disadvantaged
3 in this head-to-head competition in the marketplace.
4 Dr. Noll's written direct testimony
5 describes a five-step process for applying rates
6 from these noninteractive agreements. And while I
7 give you a demonstrative that sets it forth, again,
8 because I'm running a bit long and because he will
9 be the next witness, I will spare you my
10 walk-through, because you're going to hear that
11 walk-through from the very same demonstrative in
12 several hours time, hopefully.
13 And so I have it here for you, but we'll
14 leave the details of how we get there to Dr. Noll.
15 Suffice it to say, as I indicated
16 earlier, that this process generates a bottom line,
17 once properly adjusted, very close to the outcome of
18 the direct licenses.
19 I do want to say one -- I do want to
20 speak about one aspect of the adjustment process,
21 which is critical. I want to come back to the
22 distinction which must be accounted for in dealing

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1 whether with an interactive service of the type that
2 Dr. Ordover promotes or with a noninteractive
3 service of the type that Dr. Noll alternatively
4 promotes. And that is to account, again, for the
5 basic difference in the package of product and
6 services provided by the respective enterprises.
7 If you're looking at a Last.fm, it's
8 basically providing music format programming to a
9 user. That user requires a device to listen to it
10 and an Internet device to connect to it, neither of
11 which is provided by Last.fm, each of which,
12 presumably, is the subject of a separate transaction
13 and purchase by the consumer.
14 When you subscribe to SiriusXM, you get
15 the platform and the content; you get their unique
16 distribution network; you get the receiver in the
17 car; you get the benefit of the satellite and
18 repeater network, the entire distribution system.
19 And so without making an adjustment to
20 account for that significantly greater cost and to
21 apply, let's say, a benchmark rate to the full
22 retail price of a SiriusXM, without making a basic

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1 adjustment to account for the fact that part of the
2 bundle of services is distinct and different and far
3 more costly to provide, then the benchmark service
4 would be extraordinarily inappropriate.
5 And Dr. Noll makes that adjustment in
6 ways he will describe and defend and, we assert, is
7 critical because, as you will also hear, Dr. Ordover
8 fails entirely to account for that phenomenon
9 working from his interactivity benchmark. And that
10 creates a major, major distortion, we would submit,
11 in the analysis.
12 Now, I turn briefly to a recap of a few
13 points from the SoundExchange -- from the
14 SoundExchange case. I mention that Dr. Ordover
15 falls back on the interactive licenses, and at one
16 level, that's not surprising.
17 In the recognition that these licenses
18 have a very significant potential to displace sales
19 and license fees because of their on-demand nature,
20 the fees that the record industry has been able to
21 garner from these agreements are extraordinarily
22 high. And, also, understandably, from the

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1 standpoint of SoundExchange, in its ruling in 2007,
2 this Tribunal, on the record they developed, found
3 that such a benchmark with adjustments was plausible
4 in setting a top end of the market estimate.
5 But as the record here will
6 demonstrate -- this is really critical -- a
7 tremendous amount has changed technologically and
8 competitively in the last five years. New Internet
9 services whose functionality is far more similar to
10 the music service component of our client are now
11 direct competitors of our client for music
12 listenership in the vehicles. That's what I just
13 discussed.
14 And like SiriusXM and unlike the
15 interactive services, these newer services are far
16 more likely to be promotional of record sales than
17 the interactive services, and not to mention, of
18 course, a major change, which is the direct license
19 evidence itself.
20 So we have a dramatically different
21 record here than you faced back in 2007.
22 Now, Professor Ordover, his primary

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1 analysis really ignores all of these realities. He
2 pays no heed at all to the new generation of
3 Internet competitors. And, in addition, while he
4 makes an adjustment account for the music/nonmusic
5 component of the respective services, which both
6 sides, you will see, agree is necessary, as I
7 indicated, he makes no adjustment whatsoever to
8 account for the much greater consumer value derived
9 from on-demand access for sound recordings, facts
10 which the record companies take into account when
11 they price these different categories of license
12 agreements.
13 He takes the rather astonishing position
14 that this reality requires no adjustment whatsoever
15 to the percentage rate to be applied to SiriusXM's
16 retail rates.
17 Ostensibly -- and that is you can just
18 ingraft the rate that's charged -- the percentage of
19 revenue that is charged for an interactive service,
20 just ingraft that onto SiriusXM's own retail rates
21 without further adjustment, ostensibly because these
22 various differences between the services will all be

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1 taken care of somehow in the different retail rates
2 they charge.
3 So, in other words, Professor Ordover's
4 primary modeling assumes that all matter of audio
5 music services will be charged the same percentage
6 of their retail revenue irrespective of the
7 different features they offer, the different
8 functionality they provide, or the actual or
9 perceived promotional or substitutional effects of
10 those services.
11 Now, that premise is just fundamentally
12 incorrect. It's incorrect as a matter of basic
13 economics. As Professor Ordover even had to admit
14 in his deposition in this case, it makes no sense
15 that the price of an input to a finished product
16 would invariably represent the same percentage of
17 the price of the final product. We know that's not
18 true.
19 And, as importantly, it's undermined by
20 the actual evidence you will have in front of you.
21 Agreement after agreement shows that the percentage
22 royalty rates paid for music vary depending on the

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1 service type and their level of interactivity.
2 There's simply no reason to believe that a
3 noninteractive service, like SiriusXM, would pay
4 some 60 percent of revenue for its music channels as
5 might and do some interactive services.
6 Now, if you turn to Demonstrative
7 Number 13, please.
8 I just want to cite and preview what
9 Dr. Noll will be highlighting, which is, for all of
10 the differences between the parties and the dramatic
11 differences in the fee consequences, this
12 demonstrative is really designed to show that there
13 are really two major aspects of the approaches
14 adopted by Professor Noll on the one hand and
15 Professor Ordover on the other that drive the
16 enormous bottom line differences.
17 Now, this is putting the direct license
18 experience for the moment to one side.
19 The first row, which is labeled
20 Benchmark Agreement, you will see, the very choice
21 of benchmark service in Dr. Noll's case, custom
22 radio services with the stated -- and I'm not going

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1 to read these into the record because one or more
2 aspects of these are also restricted -- with the
3 stated percentage of revenue rate versus interactive
4 music services itself drives, as you can see at the
5 very get-go, an enormous distinction. One is a more
6 than double nominal rate higher.
7 And while both Dr. Ordover and
8 Professor Noll, as I indicate, agree that you have
9 to make an adjustment from whichever benchmark
10 service to account for the fact that fully half --
11 or approximately half of our client's programming is
12 nonmusic, Dr. Noll performs the next necessary
13 adjustment, which Dr. Ordover does not, which is, as
14 I indicated, to account for the revenues associated
15 with the cost of providing the platform, not simply
16 the channel.
17 And as Dr. Noll will describe, when you
18 correct for those errors, you find that even under
19 Dr. Ordover's approach, the rates drop back out of
20 the stratosphere into the realm of the plausible.
21 And the last demonstrative here just
22 does the math setting forth for Your Honors' benefit

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1 and setting the stage for Dr. Noll's testimony
2 showing the consequences of just those two different
3 core assumptions driving the competing benchmark
4 analysis here.
5 MR. RICH: I have about 15 more minutes.
6 Would you like me to conclude?
7 CHIEF JUDGE BARNETT: We need to take a
8 five-minute recess. I know you're near the end. I
9 don't like to interrupt --
10 MR. RICH: It's a good breaking point.
11 CHIEF JUDGE BARNETT: -- but the court
12 reporter needs to zap her information off.
13 So we'll take five-minute recess.
14 (Whereupon, a brief recess was taken
15 from 10:54 a.m. to 11:01 a.m.)
16 CHIEF JUDGE BARNETT: Good morning,
17 again.
18 Please be seated.
19 Mr. Rich, are you ready to wrap up?
20 MR. RICH: Thank you, yes.
21 I want to spend a very few minutes
22 discussing SoundExchange's wildly optimistic

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1 portrait of our client's financial prospects.
2 I suggest that Your Honors, and urge
3 Your Honors to view much of that evidence under a
4 yellow flag of caution.
5 SoundExchange's counsel, previewing a
6 series of its witnesses, I'm sure, will stand up
7 here and describe how our client has turned the
8 corner financially, how much more robust it is today
9 than it was five years ago, and cite optimistic
10 statements by executives of our client about the
11 newfound health of the company and its prospects for
12 growth.
13 This may sound familiar to Your Honors.
14 Five years ago, in 2007, SoundExchange
15 put on the stand an expert by the name of
16 Mr. Butson, who forecasted confidently that Sirius
17 and XM, the separate companies then, would have a
18 combined 33 million subscribers by 2010.
19 In his view, this projected growth
20 justified rates as high as 23 percent of revenues by
21 the -- during the prior license term. Now, how did
22 that work out? In fact, less than two years later.

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1 just three years ago, the now combined company was
2 literally hours from bankruptcy.
3 It averted that by -- only by giving up
4 40 percent of the company to the one investor,
5 Liberty Media, that offered a rescue package. It
6 was a very expensive rescue package. It carried a
7 15 percent rate -- payback rate, diluted the stake
8 of the existing shareholders by 40 percent, and it
9 was a hit that was compounded by a drop in
10 SiriusXM's stock price to a nickel a share.
11 The company's last annual report
12 disclosed that $100 invested in SiriusXM five years
13 earlier was worth only $55 as of December 31, 2011;
14 actual subscribers in 2010, 20 million, more than a
15 third fewer than predicted by Butson, 3-1/2 million
16 of whom are on promotional trial subscriptions.
17 Revenue and cash flow in 2010,
18 42 percent and 58 percent respectively below
19 Mr. Butson's predictions.
20 The analysts from that period fared no
21 better. Morgan Stanley, whose projections are
22 relied on this time around by SoundExchange, made

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1 similar massive miscalculations. Forecasts in 2006,
2 '7 and '8 predicted that our client would have
3 between 25 and 35 million subscribers in 2010.
4 And there were similar dramatic
5 overestimations of revenue by Morgan Stanley, as
6 more fully described in Mr. Stowell's testimony.
7 Total new car sales, which now, as
8 you've read, are really the drivers of our client's
9 business, plummeted to levels not seen since the
10 early '80s.
11 The company is still saddled with
12 $2.4 billion in debt coming due in the 2013-2015
13 period. The company still has a junk credit rating.
14 Despite its forecasting failures last
15 time around, SoundExchange is back once again
16 claiming the sky is the limit on what our client can
17 afford -- can afford 57.8 percent, ostensibly --
18 based largely on Morgan Stanley projections that
19 have proven wrong time and again.
20 I submit that the lesson of the current
21 rate period is that caution is warranted in reading
22 these projections. As explicated by

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1 Professor Stowell, experience of the past five years
2 on its own should counsel caution in adopting
3 SoundExchange's prognostications about SiriusXM's
4 prospects.
5 Professor Stowell will explain that,
6 based on various considerations, including the
7 company's tumultuous history and recent brush with
8 bankruptcy, the ongoing uncertain global economic
9 climate, increased dependence on the automobile
10 industry, and an increasingly robust competitive
11 landscape which is likely to continue to gain
12 momentum throughout the next license period,
13 SiriusXM faces a threat of disruption that is equal
14 to or greater than that which it faced during the
15 Satellite I proceeding.
16 Professor Stowell's testimony explains
17 that the royalty that SiriusXM is required to pay
18 SoundExchange has a large impact on its bottom line
19 finances and any increase to the royalty rate would
20 substantially increase the likelihood of such a
21 disruptive impact on the company.
22 Additional testimony from other

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1 executives of the company and experts will amplify
2 on some of these considerations. James Meyer, who
3 is SiriusXM's president of operations and sales,
4 will provide an overview of the business, the
5 competitive landscape in which the company is
6 operating, the importance of the OEM market, and the
7 company's continuing investments and innovations in
8 its technological infrastructure.
9 Mr. Meyer will testify how SiriusXM has
10 become increasingly dependent on the OEM market and
11 how this dependence, combined with the global
12 economic conditions and numerous other challenges,
13 makes its projected financial health during the 2013
14 to 2017 period far from certain.
15 One such salient factor which Mr. Meyer
16 will focus on is the increasingly robust technology
17 in the market today, which has fostered development
18 of strong competition from new Internet-based audio
19 content providers of the type I discussed briefly
20 earlier.
21 Mr. Meyer will describe in greater
22 detail the way in which these low priced, in some

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1 cases, free competitors, whose cost structures
2 diverge widely from the companies will be SiriusXM's
3 primary challenge during the 2013 to 2017 licensing
4 period.
5 Mr. Rosenblatt, as I mentioned, who is
6 president of GiantSteps Media Technology and a
7 technology industry veteran and expert in the field
8 of digital music services, will corroborate
9 Mr. Meyer in identifying important trends in the
10 digital audio entertainment marketplace that were
11 largely unforeseen at the time of the prior
12 proceeding, and which, together, would dramatically
13 increase the range and scope of competition facing
14 SiriusXM in the coming license period.
15 In turn, SiriusXM's CEO, Mel Karmazin,
16 and its chief financial officer, David Frear, will
17 testify that although encouraged by the company's
18 recent profitability and optimistic about the
19 company's prospects in the near term, SiriusXM's
20 future is far from clear.
21 Mr. Frear will point out that while the
22 company's financial performance has improved, it

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1 will take years to recoup nearly 20 years of losses
2 experienced by the company; as I mentioned,
3 $5.5 billion in negative cash flow, $8 billion in
4 net operating losses.
5 He'll also describe the aggressive cost
6 cutting the company has engaged in across other
7 areas of its operations, and notably, including its
8 other programming and its -- its marquee exclusive
9 programming, it has dramatically reigned in the
10 costs there and views its obligations here no
11 differently, part of which was the impetus to pursue
12 the competitive licensing paradigm in the
13 marketplace for sound recording performing rights.
14 Mr. Karmazin will explain why, in light
15 all of these considerations, an increase in the
16 royalty rate from the existing level, let alone of
17 the magnitude sought by SoundExchange, is
18 unwarranted.
19 Next-to-the-last topic, where do the
20 801(b) factors fit into the mix here?
21 I'm going to preview what our witnesses
22 are going to say on some of these factors.

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1 I indicated analytically that even when
2 Your Honors are working with marketplace benchmarks,
3 to the extent Your Honors were to find that one or
4 more of the Section 801(b) factors favors SiriusXM
5 here, this may well lead you to temper those
6 marketplace points of reference when you set a
7 reasonable fee.
8 Now, Professor Ordover concedes at a
9 minimum, one would need to inquire as to the
10 relative impact the 801(b) factors would have as
11 applied to benchmark services that one or another
12 party cites on the one hand, and SiriusXM on the
13 other, to assess their comparability and make any
14 appropriate adjustments. Yet, he hasn't attempted
15 to do that. He simply assumes there are no
16 adjustments necessary.
17 In contrast, Dr. Noll and
18 Professor Stowell do explicitly discuss the impact
19 of 801(b) factors on the process here.
20 Factor 1 is availability. Satellite I,
21 the Judges found a lack of persuasive evidence
22 favoring either side concerning the net promotional

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1 or substitutional effect of SiriusXM's performances
2 of sound recordings.
3 In this proceeding, another one of our
4 witnesses, Steven Blatter, who is the senior vice
5 president and general manager of music programming
6 for SiriusXM, will provide much more detailed
7 evidence attesting to the promotional benefits of
8 satellite radio for artists and record companies.
9 Mr. Blatter will describe how the direct
10 impact of airplay on SiriusXM on the sale of
11 recorded music is substantially greater than it was
12 when he testified in the previous proceeding and how
13 those promotional benefits are valued by recording
14 artists, artists' managers and record companies.
15 Notably, for the first time in a CRB
16 proceeding, he'll present data from Soundscan and
17 Mediabase, industry standard reports of sales and
18 airplay data, demonstrating that plays on SiriusXM,
19 in circumstances where SiriusXM is the only
20 broadcaster featuring a particular track, often
21 leads directly to increased purchases or downloads
22 of that track and that recording artists routinely

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1 recognize and credit our client for that impact.
2 This testimony and evidence will be
3 supplemented by evidence out of the record
4 industry's own files attesting to the promotional
5 effects of the satellite radio versus the
6 substitutional effects that I mentioned of on-demand
7 services.
8 Second factor, fair return.
9 As I mentioned, SoundExchange premises
10 much of its rate proposal on predictions as to
11 SiriusXM's profitability in the upcoming license
12 term.
13 As both company witnesses, including
14 Mr. Karmazin and Mr. Frear, and experts like
15 Professors Noll and Stowell will explain, that
16 approach ignores enormous investments on the part of
17 SiriusXM and its predecessor companies to get to the
18 point where it actually can begin to reward that
19 investment, not least of which is the accumulated
20 net operating losses of $8 billion.
21 In SoundExchange's view, the billions in
22 investments and losses which SiriusXM and its

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1 stockholders endured for years in an effort to
2 create a profitable enterprise should simply be
3 ignored when it comes to rewarding the record
4 companies.
5 This supposition, we would submit,
6 ignores how real markets operate, ignores
7 expectations of investors, and simply constitutes
8 bad public policy.
9 It's also ironic. One of the listed
10 witnesses for the other side, Charles Ciongoli, who
11 was, until very recently, apparently -- I think he's
12 now changed his position -- the chief financial
13 officer of Universal Music Group, one of the giants
14 in the field, acknowledged at his deposition the
15 basic tenet that Universal Music Group should be
16 able to, quote, recoup our investments and to earn
17 an appropriate return on invested capital, unquote.
18 We agree. No differently than a major
19 record company is entitled to recoup its long-term
20 investments, rates should be set here so as to
21 enable SiriusXM to do the same.
22 Professor Stowell demonstrates how

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1 adoption of SoundExchange's conception of
2 marketplace rates jeopardizes that opportunity.
3 Factor 3, relative contribution.
4 I've discussed this. You'll hear from
5 Dr. Noll further about the importance of this
6 element applied to the adjustments necessary to the
7 respective benchmarks.
8 Again, SiriusXM's contribution to the
9 service offered to consumer is far more encompassing
10 than that of any of the benchmark services and
11 requires recognition in terms of the -- the process
12 and -- and backing out costs and/or other
13 adjustments to account for that, which Dr. Ordover
14 simply ignores.
15 Factor 4, disruption.
16 I think I've said enough about it in
17 terms of -- of the prospects of it.
18 And -- and let me end very briefly with
19 a few words about the revenue definition that I
20 mentioned at the outset.
21 SoundExchange, as part of its case,
22 proposes a radical change to the governing revenue

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1 definition to which any percent of revenue fee would
2 here be applied. The effect of it would be to
3 eliminate deductions for revenue that's totally
4 unrelated to performances under the statutory
5 license, including different categories of
6 performance, webcasting -- not under this license --
7 works in the public domain, like pre-1972 sound
8 recordings. Those would all go by the boards.
9 Those would all be compensable as if they were
10 protected under this statutory scheme and/or under
11 copyright law.
12 As importantly, the effect of that
13 proposed revenue definition would be to make
14 impossible realizing the economic benefits of any
15 direct licenses. Under the current statutory
16 definition, when SiriusXM reaches terms on a direct
17 license and performs music coming under the catalog
18 of the direct licensors, it takes a deduction so as
19 not to double pay with respect to those
20 performances.
21 Logically, it wouldn't pay once to the
22 individual label and only to pay a second time to

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1 that label indirectly through SoundExchange, which
2 would then presumably distribute it again. And the
3 current regulations allow and definitions allow that
4 process. SoundExchange would cut that off
5 completely.
6 We don't think it's accidental. We
7 think it's part of the broader fabric of concern
8 over the direct licenses, and when we get to that
9 aspect of this case, we will urge Your Honors to
10 maintain the current definition in place so as,
11 among other reasons, not to encourage and allow
12 SoundExchange to frustrate the intended economic
13 benefits of the direct licenses.
14 In conclusion, Your Honors, thank you
15 for your patience.
16 We urge Your Honors at the end of the
17 proceeding to reject SoundExchange's rate case and
18 instead adopt the rates suggested by the direct
19 license evidence proposed by our client.
20 Thank you very much.
21 CHIEF JUDGE BARNETT: Thank you,
22 Mr. Rich.

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1 Good morning.
2 MR. FAKLER: Good morning, Your Honors.
3
4 OPENING STATEMENT ON BEHALF OF MUSIC CHOICE
5
6 MR. FAKLER: Again, good morning,
7 Your Honors. My name is Paul Fakler. I'm with the
8 firm of Arent Fox. I have with me my colleagues,
9 Martin Cunniff, Matthew Trokenheim, and we're here
10 today representing Music Choice in connection with
11 the adjustment of rates for the preexisting
12 subscription services, or the PSS, as we like to
13 shorten it.
14 CHIEF JUDGE BARNETT: Could you spell
15 your last name for me?
16 MR. FAKLER: It's Fakler, F-A-K-L-E-R.
17 CHIEF JUDGE BARNETT: Thank you.
18 MR. FAKLER: So, yes, we do like to
19 shorten it as PSS because we find that P-S-S, being
20 PSS, would be a little distracting. So we call them
21 PSS. And the PSS are a fundamentally unique digital
22 music services among all the digital music services,

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1 and for a number of reasons, but that uniqueness has
2 an impact or a bearing on the rate setting.
3 So I'd like to start by discussing
4 briefly the history of the PSS and the compulsory
5 license.
6 The PSS story is a bit different than
7 the story of the SDARS who entered the market years
8 after the PSS did and, in fact, after there was
9 already a public performance right for sound
10 recordings, which was not true at the time
11 Music Choice entered the market.
12 And the PSS were three -- now they've
13 dwindled to two -- companies who essentially
14 invented the digital music service. They did this
15 by coming up with a commercial-free radio product
16 that was transmitted to consumers in their homes
17 through their cable and satellite television
18 service.
19 But in order to consider the history of
20 the PSS and the reasons for the compulsory license,
21 one has to look at the legal and licensing landscape
22 that was in place at the time that Music Choice

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1 launched its service.
2 Prior to 1972, sound recordings were not
3 protected by Federal copyright whatsoever. In 1972,
4 when Congress did extend copyright to sound
5 recordings, they withheld the public performance
6 right. All of the other exclusive rights were
7 granted to sound recordings, but the public
8 performance right was withheld.
9 And because of that, broadcasters and
10 other companies that publicly perform sound
11 recordings still did not have to get a license or
12 pay royalties to the record companies.
13 And it was in that context that
14 Music Choice developed and launched its service.
15 The service was developed in the late '80s, launched
16 by 1991, and, in fact, was being transmitted to
17 customers throughout the country for years before
18 there was, in fact, a public performance right for
19 sound recordings. That happened in 1995 with the
20 passage of the DPRA.
21 But when Congress did, for the first
22 time, create this limited digital performance right

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1 and this new revenue stream for record companies,
2 they also implemented a compulsory license. And
3 that's the compulsory license we're here about
4 today.
5 And the legislative history of the DPRA
6 is very clear that one of the purposes -- one of the
7 purposes for instituting the compulsory license was
8 specifically to ensure it would remain economically
9 feasible for the few existing pioneers at that time,
10 like Music Choice, to continue already existing
11 operations.
12 And to that end, Congress chose to
13 implement a policy-based standard for setting the
14 royalty rate rather than a marketplace willing
15 buyer/willing seller standard, which they certainly
16 could've done and was in place for certain other
17 statutory licenses.
18 But they purposely chose this
19 policy-based factor that takes into account things
20 like the financial viability of the licensed
21 service, disruption to the industry of the licensed
22 service and the like.

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1 When -- fast-forward to 1998 and the
2 DMCA, or the Digital Millennium Copyright Act, at
3 that point, with the advent of the Internet, and it
4 started to become clear there were likely going to
5 be all sorts of other wonderful digital music
6 services coming down the pike. The record labels
7 went to Congress, and they persuaded Congress to
8 say -- to change the rate-setting standard to a
9 marketplace standard of willing buyer/willing
10 seller.
11 But at the same time, Congress chose to
12 grandfather the preexisting services, and allow them
13 to continue to have this policy-based rate instead
14 of moving them to a marketplace rate.
15 And, again, the legislative history in
16 the DMCA uses almost identical wording to that in
17 the DPRA, saying that the reason for the
18 grandfathering was to prevent the disruption of the
19 existing operations of the PSS.
20 Now, when it suits SoundExchange's
21 tactical purposes, they acknowledge all of this.
22 Five years ago, when there was at least the

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1 beginning of a PSS proceeding, SoundExchange went to
2 the Register of Copyrights and requested a ruling
3 that the PSS designation would be strictly limited
4 to the three companies that were in business at the
5 time of the passage of the DMCA.
6 And in their briefing to the Register of
7 Copyrights, they noted -- they said the reason for
8 the grandfathering was to protect the legitimate
9 business expectancies of the preexisting services.
10 And the Register agreed. She issued a decision that
11 did limit the applicability of PSS status to those
12 three companies.
13 And in her decision, she noted that the
14 purpose of the grandfather was to protect the PSS in
15 recognition that, as pioneers, they had invested a
16 great deal of resources in developing services and
17 deserved to continue developing the services under a
18 policy-based standard that allowed for below-market
19 rates.
20 She went on to also note that
21 grandfathering provisions are frequently included in
22 statutes to ensure continuity and to award the

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1 investment and efforts of those who were the first
2 to take on the struggles and risks of novel
3 enterprises and methods. And that description
4 certainly describes the PSS, the very first digital
5 music services back before it was hip or cool.
6 Now, there is a certain amount of
7 precedent in 801(b) rate-setting proceedings that
8 you can look to for certain general principles that
9 should apply, and particularly that discuss the
10 relationship between a policy-based rate and a
11 market rate.
12 And it's clear from looking at the
13 appellate precedent that the 801(b) rate-setting
14 standard is a very different exercise than just
15 setting a market rate.
16 It requires more judgment on the part of
17 the Judges because you were called upon to implement
18 these policy factors dictated by Congress, and it
19 really can't be short-circuited by some sort of just
20 mathematical formula. The D.C. Circuit itself noted
21 that an 801 royalty must be set to achieve the
22 policy objectives and not as the result of a

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1 rigorous mathematical derivation.
2 And it's also clear the appellate
3 decisions have held time and time again that the
4 policy rate under 801(b) is not a market rate.
5 Perhaps the most important appellate guidance that
6 could be of help to the Judges are the two appellate
7 decisions from the first PSS rate-setting
8 proceeding. The PSS were not only the first digital
9 music services, they were also the first digital
10 music services to have their rates set pursuant to a
11 proceeding.
12 And in that proceeding, initially, there
13 was a CARP convened that issued a decision, and that
14 decision was appealed to the Librarian of Congress
15 who, for the most part, overturned the CARP, and the
16 Librarian did his own analysis and issued a new rate
17 decision.
18 And at that first level of appellate
19 review, the Librarian specifically rejected the
20 argument made by the RIAA at the time, that the PSS
21 rate had to be consistent with market rates. The
22 Librarian said that the PSS rate need not mirror a

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1 freely negotiated marketplace rate and rarely does,
2 because it is a mechanism whereby Congress
3 implements policy considerations which are not
4 normally part of the calculus of the marketplace
5 rate.
6 So the Librarian recognized that any
7 notion that one can short-circuit the policy factors
8 by claiming that these various policies are already
9 baked into a marketplace rate, the Librarian
10 directly rejected that concept.
11 The Librarian's decision was appealed to
12 the D.C. Circuit, and on the rate portion with
13 respect to the methodology and the result, it was
14 affirmed completely.
15 And, once again, the D.C. Circuit
16 similarly rejected this argument by the RIAA about
17 marketplace rates.
18 Holding that the RIAA's claim that the
19 statute clearly requires the use of market rates is
20 simply wrong, the PSS standard, it held, does not
21 use the term "market rates," nor does it require
22 that the term "reasonable rates" be defined as

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1 market rates. Moreover, there is no reason to think
2 that the two are coterminous, for it's obvious that
3 a market rate may not be reasonable and vice versa.
4 Another general principle that can be
5 abstracted from these appellate decisions are that
6 to the extent that a market rate is considered in
7 setting the PSS rate, it can only be used to
8 determine the upper bounds of a possible reasonable
9 rate under the policy factors. The D.C. Circuit
10 specifically held that an above market rate can
11 never be a reasonable rate under 801(b).
12 Now, that's not to say that marketplace
13 evidence can't be considered in setting the policy
14 rates. That's also very clear from the precedent.
15 But they have to be used as points of reference that
16 are weighed along with the evidence that go directly
17 to the policy factors in order to set a reasonable
18 rate. It's also clear from the precedent that not
19 just any marketplace evidence can be considered.
20 Various precedent, including previous
21 decisions of the Copyright Royalty Judges, have
22 repeatedly held that in order for a marketplace

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1 license agreement to be used as a benchmark, it must
2 be an agreement for a comparable music service.
3 In the Section 115 mechanical
4 rate-setting proceeding, the last one, the one that
5 didn't settle, the Judges rejected a number of
6 benchmarks that were offered precisely because the
7 benchmark -- the proposed benchmark markets were not
8 comparable to that of the target market for the rate
9 being set.
10 Even more importantly, five years ago in
11 the last SDARS proceeding, the SDARS wanted to use
12 Music Choice as a benchmark to set their rate.
13 SoundExchange objected to this strenuously and put
14 on significant economic evidence demonstrating that
15 the market for the PSS -- the Music Choice,
16 essentially, because it's the -- almost the only
17 player left in the PSS market -- but that that
18 marketplace was radically different in all of the
19 key, most important ways that you would need to try
20 to adjust for a comparable benchmark, the demand --
21 the demand characteristics, the value, the way that
22 users use the service, all of these things were so

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1 radically different that it was noncomparable in any
2 way, could not be used as a benchmark. And
3 Your Honors agreed and rejected that as use for a
4 benchmark.
5 So it's clear from all of this that to
6 be a usable benchmark, if you're using a license
7 agreement for another music service, those services
8 have to be comparable, at least in a way that can be
9 adjusted for, but which is the difference between
10 comparable versus identical.
11 With those general principles in mind,
12 I'd like to talk a little bit about Music Choice's
13 case, which is consistent with this precedent.
14 And I would also like to talk about
15 SoundExchange's case, which it completely ignores
16 these principles and precedent and, in fact, defies
17 them.
18 For its case, Music Choice presents the
19 testimony -- the fact testimony of David Del Beccaro
20 and Damon Williams.
21 Mr. Del Beccaro is the president and CEO
22 and founder of Music Choice. It was his idea, back

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1 when he was working for Gerald Communications, to
2 launch a service like Music Choice. He helped put
3 together the investors. I believe he worked on some
4 of the original technology involved in bringing it
5 to market, and he's managed the company ever since.
6 Mr. Williams is the vice president of
7 programming and content development for
8 Music Choice. He's got 30 years of broadcast
9 programming experience.
10 Now, as Mr. Del Beccaro testifies, the
11 PSS, as I mentioned before, were the very first
12 digital music services. And they were the first to
13 have their rate set in a proceeding.
14 And Mr. Del Beccaro describes the
15 process through which the rate was initially set.
16 And that was, again, initially in a CARP, that rate
17 was changed by the Librarian of Congress on appeal,
18 and that was then upheld by the D.C. Circuit.
19 And because of this rigorous level of
20 appeal, the Librarian of Congress' decision provides
21 a very significant and useful roadmap for setting
22 the rate for the PSS. Indeed, the Librarian of

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1 Congress, in that decision, noted that a reasonable
2 way for the rate to be adjusted in the future would
3 be to essentially just take into account changes in
4 circumstances that occur during the period, and that
5 either side could use that to argue to have the rate
6 lowered or raised.
7 In order to describe the Librarian of
8 Congress' decision, I think it would be helpful just
9 very briefly to talk about some basics in music
10 licensing, and particularly the difference between
11 the sound recording copyright and the musical work
12 copyright.
13 A sound recording, in copyright
14 parlance, is a -- is a classic derivative work. And
15 what that means is that to create a sound recording,
16 the recording artist takes a preexisting work, the
17 song, which was written by a songwriter or a
18 composer, and then adds some creativity to it to
19 create a new work based on the preexisting work.
20 And in the case of a sound recording, the performing
21 artist gives their specific rendition of the
22 preexisting song, and that is captured and wrapped

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1 up, along with the song, into the sound recording.
2 Musical work or composition performance
3 rights are administered in the United States by what
4 are called performing rights organizations, ASCAP,
5 VMI (verbatim) and SESAC, and those bodies issue
6 blanket license for any sort of business that wants
7 to publicly perform these songs, typically in the
8 context of also publicly performing the sound
9 recordings.
10 The Librarian of Congress principally
11 relied on the PSS' PRO license as the marketplace
12 evidence that it used to set the PSS rate, finding
13 no evidence in that proceeding that the sound
14 recording performance right in the context of a
15 performance-based service would be worth any more
16 than the musical works right.
17 Now, the Librarian of Congress
18 recognized that these were two different copyrights,
19 technically. But the Librarian also recognized they
20 were certainly related, and that they were really
21 intertwined within the product or the -- or the
22 recording that Music Choice and the other PSS were

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1 using.
2 The Librarian also recognized that, you
3 know, the exact same copyright was being licensed in
4 the sense of the public performance right, as
5 opposed to any of the other exclusive rights, and
6 that it was a license for the PSS, which were, at
7 the time, as they still are, very unique services.
8 So those licenses took into account
9 these odd things that wouldn't be able to be
10 adjusted for with respect to other licensed
11 services.
12 Now, all of this is still true today. I
13 mean, the bottom line is even SoundExchange's
14 witnesses agree that the PSS are completely unique,
15 that there are no comparable music services, there
16 is no marketplace evidence related to a service that
17 is comparable. Their witnesses say it, as well as
18 our -- ours do.
19 So the Copyright Royalty Judges are
20 essentially in the same position that the Librarian
21 was back then as far as benchmarks. It's really the
22 only game in town. And, of course, as it was used

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1 and upheld on two levels of appeal, certainly it's
2 acceptable to use that as a benchmark.
3 Now, Music Choice recognizes in some
4 prior proceedings, the Copyright Royalty Judges have
5 chosen not to use the musical works benchmarks to
6 set rates for other services, particularly
7 noninteractive webcasting and the SDARS. But, of
8 course, for both of those services, the Judges were
9 able to find a marketplace comparable, namely,
10 interactive webcasting, that the Judges found were
11 comparable and could be adjusted for and used as
12 benchmarks.
13 That is certainly not the case today.
14 As I mentioned, even SoundExchange
15 mentioned none of these services are comparable and,
16 in fact, in the SDARS decision last time when the
17 Judges said that Music Choice could not be used
18 because it wasn't comparable, all of the
19 distinctions between the PSS, Music Choice and the
20 SDARS are also differences between Music Choice and
21 interactive webcasting or any of these other music
22 services and, in fact, there are even more

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1 differences in some instances.
2 So that really puts us -- that's one of
3 the other reasons that the PSS are really in a
4 unique position, not only in the market, but before
5 the Copyright Royalty Judges, to have their rates
6 set.
7 Now, Mr. Del Beccaro also discusses
8 certain foreign markets in which the musical work
9 and the sound recording performance rights are
10 licensed side by side.
11 And in those instances, the musical
12 works rate is typically valued roughly the same as
13 the sound recording rate; in some instances, higher.
14 He also discusses copyright royalty tribunals that
15 exist in Canada and the United Kingdom that set
16 rates for performance rights license in those
17 jurisdictions in the absence of industry agreements.
18 Those tribunals set these rates pursuant
19 to a marketplace willing buyer/willing seller
20 standard, and both of those tribunals have
21 repeatedly held that when the musical works right
22 and the sound recording performance rights are both

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1 licensed for the same service, that they have an
2 equivalent value.
3 Now, turning back to the original
4 Librarian of Congress' decision.
5 The Librarian of Congress had to use an
6 estimate of what the PSS PRO rates would be because
7 at the time, the PSS were still negotiating their
8 PRO licenses with ASCAP, BMI, SESAC. And the
9 estimate that the Librarian came up with was roughly
10 10 percent of revenue.
11 As Mr. Del Beccaro testifies, that
12 estimate turned out to be grossly high. In fact,
13 it's roughly double what the actual final rates
14 turned out to be for the PROs.
15 For this reason alone, in the original
16 PSS proceeding, the rate was set twice as high as it
17 ought to have been under the Register -- under the
18 Librarian's reasoning.
19 But Mr. Del Beccaro also goes through
20 the 801(b) policy factors and talks about various
21 changes in circumstances that occurred since the
22 last rate setting that show that Music Choice can

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1 now make an even stronger case for setting the rate
2 on the lower end of the range.
3 Turning to the first factor, maximizing
4 the availability of creative works to the public.
5 The Librarian of Congress focused
6 entirely on the sound recording as being the
7 creative work made available to the public. And
8 that made sense at the time, because when
9 Music Choice first launched, essentially what you
10 got in your home was a black screen with some basic
11 song ID information and white text on it, and you
12 got the music played in a commercial-free stream of
13 music.
14 That has changed substantially since
15 that time. You know, as a preliminary matter,
16 Mr. Williams describes in detail how the channels
17 themselves are creative works in the sense that it
18 requires a great deal of creativity and expertise to
19 select which songs get played on which channels.
20 Music Choice certainly devotes a lot of staff and a
21 lot of money towards hiring people who are very
22 skilled in doing this. But also, those channels,

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1 what goes through those channels, has changed.
2 As I said before, it used to be,
3 essentially, a black screen. Now there is an
4 on-screen display with all sorts of graphical
5 content that's created by Music Choice. There's
6 textual content that gives facts and trivia about
7 the artists that are meant to sort of engage the
8 user and keep them more engaged with the
9 Music Choice service.
10 Oftentimes, there's promotional content
11 to help promote the recording artists and new
12 releases, things of that matter.
13 All of that creative content is created
14 by Music Choice, not by the record labels, and is
15 added to the service.
16 Now, Music Choice has also developed a
17 recording studio where artists come in and record
18 promotional interviews, but also record music that
19 sometimes winds up on the Music Choice channels. So
20 Music Choice is actually itself creating sound
21 recordings. Some; I'm not trying to say it's the
22 bulk of what gets played on Music Choice, but there

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1 are certainly some that get played on the channels.
2 So there's a bunch of additional
3 creative content that Music Choice contributes to
4 the service that wasn't true at the time of the
5 first proceeding.
6 Since that original proceeding,
7 Music Choice has more channels of content. It went
8 from 31 to 46, and next year expects to go to 300.
9 There's more programming and content
10 staff. It went from 16 at the time of the first
11 proceeding to 43 now, and expects to be 58 by 2017.
12 And the amount spent by Music Choice on
13 programming and content creation has quadrupled
14 since the time of the first rate setting.
15 With respect to the second factor,
16 affording the copyright owner a fair return for its
17 creative work and a copyright user fair income under
18 existing economic conditions.
19 The Librarian of Congress adopted on
20 that one essentially the CARP's findings, which were
21 that the PSS were struggling financially, their
22 long-term viability was far from certain, and all of

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1 that support is setting the rate on the lower end of
2 the spectrum.
3 Fifteen years later, DMX, one of the
4 original PSS, was dissolved in bankruptcy; it's out
5 of that market. Muzak, the only other PSS, has
6 chosen not to expand its business beyond the one
7 affiliate that it had back at the time.
8 And Music Choice's financial position,
9 as you can see in Mr. Del Beccaro's testimony and
10 his exhibits, is even more precarious now than it
11 was in 1996 through '98, when the rate was set.
12 As it turns out, the projections that
13 Music Choice gave to the CARP were unduly
14 optimistic. Although they have managed to expand
15 their subscriber base over the years quite
16 substantially, at the same time, their average fee
17 per subscriber on a monthly basis has plummeted.
18 And that's, of course, due to the
19 competitive dynamics of the cable market, where
20 Music Choice has to compete with audio-visual
21 programming and all sorts of other content for
22 carriage as part of the basic cable package, which

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1 frankly, for better or worse, the cable companies
2 seem to believe is more highly valued by their
3 customers. And all of those forces have driven the
4 rate down substantially.
5 Only recently has Music Choice managed
6 to turn an occasional profitable year on an annual
7 basis. Although some years have been profitable and
8 then others it goes back into a loss, they're
9 certainly far from recovering the cumulative losses
10 that they've endured over the years under the
11 original rate; nor are they close to providing a
12 return on investment for their original investors.
13 So these facts all continue to support,
14 and even more strongly so, setting the rate on the
15 lower end of the spectrum.
16 Now, the third factor looks to the
17 relative roles of the PSS and the copyright owners
18 in making the product available to the public, and
19 there are several subfactors to look at.
20 The first are the relative creative
21 contributions.
22 Now, frankly, this pretty much mirrors

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1 the first factor, so to the extent that Music Choice
2 is adding more creative content to the service than
3 it did before, certainly we would understand the
4 record companies having the better of this factor,
5 but by a lesser margin. But all of the other
6 subfactors continue to go in favor of setting a
7 lower rate.
8 The second subfactor is the relative
9 technological contributions.
10 The Librarian focused on the various
11 technology that the PSS had developed to create and
12 launch their services, to create an entire new type
13 of digital music service, and noted that the record
14 companies were not required to make any
15 technological contributions to that.
16 That is certainly even more true today.
17 Mr. Del Beccaro sets out in his testimony various
18 new technologies that Music Choice has had to
19 implement to improve its service and try to stem the
20 flow of the lowering and lowering user rates.
21 Some examples are the on-screen displays
22 that I discussed before; the production studio for

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1 recording artists' interviews and performances;
2 improvements to the digital playback systems; the
3 creation of a data center and disaster recovery
4 systems; improvements to the satellite uplink system
5 to allow for more channels to be transmitted; and
6 various technology required to integrate social
7 media platforms into the service.
8 And, again, with -- the record labels
9 still have not had to make any technological
10 contributions related to the PSS.
11 JUDGE WISNIEWSKI: Mr. Fakler, if I
12 could interrupt you just a second on that point.
13 MR. FAKLER: Absolutely.
14 JUDGE WISNIEWSKI: Are you suggesting,
15 then, that the -- that the -- what you described as
16 the policy-based reason for setting the rate for the
17 PSS is a moving target in the sense that, as the PSS
18 adopts new technology, then that new technology also
19 has to be taken into account in order to preserve
20 their rate of return or to preserve them
21 economically?
22 MR. FAKLER: Yes, I absolutely do think

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1 so.
2 And I think that if you look at even the
3 way that the Librarian suggested that one would look
4 to changes in circumstance over the
5 intervening years, you know, the key -- and also
6 consistent with the legislative history, which is
7 to -- to allow the PSS to maintain their businesses,
8 it's a very unusual consideration given to a small
9 group of fairly modest companies, but there it is in
10 the legislative history and in their rate.
11 So, yes, I do believe -- I don't think
12 that you just take a snapshot of the initial launch
13 technology and any new technology that's required to
14 keep the service in business doesn't get counted.
15 JUDGE WISNIEWSKI: Do you distinguish
16 between new technology required to keep the service
17 in business and new technology that expands the
18 nature of that business?
19 MR. FAKLER: I don't think that there's
20 a distinction between those two.
21 And I think that Mr. Del Beccaro will,
22 you know, testify to that to some degree.

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1 In the competitive world in which the
2 PSS have been trying to continue to exist, it
3 requires that they're constantly adding new value to
4 the service to persuade the cable companies to -- to
5 slow down that lower and lower value. They have to
6 keep demonstrating added value to the cable
7 companies.
8 And so for that reason, I think those
9 two are actually the same.
10 And with respect to the next subfactor,
11 the relative capital contribution, the Librarian of
12 Congress essentially looked at the technological
13 contributions that they had already -- that he had
14 already evaluated and noted that each of those
15 required substantial capital investments to
16 implement.
17 And so for that same reason, all of
18 these technical contributions that I just discussed,
19 the more recent ones, all of them required
20 significant capital investments by Music Choice. In
21 fact, for Music Choice alone, those capital
22 investments are far greater for Music Choice alone

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1 than the 10 million for the entire PSS industry that
2 was credited at the time of the first proceeding.
3 The next subfactor are the relative
4 costs and risks borne by the services.
5 And here, the Librarian of Congress
6 found that the costs and the risks of the PSS
7 greatly outweighed those of the record companies,
8 which is not to say that -- I mean, the Librarian
9 recognized that record companies experience certain
10 costs and risks associated with their primary
11 business, which is the recording and distribution of
12 copies of sound recordings.
13 But the Librarian also noted that those
14 costs and risks have been there for many decades.
15 Largely, the record labels had adapted their
16 businesses to accommodate those costs and risks.
17 But, most importantly, none of those costs and risks
18 were affected or certainly were increased by the
19 PSS. To the contrary, the Librarian found that the
20 risks were somewhat lowered by the PSS because of
21 the promotional impact, the Librarian found, from
22 the PSS service.

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1 This is even more true today. As set
2 out in Mr. Del Beccaro's and Mr. Williams'
3 testimony, first of all, the PSS lower the costs of
4 the record labels in a way they didn't before, which
5 is by doing these customized artist promotions that
6 include custom programming on the channels, they
7 include custom advertisements on the screen and
8 promotional materials. The record labels
9 specifically asked Music Choice for -- to do these
10 promotions, and Music Choice does them at no cost to
11 the record labels.
12 So that's a cost saving, a new cost
13 saving that's coming from the PSS.
14 And, of course, they also continue to
15 lower the risk to the record labels through the
16 promotional impact.
17 It's also important to note that even
18 during this admittedly difficult transition from
19 the -- for the record labels between physical
20 distribution models and digital, they have still
21 managed to turn profits, in very stark contrast to
22 Music Choice's performance.

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1 Digital actually lowers several of the
2 historical costs for the record labels substantially
3 with respect to production and distribution. It's
4 also important to note that last year, the overall
5 album sales actually increased. And the
6 long-awaited inflection point -- the record labels,
7 themselves, anticipate that inflection point, where
8 the increases in digital will finally make up for
9 losses in physical, will be upon us within the next
10 year or two.
11 For the PSS, the risks are only
12 increasing. As set out in Mr. Del Beccaro's
13 testimony, you know, the revenue per subscriber
14 continues to go lower.
15 Music Choice is now a mature service,
16 unlike at the time of the first rate-setting
17 proceeding, specifically in the sense it can no
18 longer hope that increased market penetration is
19 somehow going to solve the profitability problem.
20 Music Choice has also had to develop
21 video content to package along with its audio
22 services in order to help stem, again, this -- this

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1 constant lowering of the per-subscriber fee.
2 When it -- you know, when it adds that
3 video content to its channels, it has to direct
4 license that at much higher rates from the record
5 labels.
6 So at this point, it's very unclear
7 whether the video component of the residential
8 business will ever be profitable enough to sort of
9 make up for these losses on the audio side.
10 And, finally, the fifth subfactor is the
11 relative contribution to opening of new markets for
12 creative expression and media for their
13 communication.
14 And the Librarian of Congress found
15 easily, you know, just by the nature of the PSS,
16 they were opening these new channels, these new
17 media, and it did not require any contribution from
18 the record labels other than the sound recordings
19 which, of course, they weren't really providing,
20 Congress was providing, in a sense.
21 Turning finally to the fourth factor,
22 which is maximizing any disruptive impact on the

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1 structure of the industries involved, the Librarian
2 of Congress specifically noted that setting a rate
3 too high ran the risk of driving one or more of the
4 PSS out of the business. The Librarian found this
5 completely unacceptable outcome under the fourth
6 factor.
7 The Librarian also contrasted this with
8 the effect of the rate -- the royalty stream from
9 the PSS on the record companies, noting that even if
10 the rate was set at the extremely high 41.5 percent
11 rate that the RIAA was asking for in the proceeding,
12 it wouldn't have any material impact on the revenues
13 of the record labels.
14 That's certainly just as true, if not
15 more so, today. We've seen the loss of DMX. We've
16 seen Music Choice's poor financial performance
17 certainly indicates that the rate was set too high
18 in the first place. At the same time, PSS royalties
19 are nowhere near a primary or even tertiary revenue
20 stream for the record labels.
21 In fact, if the labels were to get the
22 45 percent rate that they're asking for in this

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1 proceeding, that increase would amount to roughly a
2 fraction of a hundredth of a percent of the gross
3 revenues of the record labels.
4 So this is just a meaningless event, no
5 matter where the rate gets set for the record
6 labels.
7 So, in summary, based on the actual PRO
8 rate, which was initially set twice as high as it
9 should have been, and the various changes in
10 circumstance related to the policy factors,
11 Music Choice is requesting a rate of 2.6 percent of
12 revenue.
13 Now, this rate proposal is further
14 supported by the expert testimony of Music Choice's
15 economist, Dr. Gregory Crawford. Dr. Crawford is
16 currently a professor of economics at the University
17 of Warwick in England. He was previously the chief
18 economist for the FCC. He's researched and
19 published extensively on economic matters relating
20 to the cable industry which, of course, is very
21 helpful, since that's the industry the PSS are in.
22 And he presents two main areas of

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1 analysis: In the first area, he uses the
2 widely-accepted Nash Noncooperative Bargaining Model
3 to demonstrate the suitability of using the musical
4 works performance license as a benchmark for the
5 sound recording performance license specifically for
6 the PSS.
7 He also uses the Nash model to
8 demonstrate that, in a hypothetical marketplace
9 negotiation, the sound recording license rate would
10 be lower than the musical works performance license,
11 and therefore, the PRO license should set the upper
12 bound of potential ranges of marketplace outcomes.
13 In the second area, he analyzes
14 Music Choice's financial performance, particularly
15 in light of the second and fourth policy factors.
16 He also uses the capital asset pricing model to
17 determine Music Choice's reasonably expected rate of
18 return on capital.
19 And he does all of this to estimate what
20 the surplus should be for Music Choice's residential
21 music service available to be split between
22 Music Choice and the record company.

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1 Dr. Crawford estimates that surplus to
2 be 3.05 percent of revenue and concludes, therefore,
3 that a reasonable rate for the PSS would range from
4 .61 to 2.43 percent of revenue, which is essentially
5 just saying SoundExchange should get somewhere
6 between 20 percent and 80 percent of the entire
7 surplus.
8 And as you can see, the Music Choice
9 rate proposal is at the high end of Dr. Crawford's
10 range.
11 Now, before I talk about SoundExchange's
12 rate case, I just want to talk briefly about the
13 other terms in the CFR that relate to the PSS
14 license.
15 Mr. Del Beccaro has testified that the
16 PSS and SoundExchange have been operating under
17 these regs for many years now without any particular
18 issues that either side has ever discussed with the
19 other.
20 There's, frankly, no reason to change
21 them at this late date. SoundExchange is asking to
22 make various changes to the regulations. They try

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1 to couch them as mere stylistic and just trying to
2 conform them to the SDARS regulations, but if you
3 look through the red lines -- and, unfortunately,
4 you do have to hunt through all the red lines to see
5 all of the changes they're requesting to make --
6 many of them, in fact, take away substantive
7 protections for the PSS and other benefits to the
8 PSS that are in the existing regs.
9 And, notably, when they get to one of
10 the provisions; namely, the fee shifting threshold
11 for audits, suddenly they don't want to conform the
12 PSS regs to the SDARS. Why? Because the PSS regs
13 are better for them than the SDARS' regs.
14 So they're really not trying to conform
15 these things in any way. In any event, they haven't
16 provided in their direct case any justifications --
17 any substantive justifications for changing any of
18 these regulations that the parties have been using
19 for many years.
20 And also, notably, there are many
21 compulsory licenses in the Copyright Act, there are
22 many sets of implementing regulations in the CFR.

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1 They're not all identical. They don't necessarily
2 have to be identical. And Music Choice submits that
3 they shouldn't be changed in this case.
4 Now, turning to SoundExchange's rate
5 case, as noted before, there is precedent on how a
6 rate should be set for the PSS. There is precedent
7 about these general principles for 801(b) rate
8 setting.
9 SoundExchange ignores all of them. In
10 fact, in its written case, it almost entirely
11 ignores the PSS. You really have to hunt through
12 their testimony to find any reference to us. In any
13 event, there is certainly no fact witness testimony;
14 there isn't a shred of fact witness testimony that
15 supports their rate proposal.
16 In fact, the only fact witness that even
17 mentions the PSS rate is Steven Bryan of Warner
18 Music Group.
19 What does Mr. Bryan say? He gives no
20 testimony on what the rate should be. He says
21 nothing relating to the policy factors related to
22 the PSS. In fact, he only gives one paragraph of

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1 testimony about the PSS rate, and in that paragraph,
2 he says only two things.
3 First, he admits that the PSS is
4 completely unique among digital music services and
5 admits there are no marketplace agreements that are
6 in any way similar.
7 The second thing he says is
8 hypothetically, Warner Music Group would not
9 voluntarily agree to license the PSS at a rate as
10 low as 7.5 percent because they're able to get these
11 higher rates in these other admittedly noncomparable
12 areas.
13 Well, neither of these things support
14 the specific rate that SoundExchange is proposing.
15 And, in fact, the first admission about how
16 noncomparable the PSS is actually shows why their
17 expert witness' opinion is completely useless to
18 setting the rate in this proceeding.
19 That turns to their economist for the
20 PSS, Dr. George Ford.
21 And I think Dr. Ford's testimony can
22 only be described as, you know, a rate in search of

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1 a methodology.
2 He ignores the precedent entirely.
3 Dr. Ford, like Mr. Bryan, admits that the PSS market
4 is completely unique. He admits that there were no
5 marketplace comparables to use in a traditional
6 benchmarking analysis.
7 That admission alone should doom his
8 decision, because all he does is then proceed to
9 rely on a series of admittedly noncomparable
10 benchmark services.
11 Apparently, in Dr. Ford's view, it's
12 okay to use noncomparable benchmarks as long as you
13 use a lot of them, and that was essentially his
14 approach.
15 He took the analysis actually done by
16 Dr. Ordover, SoundExchange's other economist in this
17 case -- and there was a range of percentage of
18 revenue rates that ran from 43 percent to 70 percent
19 in certain digital music service markets -- and he
20 assumed that that range constituted the entire range
21 of existing direct licensed digital music service
22 rates. And based on that assumption, he then

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1 reasoned because SoundExchange's 45 percent rate was
2 at the low end of that range, it was, per se,
3 reasonable.
4 Now, there are a lot of problems with
5 that methodology. One question that immediately
6 comes up is if Dr. Ford was going to rely on
7 Dr. Ordover's staff and his analysis for his
8 opinion, why not just have Dr. Ordover give the
9 opinion on what that analysis and work meant for the
10 PSS?
11 The other question which, in their
12 deposition testimony, Dr. Ford acknowledged that he
13 never spoke to Dr. Ordover, although he spoke to
14 Dr. Ordover's staff. And Dr. Ordover did not even
15 know who Dr. Ford was, and certainly didn't know he
16 was talking to his staff or using any of his
17 analysis.
18 So why was Dr. Ford and -- firewalled
19 off from Dr. Ordover? Well, the answer to both of
20 these questions, I think, are the same. It was
21 Dr. Ordover who SoundExchange put before the Judges
22 five years ago in rebuttal in the SDARS case to

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1 explain all of the reasons why Music Choice was so
2 unique and so different from the SDARS that it
3 couldn't even be used as a benchmark.
4 Dr. Ordover understands that you can't
5 use a noncomparable digital music service as a
6 benchmark. That was his very testimony that the
7 Judges accepted and agreed with. So he would be the
8 last person able to sit here with a straight face
9 and use this sort of methodology that relies
10 entirely on noncomparable benchmarks.
11 But there are other problems. Even if
12 it were somehow valid to use these noncomparable
13 benchmarks, the fundamental assumption, as I said,
14 was this range of rates was the total range of rates
15 out there, that there was no digital music service
16 directly licensed who was paying at a rate less than
17 43 percent.
18 The fact is, that's completely false.
19 There are dozens of digital music service agreements
20 that pay at a rate substantially lower than
21 43 percent. Apparently, Dr. Ford didn't know that;
22 apparently, he didn't ask. But, in any event, that

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1 completely undermines his critical assumption.
2 There's another fundamental problem with
3 his methodology as well, in that he relies on the
4 nominal percentage of revenue rate in these various
5 noncomparable digital music service agreements. And
6 as the Judges know from SoundExchange's case, all of
7 these agreements have multiple ways that you can
8 figure out what the actual royalty rate is, and
9 which one of those metrics gets used depends in
10 large part on the performance of the music service.
11 The fact is, none of these digital music
12 services pay on the nominal percentage of revenue
13 rate. So all of these noncomparable services that
14 Dr. Ford used, he used a revenue -- he used a rate
15 that nobody actually pays on.
16 So for all of those reasons, each one, I
17 believe, independently nullifies any utility of his
18 decision. They're all still there.
19 He then turns to the policy factors very
20 briefly, but he only does so to essentially argue
21 that all of the policy factors are already baked
22 into these noncomparable digital music service

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1 agreements. And, of course, that is completely at
2 odds with the Librarian of Congress' decision, the
3 other 801(b) D.C. Circuit decisions, and
4 specifically, the Librarian of Congress, who said,
5 on this very point, that market rates do not
6 typically already include these policy factors.
7 And that's common sense and consistent
8 with the legislative history, because why would
9 Congress choose these four policy factors instead of
10 a market rate when they could have chosen a market
11 rate? Why did they grandfather the PSS with these
12 policy rates when they went to an actual market
13 rate? All of that is meaningless if you believe
14 that a market rate already takes into account the
15 four -- the 801(b) policy factors.
16 Avoiding the policy factors by assuming
17 that they're all necessarily satisfied by market
18 rates, it contravenes Congress' very intentional
19 decision to set the policy standards this way, and
20 it's totally in conflict with the precedent.
21 Now, Dr. Ford even goes on in the fourth
22 factor to claim that a rate that puts Music Choice

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1 out of business is still consistent with the fourth
2 policy factor. Well, that's, again, completely
3 inconsistent with the precedent here and, of course,
4 the legislative history and the very purpose for
5 using the policy factor.
6 So, in conclusion, the Copyright Royalty
7 Judges, with respect to the PSS rate, anyway, are
8 presented with two historically contrasting
9 methodologies.
10 One, Music Choice looks to the prior
11 precedent, prior rate setting, even for the PSS,
12 uses the same methodology, uses the same benchmark,
13 and then adjusts for changes in circumstance, which
14 is exactly what was suggested by the Librarian of
15 Congress in that decision.
16 SoundExchange, on the other hand,
17 completely ignores all of these general principles
18 and precedent as if they never happened.
19 SoundExchange proposes benchmarks from admittedly
20 noncomparable services, using rates that are not
21 actually paid in the marketplace by any of those
22 services.

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1 Their entire proposal is based on the
2 false assumption that no direct license music
3 service pays less than 43 percent, and then claims
4 that it need not bother submitting any evidence on
5 the 801(b) factors because, contrary to precedent,
6 those factors are already baked into these
7 noncomparable performance licenses.
8 The result is a request on
9 SoundExchange's part for a sixfold increase in the
10 rate Music Choice will pay.
11 If Congressional intent and precedent
12 are to mean anything in this proceeding, the choice
13 between Music Choice's rate proposal and
14 SoundExchange's rate proposal is no choice at all.
15 Thank you very much.
16 CHIEF JUDGE BARNETT: Thank you,
17 Mr. Fakler.
18 Your timing is impeccable. We will take
19 our noon recess and reconvene at 1:00.
20 (Whereupon, at 12:03 p.m.,
21 a luncheon recess was taken.)
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1 AFTERNOON SESSION
2 (1:03 p.m.)
3 CHIEF JUDGE BARNETT: Good afternoon.
4 Please be seated.
5 MR. RICH: Your Honor, before Mr. Handzo
6 begins, I was hoping I could raise an important
7 evidentiary housekeeping matter that may have some
8 bearing on his opening.
9 CHIEF JUDGE BARNETT: You may.
10 MR. RICH: Thank you.
11 By agreement of the parties, we
12 exchanged last evening demonstratives as a courtesy,
13 and also by agreement, we have been exchanging
14 proposed -- exhibits proposed to be introduced by
15 the adversary on cross-examination.
16 And we have, as of noon today, received
17 now three such sets of designations from our friends
18 at Jenner & Block. And what we found was, in the
19 demonstratives last night, there is a reliance on
20 postclose of direct case and outside of discovery
21 financial records in the case of the demonstratives'
22 public filings, but nonetheless, deeply into 2012

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1 relating to, no surprise, our client.
2 And in the proffers of exhibits done in
3 good faith, as per the agreement, there is, in
4 effect, an effort to de facto update, through
5 cross-examination exhibits, the entire financial
6 record of this case through the direct case, meaning
7 documents that are well outside of the end date of
8 November '11, our direct case, well outside of
9 anything produced in discovery. That record closed
10 in March; they're just brand-new documents.
11 Now, as Your Honors are aware, when we
12 attempted to update, for example, to freshen the
13 record through Messrs. Gertz and Dr. Noll on direct
14 licenses, we were met with a fierce opposition,
15 mostly sustained by Your Honors, about the fact that
16 that's not the role of the direct case.
17 You're bound by your case and -- unless
18 it's in the discovery record and so forth. And we
19 have, therefore, abided by that.
20 And so what we have is really a de facto
21 effort here, as we see it, in the making of a
22 one-sided update of the case; that is, updating in

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1 the guise of cross-examination exhibits documents
2 that never would have properly made it into, for
3 example, the list document, their key financial
4 expert, had they done -- had they proposed to amend
5 Dr. Lys with the May 2012 slide deck that's in
6 Mr. Handzo's opening, we would have taken their
7 briefing on the Gertz and Noll motion, flipped it
8 around, used their words and said, sorry, it doesn't
9 work.
10 It's -- it's an update of information
11 well beyond the close date. Their arguments, which
12 you read, were we have to have some closure in the
13 direct case.
14 So what we're facing is this imbalance,
15 potentially, where we are preparing our direct
16 witnesses, going on the stand beginning today, based
17 on a record frozen as to the direct written cases.
18 We are not proposing to examine Mr. Frear, for
19 example, tomorrow on financial developments post his
20 written direct testimony. It had been our
21 understanding that would be inappropriate under the
22 governing strictures.

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1 A great example of the imbalance is that
2 when Professor Noll suggested in our original
3 proposed amended testimony to make reference to a
4 2012 Pandora 10-K, as Your Honors will recall, that
5 was objected to. And that was rejected and,
6 therefore, stricken and no longer appears in the
7 revised amended -- one of the very exhibits they're
8 proposing to cross-examine Dr. Noll with and
9 introduce in evidence is that same document.
10 So it seems to me, unless I'm missing
11 something, that we ought to have at least an
12 equitable understanding about everybody can update
13 within whatever parameters, in which case, we can
14 affirmatively address the circumstances that would
15 come in collaterally through cross, or nobody can do
16 that until the rebuttal case. But certainly, it
17 shouldn't come through the side door.
18 Technically speaking, if you know the
19 rules, as you do of your own Court here,
20 cross-examination is, by definition, limited to the
21 subject of the direct examination. By definition,
22 our witnesses did not address post-November '11

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1 financial developments, and to be met now with
2 cross-examination where we could not affirmatively
3 have used those, in what appears to be a systematic
4 effort to sort of end run the understandings we
5 thought we had, in fact, the parameters advocated by
6 our adversary, seems to us inappropriate.
7 And I didn't want to interrupt
8 Mr. Handzo's opening where it's there, but I think
9 if we could get some guidance from Your Honor, it
10 would be -- Your Honors, it would be very helpful.
11 CHIEF JUDGE BARNETT: Mr. Handzo, do you
12 want to respond?
13 MR. HANDZO: Sure.
14 The objections to the written testimony
15 were based on a specific regulation --
16 JUDGE WISNIEWSKI: Actually, gentlemen,
17 you should be at the podium for these things.
18 MR. RICH: That's fine.
19 MR. HANDZO: That's fine.
20 I have a bad habit, by the way, of
21 ignoring those microphones. I was in Court in a
22 trial last month and thought I was off the mic when

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1 conferring with one of my colleagues, and the judge
2 let us know that we were on the mic.
3 In any event --
4 JUDGE WISNIEWSKI: Those microphones
5 actually are off unless you press them down.
6 MR. HANDZO: Thank you.
7 In any event, the objection to the
8 written testimony was based on the specific
9 regulation which addresses that, 351.4. It doesn't
10 address the situation that Mr. Rich is now talking
11 about, which is what happens when a witness gets on
12 the witness stand and there are things about which
13 you wish to cross-examine that witness that may
14 relate to more recent events.
15 That's not something that is barred by
16 the regulation, nor is it unfair, because almost by
17 definition, what you're doing is you're
18 cross-examining the witness about something the
19 witness has knowledge of. You're cross-examining
20 the witness about the witness' own statements, for
21 example.
22 In this case, talking about the -- the

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1 various SiriusXM documents or statements that
2 various folks made, they're their own statements.
3 So it seems a little bizarre not to be able to
4 cross-examine them about their own statements,
5 whenever made. And I'm aware of no rule of this
6 Court that would forbid it.
7 Now, I will say I think this issue has
8 come up before, and I recall it coming up in the
9 first SDARS case, where we had the same sorts of
10 issues about financial information being updated
11 after the close of discovery, in fact, around the
12 time the hearings began.
13 My recollection is that the Court
14 generally was -- tended to be permissive of updating
15 that information; as long as there wasn't any unfair
16 sandbagging by doing it, updating with information
17 that the other party had no basis to know.
18 But in this, there's certainly, again,
19 no unfair sandbagging. These are their own
20 documents and their own statements.
21 And, again, to cross-examine a
22 witness -- to not be able to cross-examine a witness

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1 about the witness' own statements is just not
2 something that these regulations contemplate.
3 And I will also say I think Mr. Rich,
4 with all due respect, is incorrect when he says it
5 would necessarily be beyond the scope of the direct.
6 The scope of direct is defined by the subject matter
7 of it, and as long as the cross-examination relates
8 to the subject matter of it, it is within the scope
9 of the cross-examination.
10 That's all I have, but I'm happy to
11 respond to questions from the Court, if you wish.
12 CHIEF JUDGE BARNETT: No, thank you.
13 Brief statement in rebuttal, Mr. Rich.
14 MR. RICH: Very simply, Your Honors,
15 I've never viewed these proceedings as a game of
16 "gotcha."
17 If there is interest, as there should
18 be, in having a complete record and, from our
19 standpoint, an up-to-date record, we have no dispute
20 about that. The question is, what is the orderly
21 way to present that information?
22 If, as a matter of practice and as

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1 advocated by SoundExchange in repeated filings
2 indicating that you need a period of closure for the
3 direct case, or else it will be a constantly
4 updating exercise -- that's their characterization
5 in response to our efforts to update information
6 viewed as highly relevant by our client -- then,
7 surely, that has to work both ways.
8 And the device of saying, well, Dr. Noll
9 can't affirmatively use a Pandora 10-K because
10 that's an amend -- an impermissible amendment, but I
11 can turn around and use that 10-K -- which, by
12 definition, is not part of his direct testimony --
13 to impeach him or otherwise cross-examine him and,
14 moreover, introduce that very same document in
15 evidence on cross-examination, creates a complete
16 imbalance in the creation of an orderly record.
17 To be clear, we are not looking to avert
18 developing a complete record here. We're looking to
19 do it in some logical way and also to have some
20 understandings in terms of rules of the road in
21 terms of what are the proper boundaries for us,
22 then, to bring our witnesses current during their

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1 direct examinations and, in turn, SoundExchange's
2 witnesses current, I assume, during those.
3 We're all for that, but the idea of
4 doing it through the side door seems inappropriate.
5 I mean, truly, I think one way to
6 conceptualize this, which is not far from real, is
7 that SoundExchange clearly understood that these
8 documents they wanted to use could never have come
9 in through the direct technique of an amendment
10 through one of their witnesses for the very reasons
11 that Mr. Handzo cites.
12 Can it possibly be that they can
13 completely end run that and avoid that by the device
14 of saying, oh, in a general sense, this falls within
15 the subject matter, meaning the financial health of
16 the company, and, therefore, we can take the very
17 same documents outside of the time period, never the
18 subject of testimony by any of our clients, and use
19 them -- not only use them as general probing and
20 impeaching documents on cross, but independently,
21 then, to get them admitted into evidence?
22 We would urge Your Honors that that

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1 approach will be piecemeal, will be one-sided, will
2 be imbalanced and, at the end day, won't create a
3 full and fair record here.
4 JUDGE ROBERTS: Mr. Rich, isn't the
5 better approach here, if you do have an objection to
6 the specific use of a document, to raise it at that
7 time on the grounds that it's outside the scope of
8 the direct?
9 MR. RICH: We're fully prepared to do
10 that, and if that the Panel's preference, that's
11 certainly fine with us. However, we -- we felt
12 uncomfortable, candidly, having Mr. Handzo proceed
13 with what may be a centerpiece of his opening with
14 such a document without stating at least our
15 position very forcefully felt on the subject.
16 If, as a matter of procedure,
17 Your Honors decide that's how you want to proceed,
18 obviously, we will -- we will address it on that
19 basis.
20 CHIEF JUDGE BARNETT: Can we confer?
21 (The Judges confer.)
22 CHIEF JUDGE BARNETT: Thank you for your

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1 patience.
2 Please be seated.
3 Counsel, I will state that painfully
4 obvious opening statements are statements of what
5 the parties anticipate the evidence will show.
6 Mr. Handzo can proffer anything he wants
7 during his opening statement. It doesn't make it
8 evidence. And at the time that he presents
9 something or moves that something be admitted into
10 evidence or offers something into evidence, if
11 there's an objection at that time, we can deal with
12 it at that time.
13 I do ask, Mr. Rich, that to the extent
14 you have an objection to it being offered during the
15 opening statement, you make that now or make your
16 record now, which you have done, rather than
17 interrupting the opening statement.
18 MR. RICH: Understood, Your Honor.
19 Thank you very much.
20 CHIEF JUDGE BARNETT: Um-hum.
21 Mr. Handzo.
22 MR. HANDZO: Thank you.

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1 OPENING STATEMENT ON BEHALF OF
SOUNDEXCHANGE
2
3 MR. HANDZO: As Mr. Rich anticipated, we
4 do have some demonstratives as well.
5 And before I begin, I should introduce
6 my colleagues, Garrett Levin and Ann Wagner back
7 there.
8 My colleagues, Michael DeSanctis and
9 Jared Freedman. Were here this morning, but they
10 apparently didn't feel the need to listen to me. So
11 they've left. And Mr. Moskowitz is also part of the
12 team, got a hall pass, apparently, for today.
13 But you will see all of them in due
14 course.
15 I'm going to respond to SiriusXM and
16 Music Choice in the order that Mr. Rich and
17 Mr. Fakler appeared, so I'll start with SiriusXM.
18 SoundExchange submits that the
19 appropriate marketplace benchmarks suggest rates in
20 the range of 20 to 30 percent of revenue for
21 SiriusXM. That is consistent with other digital
22 music services.

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1 For most digital music services, royalty
2 rates cluster around 50 to 65 percent of revenue.
3 Ring tones, downloads, interactive streaming, all
4 the marketplace benchmarks are at that level or
5 higher.
6 Now, making allowance for the fact that
7 SiriusXM broadcasts nonmusic content as well as
8 music content, royalty rates in the range of 20 to
9 30 percent of -- of revenues -- in other words,
10 about half of the royalty for an all-music
11 service -- seem appropriate based on the belief
12 which all the experts seem to accept, that nonmusic
13 content is about half the value of the service or
14 half the value of the content for consumers.
15 So a royalty rate that is half of what
16 SoundExchange, record companies and artists obtain
17 for other digital services seems appropriate.
18 SoundExchange does propose, however,
19 that this Court set the rates below that range at
20 the outset, rising to the bottom of that range by
21 the end of the rate period.
22 And specifically, SoundExchange proposes

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1 that the rates begin at 12 percent of revenue in
2 2013 and rise to 20 percent in 2017.
3 Mr. Rich, this morning, seemed to
4 suggest that somehow, the record companies and the
5 artists just want a handout here, just want to put a
6 hand into SiriusXM's pocket now that it's making
7 money. No.
8 What's happening here is those are the
9 appropriate marketplace rates, as we will
10 demonstrate in this case. What SoundExchange is
11 asking for is -- is a marketplace rate, not a
12 handout.
13 Now, broadly, I think there are two
14 issues that are framed for us in this proceeding by
15 this Court's prior decision in the SDARS I case.
16 The first question is, what rate would a
17 willing buyer pay a willing seller for the right to
18 publicly perform sound recordings on a satellite
19 radio service? And once we've determined what that
20 rate is, is there any reason then to adjust it to
21 account for the factors set forth in 801(b)?
22 That is how this Court approached the

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1 analysis in the SDARS I case, and we propose to
2 follow it here.
3 Now, I'm going to take those issues in
4 reverse, first, as to whether there will be any need
5 to adjust a marketplace rate.
6 In SDARS I, this Court concluded that
7 the first three statutory factors would likely be
8 satisfied by any rate that was a marketplace rate, a
9 rate that a willing buyer would pay a willing
10 seller. Just by operation of the markets, one would
11 expect that price would comply with the statutory
12 mandate to reward risk, to encourage the creation of
13 new music and so on.
14 No evidence will be offered in this case
15 that will give you any reason to deviate from that
16 ruling. Both sides in this case still offer some
17 evidence about their creative technological and
18 financial contributions and the risks, but nothing
19 in kind any different than what was offered in SDARS
20 I. And, indeed, I believe there's mercifully less
21 of it than last time around.
22 So that conclusion that the first three

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1 factors are satisfied by a marketplace rate I think
2 should apply in this case as well. And Dr. Ordover
3 will testify on behalf of SoundExchange that in his
4 opinion, marketplace rates will satisfy those
5 factors.
6 In SDARS I, however, the Court did, I
7 think, deviate from a marketplace rate based on the
8 fourth factor, disruption. Two-thirds of the Court
9 at least will recall that in that case, the Court
10 found that 13 percent of revenues was the upper
11 bound of a reasonable marketplace rate.
12 The Court did not find -- did not
13 determine what a lower bound was, except to say that
14 it would have to be higher than the musical works
15 rate. And the Court also found that a marketplace
16 rate closer to the higher end of the scale, rather
17 than lower, was most strongly indicated by the
18 evidence.
19 Nevertheless, the Court set the rate at
20 6 percent of revenue at the beginning, going up to
21 8 percent at the end of the term. And the reason
22 for cutting it back from that 13 percent, as

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1 expressed in the Court's decision, was that a higher
2 rate might be disruptive in two ways: First,
3 SiriusXM still had a number of satellites that it
4 needed to launch to replace its existing satellites.
5 That's a very expensive proposition.
6 SiriusXM didn't, at that point -- wasn't
7 clear that they had the money to do it, and so the
8 Court was concerned that a higher rate might prevent
9 SiriusXM from going forward with those satellite
10 launches. And, of course for a satellite service,
11 no satellites, no service. So the Court believed
12 that that would be disruptive.
13 The second reason the Court found there
14 might be disruption from a larger rate increase was
15 that SiriusXM had not achieved positive EBITDA at
16 that point, and the Court felt that unduly delaying
17 that would also be disruptive.
18 The Court adjusted downward accordingly,
19 but the evidence in this case, I think, will show
20 that there is no need for any adjustment of a
21 marketplace rate under Section 801 other than,
22 perhaps, to increase that rate over time rather than

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1 imposing it all at once.
2 The evidence is overwhelming that the
3 rates requested by SoundExchange will not be
4 disruptive, because SiriusXM is in a very, very
5 different place than it was five years ago.
6 On the numbers, in a third quarter 2011
7 earnings call, Mr. Frear, who is the CFO of
8 SiriusXM, said that fixed expenses since 2008 have
9 declined by 31 percent, while revenue has increased
10 by 25 percent. And you can imagine what a
11 difference that makes, but we can display it
12 graphically.
13 It's the first tab in the binder that
14 you have. And this is from a stockholder
15 presentation by SiriusXM in 2012.
16 And you can see their representation of
17 the growth in the number of subscribers that they
18 have, continuing out through the end of this year.
19 Obviously, when you have growth in
20 subscribers, you have growth in revenue. And that's
21 the next chart, again, from the same presentation.
22 Again, this is a SiriusXM presentation, and it shows

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1 their multiyear revenue growth going up to very
2 lofty levels by the end of this year and, obviously,
3 dramatically increasing over 2008.
4 When you've got increasing revenue and
5 decreasing costs, your EBITDA obviously also
6 improves. And this is a slide from the same
7 presentation showing how the EBITDA has improved.
8 In fact, it was negative in 2008, it turned positive
9 in 2009, and has continued to grow at healthy levels
10 since then.
11 And then, lastly, when we litigated
12 SDARS I, there was a great deal of testimony about
13 free cash flow and the importance of free cash flow
14 to SiriusXM's business. Free cash flow is just the
15 money they have available to use as they choose to
16 pay down debts, to make acquisitions. Whatever they
17 need to do, that's the money they have to do it.
18 And as you'll see from Tab 4, the free
19 cash flow has been growing very dramatically, again,
20 from a negative in 2008 to a very healthy positive
21 anticipated at the end of 2012.
22 And I think it's useful to keep in mind

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1 that all of this is happening during a time when the
2 country has gone through the worst recession that
3 we've had since the Great Depression. It is quite
4 remarkable that SiriusXM experienced that
5 improvement during this period of time, but they
6 obviously did.
7 Now, why did that happen? Well, there's
8 a couple of things.
9 First of all, Sirius and XM, which were
10 separate companies at the time we litigated SDARS I,
11 merged shortly after that. The merger was
12 completed, I believe, in 2008. And as part of that
13 merger, SiriusXM has been able to reduce costs
14 fairly dramatically.
15 I think Mr. Frear, in his written
16 testimony submitted in this case, testifies that
17 costs -- variable costs, not including content, were
18 reduced by more than 500 million since 2008.
19 Another reason for the improvement is
20 scale. SiriusXM is a business that has very high
21 up-front costs of starting the business. You've to
22 launch the satellites, you've got to build the

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1 repeaters and so on. So you've got very high
2 capital costs at the beginning, but then those costs
3 don't increase very much as you add new subscribers
4 because you don't have to launch more satellites to
5 have more subscribers.
6 So the larger the business grows and the
7 more revenue they have, the costs don't increase at
8 the same rate. So their profitability dramatically
9 improves and so they hit the turning point where,
10 all of a sudden, you're making a lot of money.
11 And if you look at Tab 5 -- again, this
12 is from the same presentation -- this is SiriusXM's
13 discussion of how their leverage is improving.
14 In addition to all of that, SiriusXM
15 imposed what, in effect, was a price increase. I
16 believe it was 2008 or 2009 -- I'm now forgetting
17 the exact date, but SiriusXM imposed on its
18 subscribers a music royalty fee. In other words,
19 when the rates went up as a result of this Court,
20 SiriusXM tacked onto its subscription price an
21 additional fee of $1.98 for consumers who received
22 music as part of their package, which is pretty much

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1 all of their consumers.
2 And through that, it was able to recoup
3 most, if not all, of the price increase. They
4 reduced that music royalty fee to $1.40 in
5 December 2010 because that was required to comply
6 with the FCC's regulations.
7 What happened was, when Sirius and XM
8 merged, the FCC did not allow them to do a price
9 increase, generally speaking. It did allow them to
10 impose this fee under certain circumstances, so they
11 did. They had to cut it back a little bit to comply
12 with the FCC.
13 The key point here is they were able to
14 respond to a rate increase by, in effect, increasing
15 their prices to their subscribers. And the
16 testimony at the time -- the statements at the time
17 were doing that did not increase their churn.
18 In other words, increasing that price
19 did not, as far as they could tell, really cost them
20 any subscribers. People didn't say, nope, you
21 increase the price, now I'm going to leave. So they
22 were able to recover most of those costs.

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1 Now, this is how Mel Karmazin, who is
2 the CEO of SiriusXM, summed it up in an earnings
3 call in the third quarter of 2011. Quote, Our
4 400 million free cash flow guidance represents a
5 staggering 90 percent increase over 2010. Just a
6 few short years ago, in 2008, the combined negative
7 free cash flow of SiriusXM exceeded 550 million. To
8 put it mildly, we've come a long way, and it gets
9 better. Our 2012 guidance calls for free cash flow
10 to increase 75 percent next year, versus 2011, to
11 approximately 700 million, driven by improved
12 operating results and lower capital expenditures.
13 Mr. Karmazin goes on to say, quote,
14 Let's put this in perspective. In 2012, we plan to
15 grow our cash generation to nearly $2 million every
16 day. That's including weekends and holidays. Truly
17 an astounding statistic, which obviously will
18 represent the best free cash flow in the history of
19 the company.
20 Mr. Karmazin said that at the end of
21 2011, but those rosy prognostications continue.
22 More recently, he has said -- and this, again, is a

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1 quote -- Our strategy is working, our execution is
2 strong and we have a fantastic organization capable
3 of meeting our goals. We have started this year
4 with great results, and I believe it's an exciting
5 time to be a shareholder of our company. Based on
6 everything we know today, we are confident that 2012
7 will be a great year for us, and 2013 will be even
8 better.
9 To the extent that Mr. Rich has
10 suggested in his opening that these are all just
11 kind of SoundExchange experts' pie-in-the-sky
12 projections, these are the words of SiriusXM as to
13 what they anticipate and how they're doing.
14 The improvement is going to continue
15 beyond 2013, and it's going to continue because,
16 again, you continue to improve the scale. As you
17 get more subscribers, costs don't increase at the
18 same level; profits increase.
19 And Mr. Frear has said, and we've quoted
20 it in Mr. Lys' testimony, that fixed costs are going
21 to remain stable as -- in the future, as their
22 revenues grow.

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1 In addition, Mr. Frear has said that
2 they expect cost decreases, in fact, because, for
3 example, they're going to get more efficient about
4 how they create these receivers, they're going to
5 have better ways to do it. They'll get some more
6 synergies from combining the XM network and the
7 Sirius network, which hasn't fully happened yet.
8 And, finally, they have, yet again,
9 increased their subscription price from 12.95 to
10 14.95 for the basic package with no increase in
11 churn, according to Mr. Karmazin.
12 So the results are substantial revenue
13 growth projected by the analysts, and that's the
14 next tab, Tab 6. Tab 6 shows the actuals up until
15 2010 and then the projection forward by the
16 analysts. And this document appears in the
17 testimony of Mr. Lys.
18 As you can see, there is anticipated by
19 the analysts very, very healthy growth.
20 Based on that, we asked Mr. Lys in his
21 testimony to project out the impact of the rate
22 increase that SoundExchange is requesting in this

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1 case. And his projections can be depicted -- are
2 depicted graphically in the next two tabs.
3 Tab 7 shows the projected EBITDA for
4 SiriusXM, assuming SoundExchange's rate is accepted.
5 And the next tab, Tab 8, shows the same
6 thing, except free cash flow instead of EBITDA.
7 I think it is entirely clear from these
8 documents that if the Court accepts SoundExchange's
9 rate proposal, SiriusXM will remain a very, very
10 financially healthy company.
11 Now, SiriusXM, in its filings with this
12 Court, has attempted to argue that no, the future is
13 really not that great and there are risks a-plenty
14 out there and there will be tremendous disruption if
15 you increase the rates.
16 I think if you look at the arguments
17 they make, they simply do not withstand scrutiny and
18 they're not really supported by the evidence.
19 First and most general, SiriusXM, I
20 think in Mr. Karmazin's testimony, says, well, you
21 know, there's always a danger that the economy will
22 turn south again, and so that's a risk.

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1 But, here's what Mr. Frear had to say in
2 March of 2011. Quote, the great news is that we
3 seem to grow regardless of the environment. So we
4 grew through the recession. The total subscribers
5 dropped a little bit one year, but that was entirely
6 related to auto sales. If you look underneath the
7 covers, self-paid subscribers has grown
8 consistently, including through the depths of the
9 recession.
10 So, Number 1, I think we all hope
11 there's not going to be any economic downturn; but,
12 Number 2, SiriusXM seems to deal with it quite well.
13 The next aspect of disruption that
14 SiriusXM claims is that they will face increasing
15 competition from -- primarily from Internet services
16 like Pandora, which will become increasingly
17 available in the car.
18 But, again, I quote Mr. Karmazin from a
19 third quarter 2010 earnings call. Quote, Our
20 incredible operational and financial performance
21 over the past several quarters is clearly a
22 reflection of our competitive advantages, which

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1 include nearly complete coverage of the continental
2 United States. Not many companies can deliver
3 content as ubiquitously as we can and, certainly, no
4 audio content provider out there today or at any
5 time in the future will be able to match that -- I'm
6 sorry.
7 I should have said any time in the near
8 future to quote Mr. Karmazin accurately.
9 He then goes on to say, Not only do
10 those competitive advantages help explain our recent
11 performance, but I also want to point out that these
12 factors are not going to go away as we look forward.
13 In fact, some of these competitive advantages will
14 continue to improve and further differentiate our
15 business from existing competitors and any potential
16 competitors on the horizon.
17 So while SiriusXM in this Court says woe
18 is us: we're going to be facing increased
19 competition in the future in their public
20 statements, they assure everyone that they think
21 they're the ones with competitive advantage and it's
22 only going to get better.

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1 Another of the risks that SiriusXM
2 claims is that it is linked to the OEM markets, that
3 is, its future is, to some degree, tied to the auto
4 industry and their ability to get satellite
5 receivers in the cars. And they paint that as a
6 potential problem for the future.
7 In fact, it's exactly the opposite. If
8 you look at Tab 9, again, from a SiriusXM
9 presentation, this is what they're projecting in
10 terms of the number of cars on the road that have
11 factory installed SiriusXM receivers.
12 I think it's important to keep in mind
13 this is their market. This is who they can sell to,
14 people who have those receivers in the car. And
15 it's going to go up from below 20 million in 2009 to
16 close to 100 million by the end of this rate period.
17 So they're going to have 100 million
18 cars on the road that they can sell to. It is a
19 tremendous advantage for them, and they know it.
20 SiriusXM also talks about the risks
21 related to having a satellite system, but it was
22 their intention to replace both systems with all of

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1 the replacements they needed by the first quarter of
2 2012. The launch of that last satellite, I believe,
3 was delayed, but it's fully paid for. It's not
4 something they need to reserve capital for; they've
5 already done that.
6 All of their satellites, according to
7 them, will last through 2020, and they won't start
8 having to invest for the next one until 2016.
9 In addition to that, in October of 2010,
10 SiriusXM launched an in-orbit spare. So if anything
11 happens to either a Sirius or an XM satellite, they
12 have a spare up there ready to go. So the risks
13 from -- related to having a satellite business are
14 minimal, and the costs are pretty much already taken
15 care of.
16 Maybe the thing that Sirius seems to
17 talk about most is debt. They say, gee, we've got
18 billions of dollars in debt, and that's a big
19 problem. Well, actually, no, it's not.
20 The first thing to know is, actually,
21 their leverage ratio has been improving
22 dramatically. And I think if you look at the next

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1 tab, Tab 10 -- again, this is a SiriusXM
2 presentation -- you'll see how their leverage ratios
3 are improving.
4 And the evidence will also show that
5 when any of this debt comes due, SiriusXM expects to
6 be able to refinance it at a lower cost, which will,
7 yet again, improve their financial performance.
8 Here's what Mr. Karmazin said in a third
9 quarter 2011 earnings call. Quote, Remember that
10 over the next few years, we will have the
11 opportunity to refinance some of our expensive
12 legacy debt at lower rates, nor does SiriusXM expect
13 to have any problem refinancing.
14 Mr. Frear, in a fourth quarter 2010
15 earnings call, said this: Quote, You know, I think
16 I just want to reemphasize the point that Mel made
17 in there that we believe we'll be -- very
18 comfortably cover our 2013 and 2015 maturities out
19 of the cash flow of the business.
20 So they expect to just be able to take
21 care of this out of their cash flow. And the truth
22 is that SiriusXM does not want to pay off its debt.

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1 Mr. Rich talked about their debt being sort of junk
2 status. Well, the reality is Mr. Karmazin has said
3 we don't want to pay off our debt. We could be an
4 investment grade company. We could just pay it off,
5 but we don't want to.
6 And this is a quote from a
7 September 2011 presentation by Mr. Karmazin: Quote,
8 We can grow our business in, many, many ways, but we
9 don't see any real advantage of us being an
10 investment grade company. I mean, we know we can
11 easily. If you run out the numbers, you can see how
12 we could be debt free if, in fact, that was our
13 interest.
14 I don't see any reason for this company
15 to be an investment grade company. I don't know
16 what advantages that has for us.
17 So while they talk about the dangers and
18 the burdens of this debt, the reality is, as
19 Mr. Karmazin says, they could pay it off; they just
20 have decided not to.
21 The reality is that when you hear all of
22 the evidence in the case, the conclusion is going to

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1 be that the biggest issue that SiriusXM faces is
2 really what to do with all the money they're making
3 at this point. And that sounds like lawyer
4 hyperbole, but it's not. That is something that
5 Mr. Karmazin actually said recently on a cable TV
6 show called Mad Money, and we actually have the
7 audio of that one.
8 (Audio played from Mad Money.)
9 MR. HANDZO: A billion, 2 or a billion,
10 3 cash on the books and they don't know what to do
11 with it. Go buy back some stock -- which is fine,
12 they're entitled, but they really can't sing the
13 blues about how a rate increase is going to be
14 disruptive.
15 And the last thing I should say on the
16 point of disruption, and then I'll move on, is that
17 there's nothing that SiriusXM has offered by way of
18 evidence of disruption that meets this Court's
19 definition of what would be disruptive under the
20 fourth 801 factor.
21 This Court, in SDARS I, said that
22 disruption is something that directly produces an

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1 adverse impact that is substantial, immediate and
2 irreversible in the short run, because there's
3 insufficient time for either the SDARS or the
4 copyright owners to adequately adopt to the changed
5 circumstances.
6 Nothing that we're talking about here is
7 substantial, immediate and irreversible in the short
8 run; far from it.
9 As I understand the Court's holding,
10 evidence that at some point in the future, there
11 could be an economic downturn, evidence that at some
12 point in the future, there could be competition,
13 that is -- and -- and because of that, you'd like to
14 maintain a bigger pot of cash than you might
15 otherwise have, that's simply not evidence of
16 disruption under this statute. And, certainly,
17 nothing that SiriusXM offers here meets that
18 standard.
19 The only substantial impact -- the only
20 thing that could constitute disruption would be a
21 substantial impact from the rates itself, not from
22 some extraneous change, like a change in the economy

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1 or technology. And the only impact I think you
2 could have from the rates themselves would be
3 imposing a very substantial increase in the rates
4 all at once. And that is why SoundExchange's rate
5 proposal scales up over time, rather than asking for
6 an immediate increase to the endpoint that we have
7 of 20 percent of revenue.
8 So we would submit, considering all of
9 that, the only real issue in this case becomes what
10 do the marketplace benchmarks tell you about what
11 the willing buyer/willing seller rate will be. I do
12 understand that under the statute, you would then
13 have to compare that against the 801 factors and
14 determine whether any change is necessary, but I
15 submit that the evidence will show you that it is
16 not.
17 Now, in terms of the marketplace
18 benchmarks, SoundExchange has submitted analysis by
19 Dr. Ordover and, as we have in the past, Dr. Ordover
20 starts with a benchmark analysis. The Court used,
21 in the SDARS I case, interactive streaming as the
22 benchmark, and Dr. Ordover will testify here that

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1 that is still the correct benchmark.
2 In SDARS I, the Court found that the
3 interactive subscription market is a benchmark with
4 characteristics reasonably comparable to the
5 noninteractive SDARS. Nothing has changed in that
6 regard. It was an appropriate benchmark in SDARS I;
7 it remains the appropriate SDARS -- appropriate
8 benchmark today.
9 In SDARS I, the way the Court used that
10 benchmark was it determined from Dr. Ordover's
11 testimony that the royalty rate in the interactive
12 market, the benchmark market, was about $7.50 a
13 month.
14 The Court then adjusted that rate to
15 account for the salient difference between the
16 benchmark market, interactive services and the SDARS
17 services; and the salient difference is the absence
18 of interactivity in the satellite services.
19 So it adjusted that royalty rate
20 downward to come up with an implied royalty for the
21 noninteractive satellite services of $1.40 per
22 subscriber per month, and it then translated that

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1 into a percentage of revenue by dividing that number
2 into the average monthly price of a subscription,
3 which was then $11.25. That yielded the percentage
4 of revenue rate of 13 percent.
5 Now, Dr. Ordover in this case will give
6 you a number of different ways to analyze this
7 interactive benchmark, but one of the ways he does
8 it is really basically the way the Court did it in
9 this SDARS I decision, following the same
10 methodology.
11 The average royalty rate today for
12 interactive service is about $5.95. Now, to get
13 the -- to adjust that for the absence of
14 interactivity, Dr. Ordover did the same thing
15 basically that Dr. Pelcovitz did in the recent
16 Webcasting III case. He started by taking the
17 average retail price of an interactive streaming
18 service and he compared it to the average retail
19 price of a noninteractive service.
20 And the difference in those retail
21 prices between an interactive and a noninteractive
22 service basically reflects the value that consumers

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1 attribute to interactivity. And, since the royalty
2 that a service is willing to pay record companies
3 for music content is a function of the retail price
4 that consumers are willing to pay, the royalties in
5 the two markets relate to one another.
6 I guess, in my layman's terms, the more
7 consumers will pay for the music, the higher the
8 royalty the service will pay for the music.
9 So the ratio of the interactive royalty
10 to the noninteractive service royalty is expected to
11 be the same as the ratio of the consumer
12 subscription price for an interactive service
13 compared to the subscription price of a
14 noninteractive service.
15 And I can't follow this stuff without
16 looking at a piece of paper and seeing the numbers,
17 so we have one. It's Tab 11.
18 So this is how the -- those numbers
19 work. The average monthly subscription price for an
20 interactive service is 9.99. That's what the
21 consumers pay. The average monthly subscription
22 price for a noninteractive service, that is, the

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1 streaming service, is 4.86. Dividing the
2 interactive consumer price into the noninteractive
3 consumer price gives you a ratio of .4865, or
4 48 percent.
5 So that's your interactivity adjustment,
6 based on the differing value that consumers place on
7 an interactive service versus a noninteractive
8 service.
9 And then we complete the steps that the
10 Court followed in SDARS I. As I said before, the
11 average royalty rate for an interactive service is
12 $5.95. So if we apply that 48 -- .4865 ratio to the
13 interactive service royalty, we get an implied
14 royalty rate for a noninteractive service of $2.89.
15 And that, as a percentage of SiriusXM's subscription
16 price, is about 22 percent.
17 Now, as I said, Dr. Ordover had several
18 different approaches to analyze this benchmark.
19 What I think he will say about the approach that I
20 just described is that it assumes that the only
21 significant difference between the interactive
22 benchmark market and the satellite radio market is

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1 interactivity.
2 There may be other differences that
3 drive the consumer value for those two different
4 services, and so another way to do this is to
5 compare the consumer subscription price for an
6 interactive service to the consumer subscription
7 price for satellite radio.
8 And the belief of economists there is
9 that those different prices will reflect the
10 different value that consumers place on the service
11 and, therefore, will drive the royalty that the
12 services are willing to pay.
13 So Dr. Ordover looked at the ratio of
14 what consumers will pay for a satellite service
15 versus what consumers pay for an interactive
16 streaming service, and he applied that ratio to the
17 royalty that interactive services pay for sound
18 recordings in order to derive a royalty for the
19 satellite service.
20 Basically, he's sort of doing the same
21 thing that I described earlier except, instead of
22 comparing the rates for streaming services, he's

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1 comparing the rates of an interactive streaming
2 service to satellite radio.
3 Now, there is one complication here, and
4 the complication here is that when you look at the
5 price that consumers will pay for satellite radio,
6 you have to take into account the fact that part of
7 what they're paying for is nonmusic content, not
8 music content. And so he needed to adjust for that.
9 And in this case, he had data that he didn't have in
10 SDARS I.
11 Since the time of SDARS I, SiriusXM has
12 offered a mostly music package at 9.99 that didn't
13 have the most nonmusic content, and it offered a
14 nonmusic content package also priced at 9.99.
15 And Dr. Ordover concludes that the fact
16 that those two packages are priced the same suggests
17 that the marginal consumer views the nonmusic
18 content as having the same value as the music
19 content.
20 As it turns out, this really isn't an
21 issue all that much in dispute, because in
22 Dr. Noll's written testimony, he also says that the

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1 music content and the nonmusic content appear to
2 have roughly the same value.
3 So based on that, Dr. Ordover opines
4 that a hypothetical music only satellite service
5 would retail at about half the price of the current
6 service. And, again, we've got the math laid out in
7 Tab 12.
8 And this looks a little more imposing,
9 so I'm not going to try and walk through it all.
10 The -- the math is here, but the bottom line is
11 you're doing the same sort of ratio between the
12 prices and then using that ratio to determine -- to
13 determine the satellite radio subscription -- I'm
14 sorry -- royalty on the theory that it would bear
15 the same relationship to the interactive royalty as
16 the consumer prices do.
17 The result of all of that is that
18 Dr. Ordover concludes that marketplace rates would
19 range from low 20 percent of revenue to upper
20 20 percent of revenue.
21 Now, needless to say, Dr. Noll has a
22 different approach on behalf of SiriusXM. And as

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1 you heard from Mr. Rich this morning, he principally
2 relies on these direct licenses that SiriusXM
3 negotiated with certain independent record labels.
4 The first thing to know about those
5 licenses is that collectively, they represent
6 something like 2 percent of the market, plus or
7 minus. And when you realize that there are, you
8 know, 60 plus indies that signed these direct
9 licenses, and together they represent 2 percent or
10 so of the market, what that's telling you is that
11 each one of these is a very, very small fish.
12 And at the end of the day, I think the
13 evidence is going to show you that an indie with a
14 .03 percent market share is not going to negotiate
15 the same deal that Sony or Universal, with a 20 or
16 30 or 35 percent market share, would negotiate.
17 The second thing to know is that when --
18 Mr. Rich earlier today showed you a chart where he
19 compared the various benefits of different types of
20 benchmarks, and in one of them was is it a rate from
21 a competitive market. Well, the reality is that
22 these direct licenses are not really negotiated in a

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1 competitive market; they are negotiated in a heavily
2 regulated setting.
3 As I think Dr. Noll will admit, when
4 these licenses were negotiated, there's a statutory
5 license that's kind of overhanging the negotiations.
6 So, for example, labels don't have any
7 ability to just refuse to license. They don't have
8 any ability to say no, I don't like the price, I'm
9 just not going to do it. Their only choices are
10 license at the rate that's offered or come to this
11 Court and ask to set a rate. But they can't say no,
12 which distinguishes this whole scenario from what
13 would happen in an actual market setting.
14 And that, in turn, means that what
15 drives the negotiated rate with these direct
16 licenses is not what the parties think would happen
17 in a marketplace. What drives the negotiated rate
18 in this setting is what do the parties think this
19 Court is going to establish as the statutory rate.
20 That's going to be the -- the thing that
21 they think about when they're deciding what rate to
22 agree to.

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1 Now, because all of the indies who
2 signed these deals are very small players, none of
3 them have ever participated in proceedings before
4 this court, and they are very ill-equipped to make
5 that judgment about what rates may come out of this
6 proceeding.
7 In fact, in the negotiating documents, I
8 think you will see, these indies were told by MRI,
9 which was representing SiriusXM, that, you know, the
10 rate currently is 7.5 percent, will go up to
11 8 percent, don't think it's going to go up above
12 that or, if it does, it's going to go up very
13 little, maybe by .5.
14 So when these indies are negotiating,
15 they're being told that here's the rate, it's not
16 likely to change or it will change very little.
17 They don't have any experience with this Court.
18 They don't know how the rates are set. They're
19 going to accept that, and that's basically the
20 negotiation. It's not a marketplace negotiation.
21 The other thing to keep in mind about
22 these licenses is that with -- they were negotiated

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1 with the statutory rates sort of as a ceiling, but
2 then what SiriusXM did through MRI is it offered
3 some inducements that are not part of the statutory
4 license.
5 For example, you will see that SiriusXM,
6 again, through MRI, in its talking points for
7 negotiations emphasized to these labels that they
8 would be paid 100 percent of the royalty. As the
9 Court knows, under the statutory standard, labels
10 get 50 percent, and SoundExchange distributes
11 45 percent directly to the featured artists and
12 5 percent to the nonfeatured artists. So the label
13 only directly gets 50 percent, rather than
14 100 percent.
15 So what SiriusXM is doing is it's going
16 to these labels and saying, in contrast to the
17 statute, we'll give you 100 percent. That matters
18 to these labels, because if you are a label that has
19 made advances to an artist and you're entitled to
20 recoup your advance from the royalties, getting
21 100 percent of the royalties obviously allows to you
22 recoup a heck of a lot faster than you would if you

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1 were only getting 50 percent. And you'll see
2 evidence that that was something that motivated at
3 least some of these indies. Some of the indies were
4 offered advances, which SoundExchange can't do.
5 So there are various inducements that
6 simply are not part of the statutory scheme that may
7 have caused these indies to accept what they
8 perceived as a very small haircut off what they were
9 being told was the statutory rate.
10 I think the fourth thing to consider
11 here with respect to these direct licenses is that
12 if only 2 percent of the market took the deals,
13 98 percent either turned it down or SiriusXM knew it
14 was futile to even offer. And we would submit that
15 a rate that 90 percent -- 98 percent of the market
16 won't accept is not a marketplace rate.
17 Now, I think what Dr. Noll will say, and
18 we'll hear soon enough, is that 98 percent of the
19 market declined these offers because they preferred
20 to act collusively through SoundExchange.
21 But to what end? Because acting through
22 SoundExchange just means that these record companies

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1 would have to come to this Court to set a rate. And
2 if this Court is going to set a marketplace rate
3 anyway, why would they turn down a marketplace rate
4 that's being offered voluntarily by SiriusXM?
5 Dr. Noll has an answer. Dr. Noll says
6 that the record companies that declined these direct
7 licenses did so because they expect this Court to
8 set an above market rate.
9 Dr. Noll says that the whole regulatory
10 process is rigged in the record companies' favor,
11 that the record companies, that SoundExchange have
12 informational and political advantages in this
13 regulatory system, which would lead them to want to
14 come to this Court because they confidentially
15 expect a higher than market rate from this Court.
16 Now, I have to say I'm all in favor of
17 judges who want to be biased in my favor, but this
18 is the fifth time I've been in this Court. And if
19 the Court has been biased in my favor in the past, I
20 didn't see it. I don't believe that this system is
21 biased in anybody's favor. It is an equal, level
22 playing field. Everybody plays by the same rules.

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1 And the reality is that Dr. Noll's
2 theory really kind of falls apart, unless you accept
3 his premise. Because unless you accept his premise
4 that the record companies think they will do better
5 than a marketplace rate here, they would have had no
6 reason for 98 percent of them to refuse these direct
7 licenses.
8 Dr. Noll's fallback is a benchmark based
9 on agreements with a single webcaster, Last.fm.
10 Even if the statutory webcasting rate represented a
11 useful benchmark -- and it does not -- Dr. Noll
12 ignores the rates that SiriusXM itself negotiated
13 for its noninteractive Internet streaming; he
14 ignores the rates set by this Court; and, just as
15 importantly, he ignores the impact of per-play rates
16 on the webcasting market.
17 As this Court knows, when it has set
18 rates for webcasters in the past, it has set them as
19 a per-play rate and the rates negotiated between
20 SoundExchange and SiriusXM for its webcasting,
21 likewise, on a per-play basis.
22 Now, in the Last.fm deal that Dr. Noll

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1 relies on, the rates are stated as a greater of a
2 percentage of revenue, a per-play rate or a
3 per-subscriber rate. And Dr. Noll concludes from, I
4 think, one monthly statement by Last.fm to Universal
5 that based on the number of plays in that statement,
6 he can ignore the per-play rates in this deal and
7 just conclude that he only needs to look at the
8 percentage of revenue rates.
9 But what he doesn't consider is what
10 rate SiriusXM would, in fact, pay under the Last.fm
11 deal if it was operating under that deal. In other
12 words, SiriusXM might use music a lot more
13 intensively than Last.fm does. It might have a lot
14 more plays if we were ever in a position to figure
15 out how many plays it has.
16 You just can't tell how that deal would
17 apply to SiriusXM unless you know the number of
18 plays, and Dr. Noll has made no effort to figure
19 that out.
20 Now, finally, I should point out that
21 Dr. Noll applies the rate that he derives from all
22 of this to SiriusXM's revenues after he nets out

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1 both the revenue from nonmusic content -- that he
2 attributes to nonmusic content and what he claims is
3 the value of the SiriusXM network, satellites and so
4 on.
5 In that regard, it seems as though
6 Dr. Noll is essentially repackaging testimony that
7 was offered by Dr. Woodbury on behalf of SiriusXM in
8 SDARS I. Dr. Woodbury essentially made the same
9 arguments and offered the same kinds of calculations
10 that Dr. Noll is doing here.
11 Dr. Woodbury referred to that as his
12 functionality adjustment, and the Court specifically
13 rejected it. They referred to Dr. Woodbury's -- the
14 Court referred to Dr. Woodbury's theory as the
15 unsubstantiated theory that any such other inputs
16 could produce the same level of revenue, absent any
17 music to broadcast.
18 In other words, the network doesn't have
19 any value, except as a vehicle to -- to broadcast
20 the content. And so you cannot simply say the
21 network has an independent value from the content.
22 It doesn't. It has no value independent of the

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1 content. And you have to assess all of it together,
2 which Dr. Ordover does; Dr. Noll does not.
3 SoundExchange proposes for SiriusXM that
4 the rates begin at 12 percent of revenue in 2013,
5 increase to 20 percent at the end of the rate term.
6 And we would submit that the evidence supports that.
7 No accommodation is needed for the
8 801(b) factors other than ramping up over the rate
9 term, which is what SoundExchange proposes.
10 I do want to spend a few minutes talking
11 about Music Choice.
12 JUDGE WISNIEWSKI: Actually, before you
13 get there, Mr. Handzo, if I can interrupt you for a
14 second.
15 MR. HANDZO: Sure.
16 JUDGE WISNIEWSKI: You had mentioned the
17 music royalty fee or surcharge of $1.98.
18 Was that encompassed within the revenue
19 definition that applied under SDARS I?
20 MR. HANDZO: I'm hesitating. I believe
21 the answer is yes. I'm not 100 percent confident.
22 I will do what you have seen me do often

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1 in these proceedings in the past; I'll look back to
2 my colleagues -- the answer is yes.
3 JUDGE WISNIEWSKI: So, in effect, you've
4 got some portion of -- of that surcharge effectively
5 to the extent that it was reflected in additional
6 revenue --
7 MR. HANDZO: Yes.
8 JUDGE WISNIEWSKI: -- and that continued
9 to be the case on the -- when it was reduced to
10 1.40?
11 MR. HANDZO: I think it should be, yes.
12 I mean, that rate increase went in fairly recently.
13 I should say, though, as you know from
14 our case, SoundExchange has some issues with -- with
15 the revenue base against which the royalty rate
16 is -- is assessed. And since you raised the
17 subject, let me --
18 JUDGE WISNIEWSKI: That's the point I
19 was getting to, just to see what that -- if you
20 could highlight that for us.
21 MR. HANDZO: Sure.
22 When the Court set the rates in SDARS I,

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1 it determined that the royalty that the Court found
2 was established by the upper bounds of the market --
3 well, I should back up.
4 When the Court set the rate, it
5 determined what the market rate would be, and then
6 it divided that into the per-subscriber fees that
7 SiriusXM was charging to derive its percentage of
8 revenue.
9 And I think we -- we submitted the
10 testimony of Jonathan Bender, who has analyzed the
11 payments that SiriusXM has made. And it turns out
12 that the percentage of revenue that SiriusXM
13 actually pays against is far below the number that
14 the Court used to determine the percentage of
15 revenue.
16 Now, it seems to me you can sort of
17 address that two ways. Obviously, ultimately, the
18 royalty that gets paid is a function of the
19 percentage of revenue versus what amount of revenue
20 are we levying it against.
21 And the -- the real point here is that
22 when -- if the Court was establishing a percentage

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1 of revenue assuming that it was going to be paid
2 against a certain revenue base and then it turns out
3 it wasn't paid against that revenue base, it was
4 paid against something substantially less, we submit
5 that a change needs to be made. And we have
6 submitted regulations which we think would make that
7 change. The other way to do it would simply be to
8 adjust the percentage of revenue accordingly.
9 Judge Wisniewski, if that addresses your
10 question, I was going to go back to Music Choice.
11 JUDGE WISNIEWSKI: Yes, it does. Thank
12 you.
13 MR. HANDZO: As the Court knows, there
14 are only two PSS services, and only Music Choice is
15 participating in this proceeding. The current rate
16 is 7.5 percent of revenues. SoundExchange is
17 proposing a royalty that starts at 15 percent and
18 ends at 45 percent, while Music Choice has proposed
19 a rate of 2.6 percent.
20 One thing I think both parties actually
21 do kind of agree on is that services like
22 Music Choice offering a noninteractive audio

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1 programming delivered through cable TV is fairly
2 unique in the digital space. And this Court has
3 recognized in the past, SoundExchange has recognized
4 that in the past.
5 And that certainly does make setting a
6 rate a little bit challenging. But what Dr. Ford
7 has done is he looked at the prevailing market rates
8 for numerous types of digital services. Mr. Fakler
9 says, oh, he -- you know, he was too high, there are
10 some lower than he's saying. But I can tell you
11 there are none that are as low as the rate that is
12 now being charged to Music Choice. And that's the
13 fundamental point.
14 It is hard to find something that you
15 can point to as this is the service that is
16 comparable, and here's the benchmark; however, what
17 you can do is you can look at everything that's out
18 there, and what you can see is that Music Choice has
19 got a royalty rate that is way lower, way lower than
20 anything else you see in the market. And there's
21 just no reason for it to be an outlier in that way.
22 As Dr. Ford will explain, one of the

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1 virtues of a percentage of revenue rate is that it
2 adjusts in accordance with the revenue that the
3 service is using.
4 So if Music Choice isn't earning a high
5 revenue, since it's paying on a percentage of
6 revenue basis, the royalty goes down accordingly.
7 So although Music Choice talks about how
8 we can't charge all that much for our service, the
9 reality is that if you impose a percentage of
10 revenue fee, it's going to, in effect, self-adjust.
11 The evidence that I think Dr. Ford will
12 present will make it clear that under anything you
13 might use as a benchmark, any digital service,
14 7.5 percent is just way too low. There's just
15 nothing like it out there.
16 And so then the fallback for
17 Music Choice appears to be, well, okay, but we need
18 to adjust down to account for the 801 factors. And
19 I think that Music Choice just greatly overstates
20 the impact of those factors.
21 As I sat through Mr. Fakler's opening
22 today, it kind of sounded to me -- and I apologize

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1 if I'm mischaracterizing, but it sounded to me like
2 he was effectively saying that the statute was
3 intended to make the record companies and the
4 artists the guarantors of Music Choice's economic
5 survival.
6 I don't believe that's what the statute
7 was intended to do.
8 The statute does not require that PSS
9 services remain in business forever no matter what
10 it costs the recording industry to do it.
11 Indeed, Mr. Fakler appears to go
12 further, and he appears to say, even if we choose to
13 invest in new technologies, if we have costs, then
14 the recording industry has to underwrite those. And
15 that is surely not the point of the 801(b) factors.
16 The reality is that if Music Choice
17 struggles financially -- and SoundExchange does not
18 concede that at all -- the royalty that it pays is
19 not the cause, and the copyright owners are not
20 required to simply do whatever needs to be done to
21 help Music Choice surmount any economic hurdles that
22 it may face.

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1 Apart from arguing the disruption and
2 801(b) factors, Music Choice relies on the musical
3 works benchmark, I don't think I really need to say
4 much more than other -- than that -- about that,
5 other than it has been rejected by this Court on
6 numerous occasions.
7 Accordingly, we would ask the Court to
8 adopt the SoundExchange proposal for Music Choice.
9 And I just want to close by coming back
10 to SiriusXM for a moment.
11 When Mr. Rich started off at the very
12 beginning of this morning, he said that SiriusXM
13 pays the record companies and the artists a lot of
14 money. And he just stressed that at the outset,
15 here's the tens of millions, hundreds of millions of
16 dollars that we pay the record companies, and we'll
17 pay them even more in the future.
18 But the reality is SiriusXM makes a lot
19 of money, so much so that as you heard Mr. Karmazin
20 say a little earlier, they don't even know exactly
21 what to do with it all.
22 Sirius can afford to pay for the content

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1 that it broadcasts. In fact, Mr. Karmazin has
2 bragged about it.
3 And this is my last Mel Karmazin quote
4 for the moment. In April of 2012, he said, And,
5 again, we're a very profitable, successful company.
6 If we want a performer, we can afford to pay more
7 than anybody else can because we're making more,
8 unquote.
9 Well, SiriusXM now comes into this Court
10 and sings a very different tune about its ability to
11 pay for performers. But they can pay.
12 And if SiriusXM winds up with a billion
13 dollars or more of free cash at the end of this
14 year, at least half of that, if not more, is due to
15 the sound recordings that they are broadcasting.
16 As a very profitable, successful
17 company, SiriusXM should be able to pay a fair
18 market rate for the music content that has made it a
19 very profitable, successful company.
20 The surveys that SiriusXM does of its
21 subscribers show that the thing they value most
22 about this service is the music. It is the music

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1 that drives their profitability. And the music is
2 entitled not out of some sense of fundamental
3 fairness or just because the money is there, but the
4 music is entitled to get a fair market rate. That's
5 what we're asking for. That's what we think our
6 evidence supports.
7 Thank you.
8 CHIEF JUDGE BARNETT: Thank you.
9 Do you want to take a recess?
10 It will be about 10 minutes so the court
11 reporter can take care of her business as well.
12 (Whereupon, a brief recess was taken
13 from 2:18 p.m. to 2:29 p.m.)
14 CHIEF JUDGE BARNETT: Please be seated.
15 MR. HANDZO: If I may, I just have a
16 housekeeping matter before we call the first
17 witness.
18 CHIEF JUDGE BARNETT: Okay.
19 MR. HANDZO: One of the SoundExchange
20 witnesses, Thomas Lys, we learned a day or two ago
21 was recently admitted to the hospital, and, in fact,
22 may not get out of the hospital before the end of

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1 this trial; that is, the direct phase of the case.
2 I don't know that to be the case yet.
3 And the background is some weeks ago he
4 had a fall from a horse, he broke his leg. But
5 then, apparently, there have been complications,
6 possible bone infections, so on, so they're talking
7 about doing skin grafts and all sorts of things.
8 I'm not asking the Court to do anything
9 about this now, because we just don't know how this
10 is all going to play out, but we have told counsel
11 for the Services, and I did want to just at least
12 put it on everybody's radar screen because it may --
13 it may be something that we'll need to ask for an
14 accommodation about later.
15 CHIEF JUDGE BARNETT: Okay. Thank you
16 very much.
17 MR. HANDZO: Thank you.
18 CHIEF JUDGE BARNETT: Mr. Rich, you may
19 call your first witness.
20 MR. RICH: Your Honors, we call
21 Professor Roger Noll as our first witness.
22 WHEREUPON,

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1 ROGER G. NOLL
2 called as a witness, and having been first duly
3 sworn, was examined and testified as follows:
4
5 EXAMINATIONS ON QUALIFICATIONS
6
7 BY MR. RICH:
8 Q. Good afternoon.
9 A. Good afternoon.
10 Q. Would you please state your name for the
11 record?
12 A. Roger G. Noll.
13 Q. Dr. Noll, what is your occupation?
14 A. I am a professor emeritus, which means
15 retired, at Stanford University in the Department of
16 Economics.
17 I also still run my research program in
18 the Stanford Institute for Economic Policy Research.
19 Q. Would you tell the Court briefly what --
20 what the Institute for Economic Policy is involved
21 in and what your role is?
22 A. The Stanford Institute for Economic

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1 Policy Research is basically a university-wide
2 research institution that involves all of the
3 economists across campus, regardless of where
4 they're located, and the program inside of it that I
5 run is called the program and regulatory policy.
6 I'm also on the -- the steering committee, the
7 executive committee of the Institute.
8 Q. Would you please provide the Court with
9 your educational background? And I know that much
10 of this is in your CV, and we'll be selective in
11 coursing through it, or else we will devote most of
12 the afternoon here doing that.
13 A. I have an undergraduate in mathematics
14 from the California Institute of Technology, and I
15 have an M.A. and Ph.D. in economics from Harvard
16 University.
17 Q. Now, according to your vitae, you've
18 taught economics for more than 40 years; is that
19 correct?
20 A. It's approaching 50. I first started
21 teaching in '64, '65.
22 Q. Am I correct from the vitae that

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1 principally, those teaching engagements were first
2 at Cal Tech and, since 1984, at Stanford?
3 A. Yes. I've been visiting professor at
4 various places, but the two principal academic
5 appointments I've had were Cal Tech and Stanford.
6 Q. And would you please describe the
7 principal areas of your research concentration as an
8 economist?
9 A. Yes. The field that economists call
10 that I work in, the name the economists use is
11 industrial organization. The actual topical area of
12 my own research is antitrust regulation and
13 technology policy, R&D and technological progress.
14 Q. And have you written in each of those
15 fields?
16 A. Yes, I have.
17 Q. And, overall, how many books have you
18 authored or coauthored in your career?
19 A. Fourteen.
20 Q. What's the number of publications more
21 generally in terms of scholarly books and journals
22 that you've authored or coauthored?

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1 A. It's over 300.
2 Q. And focusing in the area of intellectual
3 property, have you published in that field as well?
4 A. Yes, I have.
5 Q. And if you turn to Page -- we're going
6 to offer your -- your testimony in evidence shortly,
7 but as part of the credentialing process, if you
8 would turn to Page 2 in the proposed testimony in
9 front of you, your revised amended testimony, you
10 make reference in the second full paragraph on
11 Page 2 to certain publications, including The
12 Digital Dilemma.
13 Do you see that?
14 A. Yes.
15 Q. Could you briefly describe the subject
16 areas of those publications?
17 A. Yes. The Digital Dilemma was a book
18 that was put together by a group of us for the
19 National Academies on the impact of digital
20 technology on many industries: entertainment,
21 software. We wrote a report about the policy
22 implications of these changes and how -- how

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1 intellectual property law, in particular, would have
2 to adjust to new digital technology.
3 Q. And another publication you reference in
4 that paragraph is Bridging the Digital Divide.
5 Do you see that?
6 A. Yes.
7 Q. Can you describe that briefly?
8 A. That was prepared -- that was by a group
9 of us. Actually, I led a team that consisted at
10 that time of some of my students to examine the
11 issue of the diffusion of digital technology in
12 society among consumers in California.
13 And we -- our concern there was whether
14 the growing disparity in access to digital
15 technology by educational and income groups was
16 creating some sort of a problem and, if so, were
17 there any policies that could be -- that could deal
18 with that problem.
19 Q. Next in the list is, quote, ISDN and the
20 Small User. Can you describe that briefly?
21 A. ISDN was the first digital network
22 technology that was introduced by telephone

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1 companies about 20 years ago. And this was an
2 article written with, again, a former -- a student
3 of mine at the time who is now at MIT, on what the
4 potential market impact of digital networks, ISDN,
5 was going to be.
6 Q. Next in the list of publications that
7 you indicate bear directly on the analysis you
8 provide this Court is the Economics of Information,
9 A User's Guide.
10 What is that?
11 A. That was a paper that I wrote for the
12 Aspen Institute at a conference that involved mostly
13 people from industry, where I basically explain the
14 economics of information in terms of what the cost
15 functions are, what the revenue functions are and,
16 in particular, I dealt with the issue of piracy of
17 information, what -- what a reasonable economic
18 definition of piracy really was and how the changes
19 in technology would affect the extent to which
20 piracy would occur.
21 Q. A couple more.
22 You next cite The Economics of Scholarly

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1 Publications and the Information Superhighway.
2 A. Yes.
3 Q. Can you describe that work?
4 A. That was what would the availability of
5 digital technology capable of basically producing
6 what we now have, things like ebooks, having
7 publications be distributed over the Internet and
8 over digital networks, how would that affect
9 scholarly publications and the viability of
10 scholarly journals, and the use of scholarly
11 journals as a way to vet the qualities of academics
12 for promotion and tenure.
13 Q. Finally in that list, Intellectual
14 Property Antitrust in the New Economy.
15 Can you describe that, please?
16 A. Yes.
17 That was a paper that I wrote for a
18 conference put on by the American Antitrust
19 Institute on the -- at the time, the -- there was an
20 issue of whether the innovations in information
21 technology were essentially making traditional ways
22 of thinking about antitrust policy irrelevant. And

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1 this is an article that says no, that's not true,
2 it's just more difficult, but it's still the same
3 principles applied.
4 Q. Has your research and/or writing
5 included work on the regulatory process as a
6 mechanism for setting prices?
7 A. Yes, it has.
8 Q. Can you describe a little bit your work
9 in that area?
10 A. Actually, probably the single biggest
11 part of my work has been at the intersection of
12 economics law and politics, that it's a little bit
13 bigger than just regulation, it's administrative
14 law. That is to say, how the existence of
15 administrative processes affects the performance of
16 the economy.
17 That's probably my single most important
18 area of research. And I've been doing that for my
19 entire career.
20 My first book was called Reforming
21 Regulation, and it dealt with that issue. The book
22 I'm going to write next year with two of my former

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1 students will deal with that issue.
2 Q. I take it that -- as we'll get to a bit
3 later, a portion of your written direct testimony
4 takes some of that learning on your part and applies
5 it to certain principles that you would derive in
6 this current setting; is that correct?
7 A. That's correct.
8 Q. And just to round out the record a bit,
9 what subjects have you taught over your career that
10 bear on topics we're going to be discussing today?
11 A. I have taught, in addition to sort of
12 the core courses that all economists teach,
13 microtheory and econometrics and things like that,
14 my main teaching has been in the field of industrial
15 organization. I -- my -- my -- almost every year
16 until I retired, I taught both the undergraduate and
17 graduate courses in antitrust and regulation, plus I
18 taught an undergraduate course in essentially public
19 policy analysis, benefit cost analysis.
20 Q. And I take it, again from your vitae,
21 that you've acted as either an independent expert or
22 an advisor to both committees of Congress and a

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1 variety of Government agencies; is that correct?
2 A. Yes, I have.
3 Q. Can you just enumerate several of those?
4 A. Well, I have -- I have -- was involved
5 with the Department of Justice in the creation of
6 USA-ATT. I was involved with the Federal
7 Communications Commission in the deregulation of
8 cable television that occurred in 1980.
9 I have -- I have -- I still participate,
10 I'm currently involved with a process at the Federal
11 Trade Commission.
12 I submitted an amicus submission to the
13 Federal Communications Commission just a few months
14 ago on blackouts of telecasts of sports events.
15 Q. I counted four Presidential task forces
16 or committees on which you've served; does that
17 sound right?
18 A. Yes.
19 Q. And could you --
20 JUDGE ROBERTS: Let me just interrupt a
21 second, Mr. Rich.
22 Professor Noll, I took a little bit of

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1 interest in your -- your paper to the FCC about the
2 sports blackout today.
3 THE WITNESS: Did you read it?
4 JUDGE ROBERTS: No. Unfortunately, I
5 didn't -- I didn't secure a copy of it, but I'm
6 wondering how you came out on that.
7 THE WITNESS: That it's time for the
8 Federal Communications Commission to withdraw from
9 the fray, that there's no need for the Federal
10 Communications Commission to regulate blackouts and
11 to create a cover, basically.
12 The only sport that it actually matters
13 is the National Football League. The rest of the
14 sports negotiated their way out of it, and so I just
15 think the FCC should withdraw from the fray.
16 JUDGE ROBERTS: I only raise it because
17 should the FCC repeal that rule, that would trigger
18 a proceeding before us.
19 THE WITNESS: Really?
20 Well, I'll see you again.
21 JUDGE ROBERTS: Thank you.
22

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1 BY MR. RICH:
2 Q. Just completing this credentialing
3 phase, could you briefly describe for the Court the
4 work you've done for the World Bank?
5 A. Yes.
6 I have, on a number of occasions, been a
7 member of a World Bank mission to some developing
8 country to provide technical assistance on the --
9 essentially the privatization of the
10 telecommunications industry: the entire thing, not
11 just telephones, but including digital technology
12 and the kinds of regulatory institutions and the
13 kinds of competition policy one has to have in place
14 in order for that privatization process to work.
15 And I've been probably to a dozen countries over the
16 past 25 years in that capacity.
17 Q. It's made for interesting dinner
18 conversation with me, I know that.
19 A. That's right.
20 Q. Am I correct that your written direct
21 testimony lists numerous instances in which you
22 provided expert testimony in cases dealing with,

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1 among others, intellectual property issues and,
2 specifically, in many cases, involving the licensing
3 of broadcast or digital transmission rights?
4 A. Yeah. I'm not sure I'd use the word
5 "numerous," but it's a list, maybe 20 things on it.
6 Q. Several?
7 A. Yes.
8 Q. And I take it you were a rebuttal
9 witness in the prior SDARS proceeding, correct?
10 A. That's correct.
11 Q. Representing jointly the then separate
12 Sirius and XM entities?
13 A. Well, not representing, but appearing on
14 behalf.
15 Q. Appearing on behalf of them?
16 A. Yeah.
17 Q. And a recent trial appearance in Federal
18 Court in New York, I take it, was in a case styled
19 MobiTV versus ASCAP; is that correct?
20 A. That's correct.
21 Q. And that was a rate-setting proceeding
22 under the auspices of the United States consent

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1 decree in regulating ASCAP to some degree; is that
2 correct?
3 A. That's correct.
4 Q. And what was the nature of your
5 testimony there?
6 A. My testimony was about how to set
7 appropriate rates in the context, of course, of
8 ASCAP, which is an antitrust setting, as opposed to
9 this, but it was what is the appropriate way to
10 develop benchmarks for rates, for performance -- the
11 performance part, not the -- not the recording part,
12 but the musical works part.
13 Q. And to what degree did the District
14 Court in its eventual opinion in that case follow
15 some or all of the advice you provided?
16 A. They basically adopted everything that I
17 had proposed.
18 Q. And am I correct that in recent weeks,
19 the Second Circuit has affirmed that decision?
20 A. Yes.
21 MR. RICH: At this point, Your Honors,
22 I'd like to offer Professor Noll as an expert in the

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1 economics of industrial organization, including the
2 economics of antitrust regulation and intellectual
3 property.
4 JUDGE WISNIEWSKI: Before you do that,
5 Mr. Rich, I want to give Professor Noll a chance, in
6 the interest of full accuracy, to correct the answer
7 that he gave to a question that you asked him.
8 MR. RICH: Please.
9 JUDGE WISNIEWSKI: You had asked him
10 whether he had been the author or coauthor of some
11 14 books or monographs and, actually, in your -- in
12 your vitae, you list yourself as author or coauthor
13 of seven, and instead, as the editor or coeditor of
14 the other seven.
15 THE WITNESS: The books I'm editor of
16 I'm also a coauthor of. I have at least one and
17 usually several chapters in those books.
18 JUDGE WISNIEWSKI: Chapters?
19 THE WITNESS: Yes.
20 JUDGE WISNIEWSKI: I recall that
21 vividly, because I'm almost your age.
22 THE WITNESS: No, you're not.

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1 JUDGE WISNIEWSKI: In terms of history
2 in the profession and, in fact, I used the '74 book,
3 Government and Sports --
4 THE WITNESS: The sports business? I
5 wrote three chapters.
6 JUDGE WISNIEWSKI: In a class I taught
7 the economics of team sports back in -- in '74.
8 THE WITNESS: You have very good taste.
9 JUDGE ROBERTS: Mr. Rich, could you
10 repeat that again?
11 MR. RICH: The proffer is, as an expert
12 in the economics of industrial organization,
13 including the economics of antitrust regulation and
14 intellectual property.
15 CHIEF JUDGE BARNETT: Mr. Handzo.
16 MR. HANDZO: No objection, Your Honor.
17 MR. RICH: Thank you.
18 MR. FAKLER: No objections.
19 CHIEF JUDGE BARNETT: Professor Noll is
20 so qualified.
21 MR. RICH: Thank you.
22

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1 DIRECT EXAMINATION
2 BY MR. RICH:
3 Q. Now, you have in front of you what has
4 been designated as your revised -- revised amended
5 written direct testimony in this case. That's that
6 rather large binder.
7 Do you have that, sir?
8 A. Yes, I do.
9 Q. Okay. And do you recognize that as
10 reflecting your work?
11 A. Yes, I do. This is --
12 Q. And --
13 A. -- this belongs to me. Like, obviously,
14 I haven't read the whole thing, but looking at it,
15 it looks like exactly what I did.
16 Q. Can you verify that the declaration
17 appearing at the end of that testimony bears your
18 signature?
19 A. Yes, that's my signature.
20 Q. And are the attached tables and
21 appendices those that you rely on and reference in
22 this written testimony?

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1 A. Well, that's -- it's supposed to be all
2 the things I relied upon, yes.
3 Q. Yes.
4 A. Yes.
5 MR. RICH: Your Honors, at this point,
6 and consistent with this morning's colloquy, we
7 would offer this document in evidence as SiriusXM
8 Trial Exhibit 1.
9 MR. HANDZO: No objection, Your Honor.
10 MR. FAKLER: No objection, Your Honor.
11 CHIEF JUDGE BARNETT: Okay. Exhibit 1
12 is admitted.
13 (SiriusXM Trial Exhibit Number 1 was
14 marked and admitted into evidence.)
15 MR. HANDZO: Your Honor, if I may, this
16 is the point in time when usually the opposing party
17 then asks for certain of the information to be
18 treated as restricted. And I do have such a motion
19 to make with respect to some of the information in
20 Dr. Noll's report.
21 CHIEF JUDGE BARNETT: Okay.
22 MR. HANDZO: Specifically starting at

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1 Page 77.
2 CHIEF JUDGE BARNETT: I'm going to ask
3 you to speak up.
4 MR. HANDZO: Starting at Page 77, there
5 are highlighted portions of the text which we would
6 ask to be treated as restricted.
7 JUDGE ROBERTS: On what grounds,
8 Mr. Handzo?
9 MR. HANDZO: Your Honor, the -- this
10 refers to the Slacker deal.
11 JUDGE ROBERTS: Yes.
12 MR. HANDZO: Which I believe is
13 currently in effect with Universal, and we have --
14 we ask for deals that are currently in effect to be
15 treated as restricted, because they are information
16 that is known to one record company but not to the
17 other record companies, and for having all of the
18 record companies knowing what the deals of their
19 competitors are is obviously competitively sensitive
20 information.
21 JUDGE ROBERTS: All right.
22 MR. RICH: We have no objection.

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1 CHIEF JUDGE BARNETT: The text and the
2 footnote?
3 MR. HANDZO: Yes, Your Honor.
4 CHIEF JUDGE BARNETT: Consider that
5 restricted.
6 Okay, go ahead.
7 MR. HANDZO: Then on Page 78, we would
8 ask that the last paragraph of 78, carrying over to
9 79, be treated as restricted.
10 CHIEF JUDGE BARNETT: And just the top
11 line on 79?
12 MR. HANDZO: Well, no, I'm sorry. On
13 79, I would also ask for the rest of the highlighted
14 information to be treated as restricted.
15 CHIEF JUDGE BARNETT: Okay.
16 Mr. Rich?
17 MR. RICH: No objection.
18 CHIEF JUDGE BARNETT: Okay.
19 JUDGE ROBERTS: The same reasoning,
20 Mr. Handzo?
21 MR. HANDZO: Yes, that's correct.
22 CHIEF JUDGE BARNETT: Okay. That will

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1 be treated as restricted.
2 MR. HANDZO: Then on Page 81, I would
3 ask for the highlighted information be restricted on
4 the same basis.
5 MR. RICH: No objection.
6 CHIEF JUDGE BARNETT: The highlighted
7 material on Page 81 is then restricted.
8 MR. HANDZO: Thank you.
9 Moving ahead to Page 89, we would ask
10 that the -- in the first paragraph the highlighted
11 information be restricted, so there's just
12 essentially one line there.
13 MR. RICH: What about the table?
14 MR. HANDZO: We are not asking that the
15 table be restricted.
16 MR. RICH: No objection.
17 CHIEF JUDGE BARNETT: And that's on the
18 same basis, Mr. Handzo?
19 MR. HANDZO: Correct.
20 CHIEF JUDGE BARNETT: Okay. What about
21 the two bits on the bottom of Page 89?
22 MR. HANDZO: We are not asking that that

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1 be treated as restricted.
2 CHIEF JUDGE BARNETT: Okay.
3 MR. HANDZO: Page 90, we are not asking
4 that the table be treated as restricted; however, we
5 are asking that the couple of lines in the first
6 full paragraph below that be treated as restricted,
7 again, on the same theory.
8 MR. RICH: No objection.
9 CHIEF JUDGE BARNETT: On the same basis,
10 that will be considered restricted.
11 MR. HANDZO: Then, unfortunately, I also
12 need to address the exhibits.
13 Starting with Exhibit H, we ask that be
14 treated as restricted in its entirety.
15 CHIEF JUDGE BARNETT: What's your basis?
16 MR. HANDZO: Again, the same -- the same
17 basis as before, Your Honor.
18 MR. RICH: One moment, please,
19 Your Honor.
20 (Pause.)
21 MR. RICH: We have no objection.
22 CHIEF JUDGE BARNETT: Exhibit -- or.

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1 excuse me, it's entitled Appendix H, I believe.
2 Appendix H is then considered restricted in its
3 entirety.
4 MR. HANDZO: Then turning to Appendix I,
5 there are two documents here separated by a blue
6 sheet of paper. We are not asking that the first
7 document be treated as restricted. We are, however,
8 asking that the second document be treated
9 restricted, again, on the same theory.
10 MR. RICH: Perhaps for the record,
11 Mr. Handzo, you ought to identify it so there's no
12 lack of clarity.
13 MR. HANDZO: Yes. I'll use the
14 Bates number. The first page of it is
15 SX02 00127848.
16 MR. RICH: Again, we have no objection.
17 CHIEF JUDGE BARNETT: It's entitled
18 Amendment Number 1 of Interactive Radio and Music
19 Services Agreement.
20 MR. HANDZO: Correct.
21 CHIEF JUDGE BARNETT: Those Bates page
22 numbers ending with -7855. That document will be

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1 considered restricted.
2 MR. HANDZO: Turning, then, to
3 Exhibit J, we would ask that the entire document be
4 treated as restricted. Again, the same -- the same
5 basis.
6 MR. RICH: I believe there may be
7 several documents here.
8 MR. HANDZO: The motion applies to all
9 of them.
10 MR. RICH: We have no objection.
11 CHIEF JUDGE BARNETT: Appendix J is
12 considered restricted in its entirety.
13 MR. HANDZO: Appendix K, we would ask
14 that that document be treated as restricted in its
15 entirety. And, again, there are two documents as
16 part of this exhibit. We ask that treatment for
17 both.
18 JUDGE ROBERTS: Are they amendments to
19 the agreement, Mr. Handzo?
20 CHIEF JUDGE BARNETT: It's entitled --
21 MR. HANDZO: I believe it is, yes.
22 JUDGE ROBERTS: Okay.

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1 MR. RICH: No objection.
2 CHIEF JUDGE BARNETT: Appendix K is
3 restricted.
4 MR. HANDZO: I don't know if the Court
5 will permit me to do this wholesale, but I will tell
6 you that we will make the same motion on the same
7 basis for Appendix -- Appendices M, N, O, P, Q, R,
8 and S.
9 JUDGE ROBERTS: All active agreements?
10 MR. HANDZO: Correct.
11 CHIEF JUDGE BARNETT: Did you say P, N,
12 M?
13 MR. HANDZO: M, N, O, P, Q.
14 CHIEF JUDGE BARNETT: Q, R, S.
15 MR. HANDZO: R and S.
16 CHIEF JUDGE BARNETT: Okay.
17 MR. HANDZO: I am advised that I did not
18 move with respect to Appendix L. If that's correct,
19 I need to fix that.
20 CHIEF JUDGE BARNETT: You did not.
21 MR. HANDZO: Then I would make that
22 motion with respect to Appendix L. Again, the same

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1 basis.
2 CHIEF JUDGE BARNETT: So, Mr. Rich, L
3 through S inclusive?
4 MR. RICH: Just checking, Your Honor.
5 I'll be right with you.
6 CHIEF JUDGE BARNETT: Mr. Handzo, there
7 are also some numbered tabs at the back after
8 Appendix S. Are they part of S?
9 MR. RICH: They are not.
10 MR. HANDZO: I believe they are not;
11 Cricket.
12 MR. RICH: We have no objection to L
13 through S.
14 CHIEF JUDGE BARNETT: L through S will
15 be deemed restricted.
16 MR. HANDZO: Lastly, the Tab 2 behind
17 the appendices, we would ask that Table 2.1c, 2.2a,
18 2.2b, 2.2c, 2.2d, and 2.2 -- I'm sorry, 2.3 be
19 treated as restricted.
20 MR. RICH: No objections.
21 CHIEF JUDGE BARNETT: That's on the same
22 basis, Mr. Handzo?

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1 MR. HANDZO: Yes, that's correct.
2 CHIEF JUDGE BARNETT: Those will be
3 restricted --
4 MR. HANDZO: Thank you.
5 CHIEF JUDGE BARNETT: -- on the same
6 basis.
7 Mr. Rich.
8 BY MR. RICH:
9 Q. All right. Resuming, Dr. Noll. Thank
10 you for your patience.
11 A. Um-hum.
12 Q. Please describe for this Court the
13 nature of your assignment in this proceeding.
14 A. My assignment was to determine the
15 appropriate methods and carry them out for
16 determining a reasonable rate for SDARS as called
17 for by this proceeding.
18 Q. At the end -- in the culmination of your
19 analysis, did you, in fact, reach a conclusion as to
20 an appropriate rate or range of reasonable rates?
21 A. Yes, I did.
22 Q. Jumping quickly to the bottom line, what

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1 was that conclusion?
2 A. The bottom line of the conclusion is
3 that the best -- the best benchmarks for the direct
4 licenses, which range from 5 to 7 percent, and that
5 the secondary benchmark of the least customized,
6 noninteractive Internet-based services that are
7 available over mobile technology are the second
8 best, and they come out with numbers in the same
9 range as the direct licenses.
10 Q. Have you prepared several demonstratives
11 to facilitate our colloquy this afternoon?
12 A. Yes, I have.
13 MR. RICH: With the Court's permission,
14 I'd like to distribute those.
15 CHIEF JUDGE BARNETT: You may.
16 JUDGE WISNIEWSKI: Perhaps this is a
17 good time to remind counsel that items that are not
18 put into the record will be available to be picked
19 up up here later, as usual.
20 MR. RICH: Very good.
21 BY MR. RICH:
22 Q. Why don't we start, Dr. Noll, with a

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1 description of the methodology or the conceptual
2 approach you took to going about your assignment?
3 Can you describe that, please?
4 A. Sure. I'm -- I -- basically, it's the
5 same two-pronged procedure that's been done before.
6 First of all, consider the 801(b)(1) factors, and
7 secondly, consider willing buyer/willing seller
8 benchmarks to determine what kinds of rates would be
9 like -- or satisfy the reasonableness test that are
10 appropriate here.
11 Q. And did you, as part of your
12 investigation, give consideration to both prongs of
13 this analysis; namely, the bearing that the various
14 801(b)(1) factors have on rate setting as well as
15 consideration of potential willing buyer/willing
16 seller benchmarks?
17 A. Yes. I considered both, except I did
18 not do disruption. I did the first three 801(b)(1)
19 factors.
20 Q. I take it the disruption analysis was
21 done by, to your knowledge, another expert for --
22 A. Yeah, it was done by Dr. Stowell.

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1 Q. Yes.
2 And could you describe, as you conceive
3 of it, the proper interrelationship -- you as an
4 economist, not as a lawyer -- between considered --
5 this Court's consideration of the 801(b)(1) factors
6 and its consideration of one or more market
7 benchmarks? How do they interrelate?
8 A. Well, they're -- they're distinct and
9 separate. I mean, in principle, you could end up
10 with a circumstance in which they get the same
11 answer, but there's no reason to believe that in
12 principle that would actually happen given the
13 facts, because what I understand the 801(b) -- the
14 801(b)(1) factors to do is to say there are certain
15 policy or societal considerations that you should
16 take into account, and maybe or maybe not a market
17 would take them into account. You have to be sure,
18 if you're going to use a market benchmark, that
19 these factors are, indeed, taken into account.
20 Q. I take it from that answer and from your
21 written direct testimony that you do not agree with
22 the supposition that most of these factors are

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1 simply implicitly, quote, baked into, to use
2 Mr. Handzo's opening phrase, a market analysis; is
3 that correct?
4 A. No, I don't think they're automatically
5 baked in, no.
6 Q. Could you be more specific in terms of
7 ticking through one at a time what you've listed as
8 A, B, C, D here -- or A, B, C; you didn't look at
9 disruption -- how you conceive of, conceptualize
10 those factors, and preview for the Court how you
11 believe those have application to the analysis here?
12 A. I'll do them in sequence. The
13 availability has two dimensions to it. The first is
14 providing incentives to produce creative product,
15 and the second is delivering that product to
16 consumers on a nationwide basis.
17 The way that fits into this particular
18 case, of course, is in the first instance, there's
19 some crucial factor here about inducement of more
20 creative product; and, secondly, is there an
21 availability issue for delivering music content to
22 consumers that is unique to satellite radio?

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1 And the answer to the latter is that --
2 is the nature of the coverage of satellite radio
3 compared to all the competing alternatives. That is
4 to say, there are areas in the country that have no
5 over-the-air radio and that have no wireless
6 service.
7 So that if the issue is the delivery of
8 musical content through some communications
9 technology, to dashboard of a car, in those areas,
10 satellite radio is the only one.
11 So that is the -- the part of the
12 satellite radio availability that has to be taken
13 into account in 801(b) factors.
14 If -- if, for some reason, satellite
15 radio were no longer available, then, indeed, it
16 would be the case that musical content of the kind
17 of variety and -- that is available over satellite
18 radio or over the Internet through various
19 noninteractive services would simply not be
20 available to those people.
21 And the FCC's own work indicates that --
22 that on the order of 40 percent of the service area

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1 of the U.S., containing roughly 2 percent of the
2 population, does not have wireless carriers.
3 It's a little bit harder to figure out
4 who doesn't get access to over-the-air radio, so I
5 focus there. You can actually get that information
6 from a really complicated Web site at the FCC, which
7 I spent some time with, and produce a number of
8 examples of -- of locations in the U.S. where they
9 also don't have radio.
10 Q. Meaning terrestrial radio?
11 A. Terrestrial radio. Yes.
12 Q. So that's one branch of availability,
13 yes?
14 A. That's a branch of availability.
15 Q. And there's a second element -- aspect
16 of that?
17 A. The second element of it has to do with
18 inducement effect, which is what is the -- what is
19 the contribution of -- to the inducement of more
20 creative product. And here, someone simply looks at
21 what fraction of the total revenue of the record
22 industry is accounted for by SiriusXM, and it's 2 or

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1 3 percent.
2 So even if it were to totally disappear,
3 which isn't what is at issue here, we're talking
4 about a fairly small difference in the -- in the
5 generation of revenue for the record industry.
6 Q. Did your written direct testimony give
7 consideration to the relative promotional and
8 substitutional effects of one or more potential
9 benchmarks that you examined?
10 A. Yes, it did.
11 Q. And does that have any bearing, in your
12 estimation, on the availability prong?
13 A. The promotional and substitution effect
14 is -- is -- is an input to availability in the sense
15 that if people learn about music from a particular
16 way of delivering it to them, and then they take
17 actions to acquire more of it, to buy other music
18 products other than the one of the particular way
19 they got it, that is a -- what we, as economists,
20 would call a pecuniary externality to the record
21 industry.
22 That is to say, not only do they get

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1 whatever revenue they would derive from that
2 particular way of delivering the music, they get
3 additional revenue because the customer would, say,
4 buy it from a digital download site or buy a CD, or
5 subscribe to a more expensive in-demand service and
6 specifically request that particular recording.
7 So there is an inducement of additional
8 use of music, consumption of music, if there is, in
9 fact, a promotional effect.
10 If there's a substitution effect, then
11 it's exactly the opposite, that delivering music
12 over a particular channel means there's less demand
13 for music over other channels. And, in particular,
14 obviously, digital downloads and CDs can both be
15 used to put music on an iPad [verbatim], and if you
16 buy one, you're unlikely to buy the other. As time
17 has progressed, digital downloads have substituted
18 for CDs as a way to put music on your iPod.
19 Q. Have you given consideration, as part of
20 your work on this testimony, to the promotional
21 versus substitutional effects of satellite radio?
22 A. Yes, I have.

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1 Q. Have you drawn any conclusions?
2 A. Yes. There's -- as a couple of pieces
3 of evidence, I have not done -- I have relied upon
4 the testimony of others, in parts, from their own
5 experience with SiriusXM, and then I have read the
6 documents themselves.
7 There is no reliable economics research
8 in published journals on this issue. What there is
9 is studies that the company -- the record companies
10 have done and their trade associations have done,
11 and they reach the conclusion that, indeed,
12 consumers of SiriusXM are more likely to buy music
13 in other forms than they would have been had they
14 not subscribed to SiriusXM.
15 So that would be a promotional effect.
16 Q. And, conversely, have you given
17 consideration to the promotional or substitutional
18 effects of one of the benchmarks used by
19 Dr. Ordover, which is the interactive service
20 benchmark?
21 A. Yes.
22 Again, there is -- there's no published

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1 academic research on this issue and, indeed, there's
2 not enough data available for me to undertake such a
3 research project. What you have to rely upon is
4 what happens out in the industry and what people in
5 the industry have done, and there have been several
6 internal studies performed, again, by trade
7 associations and record companies, addressing this
8 issue. They basically are ambiguous in their
9 conclusions.
10 Some think there's a substitution
11 effect, some think there isn't.
12 On balance, it seems to be the case that
13 issue is unresolved, but there's no -- there's no
14 question that you wouldn't say it's a promotional
15 effect, like satellite radio or terrestrial radio.
16 It's either nothing or it's a substitution effect.
17 Q. Your testimony also references the
18 accompanying testimony offered by our client of
19 Mr. Blatter, who heads up the music programming --
20 A. Yes.
21 Q. -- section, and you comment a bit about
22 your reactions to that in relation to the promotion

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1 substitution issue.
2 Can you summarize that?
3 A. Accepting what he says is true, that's
4 an illustration of the more general point, which is
5 that record companies put forth enormous effort to
6 get their records played on both terrestrial and
7 satellite radio, and they wouldn't do that if it
8 weren't for the fact they believed it's promotional.
9 So all that information is consistent
10 with that -- that view that -- that it -- it does --
11 and it's especially true for the less mainstream
12 genres of -- of sound recordings.
13 As time has progressed, terrestrial
14 radio has become less and less diverse in the kind
15 of recorded music that's played on radio stations.
16 We're now to the point there's only a handful of
17 classical music stations left in the United States.
18 There's almost no jazz stations left in the
19 United States. It's very hard to find folk music,
20 and certainly ethnic music, other than Latin, is
21 almost impossible to find on the radio.
22 As radio has become less and less

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1 diverse, more and more radio stations are simply
2 outlets of very large national chains that all have
3 the same playlists.
4 As that has happened, then outlet -- an
5 outlet like SiriusXM or some of the noninteractive
6 Internet services have become the only way to gain
7 access to recordings in these other genres. And in
8 those areas in particular, the promotional value is
9 especially great. Because if you're a jazz fan, you
10 really have very few options except subscribe, you
11 know, to either one of the Internet services and
12 SiriusXM, and then that's the only way you're going
13 to learn about music in that genre, new releases and
14 things like that.
15 Q. Turning to Element B of the 801(b)
16 formulation, fair return --
17 JUDGE ROBERTS: One moment, Mr. Rich.
18 Just a question for you, Professor Noll.
19 Given the promotional versus
20 substitutional effect, which you seem to indicate
21 leans in favor of promotional, rather than -- so the
22 positive side of getting music out, rather than the

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1 negative side of leasing sales through substitution,
2 how would you propose that this could be quantified
3 in a royalty rate analysis?
4 THE WITNESS: I have made no attempt to
5 do so. When we get later to the way I have done
6 these things, there are some that I don't think
7 are -- are possible to quantify at this point
8 because of the absence of any research.
9 What I'm saying is, this -- my
10 expectation of processes like this is you don't come
11 to a point estimate of what's the only conceivable
12 reasonable rate. What's going to happen in this
13 process, I think, the most likely outcome is there's
14 a range of possibilities, and the question is where
15 do you pick in them?
16 And I don't -- I can't give you a magic
17 bullet on the issue of promotion versus
18 substitutability, because there isn't enough
19 quantitative information out there for me to give
20 you a point estimate. It wouldn't be honest for me
21 to do it.
22 So I'm just saying if you come to the

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1 end and there's a range, this is a factor that says
2 go to the bottom of the range or go lower in the
3 range than you otherwise might be inclined to do.
4 JUDGE ROBERTS: Okay. Thank you.
5 BY MR. RICH:
6 Q. Could you address the second of these
7 factors in terms of its bearing on your analysis,
8 fair return?
9 A. The fair return one is -- refers to the
10 fact that a company must continue to earn the
11 competitive return on its investments or it will be
12 unable to continue to make those investments over
13 time.
14 That means one must check, at least on a
15 forward-going basis, if the company is not only
16 going to be able to pay its operating costs, but
17 it's able to recover the depreciation or
18 amortization of its capital investments, including
19 R&D, and in addition to that, earn a competitive
20 return on capital.
21 The idea that we should evaluate the
22 long-term viability of SiriusXM on the basis purely

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1 of its ability to have cash -- positive cash flow
2 and to cover its operating costs is completely
3 false.
4 It's -- it -- there's, you know,
5 2 percent turnover every month of SiriusXM
6 customers. The biggest single capital cost they
7 have is getting new customers, paying for part of
8 the radio in a car, paying the automobile company a
9 commission in order to sign people up for SiriusXM.
10 Given the 2 percent per month
11 cancellation rate, turnover rate of SiriusXM, within
12 a couple of years, they're basically gone if they
13 have no incentive to make these additional
14 investments. So you have -- you have to take that
15 into account on a forward-going basis in order to
16 determine whether the company is -- is viable.
17 And I get into this later when I get to
18 the next -- the next item, but it's important to
19 note that the calculations I have done have not done
20 this, because I was -- I took the most conservative
21 possible approach, which is to ignore the
22 competitive return on investment in doing my own

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1 calculations, but that, I believe, is an economic
2 problematic move, and I think they should be added
3 back in.
4 Q. Thank you.
5 Relative contribution, how did you
6 assess this factor?
7 A. To me, the way relative contribution
8 makes sense is you simply think about what is
9 satellite radio? It's fundamentally three different
10 inputs: It's music content -- or I should say sound
11 recording content, because there's a -- one of the
12 anomalies is that I said 55 percent of the content
13 is sound recordings, and Professor Ordover said
14 50 percent. That's because I counted comedy and he
15 didn't. So we have the juxtaposition here of
16 experts.
17 But the sound recording component is,
18 say, approximately half; the nonsound recording
19 component is roughly half; and then there's another
20 component, which is the physical infrastructure.
21 To key off of something that was said in
22 the opening remarks, each of those three probably

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1 has no value standing alone, right, in the sense --
2 so you really -- in order for SiriusXM to survive,
3 it really has to offer all that, and --
4 Q. In your testimony you refer to it as a
5 bundle of services?
6 A. It's a bundle of services, it's a
7 distribution system, a bunch of nonmusic content and
8 a bunch of music content, all of which are
9 essential. And you pull the plug on any one of
10 them, and the whole thing collapses.
11 And relative contribution, in my opinion
12 as an economist, refers to trying to figure out how
13 do you figure out what the contribution is, given
14 that all three are essential, that the service
15 couldn't survive without any of them. So that means
16 not only do you take into account the nonmusic
17 content, it also means you take into account the
18 costs of the distribution system, because the
19 entities that it's competing with are not bundled.
20 They do not -- they do not include the distribution
21 system. It's provided separately in an unbundled
22 way.

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1 So you're after what is an appropriate
2 way to unbundle the various components of this for
3 the purpose of figuring out what the price of
4 each -- implicit price of each ought to be.
5 Q. Do real companies operating in real
6 markets recognize, in a sense, that distinction?
7 Namely, that where one entity is operating in a
8 somewhat bundled basis, that -- that -- that the
9 input cost of -- the price of the input has to
10 adjust to reflect that fact and, if so, have you
11 investigated that -- and you're turning ahead of me
12 to the next demonstrative. Could you explain the
13 purpose of the next demonstrative?
14 A. First of all, let me answer the question
15 more broadly, then I'll get to this.
16 Q. Yes.
17 A. More broadly, of course -- I mean, in
18 the real world, it's really rare to have a
19 percentage of revenue as how much you pay for an
20 input.
21 You don't pay a percentage of the price
22 of the automobile when you go buy new tires. You

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1 don't pay a percentage of the price of the
2 automobile when you go fill up the gas tank. The
3 price of gas per gallon is the same, no matter what
4 car you're driving, whether it costs 20,000 or
5 200,000.
6 So right off the bat, in most of the
7 circumstances we're observing -- again, this was
8 discussed somewhat in the opening remarks -- the
9 price that is charged people is a sort of
10 per-unit-of-use price, which would be the optimal
11 thing to do except for the tiny problem that SXM
12 doesn't measure its audience, so you don't actually
13 know how many users there are to multiply a price
14 per user by.
15 And we're using -- we shouldn't lose
16 fact -- sight of the fact that we're -- we have a
17 percentage of revenue number out there simply as a
18 second best, because the other thing isn't feasible.
19 And if we had a price per user, and we knew how to
20 measure it for SiriusXM, then -- then all this issue
21 about do they increase the amount of capital costs
22 or not, do they do R&D to enhance the service or

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1 not, would be irrelevant. They still pay .0017, or
2 whatever it is, for price per use.
3 So that's the keep your eye on the ball,
4 that we would really like to do something that's
5 exactly the same as buying nuts and bolts to make an
6 automobile, that it doesn't matter whether you're
7 buying a Chevrolet or a Cadillac, it's still so much
8 for a nut and bolt.
9 Then the second part of the story, of
10 course, is, which is shown in the next exhibit, and
11 which --
12 MR. HANDZO: I'm sorry. I apologize for
13 interrupting.
14 If Dr. Noll is now going to talk about
15 this next demonstrative, I just would note that one
16 of the bars is restricted information. I don't have
17 a problem with it being demonstrative, since that
18 won't come into evidence. I just ask that we
19 somehow talk about it without mentioning the number.
20 THE WITNESS: I had already anticipated
21 that. I will not name names. And as much as it
22 pains me, I won't state numbers. My natural

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1 inclination is to talk about numbers.
2 BY MR. RICH:
3 Q. Let me just amend that further by saying
4 to the extent convenient, and not compromising your
5 testimony, if you ever reach a point where you feel
6 you would like to have the unexpurgated version, we
7 would make a motion to the Court to, on a limited
8 basis, restrict the courtroom to people entitled,
9 but to the extent you can do a workaround, I think
10 everybody would appreciate it.
11 A. The issue here is simply demonstrating a
12 core fact, which is that the -- the -- the -- one of
13 the factoids that appeared in the -- in the opening
14 arguments was the statement that everybody basically
15 pays the same royalties, and that's just not true.
16 And this is a good illustration of it.
17 If you're a mobile telephone company
18 that, among many data services that you deliver, one
19 of them happens to be interactive Internet music
20 service, you pay a much, much, much lower royalty, a
21 tiny fraction compared to the royalty that's paid by
22 the companies that all they do is provide

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1 interactive music downloads. The royalty rate for
2 the interactive music downloads is much, much
3 higher.
4 Now, why is that so? Because a mobile
5 telephone company is bundling a whole bunch of other
6 stuff, including the distribution system, in with
7 interactive music service. So you're paying for
8 text messaging and e-mail and searching the Internet
9 and all a whole bunch of stuff, plus the telephone
10 and the -- and the wireless delivery system. And
11 so, obviously, the -- the royalty rate is going to
12 be much lower for a mobile phone company's
13 interactive music service than it's going to be for
14 Spotify or Rhapsody.
15 JUDGE ROBERTS: Professor Noel, how many
16 mobile phone companies are we talking about here
17 that you looked at?
18 THE WITNESS: Well, I can only look at
19 the ones for which there's been data produced.
20 JUDGE ROBERTS: There's one.
21 THE WITNESS: This is the only one
22 that's been produced. I know from other contexts

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1 that other mobile phone companies have other kinds
2 of entertainment services, and I know that the point
3 I'm making is true, because this was exactly the
4 same point that arose in the ASCAP case involving
5 MobiTV, which was, you know, Verizon and AT&T and
6 Sprint and T-Mobile are all offering data services
7 of -- that differ from each other, that bundle
8 things in different ways, and it's the same basic
9 issue, how do we -- how do we tease out the musical
10 composition rights out of this huge bundle of
11 services.
12 JUDGE ROBERTS: Okay.
13 BY MR. RICH:
14 Q. Turning, at a conceptual level,
15 Dr. Noll, to the second branch of --
16 JUDGE WISNIEWSKI: Actually, if I could
17 follow up on that.
18 So I take it your conclusion is that --
19 that the way we tease it out, at least
20 intellectually, is by distinguishing between the two
21 groups here on the basis that one appears to have
22 greater use of that particular input than the other?

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1 THE WITNESS: I'm not sure I understand.
2 Meaning more variety of uses?
3 JUDGE WISNIEWSKI: I'm just talking
4 about the particular input here, the music input.
5 THE WITNESS: The music input. I think
6 the best way to go at the music input is to try to
7 figure out directly from those people who are just
8 providing specialized service what the value of the
9 music is and apply it to the bundled service.
10 JUDGE WISNIEWSKI: I understand. But
11 I'm trying to understand where you -- how you
12 arrived at your conclusion that one appeared to be
13 worth much more than the other. It seems that
14 you're -- you're basing that on the use of the music
15 input.
16 THE WITNESS: No, actually, the
17 different royalty rates that you see on that picture
18 come up with the same number, because the low number
19 multiplied by the monthly price and the high number
20 multiplied by a much lower monthly price come out to
21 basically the same royalty for interactive service,
22 all right?

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1 So it's not that somebody's getting it
2 cheaper, it's that if you -- it's that, you know, a
3 competitive benchmark for a telephone company is, in
4 fact, the completely dedicated, single purpose,
5 interactive service, and that pays a very high
6 royalty rate multiplied by a relatively low monthly
7 price.
8 If you then apply that to the telephone
9 company --
10 JUDGE WISNIEWSKI: If I could just stop
11 you right there for a second.
12 THE WITNESS: Yeah.
13 JUDGE WISNIEWSKI: Does that then
14 coincide with the position that you took a little
15 bit earlier, which is essentially to say, on their
16 face, these comparisons don't mean much?
17 THE WITNESS: They don't mean a thing
18 until you do what I just did, and you -- you say,
19 okay, let's multiply the rate by the actual monthly
20 price and see what the actual magnitude of the
21 royalty is. And, in this case, the magnitude of the
22 royalty is basically the same.

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1 JUDGE WISNIEWSKI: Okay.
2 BY MR. RICH:
3 Q. Just if you'll stay with this
4 demonstrative to tease the point out to make sure I
5 understand it, and hopefully, the Court fully
6 understands it.
7 On the right-hand bar, there's a
8 reference to -- I think we can disclose this part of
9 it -- interactive services typically charging the
10 range of 50 to 60 percent to entity of the retail
11 revenue base of entities like Rhapsody, Napster,
12 et cetera, correct?
13 A. That's correct.
14 Q. And what this is designed to
15 demonstrate, I take it, is that when those similar
16 services are offered by a bundled mobile service,
17 whose name we will not identify for the moment, and
18 who offers a plenitude of services that you would
19 not expect to see, and in this case, accordingly,
20 don't see, the equivalent 50 to 60 percent rate
21 applied against the full retail base of that other
22 service; is that correct?

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1 A. That's exactly right, because the --
2 what's happening is the royalty rate has been
3 adjusted downward to take into account a relative
4 contribution factor. That is to say, that one of
5 these providers is providing the distribution system
6 and the other one isn't.
7 Q. But mathematically, that 10 percent
8 against a larger X percent against a larger retail
9 base, as you pointed out, could yield the same
10 result, yes?
11 A. It should.
12 Q. That was a hypothetical 10 percent?
13 A. Yes.
14 Q. Let's turn to the second of the broad
15 concepts you explored. We just spent a few minutes
16 on 801(b).
17 In your first demonstrative, you
18 indicate also the need to consider appropriate
19 approaches to the willing buyer/willing seller
20 benchmarks: is that correct?
21 A. That's correct.
22 Q. If you turn to your next demonstrative,

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1 please, would you tell us how you approached that
2 matter conceptually?
3 A. Yes.
4 These are the criteria that I used to --
5 the first -- the first column is the criterias that
6 I used; the second column refers to the SXM direct
7 licenses; and the third column refers -- refers to
8 the interactive Internet music services.
9 The -- the point is, I start off --
10 there's a number of candidates out there for what
11 might be benchmarks, and so the first thing to do is
12 to determine which ones are the closest, according
13 to these criteria, to the rates at issue here.
14 And to go briefly through it, it's the
15 market rate you're observing is competitive.
16 Q. You spend a fair amount of time
17 discussing that in your written direct testimony.
18 Can you encapsulate that testimony?
19 A. Yes. Basically -- the basic story here
20 is the market structure here is the market structure
21 between the buyers and the sellers of the
22 performance rights for sound recordings.

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1 Q. So identify those parties, please.
2 A. And on -- on the supply side consists of
3 all the record companies, which is an industry that
4 is relatively concentrated, but it's not so
5 concentrated I would call it a monopoly, and
6 economists would generally not call it a monopoly.
7 So about 90 percent of the distribution
8 takes place with the four major labels, and the
9 biggest one is Universal, which is in the 30s. So
10 that is a moderately concentrated industry, but it's
11 not one that I'm going to complain about. I'm just
12 going to accept that as a reasonable standard for
13 competitive market.
14 On the demand side for these performance
15 rights are all the people who want to buy, for
16 whatever reason, from the record companies sound
17 recordings. And there's a whole bunch of people who
18 want to buy them, you know, there's -- this is all
19 at the wholesale level, including people who retail
20 CDs, including people who sell digital downloads,
21 people who sell interactive services, people who
22 sell noninteractive services.

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1 And that is the appropriate way to think
2 about that market interaction, and here, SiriusXM is
3 a tiny fraction of the demand side. And, indeed,
4 the demand side, in general, is essentially
5 atomistic. There's nobody out there who has
6 anything remotely resembling the market share of
7 Universal on the supply side, so I conclude that the
8 demand side of the market is workably competitive as
9 well.
10 So that if we actually observe market
11 transactions here, that they will be the result of a
12 competitive process. There may be other things
13 affecting them, but they will be the result of a
14 competitive process.
15 Q. What did you conclude as to how and in
16 what circumstances individual record labels would
17 compete over the licensing of sound recording
18 performing rights?
19 A. There's -- the reason that they will
20 compete for the -- to sell their rights to SiriusXM
21 is -- is to get play time, and play time is valuable
22 to them in two ways: First of all, for any given

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1 royalty rate, the more times your stuff is played,
2 the higher the royalty you're paid.
3 Secondly, the more play time you get,
4 the more records you sell through other channels
5 because of the promotional effect.
6 And that -- this is called an economics
7 demand diversion. There's a number of articles that
8 I cite that have talked about demand diversion in
9 not only this market, but other markets of
10 entertainment intellectual property rights. And
11 it's that phenomenon, the fact that a given label
12 wants to be played more for these two reasons that
13 induces people to be willing to compete to get on
14 SiriusXM.
15 Q. Could you use a different terminology
16 than demand diversion to -- to convey the concept
17 here in terms of as applied to a service like
18 SiriusXM?
19 A. Yes.
20 What's happening is that a particular
21 label is trying to get SiriusXM to substitute for
22 songs played -- that are released by other labels in

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1 favor of songs released by it, that it wants -- it
2 wants to get more of its songs played at the expense
3 of its competitors, not because it wants to harm its
4 competitors, that's not what it's trying to do, but
5 it wants to sell more of its own records, and it
6 wants to get more royalty income.
7 And it's that desire to cause a
8 substitution effect on the demand side in its favor
9 that is the engine of competition for these rights.
10 And this phenomenon is -- it doesn't have to be a
11 perfectly competitive market. These are obviously
12 differentiated products. There are certain unique
13 artists.
14 You know, it's unlikely this argument is
15 going to have much cut -- it's going to cut much ice
16 if the story is Adele or somebody like that, the
17 current best selling artist. But at the level of
18 filling up all the channels on SiriusXM 24/7,
19 there's a lot of play, there's a lot of room for
20 maneuvering as to which songs get on the playlist.
21 And that was what they're competing for, especially
22 in these genres that have no other playtime outlets,

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1 this is the holy game for them.
2 Q. So under the column, qualities of a good
3 benchmark, you've been discussing the criteria of a
4 workably competitive market.
5 Am I correct, then, in trying to
6 identify a suitable benchmark meeting that
7 criterion, you would be looking for a transaction or
8 transactions that reflect and incorporate the
9 incentive of individual record companies to compete
10 for increased plays of their sound recordings?
11 A. Yes, that's right. And that -- that's
12 precisely right. That's exactly the phenomenon one
13 would observe in the context of a SiriusXM.
14 Q. And let me just ask you this: In a
15 setting in which transactions between buyers of --
16 or licensees of sound recording performing rights
17 occurs, not with individual record companies, but
18 with the collective SoundExchange, does that meet
19 this criterion?
20 A. No, because SoundExchange as an entity
21 is -- is indifferent between distribution of plays
22 among its members. It's only interested in total

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1 plays times the royalty rate, which means maximizing
2 the income to the membership of SoundExchange has
3 nothing to do with this -- this competition among
4 plays. It simply has to do with getting the highest
5 royalty rate possible, because the plays are going
6 to be basically constant.
7 And so what -- what they're -- they're
8 solely interested in the royalty rate. They -- they
9 derive no benefit from a competitive interaction
10 among their members to engage in price cutting.
11 Q. Now, applying the various criteria, the
12 various qualities of a good benchmark against the
13 evidence available to you, did you arrive at a best
14 available benchmark?
15 A. Yes.
16 Q. What was that?
17 A. The direct licenses, because they
18 satisfy all these criteria (indicating) that -- that
19 I list as the -- as the basis for the best
20 benchmark.
21 JUDGE WISNIEWSKI: If I could interrupt
22 for just one second.

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1 Did I mishear you? When you were
2 talking about workably competitive market, did you
3 posit that as a feature of -- of the comparable
4 benchmark that we ought to be looking for?
5 THE WITNESS: Yeah, I mean, obviously,
6 nothing is perfect, right, but, yes, and I'm
7 accepting the structure, the market structure of the
8 recording industry as it is.
9 JUDGE WISNIEWSKI: Right. That's
10 what -- I'm curious, because now you listed these
11 five, and you've got same buyer here, rather than
12 the -- the fraction of the demand side of the market
13 that -- that you said established a competitively
14 workable market.
15 THE WITNESS: By same buyer, I'm talking
16 about the interaction between the record companies
17 and the buyer, and SiriusXM signed the direct
18 licenses, and SiriusXM is the buyer from
19 SoundExchange.
20 So the -- the --
21 JUDGE WISNIEWSKI: I understand what
22 that means.

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1 THE WITNESS: That's a separate,
2 independent issue, all right, whether it's the same
3 buyer.
4 JUDGE WISNIEWSKI: Separate and
5 independent from what?
6 THE WITNESS: The issue of whether the
7 market is competitive is separable from the issue
8 of -- you could have the result that it wasn't a
9 competitive market, but you would still undertake
10 the test, as it the same buyer. It would be even
11 more important if you had concluded that the
12 argument wasn't -- the market wasn't competitive,
13 then it would be essential that it be the same
14 buyer.
15 JUDGE WISNIEWSKI: If we have the same
16 buyer, is it a workably competitive market anymore?
17 THE WITNESS: The same buyer is the
18 person engaged in the transaction. This isn't a
19 statement about the market, it's a statement about
20 the buyer. The market contains many buyers, and the
21 license we're interested in here, the buyer is the
22 same in both cases.

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1 JUDGE WISNIEWSKI: I thought you were
2 looking for a benchmark, and the benchmark is based
3 on a market, not on a single buyer.
4 THE WITNESS: The benchmark is based on
5 a single buyer if the market contains -- if the --
6 you are right to say that if there were other buyers
7 who otherwise satisfied all the conditions, they
8 would be relevant, too. I agree with that point.
9 But I'm just using the characteristics
10 of willing buyer/willing seller that are what people
11 have used in the past about how to find a license in
12 a product-differentiated market that's -- it's
13 imperfectly competitive, what is the best possible
14 example?
15 And if we found -- usually you think
16 about it more on the seller's side than on the
17 buyer's side, but in this particular case, there's
18 no differentiating factor between the entity that's
19 the buyer in this proceeding and the entity that's
20 the buyer of the direct license. They're buying
21 exactly the same thing for exactly the same purpose.
22 JUDGE WISNIEWSKI: So when you're

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1 talking about this benchmark comparison, you're
2 limiting it to the context of the direct license
3 category that you've offered; is that correct?
4 THE WITNESS: In principle, there could
5 be other things that one would use, yes. SiriusXM,
6 in principle, could be in other businesses, all
7 right, that -- for which it was buying other
8 licenses instead of this one, in which case it
9 wouldn't work, right? If I were -- I wouldn't
10 satisfy the same buyer criteria.
11 Suppose that Sirius and XM hadn't merged
12 and XM had bought some direct licenses but Sirius
13 hadn't. Then they wouldn't be the same buyer.
14 JUDGE WISNIEWSKI: That's correct.
15 THE WITNESS: All right. Now, you could
16 argue that the XM licenses ought to be used for
17 Sirius, but it takes one more step to say that the
18 product differentiation in the industry is such that
19 those distinctions don't make any difference.
20 JUDGE WISNIEWSKI: Well, I guess so, but
21 it looks like you're essentially limiting that --
22 that workably competitive market. But I'll let

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1 Mr. Rich continue.
2 MR. RICH: Thank you. I don't want to
3 cut you off.
4 JUDGE WISNIEWSKI: No, that's fine.
5 JUDGE ROBERTS: Mr. Rich, are you going
6 to look any more at this chart, because I had a
7 question.
8 MR. RICH: We're going to stay with it
9 for a while, but why don't you go ahead?
10 JUDGE ROBERTS: Since this is a
11 description of characteristics, if you look at the
12 same sellers, you have given a checkmark for the
13 SiriusXM direct licenses and a full checkmark for
14 the SoundExchange interactive agreements.
15 But that isn't really -- they don't both
16 fully deserve a checkmark, do they? In other words,
17 doesn't the SiriusXM deserve a checkmark that is
18 only 2 percent of the size of the checkmark that
19 SoundExchange gets?
20 THE WITNESS: I think the issue of the
21 representativeness of the group of people who have
22 signed direct licenses is a valid issue to examine,

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1 and I will -- I do -- will and do examine it.
2 I agree with you, and that's exactly the
3 same answer as I gave to Sirius. Suppose there were
4 25 satellite radio companies and -- and two of them
5 had signed direct licenses, we would be in the same
6 issue, which is, shall -- you know, to what extent
7 can we make a valid statement that the two satellite
8 radio companies that signed licenses are
9 representative of the 23 that didn't?
10 I agree that that is an issue that has
11 to be addressed.
12 JUDGE ROBERTS: Okay. So you would say
13 that the checkmark that you have there should be a
14 tiny checkmark?
15 THE WITNESS: No, I don't think so. I
16 mean, the issue is -- the way I was conceptualizing
17 it is, are the buyers and the sellers -- on both
18 sides, the buyers and the sellers, basically people
19 in the same business doing the same thing? That's
20 what I was thinking about.
21 And the reality, of course, is that
22 there's only one satellite radio company, so the

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1 question of the same buyer is very narrow on the
2 buyer's side, whereas it's much broader in the
3 record label company. And there is a burden, I
4 think, upon me and others here to demonstrate that
5 that check is valid, all right? This is a summary
6 of what I've done, and I believe that check is
7 completely valid.
8 JUDGE ROBERTS: Okay.
9 BY MR. RICH:
10 Q. Why don't we turn to that, which is --
11 which is that if you could summarize your written
12 testimony as to what makes -- first of all, how many
13 licenses did you -- how many direct licenses did you
14 identify as of November of 2011?
15 A. Yes, as of November 30th --
16 Q. 29th.
17 A. -- or whatever. I believe it was 62.
18 Q. And what was the royalty range in those
19 licenses?
20 A. Five to seven.
21 Q. And did you average those?
22 A. They -- the average is around six. It's

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1 about the middle.
2 Q. Around six. And just before we get to
3 the representative issue, what is your understanding
4 of the scope of rights that was granted across these
5 licenses to SiriusXM?
6 A. It's actually somewhat broader, because
7 it gives SiriusXM some additional rights with regard
8 to its PC-based service and other things it might do
9 with satellite service.
10 Q. Did you attempt to make any adjustment
11 for that added value?
12 A. No, I didn't make any attempt to adjust
13 for that because I don't have any quantitative basis
14 to make that adjustment. I don't think there's
15 anything out there that would give me insight into
16 how much these were worth.
17 Q. In what direction would that skew, if
18 any, your analysis, failing to do that?
19 A. Because these are broader rights,
20 they're worth more.
21 Q. Now, if you would summarize your
22 testimony as to the analysis you gave and the

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1 conclusion you reached as to what makes these 62
2 licenses representative for purposes of your
3 benchmarking here where, after all, it is the role
4 of the Court to establish a fee industrywide
5 effectively.
6 A. Basically, the issue is as a
7 collectivity, do these licenses offer rights to
8 scope of sound recordings that is comparable to the
9 scope of sound recordings one would get from the
10 people who are not licensed. And, in particular,
11 the issue here is going to be how can we compare the
12 62 licenses that account for 2 percent of the market
13 with a major, which EMI is the smallest major, and
14 it's about 10 percent of the market.
15 So the question is, is this scope of
16 types of music, types of artists, age distribution
17 of recordings among -- the industry tends to break
18 recordings into three categories. There's --
19 there's the hits; there's the other relatively
20 recent releases; and there's something called
21 catalog, which is the things they keep making a
22 couple of years after they've been released.

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1 And roughly -- there's roughly
2 equally -- all three are roughly equally important
3 to the record industry.
4 So the issue is, do we have the right
5 distribution by age, by type of music, by popularity
6 of artists that would cover that full range, and
7 that's the way I approached it.
8 Q. And what conclusions did you reach?
9 A. Well, the -- the conclusion that I
10 reached by examining the repertoire offered by each
11 of these labels and sort of summing them up was
12 that, collectively, they did compete across the
13 board with the major distribution companies in all
14 of these various categories.
15 Q. Mr. Handzo, in his opening, intimated
16 that -- that a major simply would never have agreed
17 to a royalty at or around this rate.
18 Have you considered that?
19 A. Yes, I have.
20 Q. What's your conclusion?
21 A. I -- it seems to me that the principal
22 reason for the majors not to negotiate is because,

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1 again, they're the principal beneficiaries of
2 banding together in SoundExchange. For sure,
3 they're not going to get a worse outcome than the
4 rates that could be negotiated with SiriusXM, and
5 they may get a better outcome.
6 This is sort of playing a lottery, if
7 you will, where the worst possible outcome is the
8 direct licenses. So, from my perspective, there's
9 no good incentive for the label.
10 I can also say, however, that I did the
11 calculation in my report about the -- the
12 incremental plays that even the largest major, UMG,
13 would -- would be required to have in order to make
14 a half of a percentage point cut in the rate
15 profitable for them, and it's like a play every few
16 hours. It's not a big deal.
17 So they do have an incentive to compete
18 with other majors and try to take away plays from
19 other majors, but the four majors definitely have --
20 have decided they would prefer a regulated
21 environment which is supposed to come up with what
22 is a reasonable rate, which they believe the worst

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1 possible outcome is probably what they could get if
2 they negotiated directly.
3 They've chosen to go the SoundExchange
4 route.
5 Q. Let me unpack that a little bit.
6 You said -- you made reference to half a
7 percent difference.
8 Can you explain what the numbers were
9 and how you got there that get you to that half a
10 percent difference?
11 A. Yes. The issue was -- was I was
12 comparing why would you accept a 7 percent rate
13 rather than an 8 percent rate? And you have to take
14 off from the 8 percent rate the costs of operating
15 the SoundExchange system, which is about a half of a
16 percentage point.
17 So that leaves the -- the net rate from
18 SoundExchange as around 7-1/2. So the question is,
19 would I take a cut from 7-1/2 to 7, what would have
20 to be true to cause me to want to take that cut?
21 And just on the royalty payment alone, it would take
22 a 6.48 percent increase in plays, and then if you

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1 add to that promotional effects, you know, it would
2 be -- you would be better off taking a lower rate.
3 Q. Now, by definition, SiriusXM, you
4 indicated that an inducement for a label to sign a
5 direct license is -- is to increase its plays,
6 correct?
7 A. Yes.
8 Q. So that even at a nominally lower
9 effective royalty rate, more plays can generate more
10 royalty income, correct?
11 A. That's correct.
12 Q. All right.
13 Now, by definition, though, SiriusXM
14 couldn't increase -- couldn't do that for every
15 label, is that correct, given the finite amount of
16 plays available?
17 A. Well, it wouldn't -- it is -- it's not
18 the right way to put it. The answer to your
19 question is no, that's not quite right.
20 The -- one thing SiriusXM could do, if
21 we were in a world in which we had royalties based
22 on use, is respond to a lower price by having more

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1 music.
2 And the way it would work out here is if
3 having more music induces more people to subscribe
4 to SiriusXM, then the lower royalty encourages them
5 to have more plays for everybody.
6 But that is a tiny effect compared to
7 the effect any single label would be likely to
8 receive if it had a somewhat lower royalty rate.
9 So the basic argument is true. The
10 incentive for the industry as a collectivity to cut
11 its price is really small compared to the incentive
12 for any label, even a major label like Universal, to
13 cut its price.
14 Q. In that latter connection, beginning at
15 Page 49 of your testimony, you talk about the
16 response of various record industry organizations to
17 the direct licensing initiative, correct?
18 A. I do, yes.
19 Q. Could you summarize the purport of that
20 testimony, please?
21 A. Well, the -- the -- the basic story is
22 the -- all of the trade associations in the record

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1 industry, whether it's artists or record labels,
2 issued public statements, as well engaged in private
3 activity to try to convince independent labels not
4 to sign these licenses.
5 It is not true that these -- that the
6 independent -- these poor independent labels were
7 operating in a vacuum and didn't know up from down.
8 They were getting information from their trade
9 associations. There's a trade association of
10 independent labels. There's SoundExchange itself.
11 There's associations of artists who are on
12 independent labels. There's associations of
13 executives who work for independent labels.
14 All of these organizations were putting
15 out information, but, in addition to that, exhorting
16 their members not to sign the licenses.
17 And the goal of this was explicit. It
18 was the fear on the part of these organizations that
19 if competition were allowed to happen for direct
20 licenses, it would cause the rate to be lower,
21 because this proceeding would come up with a lower
22 rate. That was the fear.

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1 And so this was an explicit attempt to
2 make certain, to try very hard to make certain there
3 would be no such information available in this
4 proceeding to indicate what a competitive rate might
5 look like.
6 Q. And if you turn to the last paragraph on
7 Page 54, carrying over to Page 55 of your testimony,
8 please.
9 Let me just made read a passage into the
10 record and ask you to expand on it. This is
11 beginning with the second sentence, and the
12 carryover paragraph on 54.
13 Whereas many record companies, including
14 the four majors, are unwilling to enter meaningful
15 negotiations for direct licenses, these statements
16 show -- meaning the statements you have recounted
17 from the industry organizations that you just
18 testified to -- that the source of this reluctance
19 is the expectation that letting SoundExchange lead a
20 collective effort to set a single statutory rate for
21 the entire industry will produce more royalty income
22 for all, because SoundExchange will not respond to

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1 the competitive incentive facing each record company
2 to compete on the basis of price in order to receive
3 more plays.
4 What I want you to comment on is the
5 concluding sentence, which is, This phenomenon is
6 precisely why the direct licenses between SiriusXM
7 and 62 record companies are the most appropriate
8 benchmark for this proceeding.
9 Can you just explain that connection?
10 A. Yes. It's the obverse of the reason
11 they tried to suppress it, which is that the point
12 here is not just that they didn't want some
13 independents to get some more plays for a lower
14 rate. It was the -- the looking-forward aspect of
15 it into this proceeding that it would lead to a
16 lower rate.
17 They didn't want -- they know that the
18 job of the Copyright Royalty Judges is to try to
19 find something like a market rate, maybe with some
20 discounts for 801(b) factors. Everybody knows that.
21 And they want that -- as little of that information
22 to be available as possible. It helps them if there

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1 is no direct information about what a competitive
2 market would look like, because then you have to get
3 into all these crazy exercises that economists do of
4 trying to take an apple and figure out what its
5 price will be if it were really a banana.
6 And that process is inherently full of
7 lots of uncertainty and ends up with being in ranges
8 of reasonableness that are sometimes a factor of two
9 different. This is real, honest to goodness
10 competition that is happening to -- among companies
11 to get more plays, and that is the most direct
12 evidence we can come up with of what a competitive
13 benchmark for the rate at issue here would be.
14 Q. During my opening, Judge Wisniewski
15 asked me -- this is my paraphrase, may be
16 unreasonable -- if we were not sort of being
17 inconsistent by saying that we find 62 licenses
18 representative, but still comment on this effort to
19 dissuade by the industry.
20 Did you hear that?
21 A. Yeah.
22 Q. Can you comment on your own reaction to

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1 that, please?
2 A. Yeah. I think it's -- it's exactly
3 right. The more that the number of licensees could
4 be limited, the more of an issue there is about
5 their representativeness. And, indeed, that
6 notice -- the issue also about how many of these
7 licenses are, I can't talk about some of them,
8 right?
9 The idea is to restrict information.
10 It's -- you don't want that information out, and the
11 less of it there is, the more you can get into these
12 other exercises that do not yield anything remotely
13 resembling what a competitive market rate would be.
14 Q. If you turn back to Page 54 of your
15 testimony, please, at the top of that page, the
16 first full sentence reads, All of these
17 statements -- again, reflecting the public
18 statements of the various organizations you
19 recounted a few pages earlier -- reflect the
20 expectation that royalties for SDARS sound recording
21 performing rights will be higher if the industry
22 relies on regulation, rather than individual market

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1 transactions, and allows SoundExchange to present
2 the united front in the rate-setting process.
3 Then in the succeeding paragraph, you
4 say, These expectations are congruent with decades
5 of scholarship on regulation, which concludes that
6 the informational and political advantages of
7 regulated firms cause the expected outcome of price
8 regulation to be prices that exceed the competitive
9 level and so forth.
10 Yes?
11 Is that the area you said you've done a
12 fair amount of scholarship in?
13 A. Yes.
14 Q. And now, Mr. Handzo, in his opening,
15 characterized it as we say it's a rigged process.
16 Can you straighten out the record on that?
17 A. I don't think the judges are biased, and
18 I don't think the process is rigged. What I'm
19 saying is the information that's available to
20 determine the result is relevant to what the outcome
21 is going to be, and each -- each side wants to make
22 strategic use of information, to present the

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1 information that's favorable to it and try to fight
2 the introduction of the information that's not
3 favorable to it. That's what good lawyers do on
4 both sides.
5 And the whole issue about the direct
6 licenses is to prevent an important source of
7 information from, first of all, coming into
8 existence; and then, secondly, being presented to
9 the -- to the -- to the Judges as something to take
10 into account in setting rates, with the full
11 expectation that the more of this information is
12 presented to them, the more likely they are to come
13 up with a rate that sort of looks like the direct
14 licenses.
15 That's the whole -- that's exactly what
16 I meant by writing that, is that -- that the
17 outcomes of these processes depend on the
18 information that's given to them, and the
19 information -- if the information is restricted and
20 limited and biased, then that will have an effect
21 and that -- in its direction favored by the person
22 limiting it on the outcome.

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1 MR. RICH: It might make sense to take a
2 short break.
3 CHIEF JUDGE BARNETT: You've got the
4 nod. We will take about a five-minute break so our
5 court reporter can do her job.
6 (Whereupon, a brief recess was taken
7 from 3:55 p.m. to 4:04 p.m.)
8 CHIEF JUDGE BARNETT: Good afternoon.
9 Please be seated.
10 Before you resume, Mr. Rich, may I
11 presume that we will take up with Dr. Noll again in
12 the morning?
13 MR. RICH: Yes.
14 CHIEF JUDGE BARNETT: Okay.
15 MR. RICH: And we plan to work till
16 about 4:30, Your Honor?
17 CHIEF JUDGE BARNETT: We will go until
18 4:30, yeah.
19 MR. RICH: All right.
20 CHIEF JUDGE BARNETT: Go ahead.
21 BY MR. RICH:
22 Q. Dr. Noll, if you turn to Page 45 of your

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1 written direct testimony, there begins a section
2 addressing the topic of Market Concentration?
3 A. Yes.
4 Q. Can you describe what you're doing in
5 that section, please?
6 A. Yes, I'm -- I'm examining this question
7 of the degree of competition on both sides of the
8 market.
9 Q. And focusing on the buyer's side, we've
10 talked about the seller's side?
11 A. It also -- yeah, the main thrust of this
12 is to deal with the issue, because SoundExchange has
13 characterized SiriusXM as having monopoly power in
14 the satellite radio marketplace, and it's dealing
15 with that issue.
16 Q. And do you reach a contrary conclusion?
17 A. I -- I reach two conclusions: the first
18 is that statement is -- is incorrect, they don't
19 have monopoly power; and, secondly, even if they
20 did, it would be irrelevant.
21 Because the market of concern here is
22 the market for the rights, and they're one of many

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1 competitors in the market for the rights, regardless
2 of whether they have monopoly power in some
3 downstream market.
4 Q. Now, another assertion that we heard
5 during openings from my worthy adversary was the
6 direct licenses assertedly have not taken place in a
7 competitive market, but rather, have been tainted
8 somehow by the overhang of regulation.
9 Is that a concept you considered and
10 addressed in your testimony?
11 A. Yes, it is.
12 Q. Can you speak to that?
13 A. It's true of literally all the rights
14 markets, that there's to some degree in effect of
15 the existence of regulation of some of the prices on
16 the prices for everything, whether they're regulated
17 or not.
18 The -- the -- we have -- in a product
19 differentiated industry, you have people who offer
20 different products, and they differ in terms of
21 their technical attributes, one from the other. But
22 the -- the interactive service people compete with

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1 the most customized of the noninteractive service
2 people, and the most customized of the
3 noninteractive services compete with the least
4 customized, and the least customized compete with
5 SiriusXM, and SiriusXM competes with over-the-air
6 broadcasters.
7 The -- so the -- the -- the price, every
8 time a particular price changes, if the Copyright
9 Royalty Judges decide to change the price of a
10 statutory service, it's going to change all the
11 other prices everywhere in the whole system. And
12 that's the classic characterization --
13 characteristic of a product differentiated market.
14 So you never -- you can't be completely
15 pure. There's never going to be anything in which
16 there's no consequence -- effective regulation.
17 Having said that, outside the context of
18 SDARS and PSS, these things are all supposed to be
19 the competitive price, all right? There is supposed
20 to be a reasonable rate using a standard of a
21 workably competitive market, willing buyer/willing
22 seller. That's what all these other things are

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1 supposed to be.
2 So if you get the other prices right,
3 then what's the problem, right? It's not -- there
4 isn't some perverse horror show arising from getting
5 that other price right. It's that something that
6 competes with you has a competitive marketplace, and
7 in order for you to compete effectively, you better
8 have a competitive price, too.
9 That's not a distortion unless you
10 believe that there is a fundamental distortion in
11 the rate process that is coming out of this process,
12 that the Copyright Royalty Judges aren't doing their
13 job.
14 Q. I'd like to turn to the alternative
15 benchmark other than the direct licenses that you
16 identified as corroborative of the rates suggested
17 by the direct licenses.
18 And from your testimony, I take it that
19 in order for you to explore and ultimately identify
20 potentially suitable other benchmarks, it was
21 necessary for you to assess the competitive
22 landscape in which SiriusXM operates?

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1 A. Yes. You -- that's the object you gave
2 is to find their closest competitors.
3 Q. And what did your analysis of that
4 competitive landscape reveal?
5 A. It revealed that what we would
6 conceptualize as their closest competitors don't
7 exist, which would be either another satellite
8 service or an Internet service that can be delivered
9 to the dashboards of automobiles that is completely
10 noninteractive, that is to say, has zero
11 customization, that sort of looks like SiriusXM.
12 There's no such service.
13 The closest that comes to it is in this
14 spectrum of customized services. The things that
15 fall into the category noninteractive, the ones that
16 have the least customization are the ones that look
17 the most like satellite radio.
18 So you have to have the characteristic
19 that you are a non -- a noninteractive service; you
20 have to have the characteristic that you have as
21 little customization as anybody in that business
22 does; you have to have, obviously, licenses that are

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1 available for me to study that have been produced in
2 discovery.
3 And you add up all those, you come to
4 the nearest possible substitutes for satellite
5 radio. Because satellite radio is primarily in the
6 dashboard, you want these other services that can be
7 made available in the dashboard.
8 Q. What is the relevance of the section of
9 your testimony where you talk about the changes that
10 have been occurring in the competitive landscape in
11 the last three, four, five years?
12 A. Well, as someone who was sitting here
13 five years ago, I had no clue that all this stuff
14 was coming down the pike. I didn't know what was
15 going to happen. And I -- I would hazard to say no
16 one else did either.
17 That the -- the explosion made possible
18 by 3G telecommunications systems in
19 Internet-delivered services, both audio and video,
20 is dramatic. And -- and it -- and in particular,
21 the idea of customization is fantastic, right? It
22 was out there, but it wasn't an important driving

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1 factor in mobile music delivery.
2 And so this is all brand-new and was --
3 it was unanticipated. It wasn't even discussed,
4 really, in the previous proceeding, and here we have
5 it today where there's more people listening to
6 music over their mobile phones through the dashboard
7 than there are subscribing to SiriusXM. And that's
8 a dramatic change, a complete change in the
9 competitive landscape.
10 Q. And looking at the various competitors
11 across that landscape, did you identify one or more
12 categories that -- you said none were perfect.
13 Did you identify one or more categories
14 and specific players in that landscape who came
15 closest in your estimation to the overall
16 functionality of SiriusXM in respect of its music
17 offerings?
18 A. Well, there are a number that come
19 close, but the only ones for which I have licenses
20 to work with is Last.fm. All right. I don't
21 have -- Last.fm is the least customized of the
22 services. It -- it offers a subscription service

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1 that is a -- has the least amount of customization.
2 It doesn't involve caching and things like that. So
3 I identified Last.fm.
4 I -- I did not consider services that
5 operate under the Webcaster Settlement Agreement
6 because I was informed that I -- I actually started
7 off trying to use those and was informed that I
8 couldn't because they couldn't be used as precedent
9 in this proceeding.
10 I actually thought about some things
11 involving SoundExchange and SXM and SoundExchange
12 involving the National Association of Broadcasters.
13 That had a similar problem, in particular, the
14 problem that it was with SoundExchange, not the
15 labels.
16 So among the things that satisfy the
17 characteristics, it was direct licenses between a
18 service provider and labels, and it had minimal
19 customization, all that I had to work with was
20 Last.fm.
21 Q. Do you know whether by the terms of the
22 SiriusXM Webcaster Agreement, the parties agreed

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1 whether that would have any precedential force in a
2 proceeding like this?
3 A. I don't, but I assumed I was allowed to
4 use it, but -- that it's okay to use it. If it's
5 not okay to use it, I've wasted a lot of time.
6 Q. We'll clarify that as the proceeding
7 progresses.
8 I'd like you to comment, if you would,
9 on another one of your demonstratives, which is
10 labeled Royalty Rate Variation Across Services and
11 Tiers, midway through the book.
12 A. Yes.
13 Q. What is this demonstrating in connection
14 with your examination of the marketplace?
15 A. Well, this is an illustration of how the
16 nature of the service affects the royalty rate. All
17 right. I use the rate numbers -- even though I'm
18 fully aware and I take into account in my -- in my
19 report that the typical license says you will pay
20 the most of one or two or three or four, sometimes,
21 items, because I've actually calculated what the
22 implied percentage rate would be from the ones that

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1 are not percentage rates, and they're basically all
2 pretty similar.
3 So it's useful, because we're doing a
4 percentage rate here, I think, to focus on the
5 percentage rate. And what this says is that the
6 degree of customer control of the content is
7 important in determining what the royalty rate is.
8 Again, it's simply not true that all
9 services pay the same royalty rate as a fraction of
10 their revenues even when I confine myself to the
11 services that have no distribution component of
12 their price.
13 The rate in the marketplace does depend
14 upon the degree of customization or interactivity,
15 the degree of customer control. And it does depend
16 on it like a factor of two. So it is simply wrong
17 to say everybody pays the same royalty rate.
18 Q. All right. So getting to the piÃ¨ce de
19 rÃ©sistance at 4:10 in the afternoon when everybody
20 is at their highest energy level, if you would turn
21 to the next demonstrative and use that, please, for
22 what I'm going to make as an open-ended proposal,

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1 which is that you walk the Court through or
2 summarize the five steps you engaged in to isolate
3 out, identify, and then make appropriate adjustments
4 to the most suitable benchmark other than direct
5 licenses, and using this as a -- as a tool, if you
6 don't mind.
7 A. Yeah. This is the five-step procedure.
8 And the first one was, as I said before, identify
9 the closest substitutes. And the one I picked was
10 Last.fm from among those for which I had rates that
11 I was allowed to use.
12 I mean, I identified other close
13 substitutes, like Pandora, as another one, but I
14 can't use that rate because it's a WSA rate.
15 Q. So to be clear, barring -- barring
16 technical bars, for example, parties saying no party
17 shall use this, it's conceivable that you would have
18 had multiple additional corroborating benchmarks in
19 your view?
20 A. Oh, yes. There were other things that,
21 in principle, you could use, but they're not --
22 they're not fair game because they don't have

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1 precedential value.
2 Q. In your testimony, you characterized
3 those as sort of loading the deck in favor of
4 SoundExchange.
5 What did you mean by that?
6 A. Well, what -- what I meant was that --
7 that SoundExchange is in a beautiful position. It
8 can -- for -- for the rates in which the parties
9 have to consent to a rate being precedential,
10 they're in the position of being able to limit the
11 licenses that you look at to the ones that are most
12 favorable to them.
13 So that -- that's an illustration of the
14 point I was making before. When you restrict the
15 information available in the process, it'll cause an
16 effect on the reasonableness of the outcome.
17 Q. Thank you.
18 So why don't you now return to walking
19 through the five steps?
20 A. Okay.
21 So the -- Step 1, identify the closest
22 substitutes -- I should add that -- that, you know,

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1 Pandora is, in fact, the poster child here, but I
2 can't use the rate. Because Pandora is by far the
3 most important Internet music site. It's -- it's --
4 it has a much larger -- all by itself, it accounts
5 for about 60 percent of all Internet music delivery.
6 So it's really the big elephant in the room, but I
7 can't use it.
8 The -- the -- then the second -- the
9 second pie is to find market negotiated rates
10 pertaining to the closest substitutes, and that's
11 the last -- the Last.fm, which negotiated rates with
12 each -- I used the four major distribution companies
13 that -- the most recent rates that Last.fm has
14 negotiated with the four companies, and I get that
15 range of outcomes, which I will not repeat.
16 Q. While you have -- while you ultimately
17 isolated out one buyer, you examined a series of
18 agreements across, what, four majors with that
19 buyer?
20 A. Four major -- all four majors with that
21 particular buyer, yeah.
22 Q. Okay. Go ahead.

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1 A. Then the next step is what is the
2 implicit market price for the music channels, and
3 there's a whole bunch of ways to go at that, all
4 right?
5 The most obvious is, you know, the --
6 the number at the bottom, $3, that turns out to be
7 what most of the -- of the -- that's the
8 subscription price of the most important of the
9 noninteractive, not -- least customized Internet
10 mobile services. I use all those words because
11 they're all important. $3 is what Pandora charges.
12 And --
13 Q. Just so -- so we're totally clear as to
14 what the object of Step 3 is, would you please just
15 state that one more time?
16 A. The object is to find a market price for
17 the music content on SiriusXM. And this -- this
18 is -- what I'm looking for is the -- a comparable
19 system that is disaggregated and unbundled where
20 it's just the music that's being sold.
21 When we talk about Last.fm and Pandora
22 and these other systems that I'm -- that are in this

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1 $3 price, we're talking about something that is
2 qualitatively better -- it has higher bit rates, so
3 the quality of sound is actually a little better
4 than the quality of the sound over SiriusXM -- we're
5 talking about availability on the dashboard through
6 downloads over the Internet. That's -- and -- and
7 have -- it's the subscription service that has the
8 least degree of customization, no caching, no
9 ability to do on-demand, no infinite skips, you
10 know -- it's limitations on the degree of customer
11 control that make it the closest thing I can find to
12 SiriusXM.
13 So that's how I get $3, because that's
14 what most of them charge.
15 Now, there's some other ways to get a
16 price as well. There's a survey by
17 Professor Hauser --
18 Q. Who will testify before this Court.
19 A. -- who will be testifying, and he comes
20 up with a number that's a little higher than that.
21 Q. What did he ask? What did he
22 investigate?

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1 A. What he investigated was how much would
2 they have to cut the price of SiriusXM if they took
3 away all the music, that kind of a question.
4 And it's -- and I will let him explain
5 how you do it. Because it turns out that's very
6 hard to do. That's why he has to be a separate
7 expert. It took him months to be able to develop
8 and execute a survey that would ask that question.
9 Q. And what was his conclusion?
10 A. His conclusion was basically it's pretty
11 close, like $3.13 or $3.10. He actually came up
12 with a lower number than $3, but he did the same
13 thing that Janusz Ordover did; he didn't count the
14 comedy channels.
15 Q. You added those in?
16 A. I had to add the comedy channels back
17 in.
18 Q. And was there a third technique you
19 used?
20 A. And the third technique I used, which
21 comes up with the $3.45, was to do it on -- on the
22 cost basis, which is to look at the books of

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1 SiriusXM and separate -- and subtract from their
2 revenues the costs associated with the delivery
3 system.
4 And in doing that -- I'll go back to
5 what I said before -- I did not include a
6 competitive return on investment, because in a
7 previous decision, the Copyright Royalty Judges had
8 said we're not going to include that.
9 I think it should be included in this
10 case because of the rapid turnover that exists for
11 SiriusXM customers and the fact that the company
12 would be half as big two years from now if it didn't
13 make reinvestments in radios.
14 But none -- nonetheless, I didn't do
15 that, all right, I didn't give them a competitive
16 return on their radios.
17 And once you make that subtraction, you
18 come up with $3.45.
19 So I -- my conclusion is that the -- all
20 roads lead to Rome, that all the ways that I
21 approached this problem led to a price in the range
22 of $3 to $3.50 per month as the market price for the

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1 music content on SiriusXM.
2 I add this is an overestimate, because
3 these alternatives I have all have a problem where
4 I've been conservative. I've made assumptions that
5 benefit SoundExchange with regard to the fact that
6 the quality is somewhat better on these services,
7 you know, with regard to the fact that -- that I'm
8 not including competitive return on the radios, that
9 kind of thing.
10 So these are upper bounds, actually. I
11 think that --
12 Q. You described some of those conservative
13 assumptions in your testimony, correct?
14 A. Yeah.
15 And then the fourth -- the fourth one is
16 to do again what was done before, is to multiply the
17 percentages in Line 2 by the -- the -- the prices in
18 Line 3 and get a monthly royalty, all right, that --
19 and -- and depending on which combination of
20 percentages and monthly prices you use, you get a
21 monthly royalty of between 75 cents and 95 cents.
22 Q. That's the math of multiplying the

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1 results of 2 by 3, correct?
2 A. That's right. I'm doing exactly the
3 same thing as that was shown in the --
4 characterizing Ordover's calculations.
5 And then the last one is the same as he
6 did. You divide that by the average revenue per
7 unit per customer, which is $11.38. So you -- you
8 look at the range 75 cents to 95 cents, divide it by
9 11.38, you get the percentage of revenue.
10 Q. And what does the last demonstrative
11 depict? Does that show the various permutations of
12 the analysis?
13 A. That's another way to do the same thing,
14 another way to do exactly the same thing. This
15 breaks down the $3 to $3.45.
16 Q. I think you've covered it in a series of
17 answers, but to put it in one place, in one wrap-up
18 answer, did you consider using Internet --
19 interactive Internet services in place of or in
20 addition to using the noninteractive services to do
21 this benchmark?
22 A. Yeah, I did.

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1 Q. Why did you reject that?
2 A. Well, it gets -- it gets you to the same
3 place once you make the adjustment for interactive
4 versus noninteractive, all right. Just take the
5 interactive, multiply it by half, and you're to the
6 noninteractive, which is the numbers I used.
7 So the market is telling us that the
8 price of interactive is roughly -- is double the
9 price of the noninteractive.
10 So, you know, if you just think about --
11 this is really simple. If you want to start with
12 interactive, you cut it in half because you're going
13 to something that is noninteractive; you cut it in
14 half again because half of the content is not music;
15 and then you cut it in half again because the
16 distribution system accounts for half of the costs.
17 And when you take the royalty rates paid
18 for interactive service and then you do these
19 adjustments to them, you end up again in the same
20 range, this 6 to 8 percent range.
21 Q. Now, just to be clear, you indicated
22 that you didn't do any disruption analysis.

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1 Is it correct, therefore, that this
2 resulting range of rates does not account for any
3 potential disruption factor were the Court to
4 determine there was some potential for disruption?
5 A. Well, I -- I would say more than that.
6 If you used the higher end, it would be disruptive
7 because it wouldn't provide a competitive return on
8 the radios. And -- and, therefore, it would cause
9 SiriusXM to stop buying radios and stop having
10 new -- having radios in new cars.
11 Q. Your testimony indicates that it's
12 important in undertaking this type of analysis that
13 at the end of the day, SiriusXM, in terms of fair
14 market value appraisal at least, not pay a rate
15 that's effectively higher than those of the people
16 who are competing with it in the dashboard of the
17 car; is that correct?
18 A. That's right.
19 Q. And why is it your view that's a correct
20 outcome?
21 A. Well, the reason for it is there's no
22 reason -- the regulatory process just shouldn't

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1 stack the deck in favor of one competitor over
2 another. It shouldn't be the case that five years
3 from now, everybody's listening to music on Pandora
4 over the dashboard because the rate set for SiriusXM
5 put SiriusXM out of business.
6 Likewise, we shouldn't set a rate for
7 SiriusXM that puts Pandora out of business.
8 You could do something in this rate
9 proceeding to put either one out of business, and we
10 shouldn't do that.
11 MR. RICH: Subject to any questions
12 Your Honors have, that concludes my direct
13 examination.
14 CHIEF JUDGE BARNETT: Okay. Thank you.
15 Questions, Judge Roberts?
16 JUDGE ROBERTS: No.
17 CHIEF JUDGE BARNETT: Judge Wisniewski?
18 JUDGE WISNIEWSKI: Tomorrow.
19 CHIEF JUDGE BARNETT: Well, I'm, once
20 again, impressed with the impeccability of your
21 timing. It's time now for us to break for the day.
22 We will be in recess until 9:30 in the

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1 morning. Back here same bat time, same bat station.
2 MR. RICH: Thank you.
3 (Whereupon, at 4:27 p.m., the
4 hearing was adjourned to reconvene on
5 Wednesday, June 6, 2012, at 9:30 a.m.)
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1 CERTIFICATE OF CERTIFIED COURT REPORTER
2 I, CINDY L. SEBO, the Certified Court Reporter,
3 do hereby certify that the witness whose testimony
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5 said witness which was taken by me in stenotypy and
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13 nor financially or otherwise interested in the outcome
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19 for the District of Columbia
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22 My commission expires: April 14, 2015

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