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

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR TRANSMISSION OF SOUND RECORDINGS BY SATELLITE RADIO AND "PREEXISTING" SUBSCRIPTION SERVICES (SDARS III)	)	**Docket No. 16-CRB-0001-SR/PSSR (2018-2022)**

SIRIUS XM'S CORRECTED REPLY TO SOUNDEXCHANGE'S
PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

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Steven Blatter	Written Direct Testimony of Steven Blatter	Sirius XM	Trial Ex. 5	Blatter WDT
Ravi Dhar	Corrected Written Direct Testimony of Ravi Dhar	SoundExchange	Trial Ex. 22	Dhar CWDT
Ravi Dhar	Written Rebuttal Testimony of Ravi Dhar	SoundExchange	Trial Ex. 40	Dhar WRT
Joseph Farrell	Written Rebuttal Testimony of Joseph Farrell	Sirius XM	Trial Ex. 10	Farrell WRT
George Ford	Written Direct Testimony	SoundExchange	Trial Ex. 23	Ford WDT
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David J. Frear	Written Rebuttal Testimony of David J. Frear	Sirius XM	Trial Ex. 12	Frear WRT
John Hauser	Written Rebuttal Testimony of John Hauser	Sirius XM	Trial Ex. 11	Hauser WRT
Joe Lenski	Written Direct Testimony of Joe Lenski	Sirius XM	Trial Ex. 7	Lenski WDT
Thomas S. Lys	Written Rebuttal Testimony of Thomas S. Lys	SoundExchange	Trial Ex. 42	Lys WRT
James E. Meyer	Written Direct Testimony of James E. Meyer	Sirius XM	Trial Ex. 1	Meyer WDT
Jonathan Orszag	Amended Written Direct Testimony	SoundExchange	Trial Ex. 26	Orszag AWDT

Witness Name	Description	Party	Exhibit No.	Citation Format
	of Jonathan Orszag			
Jonathan Orszag	Written Rebuttal Testimony of Jonathan Orszag	SoundExchange	Trial Ex. 43	Orszag WRT
Carl Shapiro	Written Direct Testimony of Carl Shapiro	Sirius XM	Trial Ex. 8	Shapiro WDT
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Itamar Simonson	Written Rebuttal Testimony of Itamar Simonson	SoundExchange	Trial Ex. 44	Simonson WRT
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Jeff Walker	Written Rebuttal Testimony of Jeff Walker	SoundExchange	Trial Ex. 50	Walker WRT
George White	Written Direct Testimony of George White	Sirius XM	Trial Ex. 4	White WDT
Robert Willig	Written Rebuttal Testimony of Robert Willig	SoundExchange	Trial Ex. 46	Willig WRT

Sirius XM Radio Inc. ("Sirius XM"), a preexisting satellite digital audio radio service ("SDARS") as defined in 17 U.S.C. § 114(j)(10), respectfully submits this Reply to the Corrected Proposed Findings of Fact and Conclusions of Law filed June 19, 2017 ("SE PFF" or "SE PCL," as appropriate) by SoundExchange, Inc. and other copyright owner and artist participants (collectively, "SoundExchange").

INTRODUCTION

For all of its mass, SoundExchange's Proposed Findings of Fact and Conclusions of Law reduce to a series of basic misconceptions on which the entirety of its case rises or falls, accompanied by a number of fundamental misportrayals of Sirius XM's case. The hearing record, as summarized in Sirius XM's Proposed Findings of Fact and Conclusions of Law ("SXM PFF"), addressed and disposed of each of these. In this Reply, we confine our response to those arguments presented by SoundExchange that bear meaningfully on rate- and term-setting, and reference rather than reiterate points already fully addressed in Sirius XM's proposed findings.[1] We tie those responses back to key precedents and record citations that demonstrate the lack of merit to SoundExchange's core argumentation. That anchoring also exposes the extent to which SoundExchange has highly selectively culled the record and departed from the record entirely.[2] Immediately below, we highlight several of the most salient erroneous propositions through which SoundExchange purports to justify a dramatic rate increase.

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[1] We also refrain from responding individually to each of the nearly 2,000 proposed findings of fact directed at Sirius XM, as to do so (putting aside time constraints) would be a wasteful and duplicative diversion from meaningful issue joinder. We instead address the relevant *sections* of SoundExchange's filing, and do so in the order presented by SoundExchange where possible. For ease of reference, we also supply the Judges with an "Index of Replies" (following the tables of contents and authorities) that identifies where in this Reply we respond to particular paragraphs of SoundExchange's proposed findings.

[2] In Section X of and Attachment B to this Reply, we document SoundExchange's pervasive reliance on factual assertions that have no record basis, whether in the form of improper use of

<u>The Key Tenets of SoundExchange's Affirmative Case</u>

- *"Standard" benchmarking practice dictates that the sole legitimate benchmark against which to establish the rates payable by Sirius XM is the upstream market for licensing sound recording performances to interactive services.* SoundExchange loads the analytic rabbit in the hat by advancing an insupportable definition of "standard" benchmarking methodology that would limit the benchmarks suitable for consideration by the Judges to a universe of one: the interactive services market. This results-oriented distortion of proper benchmarking parameters, which would foreclose consideration of the rates established in *SDARS II* and *Web IV*—not to mention direct licenses entered by Sirius XM itself—has no basis in the statute and ignores all prior practice and supporting precedent, which make clear that the benchmarks proposed by Professor Shapiro meet all the criteria of comparable market rates (indeed, far more so than does SoundExchange's benchmark) and are therefore entirely appropriate for consideration by the Judges. S*ee infra* §§ III-V.

- *It is legally inappropriate for the Judges to consider the prevailing rates in rendering their determination.* SoundExchange further maneuvers to place its interactive services benchmark on special footing via the baseless legal contention that it is somehow inappropriate for the Judges to take account of the prevailing statutory rates—in other words, that the Judges must undertake their factual and economic analysis without the benefit of perhaps the single *most relevant* data point, particularly where the existing rates were the product of a similarly intensive rate-setting process implicating most of the

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trial exhibits that were admitted solely for a limited purpose or contentions that simply lack any record support. We also remind the Judges of certain pending *in limine* motions seeking to strike portions of the expert testimony of George Ford and Thomas Lys.

same factual and economic contentions as arise in the instant proceeding. This additional results-oriented manipulation of the governing legal standard for benchmarking well suits SoundExchange, since the hearing record's searching examination of the history and context in which the existing statutory rates were established, as well as of potentially relevant changes in economic or competitive market circumstances in the intervening period that might lend support for the enormous rate increase sought by SoundExchange, revealed the utter lack of support for an increase of any magnitude in the prevailing rate, let alone at the staggering level sought by SoundExchange. We demonstrate the utter lack of legal support for this cynical advocacy, which reflects a striking disregard of prior practice and precedent, as well as common sense. *See infra* § V.

- *While the Judges should ignore SDARS II, they should look to the SDARS I, the initial Web III determination, and aspects (but only certain aspects) of the Web IV proceeding as guideposts for rate-setting.* We expose the transparency of SoundExchange's choice of guiding precedent, which is most notable for: reliance on the 2008 *SDARS I* determination, while ignoring the succeeding, governing 2013 *SDARS II* decision; its resort to the initial, *vacated Web III* decision, while ignoring the undermining decision on remand that replaced it; and the claimed support it finds in the "methodology" but *not* in the *rates* determined in *Web IV*. Via this cherry-picking, SoundExchange seeks to escape the devastating consequences for its case of: (i) the Judges' rejection of the identical interactive services benchmark in *SDARS II* on the ground that it produced unreasonably high rates; (ii) *Web III Remand's* rejection of the very methodology employed by Mr. Orszag in his "Approach Two" to rate setting here, namely, the use of retail prices to adjust for the value of interactivity; and (iii) the logical economic implications of the per-

play rates established in *Web IV* for rate-setting here, as fully laid out in the testimony of Professor Shapiro. *See infra* §§ I, IV.

- *Mr. Orszag faithfully followed the Web IV rate-setting methodology in deriving rates for Sirius XM.* For this premise to be accurate, the Judges would have to conclude that even though they found less than two years ago that the interactive services market is non-competitive and generates supra-competitive rates, Mr. Orszag's application of "ratio equivalency" to yield rates for Sirius XM equivalent to the effective per-subscriber and percentage-of-revenue rates prevailing in that market nevertheless is an appropriate application of the *Web IV* methodology and is economically sound. A straightforward reading of the *Web IV* opinion, together with the cross-examination of Mr. Orszag and the dissection of his modeling by Professor Shapiro, reveal that it distinctly is not. Instead of faithfully following the economic dictates of *Web IV*, Mr. Orszag did no more than reproduce the two discredited benchmarking models proposed by Dr. Ordover in *SDARS II*. The fact that Mr. Orszag would not forthrightly own up to the identity of his benchmarking to Professor Ordover's failed efforts, instead disguising his work as simply following the dictates of *Web IV* (which it did not), speaks volumes as to its shaky analytic foundations. Concerning the purported fit of Mr. Orszag's benchmarking with the Judges' rate-setting in *Web IV*, as Professor Shapiro testified to at length, Mr. Orszag's extraction of the principle of ratio equivalency from the limited context in which the Judges there endorsed it was unsound as a matter of economics and otherwise riddled with error. Unsurprisingly, given its slavish copying of the Ordover models, the rates generated by Mr. Orszag—calling for a more than doubling from the present 11% to

at least 23%—reflect a similarly indefensible "yawning gap" from existing rates as did those earlier proposed by Professor Ordover and rejected by the Judges. *See infra* § I.

- *The Judges either inadvertently and mistakenly set rates in Web IV for subscription non-interactive services based on the minimum per-play rates, as opposed to the effective rates, contained in the interactive service agreements relied on by Professor Rubinfeld,, or violated fundamental principles of economics to the extent they knowingly did so.* SoundExchange advances these claims in an effort to run from the clear implications of *Web IV* for the reasonable rates to be paid by Sirius XM. To be clear: SoundExchange is making the preposterous claim that the Judges "missed" their intended rate target in the prior proceeding by a factor of two. The fallacy of this assertion is not only made clear from the plain language of *Web IV*; it is also belied by the recognition that it was SoundExchange's *own economist* who proposed the per-play methodology adopted by the Judges and who (as did SoundExchange itself) explicitly advised the Judges of the economic consequences of using those recommended per-play rates as opposed to effective rates. There was, moreover, nothing economically unsound in how the Judges set rates for subscription non-interactive services, including by reference to the competitive rates reflected in the Pandora-Merlin agreement. Tellingly, in its pending appeal from the *Web IV* ruling, SoundExchange makes no mention of the purported errors it identifies here. *See infra* §§ I.D, IV.A-B.

- *The Judges erred in Web IV in concluding that there is a lack of effective competition in the interactive services market.* SoundExchange bases this further assault on the Judges' reasoning and resulting rates in *Web IV* on the stated views of the major labels and of Mr. Orszag that price competition is irrelevant to a determination of effective competition.

For example, Mr. Harrison of UMG saw no apparent inconsistency between the conceded lack of any price competition between and among record labels for additional plays by on-demand services (*i.e.*, steering) and a conclusion that that licensing market nevertheless manifests effective competition. While Mr. Harrison, as well as Mr. Kushner of Warner/Atlantic, were quick to point out all of the areas of *non-price* competition in which the Majors engage (including for playlist share), sound principles of economics dictate that none of that is a substitute for the price competition that lies at the heart of a competitive market. As the Judges have recognized, market behavior by the Majors that thwarts the injection of price competition into a market via steering serves to "undermine the 'effective competition' standard that the D.C. Circuit, the Librarian of Congress and the Copyright Royalty Judges have declared to be an essential element of" a section 114 ratemaking proceeding. *Web IV*, 81 Fed. Reg. at 26373. *See infra* §§ I.C, I.J, II.C.i.

- *"Must-have" markets can feature effective competition; anti-steering provisions "reflect competition at work."* In its zeal to resurrect the interactive services benchmark, SoundExchange directly challenges two key findings made by the Judges in *Web IV* in support of their conclusion as to the lack of effective competition in the interactive services market. The first concerned the competitive consequences of the must-have status of the major labels in the interactive service market, drawn in significant part from UMG's and its supporting economist's own representations to the Federal Trade Commission. The second concerned the competition-stifling effects of anti-steering provisions as employed in the interactive services market. With no factual or economic support, on a record that shows that nothing material has changed in the competitive

dynamics of the interactive services market, SoundExchange nevertheless attempts to portray the Majors' "must-have" status as competitively innocuous and, even more astonishingly, to characterize anti-steering provisions as the embodiment of price competition. The Judges' cogent analysis in *Web IV* refutes these specious spins, as does the testimony of Professor Shapiro, who, appropriately, said he was "stunned" by the suggestion that anti-steering provisions reflect price competition at work. *See infra* §§ I.C, I.J, II.C.i.

- *In any event, the interactive services market now manifests effective competition*. SoundExchange's written testimony, particularly from Mr. Orszag, abounded in the claim that there have been "significant marketplace developments" since *Web IV* that allegedly have changed the competitive dynamics of the interactive services market and have rendered the rates in the agreements before the Judges in *Web IV* "obsolete." The hearing record demolished any such notion, notwithstanding which SoundExchange persists in advancing this claim. This persistent advocacy flies in the face of Mr. Orszag's concessions at trial that he did not even investigate the propositions he advanced, and that he was unable to cite any evidence of changes in price levels or price competition in the nature of steering in the interactive marketplace to support them. In fact, the record demonstrates the exact opposite: nothing has changed from *Web IV* in the competitive dynamics of SoundExchange's benchmark market. The representatives of the Majors who testified at trial proudly and unequivocally stated that that licensing market remains free of any price competition between and among record labels for additional plays on interactive services. It is therefore apparent that SoundExchange's benchmark continues

to fail to satisfy a key criterion of comparability, namely, the presence of effective competition in the licensing of assertedly analogous rights. *See infra* §§ I.J, II.C.i.

- *The presence of effective competition in the interactive services market renders any steering adjustment of the type employed by the Judges in Web IV unnecessary; if, nonetheless, the Judges determine that such an adjustment is appropriate, a reduction in the range of 6% to 13% from the prevailing interactive service market rates would suffice.* The record demonstrates the inappropriateness of the resort to the interactive services benchmark on account, among other reasons, of the complementary oligopoly conditions that remain present in that market. Were the Judges nonetheless to set rates with reference to that benchmark, as Professor Shapiro explained, the downward adjustments from the effective rates in the interactive services market proposed by SoundExchange misconceive the basis for, as well as the proper baseline rates from which to calculate, the form of steering adjustment that the Judges adopted in *Web IV*. SoundExchange's misconstruing of these matters leads it to propose downward adjustments that would not come close to bringing the interactive service rates in line with those one would expect to observe under competitive licensing conditions. S*ee infra* § I.K.

- *Increasing market convergence warrants adoption of the interactive services benchmark.* SoundExchange seeks to overcome the many debilitating flaws in its proposed interactive services benchmark by making a generalized series of claims as to purported market convergence, including a blatant mischaracterization of Professor Willig's opportunity cost analysis as supposedly supporting this claim. The trial record instead revealed: (i) no meaningful functional convergence between Sirius XM and interactive services; (ii)

that, to the extent such convergence has occurred, it has consisted of interactive services offering more "lean-back" functionality, bringing them closer to Sirius XM's unchanged, non-interactive service offerings, rather than Sirius XM becoming more interactive; and (iii) no evidence of increased substitution of Sirius XM for other record company revenue streams. The general testimony proffered by SoundExchange witnesses as to the increased prominence of "streaming" and its asserted negative financial impact on the record industry was most notable for its failure to tie *Sirius XM* to such asserted losses, let alone to show a trend since the *SDARS II* determination warranting a radical upward adjustment in rates. *See infra* §§ I.B, I.L, II.D, V.B.i.

- *In any event, the Section 801(b)(1) factors should trump the forces of competition in favor of supra-competitive rates that "take the [interactive service] market as one finds it" and, in so doing, maximize consumer welfare.* SoundExchange advances these arguments through Professor Willig, whose analyses bearing on rate-setting admittedly modeled a market featuring one monopoly seller (or a cartel of sellers); who effectively engaged in benchmarking from the rates in the interactive service market; and who denigrated the importance of price competition and steering as somehow detrimental to public policy interests. Consistent with this flagrant disregard for the competitive norms that guide this proceeding, and without a scintilla of legal support, SoundExchange argues that the 801(b)(1) factors warrant setting the rates payable by Sirius XM "above the benchmark" implied by the willing buyer/willing seller test, i.e., *above the competitive level*, based on an arbitrary conception of redistributive fairness that, SoundExchange asserts, would compensate for the harm of prior CRB determinations, which have "resulted in what is essentially a one-to-one transfer of wealth from artists

and copyright owners to Sirius XM shareholders." SE PFF 1606. We demonstrate the utterly misguided nature of such an approach to 801(b)(1) rate-making. S*ee infra* VI.

- *Sirius XM can well afford to pay rates double or more the prevailing rate.* Lacking a sound benchmarking model, SoundExchange seeks, through the testimony of Professor Lys, unabashedly to coat-tail on Sirius XM's significantly improved financial circumstances. Although ostensibly designed to fend off a non-existent 801(b)(1)(D) "disruption" adjustment in favor of Sirius XM, Professor Lys's prolix recounting of the state of Sirius XM's current and projected financial health also undergirds the argument that Sirius XM's ability to pay more than it is currently paying should factor into the Judges' consideration of what a willing buyer would pay a willing seller in the market being modeled here. This testimony was demonstrated to have no legitimate economic foundation, as Professor Shapiro cogently explained and, indeed, as Professor Lys himself has acknowledged – albeit in prior testimony in *Web IV* that he failed so much as to acknowledge anywhere in his fulsome testimony in this proceeding. *See infra* § V.B.ii.

- *Sirius XM should not only pay rates more than double those currently in place but should apply them to essentially all of Sirius XM's revenue, whether earned for activities covered by the statutory license or not, and to all trial subscribers.* As if a jump to 23% percent (or its monthly per-subscriber equivalent) were not enough, SoundExchange proposes a dramatic refashioning of the Gross Revenues definition that would, among other things: (i) effectively deny Sirius XM the ability to allocate and deduct revenue from programming bundles earned on account of non-statutory programming (save for where such programming is sold on a standalone basis); (ii) eliminate or cabin longstanding revenue deductions; and (iii) cap the fee-reduction for directly licensed

performances according to a measure that SoundExchange itself admits is suboptimal. In addition to the back-door rate increase SoundExchange would impose through changes to the Gross Revenues definition, it also proposes an additional $100 million or more in fees to be paid by Sirius XM each year for trial subscriptions, achieved through the disruptive imposition of a 30-day limit on free trials borrowed from the interactive-service market. Testimony from Sirius XM's fact and expert witnesses showed that proposal – which would upend 15 years of settled practice – to be bereft of factual or economic justification and ultimately counter-productive to the interests of SoundExchange and its members. *See infra* §§ VII-VIII.

SoundExchange's Critiques of Sirius XM's Affirmative Case.

SoundExchange's effort to undermine Sirius XM's three-pronged approach to rate-setting fares no better than its attempt to defend its own rate proposal. As we discuss at length below, SoundExchange's ineffectual critique of Professor Shapiro's analysis, principally via the testimony of Mr. Orszag, is devoid of evidentiary support and shot through with mischaracterizations of the record and of what Professor Shapiro did.

To start, SoundExchange's attack on Professor Shapiro's demonstration that no material changes have occurred since the Judges last evaluated this marketplace in *SDARS II* is frivolous. After making the insupportable claim that the Judges cannot consider the prevailing statutory rates in setting new ones, SoundExchange touts supposedly significant changes over the past five years that, it urges, warrant a dramatic increase to the prevailing rates; its only support for this claim, however, is the factually baseless assertion that the opportunity cost of licensing Sirius XM has increased and the economically baseless assertion that Sirius XM's enhanced *ability* to pay more means that it *would* pay more in a hypothetical workably competitive market.

SoundExchange's own proponent – Professor Lys – has elsewhere acknowledged that the latter argument fails as a matter of basic economics. *See infra* § V.B.

SoundExchange's attack on Professor Shapiro's analysis of the direct license benchmark is similarly misguided. After making the specious claim – directly at odds with prior CRB precedent – that the "shadow" of the statutory license renders any such agreements entirely unusable for rate-setting here, SoundExchange wrongly presumes that the direct licenses do not reflect competitive rates unless (i) there is evidence of actual steering by Sirius XM (which evidence, contrary to what SoundExchange claims, does exist, including in the testimony of its own direct-licensor witness); and (ii) a promise of steering was the sole motivating factor for the label to enter into the license. SoundExchange is wrong both as to the proper conceptual framework and as to what the record reflects. As Professor Shapiro explained, it is enough to conclude that the direct licenses are informative of competitive market rates for there to be evidence that the *prospect of steering* (i.e., the hope for more plays on Sirius XM) motivated labels to enter into the licenses at sub-statutory rate levels, *even if there were other factors at play as well*. SoundExchange knocks down a strawman in expounding at length on these other benefits of the direct licenses, as the conceded existence of such benefits in no way disqualifies the direct licenses as market benchmark rates to the extent they also were seen as an entree to Sirius XM's programming staff and thus to the prospect of more spins – which indisputably was the case. *See infra* § III.

Finally, SoundExchange's attempt to undermine the probative force of Professor Shapiro's analysis of the *Web IV* Benchmark ultimately boils down to the circular proposition that because Professor Shapiro arrived at a rate that is lower than that derived by Mr. Orszag, Professor Shapiro must be wrong. SoundExchange's efforts to demonstrate where Professor

Shapiro allegedly went wrong only underscore that it is not the analysis of Professor Shapiro, but that of Mr. Orszag, that is askew. For example, the record clearly belies Mr. Orszag's assertion that material changes in the marketplace have rendered the agreements reflected in the *Web IV* Benchmark outdated. Mr. Orszag never even looked at whether the rates in the interactive services agreements used in *Web IV* have changed in the past two years – in fact, they have not – and the newer, supposedly superseding Merlin/Pandora "mid-tier" agreement Mr. Orszag cites does not, in fact, provide any indication of workably competitive rates for non-interactive statutorily compliant subscription services. Quite instead, it reflects the monopoly rate (or worse) for a service that offers far more functionality than is offered by Sirius XM's satellite radio service. SoundExchange's other critiques of the manner in which Professor Shapiro converted the *Web IV* Benchmark per-play rate into a percentage-of-revenue rate for Sirius XM, including by supposedly failing to account for differences between Sirius XM and non-interactive subscription webcasters, also, we show, miss the mark. *See infra* § IV.

All told, despite devoting many hundreds of pages to attempting to disparage Sirius XM's rate-setting models, SoundExchange comes up empty. Nothing in the entirety of its papers calls into question any aspect of Professor Shapiro's thorough analyses.

I. SOUNDEXCHANGE HAS FAILED TO JUSTIFY RELIANCE ON THE INTERACTIVE BENCHMARK (*SE PFF § IV*)

1. Rather than attempting to address the many crippling flaws in Mr. Orszag's use of the interactive services benchmark that were exposed by Professor Shapiro and on cross-examination, SoundExchange resorts to obfuscation, including by: (i) setting forth a biased and highly misleading description of "standard" benchmarking practice; (ii) dramatically overstating the similarities between interactive services and satellite radio; (iii) grossly misinterpreting the Judges' evaluation of the interactive services benchmark in prior proceedings; (iv)

oversimplifying and presenting a highly misleading portrayal of "ratio equivalency"; (v) blatantly mischaracterizing Professor Shapiro's devastating criticisms of Mr. Orszag's analysis; and (vi) continuing to press the unsupportable proposition that the interactive services market is workably competitive and reflects the forces of price competition at work. Below, we address each of these points as well as some of SoundExchange's more egregious misportrayals of the record evidence.[3]

2. Before doing so, we note that while SoundExchange has set forth Mr. Orszag's qualifications, **SE PFF 25-26**, it failed to acknowledge, as was exposed during cross-examination, that Mr. Orszag has a history of providing testimony that is of limited use at best. 4/26/17 Tr. 1095:19-1102:16 (Orszag). For example, in the recent Aetna/Humana merger litigation, during which Mr. Orszag testified on behalf of the proposed merging companies, one of his analyses was found by the Court to be "almost entirely speculative." *United States v. Aetna, Inc.*, No. 16–1494 (JDB), 2017 WL 325189, at *26 (D.D.C. Jan. 23, 2017). Another was found to be based on "circular reasoning" that assumed its conclusion. *Id.* at *38. In another setting, Mr. Orszag had large portions of his testimony excluded entirely. In the so-called E-books antitrust case, three of Mr. Orszag's four principal sets of opinions were rejected as a matter of law on *Daubert* grounds. *In re Electronic Books Antitrust Litigation*, Nos. 11 MD 2293(DLC), 12 Civ. 3394(DLC), 2014 WL 1282298 (S.D.N.Y. Mar. 28, 2014). There, Judge Cote concluded that portions of Mr. Orszag's analyses were "unmoored from record facts and unsupported by any rigorous analysis." *Id*. at *15. Judge Cote went on to note that certain of Mr. Orszag's analyses rested on "layers of assumptions, many of which are untethered to the real

[3] Given the enormity of SoundExchange's filing – some 700-plus pages expended on Sirius XM alone – we do not address each of the many mischaracterizations of the record evidence. Instead, we confine our focus to those that are of particular relevance to the rate-setting task at hand.

world or at odds with the facts." *Id*. at *16. As a result, much of Mr. Orszag's work in that matter was found to amount to nothing more than "guesswork." *Id.* at *19. As was demonstrated in Sirius XM's proposed findings, and as elaborated on below, Mr. Orszag's analyses here fare no better – he has again resorted to speculative and non-rigorous analyses that are unmoored from the record facts – amounting to nothing more than guesswork.

A. SoundExchange's Discussion of the Benchmarking Approach to Rate Setting Is Highly Misleading (*SE PFF § IV.B*)

3. SoundExchange begins its distortion of the benchmarking analysis with an erroneous characterization of the purportedly "standard way" in which economists engage in benchmarking to estimate a reasonable royalty rate in this setting. **SE PFF 90**. According to SoundExchange, benchmarking is all about examining "comparable rates generated through arm's length negotiations outside the purview of the compulsory license regime." **SE PFF 90**. This gross misstatement is designed to isolate as the only appropriate benchmark SoundExchange's perennially preferred interactive services benchmark while excluding the superior alternatives proffered by Sirius XM. This results-oriented framing of the inquiry disregards the plain language of Section 114 as well as the Judges' prior practice.

4. As is discussed in Sirius XM's proposed findings, SXM PCL ¶¶ 76-82, Section 114 specifically directs consideration of "the rates and terms for comparable types of subscription digital audio transmission services and comparable circumstances under voluntary license agreements." 17 U.S.C. § 114(f)(1)(B). This provision expressly contemplates consideration as benchmarks of one of the very types of agreements – the direct licenses entered into between Sirius XM and more than 500 independent labels – that fail SoundExchange's invented benchmarking-fitness test, as such agreements are the result of negotiations that would appear to fall within "the purview of the compulsory license regime." **SE PFF 90.**

5. SoundExchange's distorted framing also flies in the face of prior CRB precedent. In both *SDARS II* and *Web IV*, the Judges relied on direct licenses negotiated between services eligible for the statutory license and record labels in setting rates even though those agreements could be said to fall within "the purview of the compulsory license regime."

6. It is no coincidence that SoundExchange's framing of "standard" benchmarking practice would exclude consideration of a second Sirius XM benchmark: the per-play rates derived from the *Web IV* proceeding pertaining to subscription non-interactive services (the "*Web IV* Benchmark"), as those rates indisputably fall within the purview of the statutory license regime. For that matter, relying on the Judges' *SDARS* precedent by examining what, if any, material changes have occurred since the 2013 *SDARS II* determination, as Professor Shapiro (sensibly) did, SXM PFF § III.A, would, by SoundExchange's lights, constitute a deviation from "standard" benchmarking because it incorporates statutory rate-setting. Under this dubious reasoning, SoundExchange would preclude consideration of the most probative potential benchmarks. S**E PFF 90.**

7. It is, of course, not inappropriate to consider the potential "shadow" effects of the statutory license – a matter as to which testimony in this and prior proceedings abounds. We note in this regard that even SoundExchange's cramped interpretation of "standard" benchmarking criteria would not immunize its preferred benchmark from the supposed taint of a "shadow" of the Section 114 license, as it is by now well understood that all licenses implicating sound recording performance rights are, to some degree, influenced by the presence of the Section 114 statutory license. *See Determination of Rate and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 78 Fed. Reg. 23054, 23065 n.32 (Apr. 17, 2013) ("*SDARS II*"). However, a proper benchmarking analysis requires a far more

encompassing consideration of *all* of the relevant factors, including the comparability of the buyers and sellers, the comparability of the rights being licensed, the nature and manner of the use of those rights and, in proceedings such as this, whether the benchmark market is workably competitive. When properly measured against the range of relevant criteria, the benchmark that SoundExchange improperly attempts to define as the only legitimate benchmark warranting consideration fundamentally does not pass muster. SXM PFF § IV(B).

8. SoundExchange's portrayal of "standard" benchmarking practice fails for a second fundamental reason. According to SoundExchange, "the same dynamics that would be expected to shape negotiations in unregulated distribution channels . . . would be expected to exert the same influence in hypothetical arm's length dealings between Sirius XM and individual record labels." **SE PFF 92**. This "take real markets as you find them" approach makes no mention of the need to ensure that the "dynamics" of the "hypothetical voluntary negotiations between individual record labels and Sirius XM" reflect the workings of effective competition. *Id.* This glaring omission comes as no surprise, as it continues to be SoundExchange's goal to maneuver around the continued – and conceded – complete absence of any price competition in the interactive services market. Indeed, the linchpin of SoundExchange's case is its effort to engraft the complementary oligopoly rates that record labels are able to secure from subscription interactive services into the SDARS market. *See* SXM PFF §§ IV.B, IV.D.

9. The implications of SoundExchange's view of the role of the CRB extend beyond this proceeding. If the litmus test for an acceptable benchmark was merely a confirmation that the "same dynamics" that "shape negotiations in unregulated distribution channels" can be presumed "to exert the same influence in hypothetical arm's length dealings between Sirius XM and individual record labels," the Judges' role in such proceedings would be just to rubber-stamp

the rates that record labels are able to secure in unregulated markets (subject only to potential 801(b) adjustments where statutorily mandated). That ministerial role would preclude, among other considerations, examination of the degree of competition those unregulated markets exhibit in the licensing of assertedly comparable rights. This cynical view of the essentially passive role to be played by the Judges has been rejected both in this forum and in the comparable ASCAP "rate court" setting. *See Determination of Royalty Rates and Terms for Ephemeral Recording and Webcasting Digital Performance of Sound Recordings ("Web IV")*, 81 Fed. Reg. 26316, 26334 (May 2, 2016) ("[I]f the Judges were to simply apply the competitive dynamics of the interactive market, they would be disregarding the particular statutory history that led to the three-tier rate structure."); *ASCAP v. Showtime/The Movie Channel, Inc.*, 912 F.2d 563, 570 (2d Cir. 1990) (observing that the rate court is not simply a "placebo" intended to rubber stamp the "fees ASCAP ha[s] successfully obtained from other users.").

B. The Interactive Service Agreements Are Poor Benchmarks for Satellite Radio (*SE PFF § IV.C*)

10. In Section IV.C of its proposed findings, SoundExchange asserts that the interactive services benchmark is "the best available benchmark for satellite radio." **SE PFF 97**. In support of this claim, SoundExchange posits that the interactive services and satellite radio are comparable "along key dimensions." *Id.* They are not.

11. In an effort to portray the interactive services as being similar to Sirius XM's satellite radio service, SoundExchange claims that "there is no difference between interactive streaming services and satellite radio in terms of the music content they deliver to subscribers." **SE PFF 98**. But, as was made clear during cross-examination, all that Mr. Orszag meant by this "key" similarity is that both Sirius XM and the interactive services distribute music for performance. Similarity at this high level of generality in no way suggests that the interactive

services benchmark is a better benchmark than any other put forward in this proceeding. 4/26/17 Tr. 1190:10-1191:19 (Orszag).

12. The next three "key" asserted similarities – that both Sirius XM and the interactive services supply "music content via digital transmission," that they are both subscription services that allow unlimited usage, and that they both offer "mobile functionality" – also fail to demonstrate that the interactive service benchmark is "the best available benchmark for satellite radio." **SE PFF 99**. *All* of the benchmarks put forward in this proceeding allow for the reception of music content via digital transmission, are subscription services that allow for unlimited usage, and offer mobile functionality. These superficial and overly broad similarities between Sirius XM and subscription interactive services provide no support for SoundExchange's reliance on the interactive services benchmark.

13. All that SoundExchange is able to muster in support of its contention that the supposed increasing convergence of the interactive services and Sirius XM makes the interactive services benchmark "the best available benchmark for satellite radio" is that the interactive services offer some "lean back" functionality. **SE PFF 99**. As Mr. Orszag acknowledged on cross-examination, this merely suggests that the interactive services have become *more like Sirius XM*, not that Sirius XM has become more like the interactive services. 4/26/17 Tr. 1191:20-1192:20 (Orszag). If anything, that would suggest that in a workably competitive market the rates paid by the subscription interactive services would come down, not that Sirius XM's royalties should go up. More to the point, this asserted convergence does not demonstrate that the interactive service benchmark is any better than any other benchmark offered in this proceeding. Indeed, the benchmarks offered by Professor Shapiro – the Sirius XM direct

licenses and the *Web IV* Benchmark – are both far superior along this dimension, as both of these benchmarks are services that, like Sirius XM, offer "lean back" functionality *exclusively*.

14. SoundExchange's claim that the interactive services benchmark is "the best available benchmark for satellite radio" is insupportable: Both of the benchmarks that Professor Shapiro considered – the direct licenses entered into between Sirius XM and more than 500 independent labels, and the *Web IV* Benchmark – are far superior to SoundExchange's preferred interactive service benchmark. The Sirius XM direct license benchmark involves precisely the same buyer (Sirius XM) and the same sellers (record labels) negotiating over precisely the rights that are at issue in this proceeding. Moreover, these agreements reflect the forces of competition at work insofar as they are the result of record labels agreeing to cut their price in an effort to secure greater plays on Sirius XM. *See* SXM PFF ¶¶ 167-68. And, while these agreements were negotiated in the shadow of the statutory license, as Professor Shapiro explained, the effect of that "shadow" was to pull the negotiated rates up *above* the competitive level. Shapiro WDT at 44-45; SXM PFF ¶ 166. As a result, and as is discussed at greater length in Sirius XM's proposed findings, only very minor adjustments are needed to derive a reasonable royalty rate for the statutory license at issue here. *See* SXM PFF ¶ 141.

15. The *Web IV* Benchmark similarly involves the same sellers (record labels, both major and independent) and the same rights; reflects the forces of competition at work (both as embodied in the Merlin/Pandora agreement and as otherwise accounted for by the Judges); and, as the Judges concluded in *Web IV*, was not impacted by the "shadow" of the statutory license. *Web IV*, 81 Fed. Reg. at 26331 ("The statutory rates did not cast a shadow that negatively affected the licensors in those agreements because . . . they voluntarily agreed to rates below the applicable statutory rates (in exchange for the steering of more plays), rather than defaulting to

the higher statutory rate."); *see* SXM PFF ¶¶ 166-67. The only difference between this benchmark and the target market is the difference in the buyer – subscription non-interactive webcasters as compared to Sirius XM's satellite radio service. However, Professor Shapiro compared these two types of buyers along the relevant dimensions and concluded they are quite similar. As a result, this benchmark is also well-suited to use in deriving a royalty rate for the statutory license at issue. *See* SXM PFF § III(C).

16. These two benchmarks stand in sharp contrast to the interactive service benchmark. That benchmark involves very different buyers, very different rights, and unquestionably fails to reflect the forces of competition at work. *See* SXM PFF ¶¶ 82, 261-62, 265. It is clearly a far worse benchmark for setting rates for Sirius XM than either of the two benchmarks proposed by Professor Shapiro. Given the significant differences between the benchmark and target, if this benchmark were to be used at all, which it should not be, significant and highly speculative adjustments would have to be made. For the reasons set forth in Section IV.B of Sirius XM's proposed findings, Mr. Orszag's effort to account for the fundamental differences between the interactive service benchmark and the target in this proceeding is woefully inadequate and leads to dramatically overstated rates.

C. The Judges' Prior Evaluations of the Interactive Benchmark In No Way Support SoundExchange's Use of that Benchmark Here (*SE PFF § IV.D*)

17. In Section IV.D of its proposed findings, SoundExchange further attempts to bolster the interactive services benchmark by selectively citing prior CRB jurisprudence as asserted support for the proposition that the Judges have previously accepted the interactive services benchmark for setting rates for both satellite radio and non-interactive webcasting services. In so arguing, SoundExchange omits the most pertinent precedent – the most recent, and still governing, *SDARS II* determination – which does not fit its thesis. As for the precedents

it does cite, its portrayals are grossly misleading. When properly evaluated, these decisions in no way support use of the interactive service agreements in the manner proposed here.

18. SoundExchange cites *SDARS I*, a decision rendered almost ten years ago, as support for its use of the interactive service benchmark, without mentioning that the methodology used in *SDARS I* to adjust the interactive service rates was fundamentally different from that proposed by SoundExchange here. Rather than use retail prices to adjust for interactivity as it proposes here, in *SDARS I* SoundExchange proposed accounting for the value of interactivity by using contractual per-play rates, comparing those found in music video non-interactive streaming service agreements to those found in music video interactive streaming service agreements. That approach resulted in a far larger interactivity adjustment factor (a more than 5:1 adjustment factor) than the approach advocated by SoundExchange here yields (a 2:1 adjustment factor using retail prices). *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 73 Fed. Reg. 4088, 4093 (Jan. 24, 2008) ("*SDARS I*").

19. Moreover, SoundExchange – remarkably – ignores the currently-effective *SDARS II* determination in which the Judges explicitly found the interactive services benchmark *unsuitable* as a basis for rate-setting for Sirius XM on multiple fundamental grounds, manifested in the "yawning gap" it yielded between the then-current rate and the highest rates calculated by its proponent, Professor Ordover. While SoundExchange later acknowledges that the Judges in *SDARS II* rejected an analysis of the interactive benchmark put forward by Professor Ordover that was *identical* to that proffered here by SoundExchange (through Mr. Orszag), **SE PFF 105**, it ducks coming to grips with many of the central critiques leveled at it by the Judges, instead

selecting a few that, it contends, no longer apply. *Id.* Even at that level of analysis, SoundExchange is wrong.

20. For instance, SoundExchange attempts to demonstrate that the Judges' conclusion that "the rights licensed by interactive subscription services are not the same as those by non-interactive services such as SDARS," *SDARS II*, 78 Fed. Reg. at 23065, is no longer applicable. **SE PFF 105**. This is not true. The rights required by Sirius XM to operate its satellite radio service are exactly the same as they were at the time of *SDARS II*, and the same is true of the interactive services. Even if SoundExchange is correct that the interactive services today offer more lean-back functionality than they did five years ago – something SoundExchange has failed to demonstrate – that does not change the fact that the interactive services still require the rights to offer the "lean-forward" functionality that they offer today and unquestionably offered at the time of *SDARS II*. And the rates these services pay for such lean-forward functionality in the unregulated marketplace touted by SoundExchange have been proven to be untempered by the forces of effective competition that must govern rate-setting here. As Sirius XM explained in its proposed findings (and as is nowhere addressed in SoundExchange's near thousand-page filing), the approach used five years ago by Professor Ordover to account for the difference in rights is *exactly* the same as the approach put forward here by Mr. Orszag. *See* SXM PFF § IV.B.i. Because there has been no change in the grants of rights required by either the interactive services or by Sirius XM to offer their respective services, there is no reason to deviate from the Judges' finding in *SDARS II*.

21. Similarly, what the Judges found to be the insupportably sharp increase in rates implied by application of the interactive service benchmark to Sirius XM for the *SDARS II* license term, *see SDARS II*, 78 Fed. Reg. at 23066, is no more justified on the current record.

Mr. Orszag's application of the identical methodology, which results in rates that are between 2.3 and 2.5 times as high as the current rate of 11%, *see* Orszag WRT ¶ 69, Table One, is invalid for the same reasons as Professor Ordover's benchmarking analysis.

22. SoundExchange's citation to the *Web IV* decision as support for its interactive service benchmark is equally unavailing. While SoundExchange notes correctly that the Judges did use the interactive services benchmark after making multiple adjustments to derive a rate for subscription non-interactive webcasters, it makes no mention of the particular approach used by the Judges to adjust that benchmark – one that, as is described in Sirius XM's proposed findings, is dramatically different from, and leads to a dramatically lower rate than, the approach used by Mr. Orszag here. SXM PFF §§ IV.B.vi.1-3.

23. SoundExchange also fails meaningfully to address the sharp limits the Judges placed on the use of the interactive services benchmark in *Web IV*. Specifically, SoundExchange ignores the Judges' conclusion that the approach used to adjust the interactive services benchmark had a legitimate underlying economic rationale only if there is a "1:1 'opportunity cost' for record companies, whereby, on the margin, a dollar of revenue spent on a subscription to a noninteractive service is a lost opportunity for royalties from a dollar to be spent on a subscription to an interactive service." *Web IV*, 81 Fed. Reg. at 26344-45. In place of this, SoundExchange substitutes the watered-down criterion that Sirius XM "competes in the downstream market with subscription interactive streaming services." **SE PFF 104**. As explained in Sirius XM's proposed findings, that Sirius XM competes *to some degree* with interactive services, which is not disputed, falls well short of satisfying the narrow economic rationale for using the interactive service benchmark endorsed by the Judges in *Web IV*. SXM PFF ¶¶ 317-18.

24. More fundamentally, SoundExchange ignores entirely the crucial finding in *Web IV* that the interactive services market is *not* workably competitive. *See, e.g.*, *Web IV*, 81 Fed. Reg. at 26344 ("The Judges were presented with substantial, unrebutted evidence that the interactive services market is *not* effectively competitive."). As discussed in Sirius XM's proposed findings, that conclusion remains as true today as it was at the time of *Web IV*: the record here demonstrates conclusively that the interactive services market continues to be infected with the complementary oligopoly power of the major labels. SXM PFF § IV.B.ii. Specifically, as at the time of *Web IV*, there continues to be a complete absence of price competition between labels to have their works performed on the interactive services; the major labels continue to be "must have" to the interactive services; and anti-steering and most-favored nations provisions continue to lock in the non-competitive conditions in the interactive market. All of these facts were conceded by SoundExchange's own witnesses. SXM PFF ¶¶ 273, 276-78, 281, 284-85.

25. Finally, SoundExchange points to a *vacated and superseded* ruling – the initial *Web III* determination – as supposed support for its continued reliance on the interactive service benchmark. **SE PFF 109-11**. SoundExchange makes no mention of the superseding *Web III Remand* decision, which undercuts its position.[4] There, the Judges evaluated the interactive services benchmark as adjusted by Dr. Michael Pelcovits. *Determination of Royalty Rates for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 79 Fed. Reg. 23102, 23114-15 (Apr. 25, 2014) ("*Web III Remand*"). Dr. Pelcovits proposed two different approaches for adjusting the interactive service benchmark – the first using the ratio of retail

[4] SoundExchange was a party to those proceedings and was aware of this decision. Indeed, elsewhere in its proposed findings here, it cites directly to the *Web III Remand* decision. **SE PFF 1774**.

prices of subscription non-interactive services to subscription interactive services (as Mr. Orszag does here in his "Approach Two"), and the second using a hedonic regression. *Id*. at 23116-18. Notably, the Judges rejected Dr. Pelcovits's use of retail prices to adjust for the value of interactivity, utilizing only the interactive benchmark as adjusted by the results of a corrected version of Dr. Pelcovits's hedonic regression to set the upper bound on the range of reasonable rates for non-interactive webcasters. *Id.* at 23118-20. The rates derived by Dr. Pelcovits using a methodology embraced by Mr. Orszag here – by adjusting for interactivity using retail prices – were found to be well outside of the zone of reasonable rates. *Id.* (detailing that Dr. Pelcovits's retail price adjustment led to per-play rates of $0.0034-$0.0035, some 50% above the $0.0023 high end of the zone of reasonable rates derived by the Judges).

D. Mr. Orszag's Claimed Reliance on the *Web IV* Methodology Cannot Be Squared With His Use of Effective Rates (*SE PFF § IV.E*)

26. In Section IV.E of its proposed findings, SoundExchange sets forth the methodology used by Mr. Orszag to arrive at the starting point for his analysis: the effective rates paid by subscription interactive services to record labels, an approach that was rejected by the Judges in *SDARS II*. Mr. Orszag claims to be following a different approach – that used by the Judges to adjust the interactive service benchmark in the more recent *Web IV* decision. *See, e.g.,* 4/25/17 Tr. 952:12-16 (Orszag) ("The amounts that I calculate are consistent . . . with the methodology that the Court used in the *Web IV* decision."). As discussed in Sirius XM's proposed findings, however, Mr. Orszag did nothing of the kind. The methodology used by the Judges in *Web IV* to derive a rate from the interactive services benchmark entailed use of the *minimum* per-play rates found in the benchmark agreements, to which certain further adjustments were made. SXM PFF §§ III.C and IV.B.vi. Mr. Orszag's approach, as SoundExchange emphasizes, uses the *effective* percentage-of-revenue and per-subscriber rates paid by the

interactive services to the major labels. **SE PFF 114-17, 130**. The economic implications of Mr. Orszag's substituting one for the other are profound and reflect an attempt to nullify the very underpinnings of the *Web IV* ruling rejecting imposition on non-interactive webcasters of the supra-competitive rates prevailing in the interactive services market.

27. In a transparent effort to give cover to Mr. Orszag's facially different methodology from that adopted by the Judges in *Web IV,* SoundExchange makes the astonishing "suggestion" that "the Judges understood that the per play rates used for the interactive services benchmark analysis in [*Web IV*] were in fact the effective rates." **SE PFF 144**. In other words, SoundExchange is arguing that the Judges made a glaring mistake, the economic implication of which was to prescribe rates some 50% below those that would have resulted from actual reliance on the rates on which they "understood" they were basing their determination. This, of course, is preposterous.

28. In support of this specious claim, SoundExchange points out only that certain adjustments to the minimum per-play rates were made to account for "various forms of non per-play consideration." *Web IV*, 81 Fed. Reg. at 26338. But in the very same paragraph of the opinion, the Judges made it abundantly clear that these adjustments were made not to convert the minimum per-play rates into effective rates but, rather, to account for certain "non-recoupable cash payments and advertising commitments with an explicit financial value." *Id.*

29. The *Web IV* decision repeatedly makes it abundantly clear that the Judges were deriving rates from the interactive services benchmark by using the minimum rates, and not effective rates, *following SoundExchange's own proposed methodology*. *See, e.g., id.* at 26335 ("Dr. Rubinfeld derived SoundExchange's proposed per-play rates by analyzing more than 80 agreements between interactive streaming services and record companies. Dr. Rubinfeld

identified 60 such agreements that contained data on per-play royalty rates. *From those 60 agreements, he selected 26 that specified minimum per-play rates*.") (emphasis added); *id*. at 26338 ("Dr. Rubinfeld first identified the average *minimum* per-play rate as defined in each of his selected interactive agreements.") (emphasis added).

30. Exhibit 16a to the Written Direct Testimony of Professor Rubinfeld, the proponent of SoundExchange's rate proposal in *Web IV*, clearly sets forth both the minimum rates after accounting for the "various forms of non per-play consideration" that SoundExchange now points to (labeled as "adjusted minimum per-play rate") and the effective rates (labeled as "adjusted effective per-play rate"). *See* Trial Ex. 678* at Ex. 16A.[5] As that exhibit makes clear, the effective rates were nearly twice as high as the minimum rate used by SoundExchange in its analysis to derive a rate from the interactive services benchmark.

31. Were there any remaining doubt as to SoundExchange's own embrace of minimum, as opposed to effective, per-play rates, SoundExchange's proposed findings of fact in *Web IV* eliminates it. It stated there:

> For purposes of deriving a benchmark calculation for his per-play rate proposal . . . Prof. Rubinfeld relied only on the agreements' stated minimum per play rates, even if the record companies were actually paid under other payment branches that conveyed substantially more compensation per-play. Had Prof. Rubinfeld instead relied on the average effective per play rates in the interactive service agreements, his proposed rate would have been nearly twice as high.

Proposed Findings of Fact of SoundExchange, Inc., *Web IV*, at ¶ 377. How, in the face of this record, SoundExchange is able to argue with a straight face here that the Judges in *Web IV* understood themselves to be drawing from the effective rates contained in the interactive service agreements defies credible explanation. **SE PFF 144 & n.3.**

[5] Exhibits denoted with an asterisk (*) have been admitted for a limited purpose, as described in Attachment A hereto.

32. In an equally disingenuous effort to square Mr. Orszag's approach with that taken by the Judges in *Web IV*, SoundExchange suggests that the Judges understood that the minimum per-play rates were "the controlling metric in the 'greater-of' formula." **SE PFF 144**. In support of this claim, SoundExchange cites a passage in which the Judges note that the parties to certain agreements "viewed the per-play rate as the rate term that would most likely apply for the length of the agreement." *Web IV*, 81 Fed. Reg. at 26325. What SoundExchange neglects to mention is that this discussion is about agreements entered into between record labels and *non-interactive* services. *Id.* The citation at the end of the language quoted by SoundExchange (which SoundExchange failed to include) only refers to the agreement between Warner and iHeart, which at that time offered only a non-interactive service. That is, the language SoundExchange cites has nothing to do with the interactive service agreements on which SoundExchange relies. And, as just noted, SoundExchange itself made it abundantly clear that the minimum per-play rates used by the Judges could not have been controlling, as they were dramatically lower than the effective per-play rates paid by the interactive services.

33. In a final effort to defend Mr. Orszag's use of effective rates, SoundExchange questions the economic soundness of the approach taken by the Judges in *Web IV*, asserting that "using effective rates – not headline contract rates – is the correct approach when undertaking such benchmarking." **SE PFF 130**. In making this assertion, SoundExchange both denigrates the Judges' acumen and, indeed, criticizes itself. As noted, it was SoundExchange and its economist that advocated the *Web IV* approach of using minimum rather than effective per-play rates. *See Web IV*, 81 Fed. Reg. at 26335, 26338. The analysis of the interactive services benchmark adopted by the Judges in *Web IV* to derive rates for subscription non-interactive services was, but for the addition of a 12% downward steering adjustment, that proposed by

Professor Rubinfeld on behalf of SoundExchange. What is more, while SoundExchange has appealed the *Web IV* decision, it has not taken issue with the use of minimum rather than effective per-play rates, nor, for that matter, with the Judges' rejection of its proposed greater-of rate formula with a 55 percent-of-revenue prong. *See* Initial Opening Brief of Appellant SoundExchange, Inc., *SoundExchange, Inc. v. Copyright Royalty Board*, No. 16-1159 (D.C. Cir.) (filed Jan. 17, 2017).

E. SoundExchange Mischaracterizes Professor Shapiro's Criticisms of Mr. Orszag's Use of Effective Per-Play Rates (*SE PFF § IV.E.4*)

34. As set forth in Sirius XM's proposed findings, Professor Shapiro demonstrated that Mr. Orszag's use of the interactive services benchmark is fundamentally unsound; is rife with methodological errors; and results in rates that are dramatically above those that would prevail in a workably competitive market. SXM PFF § IV.B. Rather than attempt to respond to Professor Shapiro's criticisms, SoundExchange grossly mischaracterizes them, setting up a series of strawman arguments.

35. According to SoundExchange, the crux of Professor Shapiro's critique of Mr. Orszag's use of effective, as opposed to minimum, per-play rates is that it was improper to do so as a matter of sound economics. **SE PFF 131-32**. In this vein, SoundExchange asserts that Professor Shapiro's "re-invention of Mr. Orszag's analysis, using headline per play rates . . . finds no support in economic theory, marketplace evidence, or the Judges *Web IV* decision." **SE PFF 132-33**. SoundExchange is wrong on all counts.

36. The matter of Mr. Orszag's use of effective versus minimum per-play rates was not, to Professor Shapiro, one of abstract economic theory; it was instead a matter of the many shortcomings in Mr. Orszag's reliance on effective rates from the interactive services market in fashioning rates in this proceeding. So understood, SoundExchange's attempt to exploit

Professor Shapiro's acknowledgement, as a general proposition, that one would want to use effective rates in a benchmarking analysis or, for that matter, that he employed such a comparator in *Web IV*, **SE PFF 135-36**, are beside the point.

37. Professor Shapiro's criticisms of using the effective rates in this particular context are that: (i) the effective rates used by Mr. Orszag are infected with the complementary oligopoly power of the major labels, resulting in rates that are dramatically above those that would prevail in a workably competitive market, and that Mr. Orszag has done nothing to account for that market power; (ii) Mr. Orszag has not demonstrated that the interactive services are sufficiently close competitors with Sirius XM's satellite radio service to justify the use of the benchmark at all in this setting; and (iii) Mr. Orszag has not followed the methodology he claims to be following. The issue that SoundExchange harps on – whether to use effective or minimum per-play rates – only comes into play in this third criticism. As Professor Shapiro explained, were one to follow the *Web IV* "ratio equivalency" methodology that Mr. Orszag claims to be embracing, it is absolutely appropriate to use minimum per-play rates, as that is the rate that was proposed by SoundExchange and adopted by the Judges in *Web IV*.

38. As Professor Shapiro explained at length, the interactive services market remains every bit as non-competitive as it was at the time of *Web IV*. That market continues to be a complementary oligopoly; there continues to be a complete absence of price competition; and contractual provisions still explicitly prevent any inter-label price competition from breaking out. Shapiro CWRT at 6-11; *see* SXM PFF IV.B.ii.2-3. That alone calls use of the interactive services benchmark into serious question.

39. Professor Shapiro went on to demonstrate a second fundamental failing with Mr. Orszag's use of the interactive services benchmark: that Sirius XM's satellite radio service and

subscription interactive services do not compete in the downstream market to nearly the degree necessary to warrant use of "ratio equivalency." Shapiro CWRT at 11-15.

40. Finally, as discussed further below, Professor Shapiro demonstrated that while Mr. Orszag claims to be following the methodology proposed by SoundExchange and adopted by the Judges in *Web IV*, he is doing nothing of the sort. He is instead using the previously rejected methodology used by Professor Ordover in *SDARS II*. Ignoring these fundamental criticisms leveled by Professor Shapiro against use of the interactive services benchmark, SoundExchange instead focuses just on Professor Shapiro's application of ratio equivalency here.

41. As Professor Shapiro made clear, implementing ratio equivalency – following precisely the approach proposed by SoundExchange and adopted by the Judges in *Web IV* – is appropriate only if the Judges first find a sufficient degree of competition in the downstream market between Sirius XM's satellite radio service and subscription interactive services to warrant its application. Shapiro CWRT at 15 ("[t]his analysis is relevant only if the Judges determine that consideration of the application of the concept of 'ratio equivalency' in the instant setting is warranted").

42. As Professor Shapiro explained, if the effective rates were used in place of the minimum rates, but the methodology adopted by the Judges in *Web IV* were otherwise followed, a dramatic market power adjustment would be necessary to convert the super-monopoly pricing into workably competitive rates. *See* 5/4/17 Tr. 2513:9-2518:2 (Shapiro). The Judges in *Web IV* were not forced to grapple with how large a downward adjustment would have been necessary, as SoundExchange itself proposed using the much lower minimum rates. Indeed, as noted in Sirius XM's proposed findings, the Judges explicitly considered whether the $0.0021 per-play

rate they derived from the minimum per-play rates found in the interactive service benchmark agreements was too low, and concluded that it was not. The Judges further noted that after a steering adjustment was made, the rate derived from the minimum per-play prong of the interactive agreements served to corroborate the effective rate derived from the Merlin/Pandora agreement – one that did not require making any adjustment to account for the absence of workable competition. SXM PFF ¶ 197.

F. Mr. Orszag's Claimed Use of "Ratio Equivalency" Is Fundamentally Flawed (*SE PFF § IV.F*)

43. In Section IV.F of its proposed findings, SoundExchange attempts to defend Mr. Orszag's use of "ratio equivalency" – an adjustment mechanism that Mr. Orszag claimed allowed him to derive a rate for Sirius XM from the interactive service benchmark agreements that is both reasonable and satisfies the 801(b) factors. According to SoundExchange, Mr. Orszag's use of ratio equivalency is consistent with that adopted by the Judges in *Web IV*. **SE PFF 146-48**. SoundExchange and Mr. Orszag are wrong. As Professor Shapiro explained, Mr. Orszag's use of ratio equivalency is unmoored from sound economics and does not adhere to the reasoning put forward by the Judges in *Web IV*. Shapiro CWRT at 11-12. It simply cannot be used – at least in the manner proposed by Mr. Orszag – to derive a reasonable rate for Sirius XM from the interactive service benchmark that satisfies the 801(b) factors.

44. As an initial matter, SoundExchange grossly exaggerates the concept of "ratio equivalency" adopted by the Judges in *Web IV*, suggesting incorrectly that it is some general theory that applies in a wide variety of circumstances. **SE PFF 147-150**. According to SoundExchange, all that is required for ratio equivalency to apply is some unquantified degree of competition between Sirius XM and subscription interactive services. **SE PFF 153**. That is simply not the case. The Judges made clear in *Web IV* that the economic rationale for applying

ratio equivalency is met only if one more dollar spent on a subscription to Sirius XM corresponds to one less dollar spent on a subscription to an interactive service. Stated differently, there must be significant competition, or a high cross-elasticity of demand, between Sirius XM and subscription interactive services. As Mr. Orszag acknowledged on cross-examination, a limited degree of head-to-head competition between Sirius XM and subscription interactive services (which is all there is) will not suffice. 4/26/17 Tr. 1198:9-21 (Orszag); Shapiro CWRT at 12; *Web IV*, 81 Fed. Reg. at 26353.

45. Sirius XM has already addressed the evidence that, in SoundExchange's view, demonstrates "downstream competition" between Sirius XM's satellite radio service and subscription interactive services. SXM PFF § IV.B.vi.2. In fact, the documents and testimony that SoundExchange relies on demonstrate only that Sirius XM and subscription interactive services compete *to a very limited degree*, well short of the high cross-elasticity of demand between the two services that would be needed for ratio equivalency to apply. Rather than recount that discussion in its entirety, we instead discuss below just those claims made by SoundExchange that have not been previously addressed.

46. SoundExchange begins its effort to demonstrate that Sirius XM and subscription interactive services compete to a sufficient degree to warrant the use of ratio equivalency by selectively quoting the testimony of Professor Farrell that he thinks "it is pretty plain, without having done a study of it, that there's competition among the – among the services." **SE PFF 153**. But Professor Farrell was speaking to whether there is competition among *non-interactive* services:

> **Judge Strickler:** Would it be fair to say that Professor Willig is looking at the world as it, in fact, exists, that there's a lack of upstream competition among the labels but there is, in fact, upstream – competition upstream – well, just competition among the – the non-interactive services?
>
> **Professor Farrell:** I think it's pretty plain, without having done a study of it, that there's competition among the – among the services.

4/24/17 Tr. 604:21-605:4 (Farrell). This testimony *does not address* the degree of competition between Sirius XM and subscription interactive services, let alone demonstrate the requisite high degree of such competition.

47. SoundExchange next points to Mr. Harrison's testimony in which he noted that subscription interactive services now offer algorithmic programming and playlists and that subscription interactive services are increasingly being listened to on mobile phones. **SE PFF 153, 156**. None of these claims demonstrate that there is in fact *significant* competition between Sirius XM's satellite radio service and subscription interactive services, and SoundExchange does not suggest otherwise.

48. SoundExchange then discussed a number of asserted admissions by Sirius XM, including from Mr. Meyer. **SE PFF 157-59**. All that these admissions demonstrate, however, is the uncontroversial proposition that Sirius XM currently does and in the future expects to compete *to some degree* with Internet-based music services. They in no way address the relevant question: does Sirius XM's satellite radio service compete with subscription interactive services to a sufficiently high degree to warrant application of ratio equivalency? The answer to that question is no. As Mr. Meyer explained at length, Sirius XM's main competition is, and will continue to be, terrestrial radio. To the extent that Internet-based music services are expected to become a competitive threat to Sirius XM in the future, that threat is expected to come primarily from free ad-supported services. Subscription interactive services are not expected to secure a

sufficient presence in the car to compete materially with Sirius XM in the coming years. *See* 5/15/17 Tr. 3717:1-3718:4, 3723:5-3726:6, 3727:19-3728:5 (Meyer); SXM PFF § I.A.iii.

49. SoundExchange also points to the results of the surveys conducted by Professors Dhar and Simonson as corroboration. Because of significant design flaws, the results of those surveys dramatically overstate the degree to which Sirius XM's satellite radio service competes with subscription interactive services. SXM PFF § IV.D.iv.

50. In another effort to demonstrate that "ratio equivalency" applies in this setting, SoundExchange notes that certain recently negotiated agreements that cover "mid-tier" services call for percentage-of-revenue rates that are similar to those paid by the fully on-demand subscription services. **SE PFF 162-63**. SoundExchange never explains how this evidence suggests that ratio equivalency should apply as between subscription interactive services and Sirius XM. At best, this evidence demonstrates that the Judges were correct that ratio equivalency applies as between subscription non-interactive services and subscription interactive services. *Web IV*, 81 Fed. Reg. at 26344.

51. Moreover, as SoundExchange acknowledged, "that [redacted]." **SE PFF 163**. That is because the major labels are able to take advantage of the significant market power they amass as a result of their "must-have" status when licensing so-called mid-tier services, just as they are able to exploit that market power when licensing fully on-demand subscription interactive services. This consistency in rates is simply more evidence of the complementary oligopoly power of the major labels when licensing services that have no option but to take a license from each of the major labels at supra-competitive rates. 5/4/17 Tr. 2518:11-2520:7 (Shapiro).

52. The claim that the mid-tier service agreements support use of ratio equivalency here is further undermined by those very agreements. The retail price charged for Pandora Plus, its new non-statutorily compliant mid-tier service, is the same as that charged for Pandora One, its previously available statutorily compliant subscription non-interactive service. 5/16/17 Tr. 3968:5-7 (Harrison) ("[redacted]."). But Pandora Plus offers greater functionality and requires a broader grant of rights than Pandora One required. As a result of this broader grant of rights, Pandora [redacted] *See* SXM PFF ¶¶ 237-38. If SoundExchange were correct that the ratio of retail prices to royalties will be constant, **SE PFF 147-48**, either the retail price for Pandora Plus should have gone up, or t[redacted] so these mid-tier offerings in no way support ratio equivalency.

G. <u>Mr. Orszag's "Approach One" Yields Dramatically Inflated Rates for Sirius XM (*SE PFF § IV.F.2*)</u>

53. As SoundExchange describes it, Mr. Orszag's "Approach One" for deriving a rate for Sirius XM from the subscription interactive service benchmark entailed reducing "the effective percentage of revenue royalty rate derived from the interactive services benchmark by 50 percent." **SE PFF 169**. In other words, Mr. Orszag simply took the [redacted] percentage-of-revenue rate he derived from the subscription interactive service benchmark and cut it in half. As noted in Sirius XM's proposed findings, this approach is identical to the primary approach used by Professor Ordover in *SDARS II* and flatly rejected by the Judges. SXM PFF ¶¶ 260-61.

54. The fundamental flaws in this approach are addressed at length in Sirius XM's proposed findings. SXM PFF ¶¶ 260-61. Rather than repeat that discussion here, we address

below only those assertions by SoundExchange that have not already been addressed or that warrant additional discussion.[6]

i. Mr. Boedeker's Survey Does Not Support SoundExchange's 50 Percent Adjustment Factor (*SE PFF § IV.F.2.i*)

55. In support of its claim that 50 percent of the value of Sirius XM's satellite radio service "can be attributed to the performance of sound recordings," SoundExchange points to the hastily-executed survey conducted by Mr. Boedeker. **SE PFF 168-69**. The Boedeker survey does not support this claim.

56. As an initial matter, the Boedeker survey, by design, does not speak to the percentage of the value of Sirius XM's satellite radio service that "can be attributed to the performance of sound recordings," as it only purported to measure the degree to which Sirius XM subscribers "value the music versus non-music content in Sirius XM's programming." **SE PFF 171**. The value of Sirius XM's satellite radio product does not come solely from its content; it also derives in significant part from the infrastructure Sirius XM provides to allow the content to be seamlessly delivered to vehicles across the country and from the extensive curation done by Sirius XM. SXM PFF ¶ 9 & § I.B.i. Mr. Boedeker's survey does not even attempt to

[6] In addition, there are certain faulty assertions made by SoundExchange that it ultimately does nothing with. For example, SoundExchange asserts that the downstream elasticity of demand for Sirius XM is lower than for interactive services. **SE PFF 362-73**. As Professor Shapiro explained, SoundExchange only comes to this conclusion because Professor Willig failed to measure the different elasticities in a consistent manner. When measured consistently, it becomes clear that the downstream elasticity of demand for Sirius XM is greater than for interactive services. Shapiro CWRT at 21-23. SoundExchange also contends that there is no reason to conclude that Sirius XM and interactive services have a different ability or incentive to steer. **SE PFF 374-85**. The fallacy of this claim is made most evident by SoundExchange itself. It notes that interactive services have some control over, at most, [redacted] of their performances. **SE PFF 379**. Sirius XM, on the other hand, has control over 100 percent of the performances on its satellite radio service.

account for these sources of value, so it cannot be used to estimate the portion of the *overall* value of Sirius XM's satellite radio service attributable to performances of sound recordings.

57. In the survey conducted by Professor Simonson, when asked open-ended questions regarding why they signed up for Sirius XM, many respondents provided reasons entirely unrelated to content, such as accessibility, general quality of the Sirius XM service, a commercial-free experience, and even the fact that the service came with their car. *See* Simonson WRT Appx. F (Table 10) at 18-20. This further demonstrates that the value of Sirius XM's satellite radio product does not solely come from the content it provides.

58. In addition to addressing the wrong question, the Boedeker survey is flawed in ways that render it unreliable even as to the limited (and entirely irrelevant) question of the relative split in value as between music and non-music content. A significant portion of the respondents to the Boedeker survey gave answers that are internally inconsistent: they answered both that they would continue subscribing to Sirius XM without music (or non-music) *at their current price* and that they would need a discount off of their current price if Sirius XM no longer offered music (or non-music). SXM PFF ¶ 334. As Professor Hauser explained, such "contradictory responses to questions regarding the value of music and non-music programming demonstrate that Mr. Boedeker's survey is poorly designed," and it follows that the "results from his survey cannot be relied upon." Hauser WRT ¶ 137.

59. In response, SoundExchange speculates that these results are not, in fact, inconsistent, claiming that if someone thinks they can get something for less, of course they would want it for less. *See* **SE PFF 236-37**; *see also* 5/8/17 Tr. 2957:7-13 (Boedeker). This speculation does not salvage the Boedeker survey. If respondents are (mis)interpreting the relevant question as a discount offer, then Mr. Boedeker's survey does not provide any

meaningful indication of what level of discount, if any, consumers would actually *need* to continue subscribing in the absence of music (or non-music) content. If SoundExchange were correct, the survey responses would be meaningless.

60. For these reasons, and those set forth in Sirius XM's proposed findings, Mr. Boedeker's survey is too flawed to provide any useful information, and it certainly does not corroborate Mr. Orszag's "Approach One."[7]

ii. SoundExchange Asserts Incorrectly That No Adjustment Is Needed To Account for the Value of Sirius XM's Distribution Network (*SE PFF § IV.F.2.ii*)

61. One of the many flaws in Mr. Orszag's Approach One is his failure to ascribe any value to anything other than content. Shapiro CWRT at 19-20. But, as Professor Shapiro explained, the value Sirius XM creates is a result of all of the components of the bundle that it offers its customers; it is not derived exclusively from the content. *See* 4/20/17 Tr. 398:13-399:12 (Shapiro); *see also* SXM PFF § I.B.i.

62. In response, SoundExchange makes a number of meritless assertions. First, according to Mr. Orszag, "it makes sense – to think about the economics here as the labels and the services as partners. They are jointly creating a product to the benefit of consumers, and it makes sense that they are sharing in that." **SE PFF 261** (citing 4/25/17 Tr. 1034:13-22 (Orszag)). This generalized conception does not address the issue presented: whether, when using a benchmark service that does not provide the infrastructure or the level of curation that Sirius XM provides, an adjustment is needed to the benchmark rate to account for the value that

[7] The "other data" that SoundExchange points to as corroborating the Boedeker survey results are similarly weak. For example, SoundExchange points to internal surveys of how frequently individuals report listening to music channels, *see* **SE PFF 257**, which is not the same as a survey measuring why someone signed up and pays for Sirius XM. Nor do surveys discussing feature importance address the issue at hand. *See id.*

Sirius XM uniquely provides. That Sirius XM and the labels should "share" the revenues generated by Sirius XM does not speak to what the split should be, nor does it address whether an adjustment to the benchmark rate is warranted to account for Sirius XM's independent contributions to the value of its service offerings.

63. SoundExchange's next two assertions in support of Mr. Orszag's claim that no value should be ascribed to the Sirius XM delivery network – that the delivery network has no "independent, stand-alone value to consumers" and that "there is no evidence from other markets that a service provider's investments in its delivery platform (including its user interface, recommendation algorithms, and so on) are carved out of its revenue base before the royalties owed to copyright holders are calculated," **SE PFF 262-63** – are similarly misplaced. These arguments miss the key point: that by combining music, non-music, curation, and a delivery platform all into one bundle, Sirius XM is creating significant value for consumers, with each piece of the bundle contributing to the overall value of the service. 4/20/17 Tr. 398:13-399:12 (Shapiro). Moreover, crucially, the overall value created by bundling these distinct components together is different than the value proposition offered by Mr. Orszag's benchmark subscription interactive services. Mr. Orszag's accounting for some, but not all, of the differences in the value proposition of the benchmark and target services is plainly wrong.

64. Finally, SoundExchange asserts that "insofar as these investments [into Sirius XM's distribution platform] result in an offering more highly valued by consumers, as reflected ultimately in the service's price and demand, both copyright holders, through higher royalties, and the service, through higher revenues, will benefit." **SE PFF 263**. SoundExchange's attempt to expropriate a portion of the value that Sirius XM alone creates is entirely at odds with the 801(b) factors.

H. Mr. Orszag's "Approach Two" Similarly Yields Dramatically Inflated Rates for Sirius XM (*SE PFF § IV.F.3*)

65. Mr. Orszag's "Approach Two," described in Section IV.F.3 of SoundExchange's proposed findings, like his first approach, yields dramatically inflated rates. SXM PFF ¶ 336. Approach Two involved adjusting the $[redacted] effective rate paid by the subscription interactive services by the ratio of subscription non-interactive service retail prices to those of subscription interactive services. **SE PFF 271**. This very approach – using the ratio of retail prices in an attempt to account for the value of interactivity – was used by Professor Ordover in *SDARS II* and by Dr. Pelcovits in *Web III*. In *SDARS II*, the Judges concluded that this approach yielded rates that were "no more than the upper bound of the zone of reasonableness" and a "bound that the Judges have little confidence in." *SDARS II*, 78 Fed. Reg. at 23066. In *Web III Remand*, the Judges rejected the use of the ratio of retail prices to adjust effective rates entirely, concluding that the resulting rates were well outside of the zone of reasonable rates. *Web III Remand*, 79 Fed. Reg. at 23118-23120. For these and the additional reasons set forth in Sirius XM's proposed findings, Mr. Orszag's Approach Two should (again) be rejected.

J. The Record Unquestionably Demonstrates That the Interactive Services Market Is Every Bit as Non-Competitive Today As It Was at the Time of *Web IV* (*SE PFF § IV.G*)

66. As detailed in Sirius XM's proposed findings, there is no doubt that the interactive services market remains just as non-competitive as it was at the time of *Web IV*. SXM PFF§ IV.B. And yet, [redacted] and despite the continued presence of anti-steering and most-favored nations provisions that prevent price competition from breaking out, SXM PFF § IV.B, SoundExchange makes the astonishing

claim that "[t]he record in this case . . . establishes that the market for subscription interactive services is effectively competitive." **SE PFF 278**. The only support SoundExchange offers for this counterfactual claim consists of a handful of assertions that, on cross-examination, were exposed as meaningless speculation.

i. Dr. Blackburn Failed To Demonstrate That The Interactive Services Market is Effectively Competitive (*SE PFF § IV.G.1.i-ii.c*)

67. SoundExchange begins its defense of the interactive market with a recitation of a portion of Dr. Blackburn's written rebuttal testimony, in which he attempted to demonstrate that the interactive services have considerable leverage when negotiating with the major labels. **SE PFF 280-303**. Dr. Blackburn's claim that the interactive services have significant leverage was exposed on cross-examination to be nothing more than speculation unsupported by any empirical evidence. In fact, the empirical evidence in the record belies Dr. Blackburn's claim: none of the supposed bases for the asserted significant leverage have, in fact, led to lower royalty rates. SXM PFF § IV.B.iv. Rather than address any of this, SoundExchange presents Dr. Blackburn's testimony as if his cross-examination had not occurred.

68. At trial Dr. Blackburn tried to bolster his claim that the interactive services have significant leverage by pointing out that [redacted] **SE PFF 294**. He contends that "[redacted], [redacted]" **SE PFF 294**. It does nothing of the sort. The far more plausible explanation is that the Major labels [redacted] *See* SXM PFF ¶¶ 292-297.

69. SoundExchange also attempts to support Dr. Blackburn's speculative claims with the testimony of Mr. Harrison. Mr. Harrison contended that [redacted] **SE PFF 300-302, 323-27**. With respect to [redacted], Mr. Harrison claimed that, [redacted] **SE PFF 300**. This self-serving testimony in no way supports the claim that [redacted] was able to use its leverage to secure favorable rates. In fact, despite this asserted leverage, [redacted] **SE PFF 300, 338**. If [redacted] asserted leverage were real, [redacted]

70. Mr. Harrison's recitation of the negotiating history between UMG and [redacted], **SE PFF 301**, also has no bearing on an assessment of whether the benchmark that Mr. Orszag uses is workably competitive because Mr. Orszag does not include [redacted] in his analysis. *See* Orszag AWDT Table One.

71. Finally, Mr. Harrison's discussion of [redacted] asserted leverage fails to demonstrate that the interactive services do, in fact, have significant leverage as a result of their size and clout. **SE PFF 302, 326-27**. Here again, all SoundExchange can muster with respect to the royalty rates paid is that, according to Mr. Harrison, [redacted] was able to [redacted] putting it right at the average rate paid by the nine interactive services that Mr. Orszag considered in his benchmarking exercise.

72. Mr. Harrison's assertion that the interactive services have considerable leverage when negotiating with record labels is all the more suspect because Universal – the entity that Mr. Harrison works for – told the Federal Trade Commission (FTC) exactly the opposite.

During the FTC investigation of the proposed merger between Universal and EMI, Universal told the FTC that [redacted] a view with which Mr. Harrison agrees. *See* SXM PFF ¶¶ 267-73. Universal went on to note that, [redacted] Trial Ex. 692 at SoundX_000072916. All told, Mr. Harrison's testimony fails to demonstrate that the asserted leverage that the likes of [redacted] have in any way renders the benchmark rates on which Mr. Orszag relies effectively competitive.

73. Finally, SoundExchange returns to a recitation of the remainder of Dr. Blackburn's written rebuttal testimony, in which he claims that marketplace evidence indicates that subscription interactive services pay workably competitive rates. **SE PFF 304-322**. Each of these pieces of purported marketplace evidence has been addressed in Sirius XM's proposed findings. SXM PFF§ IV.B.iv. As detailed there, Dr. Blackburn's cross-examination revealed that none of this evidence that Dr. Blackburn considered in fact demonstrates that the rates paid by interactive services are workably competitive.

ii. The Rates Secured by Independent Labels Do Not Suggest That the Interactive Market Is Workably Competitive (*SE PFF § IV.G.1.ii.e*)

74. In a post-trial argument not supported by the testimony of any of its expert economists, SoundExchange attempts to establish that the interactive service market is workably competitive by pointing out that agreements between [redacted] **SE PFF 335-40**. According to SoundExchange, these aggregators/distributors are far smaller than the major labels and, as a result, "cannot be considered must-haves . . . and therefore do not have complementary oligopoly power." **SE PFF 340.** From this, SoundExchange concludes

that the rates paid by these asserted non-must-have aggregators/distributors ([redacted]) must be workably competitive. *Id.*

75. As an initial matter, SoundExchange has not demonstrated that these aggregators/distributors are not must haves for the interactive services. SoundExchange's assertion is just that – no record evidence whatsoever is provided in support of this claim. In fact, the record evidence suggests that these aggregators/distributors likely do have significant market power when negotiating with an interactive service. For example, Mr. Van Arman of Secretly Group discussed at length the significance of the catalog that Secretly negotiates on behalf of, highlighting the fact that one of its more recent releases was the number one best-selling album in the United States and throughout the world when it was first released. Van Arman WDT at 1-3. Not having access to the works of such popular artists like those licensed through Secretly may very well have a significant impact on an interactive service's business. Given the importance of the aggregators/distributors that SoundExchange identifies, it is quite possible (and SoundExchange has not disproven) that these entities, just like the Majors, have significant market power when negotiating with the interactive services.

76. Even if SoundExchange is correct that these indie aggregators/distributors are not in fact must-have, it is still no surprise that [redacted] As Mr. Orszag himself explained, [redacted] According to Mr. Orszag "[redacted]

[redacted]." Orszag AWDT ¶ 103; Sirota WDT at 3-7. As a result, the fallback option for an independent label if it is unable to secure the same supra-competitive rates that the Majors are able to extract is simply to [redacted] From the interactive services' perspective, even if the aggregator is not a true must-have, the choice is stark: either [redacted]

iii. Anti-Steering Clauses Do Not Render the Interactive Services Market Workably Competitive (*SE PFF § IV.G.1.ii.d*)

77. Yet another attempt on the part of SoundExchange to salvage the interactive services benchmark runs headlong into fundamental principles of industrial organization economics as previously recognized and implemented by the Judges. This pertains to SoundExchange's extraordinary assertion that the presence of anti-steering provisions in interactive service agreements – provisions that contractually *prohibit* the licensed service to induce labels to compete on price for more plays – represent "price competition at work." **SE PFF 334**. SoundExchange seeks to transform provisions the Judges have recognized as antithetical to the competitive process, *see Web IV*, 81 Fed. Reg. at 26373-74, into benign examples of bargained-for provisions, the price-competition-eliminating-aspect of which allegedly is compensated for in the lower royalties attained by services agreeing to them. **SE PFF 328-34**. This attempt to sanitize blatantly anticompetitive provisions fails on numerous grounds.

78. At the conceptual level, SoundExchange, in particular through the testimony of Professor Willig, attempts to portray the anti-steering provisions as pro-competitive on the ground that they promote efficiency and help to maximize consumer welfare. **SE PFF 329-34**.

The argument, in essence, is that by *thwarting* price competition between record labels to attain more plays (steering), the interactive services are saved from trading away the freedom to play any and every sound recording its subscribers may want to listen to, as often as desired, for certain changes in that supposedly optimal mix so as to secure cost savings (via steering in favor of lower-priced recordings). Professor Shapiro exposed this argument for what it is: a contention that "competition with all its messiness is to be avoided." 5/4/17 Tr. 2543:24-2544:2 (Shapiro). Rather than promote consumer welfare, the anti-steering provisions choke off competition and perpetuate complementary oligopoly rates that undercut the most fundamental premise underlying price competition in our economy. That, in the words of the U.S. Supreme Court, is "that unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality, and the greatest material progress . . . ." *Northern Pacific Railway Co. v. United States*, 356 U.S. 1, 4 (1958).

79. To fully appreciate the role that anti-steering provisions have in maintaining the complementary oligopoly pricing in the interactive services market, it is critical to view those provisions in the proper context. As Professor Shapiro explained:

> The Majors are must-have suppliers, record companies, for these Services. One of the ways they've chosen to extract, use their power that's associated with must-have is through the anti-steering provisions. And so as has come up before, even if you have a must-have label, if they charge a very high rate, they could still worry once the deal is signed that their music won't be played that much because somebody could undercut it. So if you think about it, the point of view of a must-have label dealing with a Service that might steer, even to some degree, ***by putting in the anti-steering provision, it can prevent price-based competition and, therefore, end up with a high rate without having to worry about losing play share***. So in the context of must-haves, in this industry, we have a web of them, must-have labels and anti-steering provisions, the effect creates basically a dead zone in terms of pricing competition. And that's what we've seen. The market's sort of sad that way in that there is no pricing

> competition, and that's undisputed. So there's real difficulties getting this market to work right, how would it work right, given the must-have status of the label – of the Majors to begin with. It's not going to be workably competitive. But on top of that, ***the additional action one could imagine at the margin is – is cut off through the anti-steering provisions. And I think it's perfectly understandable why that's in the major labels' interest to do that, but it doesn't lead to price competition and it has not led to rates that are anywhere near workably competitive***.

5/4/17 Tr. 2546:25-2548:9 (Shapiro) (emphasis added).

80. In recognition of these fundamental market distortions, the Judges in *Web IV* concluded that the use of such anti-steering clauses in the sound recording performance context "would thwart 'effective competition'" and proceeded to hold that "in the hypothetical market without a statutory rate, such anti-steering clauses (and other anti-steering tools) would be ripe for judicial invalidation." *Web IV*, 81 Fed. Reg. at 26374.

81. Nothing in the current record warrants altering these conclusions. The entirety of SoundExchange's claim that anti-steering provisions are only agreed to in exchange for lower rates is based on surmise from the face of a small number of *mid-tier* service agreements, stitched together with out-of-context snippets of testimony from several label executives relating to the negotiation of certain of those agreements. **SE PFF 333**. It would be inappropriate to draw generalized conclusions as to industry practice implicating supposedly vigorous price negotiations over the inclusion (or not) of such anti-steering provisions from such a shaky evidentiary foundation.

82. The evidence presented by SoundExchange boils down to the fact that [redacted]. Nowhere has SoundExchange tied this to evidence that the anti-steering provisions in Mr. Orszag's entirely distinct benchmark

agreements – covering certain fully on-demand services – reflect such supposed competition. That is because there is no such evidence. *See, e.g.*, 5/2/17 Tr. 2151:21–2152:1 (Willig) (affirming that he was unable to "identify any . . . example [other than [redacted]] of an anti-steering provision being provided in exchange for a price decrease"). Indeed, the unequivocal testimony from Messrs. Harrison and Walker from, respectively, UMG and Sony, that [redacted] should put any such notion to rest. *See* SXM PFF ¶¶ 276-77.

83. SoundExchange concludes, using snippets of cherry-picked testimony from Mr. Walker about negotiations over mid-tier services, that there is "[redacted] **SE PFF 328.** As Mr. Walker's cross examination exposed, [redacted] *See* 5/15/17 Tr. 3852:9-3856:16, 3858:6-25, 3860:18-3862:12 (Walker).

84. SoundExchange's experts agreed it was impossible to "disentangle the various effects" of the "multiple competing factors" implicated in these mid-tier negotiations, including [redacted] 4/26/17 Tr. 1155:18 – 1156:4 (Orszag); *accord* 5/2/17 Tr. 2151:10-20 (Willig): [redacted]

85. The testimony from the record label executives only reinforces that there is no indication that [redacted]

[redacted] Mr. Harrison affirmed that [redacted] "[redacted] 5/16/17 4062:7–4063:4 (Harrison). In addition, Mr. Harrison acknowledged that [redacted]. *Id*. 4063:5-10 ("[redacted] Finally, [redacted] *Id*. 4063:19-4064:20.

86. Mr. Walker's testimony tells the same story. He acknowledged that [redacted] For example, [redacted] 5/15/17 Tr. 3862:6-3864:18 (Walker), [redacted] *Id*. 3854:8-13; *see also id*. 3865:9-12. Moreover, as with Universal, [redacted]. *See id*. 3864:19-3865:12.

87. In sum, what the record actually shows is that there were many moving pieces in the [redacted] agreements, with no indication that the anti-steering provision (or lack thereof) had any impact on the negotiated rate.

88. Even if the anti-steering provisions in the mid-tier services had been agreed to in exchange for lower rates (which they were not), it would in no way demonstrate that the resulting rates are workably competitive. At most, it would suggest that by agreeing to an anti-steering provision, [redacted] was able to secure a royalty rate for its mid-tier service that is

slightly discounted off of the complementary oligopoly rate – a rate that is still nowhere near the workably competitive level. 5/4/17 Tr. 2541:17-2543:7 (Shapiro). Stated differently, SoundExchange has presented no evidence whatsoever of what rates would look like for either mid-tier or fully interactive services if there was *actual price competition* between labels to have their works performed. Quite to the contrary, the very purpose of the provisions that SoundExchange points to is to ensure that such price competition *does not take place*.

K. SoundExchange's Proposed 6 to 13 Percent Downward Adjustment Is Wholly Insufficient to Convert the Complementary Oligopoly Rates Paid by the Interactive Services Into Workably Competitive Rates (*SE PFF § IV.G.2*)

89. Tacitly acknowledging that the interactive services market is not effectively competitive, SoundExchange offers three approaches for converting the complementary oligopoly rates into workably competitive rates. **SE PFF 341-61**. In its proposed findings, Sirius XM detailed the serious shortcomings of the first two of these approaches and showed that these adjustments are nowhere near large enough to convert the supra-monopoly rates secured by the Majors from the interactive services into workably competitive rates. SXM PFF § IV.B.v.

90. The thirteen percent downward adjustment that SoundExchange now offers – based solely on off-the-cuff testimony by Mr. Orszag at trial and nowhere found in either his written direct or rebuttal testimony – is premised on the asserted price discount secured by [redacted] as a result of agreeing to an anti-steering provision. **SE PFF 354-60**. This approach fails for the same reasons that the purported discount in exchange for agreeing to an anti-steering provision fails to demonstrate that the interactive services market is workably competitive, namely: (i) it relates to the prices secured by labels for mid-tier services and says nothing about the prices that Mr. Orszag used in his benchmark analysis; (ii) the record evidence fails to demonstrate that [redacted] agreement to an anti-steering provision in fact had any direct impact

on the royalty it agreed to for its mid-tier service; and (iii) it is not evidence of the impact on royalties that actual price competition might have; at best, it reflects a slight discount off of complementary oligopoly rates – not an adjustment that leads to workably competitive rates. *See* Section I.J.iii, *supra*.

L. Sirius XM Is Far More Promotional of Record Label Revenue Streams Than Are Subscription Interactive Services (*SE PFF § IV.H.2*)

91. In Section IV.H.2 of its proposed findings, SoundExchange attempts to demonstrate that there is no reason to believe that "Sirius XM has a different promotional or substitutional effect, compared to the interactive services, such that an adjustment to the benchmark market rates is necessary in order to apply them to the target market." **SE PFF 387**. SoundExchange is incorrect. There is every reason to believe that Sirius XM is more promotional and less substitutional of other record label revenue streams than are subscription interactive services. Indeed, the record evidence demonstrates that Sirius XM is highly promotional of other record label revenue streams while the subscription interactive services are highly substitutional.

92. Sirius XM has presented ample evidence demonstrating that its service is highly promotional. Its proposed findings include a litany of attestations from artists, record labels, band managers, and even *from SoundExchange's own witnesses* as to the value of having their music played on the Sirius XM satellite radio service. *See* SXM PFF ¶¶ 56-65. SoundExchange's protestation that this evidence is not "useful," **SE PFF 406**, is groundless.[8]

[8] In an attempt to downplay the significance of this evidence, SoundExchange relies largely on the testimony of Dr. Ford. As explained in Sirius XM's pending motion in *limine*, Dr. Ford's opinions stray far afield of his expertise, and much of his testimony is simply a regurgitation what record labels and music industry executives allegedly told him. *See, e.g.*, **SE PFF 411, 420 n 29**. Dr. Ford even went so far as to offer testimony "based on his research, interviews and knowledge of the music industry" on what a "successful promotional effort requires." *See* **SE PFF 420-29**. Dr. Ford's access to Google, a telephone, and a streaming service does not make

93. SoundExchange witness Glenn Barros – the President and CEO of Concord Music Group – candidly acknowledged satellite radio's promotional impact and discussed example after example of Sirius XM's role in breaking Concord artists. Barros WRT ¶ 23 ("Sirius XM's Steven Blatter and George White both indicate that Sirius XM provides promotional value to record labels and artists. I agree."); *id.* ¶¶ 24-29. He characterized Sirius XM as a "driver" in attaining artist exposure; acknowledged that Sirius XM has "champion[ed]" Concord artists; and stated that Sirius XM has been a "meaningful contributor" to artist success. *Id.* ¶¶ 24-26. A second SoundExchange witness, Atlantic Record's Michael Kushner, likewise admitted that he views Sirius XM as a "good platform to reach a broad audience," particularly in the car where terrestrial radio has traditionally dominated listening. 5/11/17 Tr. 3569:21-25, 3571:13-21 (Kushner).

94. The testimony of Sirius XM's head of music programming, Steve Blatter, who interacts with artists, record labels, and band managers – the people who live and breathe record promotions – on a daily basis, offered a sense of the mountain of communications Sirius XM receives evidencing the music industry's firm belief that Sirius XM promotes records and drives other forms of paid music consumption. *See* Blatter WDT ¶¶ 8-29. For example, [redacted] wrote to Sirius XM: "[Y]ou guys have had a MASSIVE impact." *Id.* ¶ 12; Trial Ex. 606*. [redacted] said he saw "big upticks" in sales after Sirius XM airplay and wrote "[w]hen I see across the board lifts like that I know it's your airplay impacting." *Id.* ¶ 13; Trial Ex. 607*. [redacted] claimed, "The power of

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him an expert in promoting music. *See* 5/1/17 Tr. 1895:2-1897:4 (Ford) (admitting that he has never worked for a record label or published any work on record label promotion practice or the functionality of music services). As a result, Dr. Ford's opinions on these matters should be disregarded.

[T]he [H]ighway is HUGE. *Id.* ¶ 15; Trial Ex. 609*. Another record label wrote to Sirius XM, "WE ARE LIVING PROOF OF THE POWER OF SiriusXM HITS 1!" *Id.* ¶ 20; Trial Ex. 614*.

95. The clear promotional impact of Sirius XM is not limited to CD and download sales. As Mr. Blatter explained, he has observed that "airplay on Sirius XM stations also leads to a marked increase in on-demand play on streaming services such as Spotify and YouTube." Blatter WDT ¶ 25. The record industry agrees. [redacted] wrote to Sirius XM that after Sirius XM played of Oliver Heldens' single "Shades of Grey," his streams increased by 20% on Spotify and by 101% on Apple Music. Blatter WDT ¶ 10; Trial Ex. 604*. [redacted] wrote to Sirius XM, noting the impact that Sirius XM's airplay had on Spotify activity: "Just wanted to let you know that the guys['] single Shut Me Up has crossed the one million streams mark on Spotify, all thanks to you guys and The Highway airplay, and in only 6 weeks! Thank you all so damn much! We love you guys and appreciate the support." Blatter WDT ¶ 25; Trial Ex. 618*.

96. There is the additional fact that Sirius XM's programming staff are inundated with requests from record company promotions personnel imploring Sirius XM to play their records, providing Sirius XM with free copies of new releases, offering to make artists available for promotions and agreeing to waivers of the DMCA "performance complement." *See* SXM PFFCL ¶¶ 57-58. Notably, the record contains no evidence of record executives asking Sirius XM to play their music *less* because is it substituting for other label revenue streams. *See id.* ¶ 65.

97. Finally, when corrected by Professor Shapiro, Professor Willig's own regressions demonstrate that Sirius XM has a promotional impact on both digital download sales as well as on interactive services. SXM PFF ¶¶ 216, 411-12; Shapiro CWRT at 26-33 and Appx. B.

98. SoundExchange, on the other hand, has presented no evidence whatsoever that subscription interactive services are promotional of other record label revenue streams. That interactive services now offer some "lean back" functionality and make recommendations to subscribers, **SE PFF 445-53**, does not demonstrate that these services promote *other* record label revenue streams, and it certainly does not demonstrate that the subscription interactive services have anywhere close to the promotional impact that Sirius XM has.

99. On the substitution side, there is no credible evidence that Sirius XM has a material negative impact on other record label revenue streams. All that SoundExchange points to in support of this claim are the surveys run by Professors Dhar and Simonson, **SE PFF 405**, but these surveys are so fundamentally flawed that the results they generate are meaningless. *See* Section II.F; SXM PFF § IV.D.iv. That SoundExchange is unable to present credible evidence that Sirius XM has a meaningful negative impact on other record label revenue streams should come as no surprise, as Sirius XM competes primarily with terrestrial radio, which generates no revenues for the labels. SXM PFF ¶¶ 20-25.

100. On the other hand, there is ample record evidence that subscription interactive services have a substantial negative impact on other record label revenue streams. SoundExchange witnesses have conceded as much. Professor Willig's own regression purports to demonstrate that "streaming" services have had a significant negative impact on sales of digital downloads. When corrected by Professor Shapiro, it became clear that the cannibalization of digital download sales was due to interactive services, not the other services that Professor Willig lumped into his "streaming" category. SXM PFF ¶¶ 216, 411; Shapiro CWRT at 26-33 and Appx. B. Mr. Harrison similarly agreed that subscription interactive services cannibalize the sales of CDs and digital downloads. 5/16/17 Tr. 3930:7-12 (Harrison).

101. It simply is not accurate to claim there is no evidence that Sirius XM is more promotional and less substitutional than the subscription interactive services. That Sirius XM did not quantify these substitution and promotion effects and calculate an adjustment to be applied against SoundExchange's interactive service benchmark is beside the point. **SE PFF 442-444**. Sirius XM did not propose the interactive benchmark; SoundExchange did. The burden rested with SoundExchange to adduce evidence to support *not making* an adjustment to its benchmark to account for differences in substitution and promotion effects as between the benchmark and target markets.

M. Recent Agreements Covering Certain "Mid-Tier" Services Do Not Support Setting Rates at the Level SoundExchange Seeks (*SE PFF § VI*)

102. In a final effort to defend Mr. Orszag's benchmarking analysis, in Section VI of its proposed findings, SoundExchange contends that the royalty rates paid by certain "mid-tier" offerings of [redacted] "corroborate" the rates Mr. Orszag derived from the interactive service benchmark. *See* **SE PFF 844-84**. This, of course, comes as no surprise because the mid-tier service rates suffer from the same debilitating flaw that renders the interactive rates of no use to rate-setting here, namely, they are dramatically inflated as a result of the complementary oligopoly power of the major labels unmoored by the competitive constraints of the statutory license. Instead of providing evidence of workably competitive rates, they only provide more evidence of rates that emerge in a cartelized industry. *See* §§ I.F, I.J.iii, *supra*.

103. In response, SoundExchange contends that the rates found in the [redacted] agreements are effectively competitive, pointing once again to the [redacted]. **SE PFF 861-69**. This argument fails for all of the same reasons discussed above – namely, that there is no credible factual evidence that the relatively "lower" rates in the [redacted] agreement are actually the result of the anti-steering provision, and no economic reason to

believe that even a bargained-for anti-steering provision is reflective of workable competition. *See* Section I.J.iii, I.K, *supra*.

104. With respect to the [redacted] agreements, *see* **SE PFF 870-73**, SoundExchange makes a mirror-image, and equally ludicrous, assertion that because these agreements [redacted] **SE PFF 873**, essentially contending that because [redacted] This perverse argument – that extracting a [redacted] in the future is somehow a sign of price competition – is entirely backwards. [redacted], they unquestionably do not *themselves* reflect the forces of such competition: there is no lower price charged (the agreements fall in the same range as SoundExchange's other benchmarks) and no incentive for increased plays of the record companies' music relative to other labels, *i.e.*, no actual price competition of any kind. *See* SXM PFF § IV.B.ii.

105. SoundExchange's reliance on the rates called for in these "mid-tier" agreements fails for another reason: it made no effort whatsoever to account for any of the differences between these services and Sirius XM's satellite radio service. For example, SoundExchange has offered no adjustment to account for undisputed differences in functionality, *see* ¶¶ 52, 84-86, *supra*; SXM PFF ¶¶ 236-39, and has failed to account for differences in intensity of use of the licensed sound recordings, *see* ¶¶ 275-77, *infra*; SXM PFF ¶¶ 245-47, 336-37.

106. In short, SoundExchange's use of these mid-tier service rates fails for many of the same reasons that Mr. Orszag's analysis of the interactive service agreement rates fail – both

analyses start and end with supra-competitive rates, and neither makes all of the necessary critical adjustments to account for the differences between the benchmark markets and the target market. Rather than "corroborate" reasonable rates that satisfy the 801(b) factors, they simply reinforce the many flaws in Mr. Orszag's own benchmarking analysis.

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107. All told, despite devoting some 150 pages to defending Mr. Orszag's use of the interactive services benchmark, SoundExchange has come up woefully short. As detailed in Sirius XM's proposed findings, and as elaborated on above, Mr. Orszag's approach to rate-setting is nothing more than an attempt to import the complementary oligopoly rates the Majors are able to extract from subscription interactive services into the market for satellite radio. As a result, Mr. Orszag's analyses, and the rates derived therefrom, should be rejected.

II. PROFESSOR WILLIG'S RATE-SETTING APPROACHES WRONGLY RELY ON THE OPPORTUNITY COST TO A MONOPOLY SELLER (*SE PFF § V*)

A. Introductory Sections (*SE PFF V.A-D*)

108. Section V of SoundExchange's proposed findings presents Professor Willig's rate-setting approaches based on the purported opportunity cost of licensing Sirius XM. Sections V.A and V.B (**SE PFF 456-62**) introduce the topic by arguing that profit-maximizing sellers in an unregulated market would not license a digital music service for less than their opportunity cost, and that in a Ramsey pricing analysis, ECPR analysis, or a Nash bargaining framework, record company sellers likewise would be compensated at least at the level of their opportunity cost. SoundExchange suggests that the various economists in the proceeding, including Sirius XM's economists, agree with this basic principle. Section V.C of SoundExchange's proposed findings (**SE PFF 463-69**) argues that record label executives consider opportunity costs in their licensing decisions by considering whether digital music services substitute for other forms of

consumption of sound recordings, while Section V.D (**SE PFF 470-85**) describes the mechanics of Professor Willig's opportunity cost calculation.

109. Sirius XM does not dispute that an unregulated seller would seek to cover its opportunity cost, assuming that cost is properly conceptualized and measured. Professor Willig, however, has not done so. As discussed at length in Section IV.D of Sirius XM's proposed findings (SXM PFF ¶¶ 357-426), and with more specificity in several sections below, Professor Willig has, among other errors:

- improperly based his calculation on the opportunity cost of a seller of all sound recordings that can withhold Sirius XM's access to those recordings and force all Sirius XM subscribers to turn elsewhere for access to music (SXM PFF ¶¶ 361-74);
- based his calculation on rates charged to interactive services that the Judges have determined to be infected by the complementary oligopoly power of the major record labels (SXM PFF ¶¶ 375-78);
- alternately relied on a theory of "unilateral alignment" that replicates a group boycott or monopoly pricing (SXM PFF ¶¶ 379-82);
- relied on flawed survey data from Professors Dhar and Simonson (SXM PFF ¶¶ 383-408); and
- failed to account for the promotional impact of Sirius XM on other record company revenue streams and how that might offset the opportunity costs he identifies (SXM PFF ¶¶ 409-15).

110. As Professors Shapiro and Farrell demonstrated in their written and trial testimony, the *proper* measure of the opportunity cost of licensing Sirius XM would incorporate

the possibility of effective competition between the licensor record labels by reflecting the ability of Sirius XM to substitute plays of one record label's repertory for another (that is, to "steer"). Under such a measure, playing less of one record label's repertory – or failing to secure a license at all – would not result in the loss of all music on Sirius XM or drive all subscribers to other services, as is assumed by Professor Willig. *See* SXM PFF ¶¶ 367-74 (discussing, *inter alia*, Farrell WRT ¶¶ 68-71 & Appx. D; Shapiro WDT Appx. D; Shapiro CWRT at 35-36 & Appx. C).

111. These general concepts are discussed throughout the following sections. Before moving on to those sections, Sirius XM notes its specific disagreement with the contention in SoundExchange's proposed findings (**SE PFF 460**) that Professor Shapiro's "Full Marginal Cost" is "essentially the same" as Professor Willig's "Creator Compensation Cannibalization" calculation. Professor Shapiro's model reflects the proper conception of opportunity cost, not Professor Willig's walk-away industry-wide measure. Sirius XM also notes that Mr. Harrison's claim that [redacted] (**SE PFF 466**) contradicts the point SoundExchange is making in Section V.C of its proposed findings that rational sellers consider the opportunity cost of their licensing decisions.[9]

B. SoundExchange is Incorrect that the Walk-Away Opportunity Cost is the Proper Measure of Opportunity Cost for Rate-Setting Here (*SE PFF § V.E*)

112. Section V.E of SoundExchange's proposed findings argues that the "relevant" measure of opportunity cost for determining the royalty Sirius XM should pay is the "walk-away" opportunity cost, i.e., what labels would earn elsewhere, if they refused to license Sirius XM, on account of users' consumption of music through other distribution channels.

[9] Sirius XM replies to SoundExchange's claims regarding UMG's mid-tier licenses (**SE PFF 466-68**) elsewhere in this filing, in Section I.M.

SoundExchange makes much of Professor Farrell's agreement that a record label in an unregulated market would not sign a license for less than its walk-away opportunity cost (**SE PFF 490**), and uses that to suggest that Professor Shapiro's focus on the marginal opportunity cost of additional plays on a platform (via steering) is misguided, and that steering (which allegedly plays no role in the walk-away calculation) can safely be ignored by the Judges, as it is by Professor Willig. **SE PFF 492-94**.

113. SoundExchange's attempt to create an either/or choice between the walk-away opportunity cost of licensing a music service and the marginal opportunity cost of plays on that service – and thereby to avoid the issue of steering and competition between labels for plays on a service – is a red herring designed to provide theoretical cover for the fundamental conceptual error at the root of Professor Willig's testimony. As we describe below, both potential licensing costs – what Professor Shapiro has identified as the "downstream" substitution between music distribution platforms and the "upstream" substitution between plays of one label or another – would be considered in a proper calculation of opportunity cost.

Downstream Substitution from Other Platforms

114. As to the matter of downstream substitution, Sirius XM does not disagree with the unremarkable proposition that an unregulated record label would not enter into a license with a digital music service if it lost money by doing so – i.e., if it could earn more by "walking away" from the license, taking zero from that service, and earning whatever it can from other licensees. The key issue, of course, is how properly to measure what would actually be earned elsewhere.

115. In a competitive market, a label's decision not to license (to "walk away") would not, on its own, shut down the service – the label would not be a "must have" provider – nor would it be accompanied by other labels making the same walk-away decision and thus

collectively shutting down the service. *See* SXM PFF ¶¶ 379-82 (critiquing Professor Willig's concept of "unilateral alignment"). Rather, a refusal to license would result in the service shifting its mix of music to other labels to replace the now unlicensed repertory. *See* SXM PFF ¶ 367.

116. As shown by Professors Farrell and Shapiro, the downstream opportunity cost to the label operating in that competitive environment would be equal to the industry-wide opportunity cost (which assumes all Sirius XM subscribers would go elsewhere absent a license) times the fraction of Sirius XM subscribers who would actually leave if Sirius XM lost the music of just the one label. *See* SXM PFF ¶¶ 367-74. For example, Professor Farrell showed that if 10% of subscribers would leave a service given the loss of a label license, Professor Willig's industry-wide $2.55 would be one-tenth of that figure ($0.255). *See* SXM PFF ¶ 369 (citing the economic model in Farrell WRT 68-71 & Appx. D); *accord* 5/4/17 Tr. 2570:11-2571:9 (Shapiro) ("If one takes the correct approach, then . . . . for a label that [is] withholding the music [that] would lead to a 10 percent reduction in the Sirius XM subscribers, the figures would all be 10 percent as big.").

117. Professor Shapiro provided several "scenarios" – all discussed in Sirius XM's proposed findings – to refine this conclusion and demonstrate how such competitive licensing dynamics would work in practice. The fourth of those scenarios involved the decision by a label not to license at all (i.e., to walk away from a deal). *See* SXM PFF ¶ 371; Shapiro CWRT at 35-36 & Appx. C at C-6–8 ("Refusal to License" scenario). As Professor Shapiro there explained, if Sirius XM were to lose access to the music of Warner, which represents about [redacted] of plays on Sirius XM, and responded with a slight price cut, the opportunity cost would be about 1/60 the level calculated by Professor Willig – reflecting the fact that only a small fraction of subscribers

would actually leave Sirius XM under such circumstances and seek music elsewhere. If Sirius XM did not change its price to help retain subscribers, the opportunity cost would still be 1/10 ($0.255) the number calculated by Professor Willig. Shapiro CWRT Appx. C at C-7.

118. Similar results are obtained even if one relaxes these assumptions. For example, if the percentage of subscribers lost due to a failure to license Warner were twice its performance share, the opportunity cost would still be 1/8 that calculated by Professor Willig. Even if the percentage of lost subscribers were to triple, Professor Willig's calculated opportunity cost would still be four times the proper number. Shapiro CWRT Appx. C at C-7. Professor Shapiro cautioned, however, that if one were to push to the point where the loss of a single label's music would cause Sirius XM to lose 30% of its subscribers, it would raise serious concerns about the market power of such a record company: the label would be approaching the "must-have" status that undergirds Professor Willig's monopoly-seller calculation. *Id.* at C-7–8.

Upstream Substitution Between Labels

119. Professor Shapiro's scenarios also showed that the cost of downstream substitution between platforms – which forms the basis of the walk-away opportunity cost – is only one (small) part of the picture. Under even the most aggressive assumptions (albeit still falling short of full "must-have" power), the walk-away opportunity cost of extending a license to Sirius XM will be well below the $[redacted] per subscriber per month Sirius XM currently pays and the $1.03 it is proposing here. If that walk-away cost is covered – i.e., if the label is not losing money on downstream substitution simply by being in business with Sirius XM – then a record company in a competitive licensing environment naturally would consider the cost of

upstream substitution as well, i.e., the costs of obtaining additional plays on Sirius XM relative to its competitors.[10]

120. As Professor Shapiro showed in his "Pure Steering" scenario, if a label can induce Sirius XM to shift plays to its repertory without causing any (downstream) subscriber loss, it will increase its (upstream) income from Sirius XM with zero marginal opportunity cost. Shapiro CWRT at 36 & Appx. C at C-3–4. And if some subscribers do leave, the label not only will increase its upstream income on Sirius XM (at the expense of its rivals), but also earn additional downstream revenue from other platforms (a *negative* opportunity cost) on account of such subscriber movement. *Id.* Appx. C-4–5 ("Sirius XM Loses Subscribers Due to Steering" scenario).

121. Professor Willig failed completely to consider the possibility or the opportunity cost of this *upstream* substitution (changes in plays of a label's repertory at the expense of rivals) and thus failed fully to account for how opportunity costs would be calculated in a competitive licensing market. As Professor Farrell explained, "Professor Willig's analysis relies on the presence of competition among music distribution channels, but, asymmetrically, ignores the possibility of competition among record labels." Farrell WRT ¶ 36. And as Professor Shapiro concurred,

> You cannot properly evaluate opportunity cost just by looking at downstream. The first place to look is upstream. That's where they get additional plays. . . . Professor Willig skipped over the first step, the main thing, and then went to the second [downstream substitution] because he didn't look at any changes in play shares. If you look across all these scenarios, the Sirius XM pie is shifting towards Warner. And he is not even allowing [for] that.

[10] SoundExchange inadvertently admits as much in the last paragraph of the section (**SE PFF 495**), where it acknowledges that "how much above walk-away opportunity cost the royalty rate is set in a marketplace negotiation may well be determined by the service's ability to steer between the sound recordings of different labels."

4/20/17 Tr. 437:13-24 (Shapiro).

122. In sum, Professor Willig's walk-away opportunity cost calculation does not make steering "not relevant," as SoundExchange suggests (**SE PFF 495**); it makes his analysis incomplete and incorrect. Only by calculating the walk-away opportunity cost of the entire industry acting in concert – and obtaining a wildly inflated $2.55 result – is it possible for him to suggest that the walk-away opportunity cost is the only relevant measure.

C. SoundExchange Has Failed to Defend Professor Willig's Use of Industry-Wide (Monopoly) Opportunity Cost (*SE PFF § V.F*)

123. Section V.F of SoundExchange's proposed findings advances three primary arguments: (1) that Professors Shapiro and Farrell are wrong to identify the Willig opportunity cost calculation as the result of copyright owners' bargaining as a collective (because the must-have status of the labels will, on its own, lead to an opportunity cost equal to that of the monopoly seller), **SE PFF 497-99**; (2) that Sirius XM is wrong to contend that a market with must-have labels cannot be effectively competitive, *id.*; and (3) that Sirius XM is wrong for the additional reason that the uniformity of pricing typically found in the sound recording licensing market will cause the opportunity cost calculation for a single label to equal its share of the industry-wide (i.e., monopoly) opportunity cost, **SE PFF 499**. We address these in turn below.

i. The Must-Have Status of the Major Labels Does Not Result in Effectively Competitive Rates (*SE PFF § V.F.1*)

124. SoundExchange begins by arguing that Professor Willig's opportunity cost calculation does not necessarily reflect a group boycott or cartel. Even without coordination, SoundExchange points out, the walk-away opportunity cost for a must-have label will be the same as its share of the industry-wide walk-away opportunity cost; this is so because the refusal of a must-have licensor to license its music will make the distributor "unsustainable" no different

than if all labels refused to license their music. **SE PFF 501-04**. While Sirius XM, for reasons discussed below, disagrees strenuously with the competitive implications of that observation, it does not dispute the basic premise that must-have sellers can extract monopoly prices even absent coordination.

125. SoundExchange then argues (**SE PFF 505-13**) that even if a market is populated by must-have labels, their licenses with the service could still reflect "effective competition" if the service, like Sirius XM, has the ability to steer (**SE PFF 505**) – in other words, that Professor Willig's opportunity cost calculation encompasses must-have sellers does not necessarily rule out the possibility of effective competition. This argument need not detain the Judges long.

126. To start, Professors Shapiro and Farrell each testified emphatically and repeatedly that must-have status and the ability to shut down a service are fundamentally incompatible with workable competition. *See, e.g.*, 4/20/17 Tr. 358:23-359:14 (Shapiro) (market with must-have labels "very far from workable competition"); 4/24/17 Tr. 538:21-539:9 (Shapiro) ("[Y]ou cannot have workable competition with must-have suppliers."); 4/24/17 Tr. 543:1-15 (Shapiro) ("[T]he whole point of workable competition is you don't have must-have . . ."); 5/4/17 Tr. 2549:1-18 (Shapiro) ("When you have multiple must-have suppliers, you do not have a workably competitive market."); Shapiro WDT at 22; 4/24/17 Tr. 603:17-604:3 (Farrell) (workable competition requires that "no supplier is must-have"); 4/24/17 Tr. 614:20-615:10 (Farrell) ("[P]art of workable competition would mean that no label is must-have."). *See also* SXM PFF ¶ 274.[11]

[11] SoundExchange's suggestion that Professor Shapiro expressed a contrary view in his *Web IV* deposition (**SE PFF 506-07**) overlooks the question he was answering in the deposition: how to reconcile the requirement of an effectively competitive hypothetical market for non-interactive webcasters if the major labels were in reality must-have providers. Professor Shapiro's full response (besides noting the inherent contradiction between must-have power and workable

127. In addition, whatever the claimed theoretical possibility of price competition between must-have labels, Professor Willig's opportunity cost calculation itself categorically rules it out. As described in detail by Sirius XM's economists and conceded by Professor Willig, the very premise of his calculation is *not* that a label that walks away has its music replaced by that of other labels (a threat that might cause it to lower its price to maintain those plays); rather, his model assumes that if the label refuses to enter the license, Sirius XM shuts down and subscribers go elsewhere. **SE PFF 501-02**. In that situation, the label would have no reason to be concerned about Sirius XM's ability to steer to other labels, and no incentive to compete on price. In short, Professor Willig's industry-wide calculation, which treats the opportunity cost of the must-have label the same as the opportunity cost of a single seller that controls the rights to all sound recordings, leaves no room for competition between labels.

128. Finally, and perhaps most important, both the *Web IV* decision and the record evidence regarding developments in the market since that time (or *lack* of developments) show that the threat of steering has not blunted the major labels' must-have power in any fashion or translated into "more favorable terms" for "distributors" as hypothesized by Professor Willig. **SE PFF 505**.

129. In *Web IV*, the Judges catalogued – primarily through the admissions of UMG itself – the major labels' must-have status and the degree to which it foreclosed substitution and competition between them. For example, UMG argued to the FTC, in defending its merger with

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competition) was not only that the service at issue have significant steering ability, but that the must-have label's pricing be constrained to a linear per-play metric (as is the case in the webcasting context) as opposed to fixed fees that a must-have supplier otherwise might be able to impose. 4/24/17 Tr. 540:11-21 (Shapiro). In other words, not only must the service have significant steering ability, but the label must not be able to exploit the monopoly power it amasses as a result of being must-have. Such a constraint obviously would not apply in an unregulated market.

EMI, that [redacted]." Trial Ex. 693 at 21 (cited as Pan Ex. 5025 in *Web IV*, 81 Fed. Reg. at 26342). UMG further argued that because it was a [redacted]" Trial Ex. 692 at 17 (cited as Pan Ex. 5349 in *Web IV*, 81 Fed. Reg. at 26342) (emphasis added). Contrary to Professor Willig's hypothesis, UMG's statements make clear it is the must-have labels, and not the distributors, who receive the more "favorable" terms. *See* SXM PFF ¶¶ 266-74.

130. The Judges in *Web IV* also found a complete lack of price competition in the market for sound recordings: "[T]he Judges cannot ignore the testimony from several record company witnesses, discussed in this determination, in which they acknowledged that they never attempted to meet their competitors' pricing when negotiating with interactive services. . . . The Judges were presented with substantial, unrebutted evidence that the interactive services market is *not* effectively competitive." 81 Fed. Reg. at 26344 (emphasis in original); *id.* at 26341-42 (citing proffered evidence regarding lack of price competition from Sony ("Sony has 'never cut [its] price responding to a competitor's proposal or for more plays.'"), Universal ("Universal has never lowered a proposed rate as a consequence of finding out that another Major was offering a lower rate, and, more broadly, Universal does not take any actions to compete with Sony or Warner with respect to services"), and Warner ("Warner has never offered a lower rate to an interactive service for more plays")).

131. Based on such admissions, the Judges concluded that the Majors' ability to use their must-have power either to boycott the service (i.e., refuse a license) or to extract anti-steering provisions "would be a function of their complementary market power" and "a classic example of anticompetitive conduct." *Web IV*, 81 Fed. Reg. at 26373. They continued:

> While the Majors' individual market power is not in itself necessarily improper, the hypothetical exercise of that power in this manner in the noninteractive market would be antithetical to the "effective competition" requirement inherent in the § 114(f)(2)(B) standard. That is, each Major may well be entitled by its firm-specific market power to higher rates than the Indies, but the Majors cannot bootstrap that power into a further capacity to reap the benefits of a complementary oligopolist by brandishing such power as a sword against steering.

Id. at 26373.

132. SoundExchange's attempt to cite *Web IV* for the opposite proposition (**SE PFF 509**) misses (and appears intentionally to obscure) the holding above. The passage quoted by SoundExchange merely reiterates that the Judges were not penalizing the Majors for the monopoly power inherent in their copyrights or size of repertory alone, nor suggesting it reflected any improper activity on their part. Notably, and misleadingly, SoundExchange omits the more important sentences that immediately follow the selective portion they quote:

> This holding must not be confused with the Judges' holding regarding the anticompetitive effects of the complementary oligopoly that exists among the Majors. Because the Majors could utilize their combined market power to prevent price competition among them by virtue of their complementary oligopoly power—as proven by the evidence of the pro-competitive effects of steering and the admissions of Universal and its agents discussed *supra*—the Judges must establish rates that reflect steering in order to reflect an "effectively competitive" market.

81 Fed. Reg. at 26368 (internal cross-reference omitted).[12]

[12] Professor Willig engaged in the same obfuscation during his trial testimony, displaying on a demonstrative the same portion of the *Web IV* opinion quoted by SoundExchange in its proposed

133. The Judges' conclusions in *Web IV* are just as true today. As detailed in Sirius XM's proposed findings, and elsewhere in this filing, *see infra* ¶ 264, SoundExchange's record-label witnesses readily conceded that the interactive service market has not moved an inch since *Web IV*. The very same agreements underlying the Judges' conclusion that the market was not effectively competitive at the time of *Web IV* are still in place today, and the labels adamantly *refuse* to adjust their prices to compete with their rivals or to accommodate the possibility of steering by the licensee music services. *See* SXM PFF ¶¶ 275-81. Indeed, [redacted] 5/16/17 Tr. 4027:3-18 ([redacted]), while maintaining the view that the Judges were just wrong in *Web IV* to conclude that the market was not effectively competitive, *id.* 4026:8-4027:18.

134. [redacted] jaundiced view of competitive markets – echoing that of SoundExchange as the record industry's representative overall – helps explain the record industry's persistent resort to the benchmarking safe haven of the interactive service market, where price competition has been and remains completely absent. [redacted] testimony also affirms that, to sustain their misconceived view of competition, the record industry is left with no choice but to claim that the Judges got *Web IV* wrong.

135. SoundExchange's final argument on this point (**SE PFF 514-25)** is that the major labels are must-have suppliers for Sirius XM as well as the interactive services – the suggestion being that it was therefore appropriate for Professor Willig to rely on the walk-away industry-wide opportunity cost in determining the appropriate royalty for Sirius XM. **SE PFF 525**.

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findings (**SE PFF 509**), but likewise leaving off the following (and above-quoted) sentences regarding complementary oligopoly. When asked why, his flip response was that "[i]t was a small slide." 5/2/17 Tr. 2147:18-2148:18 (Willig).

136. SoundExchange's evidence (claimed to be "unrebutted") is sketchy at best: basically, beside-the-point attestations from major-label licensing executives about the market shares and prominence of their companies. **SE PFF 517-21**. None offered any legitimate evidence about whether Sirius XM could or could not operate without a license from their companies or the impact that would have on subscriber levels, and the economists in the case notably refrained from drawing any such conclusions. *See, e.g.*, 4/19/17 Tr. 228:13-23 (Shapiro). (Even Professor Willig, despite building the must-have assumption into his opportunity cost calculation, refrained from offering the factual conclusion that the major labels are indeed must-haves for Sirius XM. *See* 5/2/17 Tr. 2023:4-16 (Willig).)

137. SoundExchange's contention regarding Sirius XM is also at odds with its claim in the same section that Sirius XM is able to steer – and can do so to the degree that it could actually blunt the must-have power of the labels, thereby converting supra-monopoly rates into workably competitive rates. **SE PFF 505**. Indeed, SoundExchange appears to want to have it both ways: arguing that the labels are must-haves for Sirius XM (in order to justify Professor Willig's monopoly-seller opportunity cost calculation) while also arguing that the labels would nonetheless forfeit their power to shut down Sirius XM (in order to avoid the non-competitive implications of the must-have assumption).

138. Regardless, even if SoundExchange is correct that the Majors are must-have suppliers for Sirius XM, it cannot and does not justify imposing on Sirius XM non-competitive rates reflecting the full force of that must-have power. The entire thrust of the *Web IV* opinion, as summarized above, was that the must-have status of the record companies is an anti-competitive problem to be rectified, not a justification for imposing an anti-competitive statutory rate on the theory that the target service is just as prone to be victimized by the labels' must-have

power. The Judges explicitly *rejected* that line of argument in responding to SoundExchange's claim that the major labels would, absent the statutory license, boycott services like Pandora:

> [T]he hypothetical use by one or more of the Majors of its power to boycott a noninteractive service—one that had sought to inject some price competition into the market via steering—would undermine the "effective competition" standard that the D.C. Circuit, the Librarian of Congress and the Copyright Royalty Judges have declared to be an essential element of the § 114(f)(2)(B) standard.

Web IV, 81 Fed. Reg. at 26373. In short, the ability of a major label to "walk away" from a non-interactive service like Sirius XM – that is, to "boycott" the service – is distinctly at odds with effective competition. Professor Willig's opportunity cost calculation is premised on what the must-have label would earn in that exact circumstance.

ii. Professor Willig's "Unilateral Alignment" Hypothesis Is Anti-Competitive and Should Be Rejected (*SE PFF § V.F.2*)

139. SoundExchange's final attempt to defend Professor Willig's monopoly-seller opportunity cost calculation is to argue that there need be no overt coordination or collusion between the labels for each of them to demand their share of the industry-wide walk-away opportunity cost. Each will know that it would be best off if Sirius XM were deprived completely of music and subscribers need to go elsewhere, so will hold out for a price equal to its share of the industry-wide (monopoly) opportunity cost. And each will understand, even absent any overt coordination, that the other labels will be in the same boat, and share the same understanding. The labels therefore will be able to hold out for their share of the monopoly price without fear that other labels will undercut them and grab a bigger share of plays (i.e., price compete). **SE PFF 526-36**.

140. This argument – what Professor Willig elsewhere referred to as his "unilateral alignment" theory—was addressed and dispatched in Section IV.D.iii of Sirius XM's proposed

findings. *See* SXM PFF ¶¶ 379-82. As demonstrated there, Professor Willig's theory assumes away any possibility of competition between labels: i.e., the possibility that a label will accept a price beneath its rivals to motivate steering in its direction and higher payments. The working premise is instead that each label will be offered the same uniform rate (or assume that to be the case), and that each will compare that offer to (and hold out for) its share of the same (monopoly) price. SXM PFF ¶ 380.

141. SoundExchange's "uniform pricing" gloss – i.e., that labels know that prices tend to be relatively uniform across labels in unregulated markets – does not cure the anti-competitive concerns with Professor Willig's calculation. It *exacerbates* them. That is, it assumes a level of certainty as to what one's competitors are doing, price and behavior-wise, that would only be attainable in a market featuring overt coordination or actual or tacit collusion. Likewise, only in a market with a free flow of sensitive competitive information between competitors could any one entity operate with the knowledge that it could hold out against steering threats or competitive price reductions from its competitors without concern of being undercut on price or losing plays to competitors on the service. Professor Willig's effort at analogy notwithstanding, *see* 5/4/17 Tr. 2618:1-2619:9 (Willig) (analogizing to the steel industry's use of "posted" prices), this is *not* an industry where license pricing or other terms and conditions are matters of public record. The uniform pricing thesis also ignores the further anti-competitive reality, as recognized in *Web IV*, that prices in unregulated sound recording licensing markets tend to be uniform precisely because record companies in those markets, as a result of their complementary oligopoly power, *do not price compete against one another*.

142. There is no justification for assuming that the same anti-competitive dynamic would hold in license negotiations between record labels and Sirius XM, or simply to accept it if

it did. And there is even less justification to assume, as SoundExchange does in its proposed findings (**SE PFF 528**), that it is the regulatory intent of Sections 114 and 801(b) to promote coordination and uniformity of pricing, rather than rivalry, among competing suppliers. While the rate set by the Judges under the statutory license will apply uniformly across all suppliers, that does not mean it should be set based on the assumption that all suppliers can uniformly avoid competing with one another, or based on benchmarks reflecting such a non-competitive dynamic.

143. Nor, finally, is there reason to excuse Professor Willig's monopoly opportunity cost on the grounds that a true cartel might seek to extract even *higher* rates than its walk-away opportunity cost. **SE PFF 533-34**. Even if true, that possibility does not change the fact that the $2.55 calculation is equivalent to the opportunity cost of a monopolist. As Professor Shapiro testified,

> [Y]ou would get this result, his result, if you had a must-have label, if you had a monopoly, a single firm controlling all the music, if you had a cartel among all the record companies that engaged in a group boycott of Sirius XM. Whatever he means exactly by unilateral alignment, as far as I can see, it's economically equivalent to a cartel, a group boycott, a monopoly, must-have, and does not capture workable competition.

5/4/17 Tr. 2565:10-2566:9 (Shapiro); *see also* SXM PFF ¶ 381. As with many of SoundExchange's arguments, the attempted rationale, whether accurate or not, does not justify the result: an opportunity cost concededly identical to what a monopoly seller of all recordings would charge. Whether achieved tacitly rather than overtly, it still does not reflect workable competition, and should be rejected.

D. <u>Professor Willig's Opportunity Cost Calculation Suffers from Numerous Other Flaws (*SE PFF § V.G*)</u>

i. Professor Willig's Opportunity Cost Calculation Relies on and Imports Complementary Oligopoly Rates into the Target Market (*SE PFF § V.G.1*)

144. Sirius XM's initial proposed findings identified another significant error with Professor Willig's opportunity cost calculation: it is driven by – and thus imports into his proposed rates for Sirius XM – per-subscriber per month rates from the interactive services that the Judges found in *Web IV* to be infected by complementary oligopoly power. *See* SXM PFF ¶¶ 375-78. Sirius XM also pointed out the glaring internal contradiction inherent in Professor Willig's approach: he concedes that those same rates, when used as benchmarks, should be examined (and potentially adjusted) to reflect effective competition, but when he uses those same rates as the basis of his opportunity cost calculation, he argues that no such adjustment should be made – that is, the Judges should take those markets "as they are." SXM PFF ¶¶ 377-78 (citing Willig trial testimony).

145. SoundExchange's papers do nothing to overcome these concerns. In a lone paragraph, they simply reiterate the mantra that the Judges should take the benchmark markets "as they are," without adjustment for effective competition, because those form part of the "real world" opportunity cost for the labels in licensing Sirius XM. **SE PFF 539**. But that contention in no way avoids the reality that Professor Willig's model has imported the rates from those other markets – "as they are" – into the target market (satellite radio) without adjustment. *Id.* Indeed, that is *precisely the point* of Professor Willig's calculation: to ensure that the labels earn from Sirius XM what they would earn from the alternative platforms if they declined to license Sirius XM.

146. SoundExchange's argument therefore does not rebut the fact that Professor Willig's calculation imports complementary oligopoly rates into the statutory setting; it simply says, "Don't worry about it." But the Judges have no such luxury. As noted in *Web IV*, the Judges are bound by the "'effective competition' standard that the D.C. Circuit, the Librarian of Congress and the Copyright Royalty Judges have declared to be an essential element of the § 114(f)(2)(B) standard."[13] 81 Fed. Reg. at 26373.

147. Similarly, the fact that there are other rate inputs to the opportunity cost calculation (radio, non-interactive services, etc.) that might also be adjusted (**SE PFF 540-44**) does not excuse Professor Willig's refusal to adjust the interactive service rates. It just means he has not adjusted any of the other rates either. The problem – the incorporation of (unadjusted) anti-competitive interactive service rates – remains.

ii. Professor Willig's Opportunity Cost Calculation Ignores the Promotional Value of Sirius XM (*SE PFF § V.G.2*)

148. Section V.G.2 of SoundExchange's proposed findings attempts to respond to yet another flaw in Willig's opportunity cost model: his conceded failure to measure the degree to which the promotional impact of Sirius XM on the consumption of recordings on other platforms would offset the opportunity costs he calculated. *See* SXM PFF ¶¶ 409-15. As Professors Farrell and Shapiro testified, it is the *net* effect of Sirius XM's promotional and substitutional values on record label revenue that is the key factor in any credible determination of the opportunity cost to that label of licensing Sirius XM. *Id.* ¶ 409 (citing Farrell WRT ¶ 56; Shapiro CWRT at 38).

[13] We address elsewhere the incorrect contention in SoundExchange's proposed findings (**SE PFF 540**) that the Judges could apply a steering adjustment of 12% to rectify any market power problems. *See* SXM PFF § IV.B.v .

149. None of SoundExchange's responses cure this basic failing; they simply shrug it off. For example, SoundExchange argues that it does not have "reliable evidence" of Sirius XM's promotional value, or that Professor Farrell did not quantify it either. **SE PFF 545-46**. Neither of those criticisms leads to the conclusion that one can simply adopt Professor Willig's opportunity cost calculation (putting aside its many other flaws) without such quantification. SoundExchange also argues that one would need to consider and compare the promotional impacts of the other platforms to which Sirius XM subscribers might divert if music were not available on Sirius XM. **SE PFF 556-58**. But as Sirius XM previously pointed out, that does not excuse Professor Willig's failure to consider the promotional impact of Sirius XM in his opportunity cost analysis; it just suggests a more nuanced, second-order analysis of promotion should have been conducted, which Professor Willig failed to do. *See* SXM PFF ¶ 414.

150. Finally, SoundExchange spends considerable energy attacking Professor Shapiro's reworking of Professor Willig's regression analysis addressing the impact of "streaming" on download sales. **SE PFF 548-55**. Professor Shapiro's rebuttal testimony adjusted the Willig regression by treating Sirius XM, non-interactive streamers, and interactive streamers as separate independent variables (Professor Willig had aggregated them together), concluding that the promotional impact of Sirius XM alone, when separated out from other forms of streaming, was actually *positive* rather than negative, as suggested by Professor Willig. Professor Shapiro's rebuttal also addressed and dispatched Professor Willig's contention that issues of multi-collinearity and inter-service substitution prevented him from treating Sirius XM separately. *See* Shapiro CWRT at 28-32 & Appx. B.

151. Professor Shapiro's fundamental point, however, was not to offer the results of the adjusted regression as a definitive measure of the promotional impact of Sirius XM, but to

demonstrate "how you get a radically different result if you simply separate out the variables," and how that difference highlights the fundamental unreliability of Professor Willig's regression approach in general. 4/24/17 Tr. 554:14-20 (Shapiro) (explaining his approach "shows how the whole thing . . . is not reliable" and "doesn't work as a methodology"). Professor Shapiro candidly explained this at trial: "I don't really put weight on these sort[s] of high-level regressions. . . . I wouldn't have taken this whole approach that Professor Willig is doing of looking at a few time series over time, seeing how they're related and thinking that you could then predict effects in this way. I just don't -- I don't think it's reliable." *Id*. 554:2-10; *see also id.* 555:2-10.[14]

152. SoundExchange's attempt to cast Professor Shapiro's results as "patently absurd" (and trumpeting his "hasty retreat" from them) overlooks this more fundamental point: that the root of the purported absurdity of the results stems not from Professor Shapiro's refinements, but from the over-simplified nature of Professor Willig's "high-level regression" itself. Moreover, even if one rejects Professor Shapiro's refinements to the Willig regression, we are simply back where we started: with a regression that concededly fails to account for either the promotional or substitutional value of Sirius XM itself, as distinct from other forms of streaming, and one that focuses solely on download sales, which SoundExchange itself denigrates as immaterial. **SE PFF 547**.

[14] The same criticisms apply to the related regression Professor Willig conducted in an attempt to analyze the impact of Sirius XM on interactive and non-interactive streaming. **SE PFF 667-75**. Sirius XM addressed those issues in SXM PFF ¶ 412 (citing Shapiro CWRT at 33). To recap briefly, Professor Shapiro identified two problems with Professor Willig's regression: the failure to separate out non-interactive from interactive services, and the failure properly to specify the model to allow for the introduction of Spotify to the U.S. in 2011. Shapiro CWRT at 33. Correcting for the latter issue by inserting a time trend variable actually reversed the conclusion that Sirius XM substituted for interactive services. *Id.*

E. <u>SoundExchange's Additional Defenses Fail (*SE PFF §§ V.H-I*)</u>

153. SoundExchange offers several additional defenses of the opportunity cost calculation which boil down to arguments that "Sirius XM didn't offer anything better" or "It could have been even *higher*." Neither of these straw-men arguments remedies the flaws in the methodology that Professor Willig himself implemented and that SoundExchange relies on to support its rate proposal.

154. To start, it is irrelevant that Sirius XM did not offer an alternative opportunity cost estimate (**SE PFF 559-68**). Sirius XM offered three rate-setting approaches that the Judges will take on their own merits; there clearly is no requirement under the statute or CRB precedent that it provide an estimate of opportunity cost as part of its case. Nor does it follow that Professor Shapiro's and Professor Farrell's critiques of Professor Willig's testimony are illegitimate solely because those witnesses did not reduce their critiques to an alternative figure, or were so bold as to rely on "Greek letters" – better known as economic models – in their analyses. **SE PFF 559**. One can point out the innumerable flaws in Professor Willig's approach – including the dramatic degree to which it overstates competitive opportunity costs – without providing a precise alternative.

155. It is likewise irrelevant that the monopoly opportunity cost calculated by Professor Willig might have been – or could become – even higher. **SE PFF 569-82**. At the end of the day, his methodology still results in a figure equal to the opportunity cost to a single-seller of all sound recordings, and still is driven in large part by the complementary oligopoly rates charged by the interactive services. Those rates are hardly commended by the possibility that the labels were able to use their market power to extract a variety of "non-royalty" concessions that might be interpreted to inflate the already non-competitive price. **SE PFF 570-75**.

156. The same is true of the suggestion that Sirius XM may increasingly substitute for interactive streaming services, or that interactive services offer "lean-back" functionality. **SE PFF 576-82, 676-87**.[15] As discussed in Sections I.L and V.B.i, there is scant evidence that Sirius XM is meaningfully competing with, or substituting for, other forms of streaming, on-demand in particular. But even if the diversion to such services grew, that would only alter the diversion ratios in Professor Willig's ill-founded monopoly opportunity cost calculation. That it might result in an even higher figure as a result does not make Professor Willig's methodology proper.

F. Professor Willig's Misconceived Opportunity Cost Calculation Also Fails Because It Is Built on Two Fundamentally Flawed and Unreliable Surveys (*SE PFF § V.J*)

157. Section V.J.1 of SoundExchange's proposed findings (**SE PFF 584-634**) describes Professor Dhar's survey, upon which Professor Willig relied for his opportunity cost calculation, and Professor Hauser's critiques of it. Sirius XM's proposed findings already addressed the debilitating flaws in the Dhar survey, explaining that: (1) it involved an artificial and biased design that over-emphasized paid interactive and non-interactive subscriptions; (2) these errors were compounded by the unrepresentative survey population, which excluded nearly three-quarters of would-be respondents who said that they had a subscription to Sirius XM; and (3) the survey cannot be used to calculate Full Marginal Cost or Creator Compensation Cannibalization because it failed to give respondents the option of replacing a Sirius XM subscription with increased listening to an *existing* (as opposed to a new) paid interactive or non-interactive subscription. *See* SXM PFF ¶¶ 383-408. We amplify below on these main defects, including that Professor Dhar's decision to exclude a large number of subscribers from his survey means that it cannot provide an accurate prediction of what choices Sirius XM

[15] **SE PFF 676-87** are found in Section V.J of SoundExchange's proposed findings.

subscribers would actually make, that its biased design and incomplete answer choices drove more respondents to say they would subscribe to a new paid music service than they would actually do, and as a result, Professor Willig's reliance was entirely improper and misplaced. We also address some of the more egregious mischaracterizations in SoundExchange's proposed findings. Finally, as discussed in Section II.F.iii below, the flaws in Professor Simonson's survey render it no more useful to Professor Willig than the Dhar survey.

i. Professor Dhar's Survey Is Rife with Design Flaws and Failed to Meet Professor Willig's Own Minimum Qualifying Criteria (*SE PFF § V.J.1*)

158. In order for Professor Willig properly to have relied on Professor Dhar's survey to quantify the monopoly opportunity cost that arises from substitution between Sirius XM and paid-interactive and paid-non-interactive services, Professor Dhar's survey both would have to have been properly designed to elicit responses from a representative sample of the relevant universe of Sirius XM subscribers and would have to have presented its switching questions in a manner that enabled determination of unbiased estimates of music services to which respondents would switch. *See* Hauser WRT ¶¶ 17, 57. Because the Dhar survey failed to meet either of these core requisites, Professor Willig's reliance on its results was inappropriate and further rendered his overall opportunity cost analysis of no value.

159. SoundExchange goes to great lengths to defend Professor Dhar's use of an Internet survey in lieu of a telephone survey. **SE PFF 591-98**. While the subject of much academic debate, the Judges need not linger on that issue in relation to appraising the Dhar survey since, in any event, the survey was not properly designed and its universe was not representative.

Population

160. Professor Dhar candidly admitted that he did not even try to survey the full universe of current Sirius XM subscribers, limiting his survey instead to those who indicated that they subscribe to the *Sirius Select* package. He deliberately omitted subscribers to other types of Sirius XM packages, including Mostly Music and All Access. Dhar CWDT ¶ 10; 5/8/17 Tr. 2847:5-2851:3 (Dhar); **SE PFF 630**. As a result, Professor Dhar disqualified from his incoming sample fully 73% of the Sirius XM subscribers who reported that they subscribed to something other than the Sirius Select package. *See* Hauser WRT ¶ 124 & Fig. 13; 5/8/17 Tr. 2858:20-2859:24 (Dhar); SXM PFF ¶¶ 395-98.

161. SoundExchange's defense of the choice to limit the population to Sirius Select subscribers – because the "Select" package is [redacted] of the Sirius XM paid subscription base (**SE PFF 629**) – misses the mark. Whether or not the initial choice to limit the survey to Sirius Select subscribers was defensible, the percentage of subscribers in Professor Dhar's survey who said they had a Sirius Select subscription (27%) does not match at all the [redacted] who have a Select subscription. *See* Hauser WRT ¶ 124 & Fig. 13; 5/8/17 Tr. 2858:20-2859:24 (Dhar).

162. It seems clear that Professor Dhar did not originally intend to limit his population to those who had a Sirius Select subscription, but rather intended his population to be those who had a "Select" subscription, whether Sirius Select or XM Select, to match this [redacted] who have a Select subscription. In his survey, respondents who said they had a Sirius XM subscription were shown a screen shot of three different packages generically labeled "Select" "All Access" and "Mostly Music" and asked to choose which one they had from among

similarly labeled answer choices (i.e., Select, All Access and Mostly Music). Dhar CWDT Appx. E at 98; Trial Ex. 708; 5/8/17 Tr. 2853:17-2954:10 (Dhar). Unless a respondent chose "Select," he or she was disqualified from this cell of the survey. Dhar CWDT Appx. D at 62. But if it was Professor Dhar's intention to capture both Sirius Select and XM Select subscribers, he failed. The screen shot respondents were shown was the Sirius Select package, which differs in significant ways from the XM Select package. *Compare* Trial Ex. 707 *with* Trial Ex. 708. Professor Dhar acknowledged that respondents who had an XM Select subscription and viewed the screenshot of the Sirius Select subscription package would likely have chosen something other than "Select" from the available options. 5/8/17 Tr. 2855:21-2856:10 (Dhar).

163. Whether because Professor Dhar showed respondents the Sirius screenshots or because respondents did not know or could not recognize which package they had, Professor Dhar had no confidence that the 27% of respondents who said that they had a Sirius Select subscription actually included all of the Sirius Select subscribers in his incoming sample, or that all of these respondents actually had a Sirius Select subscription. *See* 5/8/17 Tr. 2862:19-2863:2 (Dhar) ("[M]any of the people who had Select chose All Access and it could be that there are some who would choose All Access or choose Select . . . ."). Without confidence that Professor Dhar surveyed all of the Sirius Select subscribers in his sample, or even that his sample was comprised entirely of Sirius Select subscribers, it is improper to draw any conclusions about Sirius Select subscribers from Professor Dhar's survey.

164. Given the differences between the Sirius XM packages, subscribers to one package alone would likely not be representative of Sirius XM subscribers as a whole. *See* Hauser WRT ¶ 128. Thus, even if SoundExchange is correct that the respondents to Professor Dhar's survey were "fully capable of answering questions as to their willingness to pay and what

substitutes they might choose, regardless [of] whether they know the correct *name* of their package," (**SE PFF 630** (emphasis in original)), it is entirely beside the point. Even if the Dhar survey had adequately captured all Sirius Select subscribers, Professor Dhar acknowledged that his results could still not be projected onto the population of *all* Sirius XM subscribers. 5/8/17 Tr. 2874:16-23 (Dhar). All Access subscribers (who pay more than Select subscribers) would likely switch at higher prices than Select subscribers, and as a result, the answers that Professor Dhar obtained are not representative of the answers that he would have obtained had he surveyed a random sample of all Sirius XM subscribers. Hauser WRT ¶ 128. Professor Dhar's decision to exclude All Access subscribers likely biased his results toward switching away from Sirius XM and toward music streaming services at lower prices than would be expected amongst the full universe of Sirius XM subscribers. *Id.* ¶ 129.

165. Further, Professor Dhar conceded that his sample was not a probability sample for the entirely independent reason that he did not allocate his survey respondents in a random manner. 5/8/17 Tr. 2873:6-9 (Dhar). Respondents who qualified for more than one cell of his survey (i.e., those with more than one music subscription) "were randomly assigned to a set of questions in the main survey about just one of their services." Dhar CWDT ¶ 31; 5/8/17 Tr. 2871:14-22 (Dhar). In practice, this meant that early in the survey, a respondent who had three subscriptions would have a 33 1/3% chance of being assigned to each cell for which she qualified, but a respondent with exactly the same three subscriptions who responded later in the survey, after one or more of the cells were full, would have a 0% chance of being assigned to the full cell, and, depending on how many cells were full, would have a 50% chance or 100% chance of being assigned to another cell for which she qualified. *See* Hauser WRT ¶ 21. In short, because Professor Dhar's survey population was under-inclusive and not representative,

Professor Willig cannot properly rely upon it to accurately predict what choices Sirius XM subscribers would actually make. Hauser WRT ¶ 17.

Biased Design: Order Effect, Demand Effect, Incomplete Answer Choices

166. SoundExchange's contention that the Dhar Survey did not lead respondents to particular responses (**SE PFF 607-10**) is wrong. Moreover, SoundExchange's proposed findings evidence a serious double standard with respect to survey methodology.

167. Question order and demand effects contaminated the Dhar Survey and likely led to biased responses by making respondents more likely to choose paid music service options. *See* Hauser WRT ¶ 66. First, at the beginning of the survey, and then again just before asking respondents what they would switch to, Professor Dhar presented respondents with definitions for three types of services: satellite radio, on-demand services, and non-on-demand services, and asked respondents if they understood the definitions. *See* Dhar CWDT Appx. D at 66 (Question 200), 69 (Question 210). As Professor Hauser explained, "when you show people something, it becomes available in memory and they're much more likely . . . to choose it." 5/9/17 Tr. 3034:5-3035:3 (Hauser) (noting that "the definitions that precede these questions emphasize both on-demand and not-on-demand services").[16]

168. SoundExchange contends that it is "absurd . . . to suggest that respondents would need a definition of free music choices such as AM/FM radio." **SE PFF 628**. That misses the point: clearly, putting only these three types of services in people's minds and asking them if they understood them just before they were asked the switching questions made them top-of-mind, so respondents may have been more inclined to choose them. Hauser WRT ¶ 67. As

[16] In addition, these definitions were themselves problematic because they used terms of art like on-demand and not-on-demand and "[i]t's not clear that consumers are comfortable with those terms." 5/9/17 Tr. 3042:23-3043:7 (Hauser).

Professor Simonson noted, "the awareness of the previous questions and related answers . . . makes them salient or top-of-mind and thus more likely to influence subsequent answers . . . [and] respondents are likely to infer that the sequence of questions was designed by the researcher in this manner because the answers to the early and subsequent questions were *meant* to be linked and consistent." Simonson WRT ¶ 25 (emphasis in original); *see also* Dhar WRT ¶ 12 ("An order effect is a phenomenon in which the order in which preceding questions were asked systematically influences the answers provided by respondents to a subsequent question"); 5/8/17 Tr. 2832:10-2834:25) (Dhar).[17]

169. The repeated references to the On-Demand and Not-On-Demand definitions (Questions 200 and 201), and only providing answer options for new, paid On-Demand and Not-On-Demand subscriptions (Question 210),[18] provided respondents with cues that could help them try to figure out the purpose of the survey and guide their answers accordingly. As Professor Hauser explained, "there's so much emphasis here on paid subscriptions, it's quite possible that respondents could guess the goal of the survey. That would be to have them answer yes, I like paid services." 5/9/17 Tr. 3034:24-3035:3 (Hauser); *see* Hauser WRT ¶ 70. In his rebuttal testimony, Professor Simonson corroborated the idea that it is important to avoid "the important survey concept known as 'demand effect'" and that "[d]emand effects pertain to the phenomenon whereby survey respondents use cues provided by the survey procedure and questions to try to figure out the purpose of the survey and what they imagine to be the 'correct' answers to the

[17] Evidencing the double standard, Professor Dhar characterized it as "contextualiz[ing]" when applied to his own survey. 5/8/17 Tr. 2900:22-2901:6 (Dhar).

[18] Question 210 offered respondents who said that they would cancel their Sirius XM subscription only the following alternatives: "Yes, I would subscribe to an **On-Demand** music streaming service like Apple Music or Spotify at $9.99 per month"; "Yes, I would subscribe to a **Not-On-Demand** music streaming service like Pandora One at $4.99 per month"; "No, I would <u>not</u> subscribe to a paid music service in place of Sirius XM"; and "Don't know/unsure." Dhar CWDT at 69 (Question 210); **SE PFF 605**.

questions they are asked." Simonson WRT ¶ 26. When these cues are present—as they are in Professor Dhar's survey—"respondents then tend to provide what they perceive as the 'correct' answers, to make sure that the results 'come out right.'" *Id.*

170. SoundExchange nonetheless insists that "there is nothing the least bit leading about the question and it is not biased to favor a 'yes' response" because respondents were given the option of choosing "No, I would not subscribe to a paid music service in place of Sirius XM." **SE PFF 624.**[19] But *not choosing* to subscribe to a paid service is qualitatively different from *choosing* to switch to a non-paid option or listening to an existing subscription. Hauser WRT ¶ 69. The fact that in response to Question 210 "plenty of people are willing to say, no, they would not subscribe," 5/8/17 Tr. 2928:16-21 (Dhar), is not evidence that the question was not biased or skewed. Borrowing again from Professor Dhar's rebuttal testimony, "it just says order bias happens, like every bias doesn't happen for everybody; it happens, you know, for many people but not everybody." 5/8/17 Tr. 2834:19-25 (Dhar). Had the question been framed properly to allow respondents to actively select any of the wide range of other options, respondents may have been more likely to select a non-paid alternative or an existing subscription and less likely to select a new paid subscription. Hauser WRT ¶ 69. Indeed, when

[19] SoundExchange is also wrong that clear instructions could neutralize the biasing effects of a question that focused excessively on new paid music services. **SE PFF 623-24**. But even were it otherwise, Professor Dhar conceded that the instructions were not clear, acknowledging in response to questioning by Judge Strickler that it might "put[] people's minds in a wrong direction" to ratchet a survey respondent back and forth between "keep in mind all other music services I subscribe to" and "stop thinking about ones that you subscribe to, think about different ones." 5/8/17 Tr. 2907:11-2908:23 (Dhar) (admitting that this ratcheting was "a slow leap in protocol."). Indeed, as Professor Dhar admitted, it would have been clear and potentially more precise to say in Question 210, "excluding all other music services you subscribe to" rather than "keeping in mind all other music services [you subscribe to]." 5/8/17 Tr. 2906:6-2907:10 (Dhar).

Professor Hauser allowed respondents to actively select from a wide range of other options, this is exactly what happened. *See* SXM PFF ¶¶ 391-94.

171. Professor Hauser explained that biased responses were also likely because Professor Dhar provided too limited a set of response options; where the list of options is incomplete, "a respondent may be forced to choose one that does not express his or her opinion." Hauser WRT ¶ 63 (citing Shari Diamond, Trial Ex. 279).[20] Rather than respond directly to this criticism, SoundExchange explains that Professor Dhar, a consumer psychologist, believed that posing such a biased question is "consistent with marketplace reality." **SE PFF 625**.[21] But that explanation cannot be squared either with the actual marketplace (in which the alternatives to listening to Sirius XM are far broader than a new subscription to another paid service) or with the rebuttal testimony of Professors Dhar and Simonson. Professor Simonson characterized the failure "to list key examples of music categories available to consumers in reality," as a "major flaw," acknowledging that it meant "those music categories were less likely to be selected (and additional options not listed, such as YouTube, could not be selected at all by the respondents)." Simonson WRT ¶ 45; *id.* ¶ 10.c (omissions such as the failure "to present other music sources" "misrepresented reality and biased the results").

[20] *See also* Hauser WRT ¶ 59 (responses that are explicit or clear "may be more readily 'available' to the respondents than the implicit or unclear responses. As a result, respondents may be inclined to choose the explicit responses more often than they otherwise would."); ¶ 68 ("By aiding in the recall of paid music services, but relying on unaided recall for other music options (including free music options), Professor Dhar biase[d] his results in favor of switching to paid music services.").

[21] Notably, when questioned on this topic by Judge Strickler, Professor Dhar responded, in the apparent guise of a consumer psychologist, on the basis that he knows (without any data) that, faced with the loss of Sirius XM (and its subscription price no longer being paid), a consumer would first consider whether or not to subscribe to a different service. 5/8/17 Tr. 2750:25-2752:6 (Dhar); **SE PFF 626**.

172. For his part, Professor Dhar recognized that "[o]mitting . . . relevant options, or grouping into broader categories in which significant examples were omitted, leads respondents into selecting one of the available options which they might not otherwise have selected, thereby biasing the results in the survey in comparison to what one might see in the marketplace." Dhar WRT ¶ 17. Professor Dhar essentially conceded the systematic bias in his own survey at trial, admitting that if he had explicitly offered respondents the choice of free music or AM/FM radio in response to Question 210, he would have expected the number of people who chose free music to be higher. 5/8/17 Tr. 2920:21-2921:5 (Dhar). Professor Dhar's own rebuttal testimony renders his characterization of his own list of answer choices as "exhaustive" completely lacking in credibility. *See* 5/8/17 Tr. 2916:2-14 (Dhar).

173. Despite this recognition, Professor Dhar defended his survey design on the premise that his "understanding from the economists was that it was not relevant to them what else they would do. They were only interested in knowing, if you canceled, what would you switch [to], to a new paid subscription." 5/8/17 Tr. 2921:18:2922:1 (Dhar). With due respect, this is mere word play. If the SoundExchange economists' interest were in ascertaining the percent of Sirius XM subscribers who would switch to a new paid subscription were they to cancel their subscription, by necessity an objectively-designed survey would also elicit "what else they would do," including among the options the single most likely alternative listening source—AM/FM radio.

174. The failure to provide complete answer choices was not only a major flaw in survey methodology that severely biased results, it necessarily means that the Dhar survey cannot be used, as Professor Willig does (**SE PFF 472-75**), to calculate diversion ratios in an opportunity cost analysis. Notably, while Professor Willig eagerly plugged the responses from

the Dhar survey into his opportunity cost calculations, he either did not bother to ascertain the reliability of the data on which he relied or did not care since it supported so favorable a result for SoundExchange. As discussed in Sirius XM's proposed findings (SXM PFF ¶¶ 399-408), had Professor Willig applied his own criteria for a reliable survey to the Dhar survey, he could not professionally have used it. According to Professor Willig, the impact on creator compensation of the shift away from Sirius XM varies depending on "three distinct circumstances": (1) purchasing a new subscription to a paid interactive service; (2) increasing listening to a paid interactive service to which respondent already subscribes; and (3) increasing listening to an ad-supported interactive service. Willig WRT ¶¶ 46-47 (criticizing Professor Shapiro's use of Mr. Lenski's survey). Professor Willig took the position that, unless a survey explicitly presents respondents with *all three choices*—including the opportunity to select as an option replacing Sirius XM listening with *increased listening to a subscription service that a respondent already subscribes to*— the survey "cannot provide the information needed to assess the relevant effect, namely, the impact on creator compensation." *Id.* ¶ 46. He explained that it was important to distinguish between new paid subscriptions and increased listening to existing subscriptions because "[c]reators would receive significant compensation from the purchase of a new paid subscription service, whereas there would be no incremental rise in compensation for increased usage of an existing subscription service (since its creator compensation is not linked to usage)." *Id.* ¶ 48. Professor Willig's critique, though misguided as to the Lenski survey (which was never intended to provide a number that could be plugged into an opportunity cost calculation), is devastating for the Dhar survey as well as the Simonson survey (as further addressed below). Neither survey's answer choices included the option of listening more to an existing subscription, and Professor Dhar's survey only offered the option of listening to an ad-

supported interactive service if the respondent first jumped through a number of hoops. *See* Dhar CWDT at 69; Simonson WRT Appx. D at5; Hauser WRT ¶ 69; Dhar WRT ¶ 16.

175. Attempting to deflect attention from this fundamental and glaring omission, SoundExchange notes that "not a single one of the Sirius XM subscribers in Professor Hauser's pretest even stated that they wanted to add such an option to Professor Hauser's study." **SE PFF 613**. This again misses the point and scarcely excuses Professor Dhar's failure to include an explicit option for survey respondents to switch to a streaming service they already subscribe to. By Professor Willig's own account, a survey that does not ask respondents to identify whether they would be using an existing subscription or purchasing a new subscription cannot be used to calculate Full Marginal Cost or Creator Compensation Cannibalization. Willig WRT ¶¶ 46-47. Professor Dhar's failure to offer respondents the option of using an existing subscription is a fundamental and foundational defect that disqualifies his survey from "provid[ing] the information needed to assess the relevant effect" for which Professor Willig uses that information. *Id.* ¶ 46.

176. In addition, this failure almost certainly inflated the number of respondents who indicated that they would subscribe to a *new* paid service. Hauser WRT ¶ 69 (noting that if switching questions provided a list of options that included "existing paid subscriptions to which respondents might reasonably switch, respondents may have been more likely to select . . . existing paid subscriptions and less likely to select *new* paid subscriptions"). Some of the respondents who said that they would subscribe to a new paid service likely had in mind an existing service that they would switch to when they answered Question 210: the data show that 62% of Sirius Select respondents in the Dhar survey that also had an *existing* paid subscription to Apple Music or Spotify said that they would switch to an on-demand service. Hauser WRT ¶ 71

& Fig. 7. And 71% of Sirius Select respondents who had *existing* paid subscriptions to *both* Apple Music and Spotify said that they would switch to an on-demand service (i.e., acquire a *third* paid on-demand service). *Id.;* 5/9/17 Tr. 3035:4-3036:3 (Hauser) (these data indicated it was likely that respondents were confused and were answering the question while "thinking of using their existing service as opposed to subscribing to a new service.").

ii. SoundExchange's Dismissal of Professor Hauser's Critiques Are Wide of the Mark (*SE PFF § V.J.1.iv*)

177. SoundExchange's discussion of Professor Hauser's critiques of the Dhar Survey (**SE PFF 611-34**) is long on *ad hominem* attacks[22] and short on actual issue joinder, displaying a basic misunderstanding of the nature of Professor Hauser's criticisms. Professor Hauser conducted the Modified Dhar survey to test some of the biases in Professor Dhar's survey by making available a more comprehensive set of options to which respondents could switch, including the option to use an existing subscription. Hauser WRT ¶ 14.

178. SoundExchange accuses Professor Hauser of being "unable or unwilling to conduct a reliable survey of his own," **SE PFF 633**, which, of course, misses the entire purpose and nature of his rebuttal testimony. Professor Hauser did not purport to conduct a scientifically reliable survey, unlike Professor Dhar. As already addressed (SXM PFF ¶¶407-08), the Modified Dhar survey was designed to provide empirical evidence of some (though by no means all) of the biases infecting Professor Dhar's survey. In particular, his aim was to test the biasing effects of the manner in which the Dhar survey switching questions were phrased. That, he testified, "was the one [area] that seemed to be most important to the economists, so I focused on

[22] For example, SoundExchange characterizes an allegedly misplaced clause in one of the answer choices in the Modified Dhar survey as "a hopelessly vague and poorly worded response option which entirely nullifies any conclusions from Professor Hauser's [Modified Dhar] survey." **SE PFF 614** ("As Professor Dhar explained (and as most high-school English-class students would readily recognize), the clause 'that I already pay to subscribe to' is misplaced.").

that." 5/9/17 Tr. 3130:12-22 (Hauser). Accordingly, Professor Hauser modified only the question about the music options to which respondents would switch, while keeping other aspects of the Dhar survey unchanged. Hauser WRT ¶ 14.

179. From this limited modification, Professor Hauser was able "to demonstrate how changing *only one* aspect of Professor Dhar's survey substantially changes his results." Hauser WRT ¶ 76 (emphasis in original). As he testified, when given a full range of alternatives in the Modified Dhar survey—including all three alternatives that Professor Willig said were crucial—the percentage of respondents who said they would replace their Sirius Select subscription with a new paid On-Demand subscription dropped from 28% in the Dhar survey to 15% in the Modified Dhar survey, and the percent who said they would replace it with a new paid Not-On-Demand service dropped from 14% to 10%. Hauser WRT ¶ 101 & Table 1. In addition, when provided the AM/FM option up front as a possible response to Question 210, approximately 78% of Sirius Select respondents to the Modified Dhar survey indicated that they would switch to AM/FM radio. Hauser WRT Fig. 11-A; 5/9/17 Tr. 3059:7-19 (Hauser). This compares to the only 29% (148 out of 509) of the sampled Sirius Select respondents to the Dhar Survey who reached Question 210.2 and reported they would replace Sirius XM with AM/FM radio. Hauser WRT Fig. 10-B; Dhar CWDT Table 1. These results confirm that Professor Dhar's Switching Questions led to biased responses in favor of paid music services. Hauser WRT ¶ 104.

iii. The Simonson Survey is Also Fatally Flawed (*SE PFF § V.J.2*)

180. Section V.J.2 of SoundExchange's proposed findings (**SE PFF 635-66**) describes Professor Simonson's survey. As already addressed (SXM PFF ¶¶ 399-401), Professor Simonson's survey has crippling flaws similar to certain of those that doom the Dhar survey, particularly its failure to give respondents the option of replacing a Sirius XM subscription with increased listening to an *existing* (as opposed to new) paid interactive or non-interactive

subscription. This shortcoming renders the Simonson survey of no more value to Professor Willig than the Dhar survey, notwithstanding Professor Willig's late embrace of it, likely in tacit recognition of the debilitating flaws in the Dhar survey. *See* 5/2/17 Tr. 2058:12-18 (Willig). We respond in more detail below to these shortcomings, as well as to some of the more egregious mischaracterizations in SoundExchange's proposed findings.

181. Professor Simonson's initial assignment was to critique Mr. Lenski's survey and to conduct his own survey "correcting" some of the issues he purported to identify. *See* Simonson WRT ¶ 9. But unlike Professor Hauser, who demonstrated that "changing *only one* aspect of Professor Dhar's survey substantially changes his results," Hauser WRT ¶ 76, Professor Simonson changed the methodology, the universe, the questions and the answer choices such that, in the end, his was a very different survey, albeit "inspired by" Mr. Lenski's survey. 5/11/17 Tr. 3446:13-24 (Simonson). One of the ways Professor Simonson contends that he "corrected" Mr. Lenski's survey was by presenting some "key music options." *See* Simonson WRT ¶ 69.[23] Notwithstanding having worked on only a handful of cases involving music in his career, 5/11/17 Tr. 3468:8-15 (Simonson), Professor Simonson made these changes without doing any pretesting, and did not recall at trial how he chose the terms he used in his questions. 5/11/17 Tr. 3482:14-3484:1 (Simonson). SoundExchange attempts to justify this failure to pretest as Professor Simonson's usual practice, which was not to pretest questions that are similar to questions he has used many times before. **SE PFF 664**; 5/11/17 Tr. 3473:8-3475:4 (Simonson). This is a non-sequitur, as Professor Simonson conceded that he had never used these exact questions and that while he had used similar questions, he had done so in the context

[23] Professor Simonson contends that "by not presenting key music source options (and their prices) that are in fact available to consumers in reality, the Lenski survey failed to provide reliable estimates of the choices that consumers would make if SiriusXM were not available." Simonson WRT ¶ 74.

of antitrust surveys involving toys, not music surveys. 5/11/17 Tr. 3474:7-3575:4 (Simonson). In contrast, Mr. Lenski testified that he personally designed or supervised thousands of surveys about music or media over the last twenty years, 5/4/17 Tr. 2628:24-2629:4 (Lenski), and that he had used many of the exact questions in his survey before, *id.* 2710:16-25.

182. In any event, these extensive changes in methodology preclude its usefulness in critiquing Mr. Lenski's survey, which was not designed to be used as an input to precisely calculate opportunity cost. *See infra* § IV.E.ii. Charitably viewed, Professor Simonson has at most provided evidence in support of the rather unremarkable proposition: that if you do a different survey, you may get different results.

183. Critically, like the Dhar survey, the Simonson survey fails to give respondents the option of saying that they would switch their listening to an existing paid subscription in the event they discontinued subscribing to Sirius XM. *See* Simonson WRT Appx. D at 5. SoundExchange claims this decision was justified because Professor Simonson had "already listed seven answer options" and thought it was inappropriate to add more. **SE PFF 658**; 5/11/17 Tr. 3485:17-3486:4 (Simonson). This is truly a non-answer where one of only three options that Professor Willig himself identified as "critical" (Willig WRT ¶ 48) was left off of the list. Indeed, in determining his arbitrarily limited list of seven, Professor Simonson conceded (in response to questioning by Judge Strickler) that he *never even considered* including the option of listening more to an existing service. 5/11/17 Tr. 3491:25-3492:7 (Simonson). It follows from this fundamental omission, no differently than as pertains to the Dhar Survey, that Professor Willig's reliance on the Simonson Survey to corroborate his opportunity cost calculations (Willing WRT ¶ 76) is wholly illegitimate. *See supra* ¶ 176; SXM PFF ¶¶ 383-408.

184. Professor Simonson attempted to parry the fatal thrust of the foregoing shortcoming of his survey by suggesting that a respondent who planned to use an existing subscription should choose the option "none of the above" in responding to Question 250. **SE PFF 659**; 5/11/17 Tr. 3508:5-13 (Simonson). Apart from the fact that including an existing subscription as one of the myriad possibilities encompassed by "none of the above" would not provide sufficient information to enable it to be used in calculating opportunity cost, Question 250 allows respondents to select "as many as apply" of the seven options (Simonson WRT ¶ 60), so "none of the above" would not have been a correct response if the respondent would listen to an existing subscription in addition to at least one of the other possible options. *See* Simonson WRT Appx. D at 5 (Questions 240 & 250).

185. It is clear from the responses to Professor Simonson's survey that the failure to include a complete set of response options led to absurdly unrealistic outcomes. For example:

- Nearly half (46%) of the 322 respondents to the Simonson survey who already had paid subscriptions to both Sirius XM *and* Pandora indicated that they would sign up for a *second* paid Pandora One or Pandora Plus subscription if they could no longer listen to Sirius XM. 5/11/17 Tr. 3511:9-3512:18 (Simonson); Simonson WRT Appx. F at 25.
- Approximately one-third (35%) of survey respondents who already had a paid Pandora One subscription that lets them listen *without commercials* said that if Sirius XM no longer existed, they would replace their Sirius XM listening by listening to free non-interactive streaming music services *with commercials* (like the free version of Pandora) more than they currently do – by inference, instead of listening more to the existing subscription to commercial-free Pandora they were

already paying for, these respondents said they would instead listen more to the free version of Pandora with commercials. Simonson WRT Appx. F at 26; 5/11/17 Tr. 3514:5-22 (Simonson)

186. Professor Simonson's glib, but wholly incredible, response to these anomalous outcomes was to treat them as accurate reflections of predictable consumer behavior. *See, e.g.,* 5/11/17 Tr. 3512:15-18 ("Q. So those are people who already have a Pandora One or a Pandora Plus subscription who told you they would get another one? A. Absolutely, it makes total sense."); 5/11/17 Tr. 3514:23-3515:4 (Simonson) ("Q. Okay. So according to your survey, you have 115 people who have a paid Pandora One subscription, which lets them listen without commercials, and they're telling you that they would replace their Sirius XM subscription with another free subscription that does have commercials? A. Of course."). One need not have academic credentials in survey methodology to recognize a testimonial feint when one hears it.

187. SoundExchange further rationalized that respondents were likely to say that they would pay for an additional subscription if Sirius XM were no longer available because they have a "mental budget" for certain items, including music, and having freed up the money that used to pay for a Sirius XM subscription, consumers were likely to use it to pay for another subscription. **SE PFF 660**. But Professor Simonson admitted that this was sheer speculation on his part. 5/11/17 Tr. 3491:2-8 (Simonson) (in response to questioning by Strickler, J., admitting he had no data). And Professor Simonson further conceded that he made a deliberate decision to remind respondents of their mental budget by adding Question 230 ("Approximately how much do you pay for your Sirius XM subscription in a typical month?"), which reminded them that they now had that money to spend just before asking them what they would do if Sirius XM no longer existed. *Id.* 3499:1-10 (responding to questioning by Judge Feder); *id.* 3502:9-23 ("I

wanted to put them in the mind-set of what they're paying now, which may lead them to want to pay less or to pay more or not to pay at all."). It is not surprising that, having reminded respondents of their mental budget, Professor Simonson believes it may have played a role in their responses. But SoundExchange cannot excuse the failure to provide the option to listen more to an existing paid subscription by simply asserting that "it would be rational for [consumers] to subscribe to another streaming service." **SE PFF 660**.

188. Further absurdities are found in the responses that relate to Professor Simonson's survey questions asked of Pandora subscribers. Approximately one-third (31%) of the 332 respondents who already had paid subscriptions to both Sirius XM *and* Pandora indicated that they would sign up for a *second* paid Sirius XM subscription if they could no longer listen to Pandora One or Pandora Plus. 5/11/17 Tr. 3516:17-3517:9 (Simonson); Simonson WRT Appx. F at 35.[24] In another futile effort at explanation, Professor Simonson suggested that the respondents who were already paying for a Sirius XM subscription would pay for a second subscription to enable other members of their household to listen as well. **SE PFF 662-63**. But as discussed in Sirius XM's proposed findings (SXM PFF ¶¶ 404-05), that post-hoc attempt at justification fails – the question asked the *primary user* of a Sirius XM subscription what *he* would replace a Pandora subscription (of which he was also the *primary user*) with, not how his entire household might respond. 5/11/17 Tr. 3513:4-24 (Simonson); Simonson WRT Appx. D at 2-3 (Questions 90, 120 & 140). As Professor Hauser noted, "While respondents may pursue

[24] Doubling down, Professor Simonson categorically denied any possibility that these respondents were confused or actually thought they were saying they would listen more to their existing Sirius XM subscriptions. 5/11/17 Tr. 3517:5-11 (Simonson) ("Q. Isn't it possible that some of these 104 people actually thought they were just telling you that they would listen more to their existing Sirius XM subscription? A. No, because that was not the answer. Q. Not possible? A. No.").

alternative music services upon cancelling an existing subscription, it seems highly implausible that a respondent would want to add another Sirius XM Select subscription." Hauser WRT ¶ 74.

189. A much more plausible explanation for these bizarre results is provided by Professor Dhar (directed at Mr. Lenski's survey): that without a full set of response options, respondents were "forced to choose one that d[id] not express his or her opinion." *See* Dhar WRT ¶ 16.[25]

G. Professor Willig's Public Interest Pricing Principles Do Not Result in a Meaningful Rate Proposal (*SE PFF § V.K*)

190. Sirius XM's proposed findings thoroughly addressed Professor Willig's public-interest (Ramsey) pricing and Nash bargaining approaches to rate-setting (each of which begins with Professor Willig's $2.55 opportunity cost as a floor and proposes increases from there) and identified the "multiple levels" on which those approaches fail. *See* SXM PFF § IV.D.vi. (¶¶ 416-26).

191. The first such failing identified by Sirius XM was that each approach begins by taking as its rate floor the same flawed monopoly measure of opportunity cost described above, without any examination of whether that rate should be adjusted to reflect the forces of workable competition. By re-labeling the monopoly rates as the "opportunity cost" of licensing Sirius XM, Professor Willig would seek to avoid scrutiny of whether or not those rates are infected by market power. *See* SXM PFF ¶ 419 (citing Farrell WRT ¶¶ 90-94).

192. Second, Professor Willig did not, by his own admission, actually conduct a Ramsey analysis. That is, he did not identify a financial target that would allow for the creation

[25] Paragraphs **SE PFF 667-675** of SoundExchange's proposed findings are addressed in paragraph 151, n.13 above, as well as in SXM PFF ¶ 412 and Shapiro CWRT at 33. Paragraphs **SE PFF 676-687** of SoundExchange's proposed findings are addressed above in paragraph 156 and the sections cross-referenced therein.

of the sound recordings, and he did not attempt to identify all users of the common assets, ascertain their respective price elasticities of demand for music, or set prices to each that collectively would cover the costs to the record industry of creating and licensing their recordings while also maximizing consumer welfare. *See* SXM PFF ¶ 420. Instead, Professor Willig's so-called "Ramsey" approach simply entailed taking the monopoly opportunity cost derived from the Dhar survey and marking it up by the price-cost margin observed in the interactive services market. The result was a number so high ([redacted] per subscriber per month) that Professor Willig himself could not endorse it. Because he did not conduct an actual Ramsey analysis, he was unable to say what the correct figure would be. *See* SXM PFF ¶ 420, 423.

193. Third, Professor Willig failed to demonstrate (or even try to demonstrate) that his public interest pricing approaches satisfied the 801(b) factors. Despite claiming that the efficiency goals of Ramsey pricing were somehow consonant with the aims of 801(b), Professor Willig did not actually conduct a Ramsey pricing analysis. Nor did he attempt separately to ascertain whether existing rates, his proposed rates, or something in between would cover the labels' investments in sound recordings, maximize their availability, or otherwise optimize the 801(b) factors. *See* SXM PFF ¶ 421.

194. SoundExchange's proposed findings fail to respond to these concerns. It begins by reiterating Professor Willig's view that, at a theoretical level, public interest pricing principles (which focus on consumer welfare subject to meeting a revenue target) are "consonant" with the 801(b) factors. **SE PFF 688-92**; *see also* **SE PFF 728**. Whether true or not (Professor Willig's testimony tends to just state the similarity without demonstrating it), the alleged overlap remains a matter of theoretical speculation: as noted above, Professor Willig neither conducted an actual

Ramsey analysis nor separately examined the degree to which his range of proposed rates ($2.55 to $3.94) actually satisfied the 801(b) factors.

195. SoundExchange next addresses (**SE PFF 693-94**) Professor Farrell's contention that in a setting where royalty determinations are set iteratively and revisited every five years, a proposal to set rates *above* the weighted average of rival services "can lead to a Lake Wobegon effect involving an ever-increasing spiral in prices." Farrell WRT ¶ 80. While SoundExchange attempts to respond to that contention, it fails to address a deeper failing: because market-based benchmarks will, as Professor Willig himself attests, already provide for a margin above the rival services' opportunity costs, Professor Willig's further mark-up of his weighted average benchmark opportunity cost is a form of double counting – marking up already marked-up benchmarks. *See* SXM PFF ¶¶ 416-17.

i. Professor Willig's Nash Bargaining Model Posits a Monopoly Seller of Sound Recordings (*SE PFF § V.K.3*)

196. Paragraphs **SE PFF 695-707** describe Professor Willig's derivation of his Nash bargaining model. Sirius XM does not dispute the accuracy of the explanation. It does, however, dispute the fundamental assumptions undergirding his model. As discussed at length above, and in Sirius XM's proposed findings, Professor Willig's Nash model is based, like his other approaches, on the $2.55 opportunity cost of a monopoly seller of sound recordings. In addition to this flawed "floor," Professor Willig's modeled bargain explicitly envisions a single seller of sound recordings negotiating with the music service licensee, a direct result of which is that the model rules out the possibility of competition between record labels, both when setting the "floor" and then again when calculating the markup. *See* SXM PFF ¶ 424.

197. SoundExchange's response to these criticisms is essentially to revert to its prior defense of that industry-wide calculation (**SE PFF 709**), and to suggest that the 50/50 split of the

surplus in the Nash model cures that alleged failing, because a monopolist would extract all of the surplus in a negotiation. **SE PFF 711-12**. That response evades the issue. How the parties split the surplus above and beyond the opportunity cost does not change the fact that the opportunity cost to be covered itself is miscalculated, and that the model fails to allow for multiple sellers of sound recordings who compete against one another.[26] Farrell WRT ¶¶ 81-85.

198. SoundExchange's response to Professor Farrell's Nash-in-Nash model, which demonstrated the impact of introducing only a very limited amount of competition (a second competing label) into the Nash bargaining framework, is that it fails to describe the real world. **SE PFF 713-22**. This defense is remarkable on a number of levels. First, the Judges have found that the "real world," which is dominated by must-have labels who do not substitute for one another, is plagued by complementary oligopoly. *Web IV*, 81 Fed. Reg. at 26332-34. The entire point of the rate-setting exercise is to ascertain how such labels would license Sirius XM (absent a statutory license) under conditions of effective competition, not simply to replicate the real-world or to import the extreme market power found there into the statutory license.

199. Second, SoundExchange's "real world" criticism displays considerable chutzpah coming from a party whose own economist offered an even more simplified model with a monopoly record company seller. If Professor Farrell's Nash model is "useless because it bears no resemblance to the real world" (**SE PFF 713**) Professor Willig's model with a single monopolist seller of all sound recordings hardly fares better.

200. Third, it should be remembered that Professor Farrell has not offered his Nash-in-Nash to generate a rate proposal, but to show how changing certain basic assumptions in

[26] This appears to be a rehash of the argument that $2.55 cannot be the opportunity cost for a monopoly or cartel because such a seller would attempt to extract even more than its opportunity cost. *See* ¶ 143, *supra*.

Professor Willig's model—chiefly an allowance for competition between sellers—dramatically altered the results. That criticism still holds even if one quibbles with how closely Professor Farrell's model reflects the "real world."

201. Fourth, SoundExchange's substantive concern with Professor Farrell's model appears to be that it allows for competition. For example, SoundExchange contends that if Professor Farrell's model relaxed the assumption of symmetrical labels, one would see steering and different prices charged by the labels (given that the model does not contain anti-steering provisions), which in turn would lead to the distributor choosing cheaper but potentially less popular music. **SE PFF 717**. SoundExchange pushes that logic even further, suggesting that Professor Farrell's model fails to reflect an efficient marketplace because it lacks anti-steering commitments, as if such provisions are the sine qua non of competition. **SE PFF 720**

202. The anticompetitive nature of Professor Willig's position—really just a rehash of his view that steering by a music service is an inefficient "danger to be avoided," 5/2/17 Tr. 1964:19-21 (Willig)—was thoroughly exposed at trial. When pressed by the Judges as to whether music services would not pass along the savings of steering to consumers, who would then "vote with their dollars" as to whether they preferred the steering-influenced music mix or that of some other service, Professor Willig "totally agree[d]," *id*. 1973:14-1974:22, but continued to argue that anti-steering provisions were nonetheless to be favored, as they could (if bargained for) potentially reflect the benefits of steering without any actual steering having occurred. *Id.* 1990:1-22.

203. Professor Shapiro properly characterized this as "an argument that competition ….with all its messiness is to be avoided." 5/4/17 Tr. 2543:24-2544:2 (Shapiro). As Professor Shapiro further explained:

> When we have firms competing and price differences open up, customers pick the cheaper products, that may temporarily be inefficient because the higher-priced product may be better in some way, but the whole point of the competitive process then is to put pressure on firms to lower their prices, ultimately to serve consumers. . . . [P]art of the competitive process is a record company discounting its music, the service deciding whether it's worth shifting the music play in order to – and having a cheaper service. And let the services compete on that. So I just think that as all part of the competitive process, and efficiency and consumer benefits will come out of that. And cutting that short with these types of provisions is anticompetitive.

Id. 2544:2-9, 2544:19-2545:3.

204. SoundExchange continues its journey through the anticompetitive looking glass in **SE PFF 718-20**, quoting Professor Willig's complaint that when a service cuts its price in Professor Farrell's model, it "myopic[ally]" fails to recognize that the other labels may do the same, encouraging a destructive "down spiral" in prices. **SE PFF 718**. What Professor Willig calls a "down spiral" others would call price competition. Again, Professor Willig's attack on Professor Farrell seems aimed more at shoring up his own discredited "unilateral alignment" theory, whereby labels collectively refuse to lower their prices (that is, compete), than offering a legitimate attack on Professor Farrell's model.

205. SoundExchange does make a half-hearted attempt to do so in **SE PFF 723**, suggesting that the choice of "functional forms" Professor Farrell used in his model "has a very important set of impacts" on his result. What those impacts are, or how they are incorrect, is left unstated.

ii. Professor Willig Did Not Actually Conduct a Ramsey Pricing Analysis or Propose a Rate Arising from It (*SE PFF § V.K.4*)

206. The first section of SoundExchange's discussion of Professor Willig's Ramsey pricing approach focuses almost exclusively on a rote reiteration of Professor Willig's discussion in his written testimony of historical trends in the record industry and his regression analysis

purporting to show that "streaming" causes an $800 million shortfall in annual download sales. **SE PFF 726-49**. That regression, as discussed previously, has its own problems, chiefly that it fails to identify the promotional or substitutional impact of Sirius XM as opposed to the other "streaming" services with which it is lumped. *See supra* ¶ 100.

207. The bigger problem here, however, is that SoundExchange appears to believe that the $800 million figure is the financial target in Professor Willig's Ramsey analysis. Professor Willig himself flatly conceded that it was not. *See* 5/2/17 Tr. 2086:2-5 (Willig) ("I don't actually use that $800 million to set royalty levels"); *id*. 2167:24-2168:7 (acknowledging as "fair" the statement that the $800 million "doesn't play a direct role in the fees you propose"); *id*. 2169:15-18 (acknowledging that neither his Nash nor Ramsey calculations "actually use the $800 million figure"). Professor Willig also conceded that he did not identify a financial target sufficient to provide for the creation of the sound recordings, or base his "Ramsey" analysis on any financial target whatsoever. *Id.* 2171:21-24 (agreeing he has "not actually identified [a] specific financial target in [his] application of the Ramsey principles"); *id*. 2176:23-2177:2 (acknowledging he's done no analysis of "how much revenue is actually necessary to fund the recording industry's investment in sound recordings"); *id*. 2086:9-12 ("I didn't ask the question: Well, what exactly needs to be the increase in royalty rates for Sirius or for other categories, so as to bring in the extra $800 million?").

208. SoundExchange's papers are simply wrong to suggest that "Professor Willig calculated the financial target by assessing the amount of download sales lost due to the increase in streaming." **SE PFF 735**. They are wrong to say it was "appropriate" for Professor Willig to take the "creator compensation lost as a result of the transition from ownership models to

streaming models as the financial target for Ramsey analysis." **SE PFF 736**. They are wrong to repeat that claim in **SE PFF 742, 753**, and in heading (c) on page 289.

209. That issue aside, SoundExchange does not even attempt to respond to the larger concerns with Professor Willig's "Ramsey" approach expressed above, including that he did not actually complete a Ramsey analysis or identify a proposed royalty rate resulting from his Ramsey approach. *See* 5/2/17 Tr. 2172:7-18 (Willig) (acknowledging he had not "analyzed all the different modes of distribution that use sound recordings and determined the Ramsey prices that would result"); *id*. 2173:19-22 ("I don't put a precise number coming out of a full quantified Ramsey analysis for an answer about the correct royalty for Sirius, that's correct."); *id*. 2179:3-9 (agreeing he had not identified any particular point above $2.55 that it would be appropriate to charge Sirius XM).

210. SoundExchange's only response is that Professor Shapiro was incorrect to attempt to disaggregate the streaming services in Professor Willig's regression in order to isolate the effect of Sirius XM. **SE PFF 750-51**. That debate, already discussed above, is completely irrelevant: even if Professor Willig is right (he is not), the $800 million that flows from his regression played no role in his "Ramsey" analysis.

211. The second half of SoundExchange's Ramsey pricing discussion (**SE PFF 754-843**) focuses on the derivation of the price elasticity of demand for Sirius XM. Once again, the discussion is largely irrelevant. As SoundExchange explains, Professor Willig's "Ramsey" analysis starts with his $2.55 opportunity cost, then uses the observed price-cost margin from the interactive services market to compute the monthly royalty payment ($[redacted]) at which Sirius XM would be paying the same markup. **SE PFF 830**. The implication of Professor Willig's conclusion that Sirius XM has a lower price elasticity of demand for music than the interactive

services is that Sirius XM should pay a rate that *exceeds* $[redacted]. But Professor Willig repeatedly disavowed even $[redacted] as a legitimate Ramsey rate (as SoundExchange itself reports, **SE PFF 831**), rendering the entire elasticity discussion meaningless to SoundExchange's rate proposal.[27]

212. SoundExchange concludes its Ramsey pricing discussion by suggesting that it is acceptable – even preferable – to set the statutory rate above label opportunity costs, suggesting that if that happens to be above competitive levels, labels will simply enter into direct license agreements below the statutory rate. **SE PFF 841-43**. The Judges should reject this cynical ploy. The role of the Judges is to set rates *at*, not *above*, the statutory level. Sirius XM has provided ample factual and economic bases for them to do so. The suggestion that the Judges consider doing otherwise – to knowingly reward SoundExchange with supra-competitive rates – and remit Sirius XM to self-help measures to attain that which Section 114 guarantees them at the outset, would be wholly improper. In all events, Sirius XM is not proposing that the Judges set the statutory rate (or that that labels be "forced" to sell) below the labels' opportunity costs, as long as those costs are properly measured and not at the monopoly-seller rate calculated by Professor Willig. Indeed, as noted above, Sirius XM's proposal here is in fact well *above* the proper measure of the labels' opportunity costs. *See supra* ¶¶ 114-18; *see also* SXM PFF § IV.D.i.

***The Dhar Survey* (*SE PFF § V.K.4.ii.b*)**

213. For reasons noted above, SoundExchange's discussion of Sirius XM's price elasticity of demand is irrelevant to Professor Willig's "Ramsey" approach. Given the prominence of the Dhar Survey in SoundExchange's presentation, however, Sirius XM responds

[27] It is also wrong in certain technical respects detailed by Professors Shapiro and Farrell. *See* Shapiro CWRT at 21-23; Farrell WRT ¶ 93 n.65.

to certain aspects of the pricing questions in Professor Dhar's survey, which Professor Willig used (improperly) to calculate the price elasticity of demand. *See* **SE PFF 757-822**.

1. Professor Dhar's Survey Population is Not Representative

214. The first part of Professor Dhar's survey was his pricing questions. After being shown Professor Dhar's definitions of Satellite Radio, On-Demand music streaming services and Not-On-Demand music streaming services, respondents were asked whether they would continue or cancel their subscriptions to Sirius XM or one of several music streaming services at varying price levels. Dhar CWDT ¶ 13. Respondents who said that they had a Sirius Select subscription were then asked whether they would continue or cancel their Sirius XM subscription at up to seven price points, always beginning with $11.49 and increasing up to $20.49 until the respondent said they would cancel the subscription. *Id.* ¶¶ 56-57. The pricing questions were similar for other services.[28] Professor Dhar claimed that this was a common method of ascertaining respondents' willingness to pay for a product or service. *Id.* ¶ 13.

215. As a threshold matter, the skewed and unrepresentative nature of the "Sirius Select" population from the Dhar survey means that there is no way to know how similar the respondents in Professor Dhar's sample are to the full population of Sirius XM subscribers, so it simply is not proper to draw any statistical inferences based on the responses given by Professor Dhar's unrepresentative population. *See supra* ¶¶ 160-64; 5/8/17 Tr. 2874:16-23 (Dhar).

[28] Respondents who said that they had a free trial subscription were shown the definitions, then asked whether they would be interested in purchasing a subscription at those price points, again always starting with $11.49 and increasing up to $20.49. Dhar CWDT ¶¶61-65. Those who said they had subscriptions to Apple Music, Spotify Premium, or Pandora One were shown the definitions, then asked similar questions about continuing or canceling their subscriptions. Dhar CWDT ¶¶69-80. Finally, respondents who said they used the free version of Spotify or free version of Pandora were not shown the definitions, but were asked about their interest, if any, in purchasing a paid subscription with information about the differences between the free, ad-supported service and the paid service, and then asked if they would purchase a paid subscription at up to three price points, presented in descending order. Dhar CWDT ¶¶83-87.

2. Professor Dhar Biased the Results by Failing to Rotate the Prices

216. Second, as Professor Hauser explained, "Professor Dhar's choice of starting price is not innocuous" because answers tend to be biased towards this initial value and because academic literature has found that this type of question – iterative bidding or bidding games – is subject to a starting-point bias. Hauser WRT ¶¶ 30-33. Professor Hauser testified, and the academic literature supports, that these effects could have been mitigated by rotating the prices (i.e., presenting some highest-to-lowest and some lowest-to-highest). *Id.* ¶¶ 34-35.

217. In response, SoundExchange attacks Professor Hauser's credentials and attempts to distinguish the literature that he cites. *See* **SE PFF 794** (mischaracterizing Professor Hauser's testimony which does not support the proposition that he "does not have training, experience, or accomplishments in consumer behavior and psychology remotely approaching that of Professor Dhar); **SE PFF 794-97**. This attempt fails because, as Professor Hauser explained, "there's a very strong literature on anchoring that goes well beyond" the limited number of articles cited in his written testimony. *See* 5/9/17 Tr. 3028:15- 3030:16. And Professor Dhar conceded in response to questioning by Judge Strickler that the article he used to support his argument that anchoring effects are questionable (Trial Ex. 316) was an example of how an anchoring effect might be weak or nonexistent, rather than having any specific applicability towards his survey. 5/8/17 Tr. 2882:25-2883:12 (Dhar). In addition, as a matter of basic survey methodology, "to control for order effects, the order of the questions and the order of the responses in a survey should be rotated." *See* Hauser WRT ¶ 34 (quoting Shari Diamond, Trial Ex. 279).

218. SoundExchange also misunderstands the burden of proof, arguing that there is no evidence that respondents understated their cancellation price because Professor Hauser did not run a survey to test whether presenting the prices in the same order had an effect. **SE PFF 798**. In order for Professor Willig's use of the survey data as an input to calculate the downstream

elasticities of demand to have validity, SoundExchange was required to show that the survey is reliable. Asserting that there is no evidence that the survey is not reliable on the basis that there is no counter-survey simply avoids coming to grips with the consequential errors that the record demonstrates infect the Dhar Survey's pricing questions. *See* Hauser WRT ¶¶ 30-39. Similarly unavailing is Professor Dhar's contention – without pretesting or other support – that it would have been confusing to present the choices from high to low. **SE PFF 800**.

3. The Dhar Survey Does Not Measure Actual Willingness to Pay

219. While SoundExchange contends that the Dhar survey used a common method of ascertaining respondents' willingness to pay (**SE PFF 758**), it does not actually measure willingness to pay. Professor Dhar testified that "in my survey, you don't really need to know the price you paid for it to tell me today, right now, what price would you continue to subscribe or cancel?" 5/8/17 Tr. 2739:12-23 (Dhar); *id*. 2886:19-2887:4 (confirming that he made the decision not to ask survey respondents what they are paying now).

220. As a result, SoundExchange is left to argue that the survey response is a more reliable indicator of what a person is willing to pay than objective evidence – in the form of what that respondent *is* actually paying. That there is a difference between the two is not a purely theoretical possibility. In the Modified Dhar survey (in which the pricing questions remained unchanged from Professor Dhar's survey), 13% of respondents said that they would cancel their subscription at a price *below* the price they reported they were actually paying. Hauser WRT ¶ 54. These responses are evidence that the various flaws in Professor Dhar's pricing questions result in switching prices that are lower than what they would be in the actual marketplace. *Id.*

4. The Pricing Information from Professor Dhar's Survey is Unreliable Because It Is Not Reproducible

221. Finally, the results of the Dhar survey pricing questions were not reproducible and were therefore unreliable. Hauser WRT ¶¶ 40-50. As Professor Hauser explained, "A requirement of any reliable, scientific study is that it be replicable or reproducible. Results from a study may not be reproducible due to poor study design, inappropriate analysis, insufficient details to replicate the study, or unreliable research practices. Given that Professor Dhar asserts that his survey results are supported with a 'high degree of scientific certainty,' one should be able to reproduce the results of his Pricing Questions." Hauser WRT ¶ 40. The Modified Dhar survey was focused on the switching questions, so Professor Hauser did not change the pricing questions at all; accordingly, the results of the pricing questions in the Modified Dhar survey should have closely matched those of the Dhar survey. Hauser WRT ¶ 45. When they did not, after first confirming with a chi-squared test that the results were significantly different and ruling out other explanations, Professor Hauser ran the Dhar Reproduction survey. 5/9/17 Tr. 3081:14-3083:1 (Hauser). The purpose of the Dhar Reproduction survey was to rule out the possibility that it was the panel or differences in demographics that explained the different results from the pricing questions. Because of time constraints, the Dhar Reproduction survey had a smaller sample size and did not ask the switching questions, but it used the same panel and matched the demographics completely to the Dhar survey. 5/9/17 Tr. 3088:1-3089:1; 3092:9-25 (Hauser). The responses to the pricing questions in the Dhar Reproduction were significantly different from both the Dhar survey and the Modified Dhar survey. *Id.* 3095:16-24 (Hauser); Hauser WRT ¶ 51. The empirical finding that the responses on the pricing questions in the Dhar survey, the Modified Dhar survey, and the Dhar Reproduction survey are all significantly different from one another provides strong evidence that Professor Dhar's pricing questions are

not reproducible and that the Dhar survey therefore has serious flaws that render it unreliable. Hauser WRT ¶ 50.

222. In the face of these three separate sets of results, SoundExchange argues that Professor Hauser cannot conclude that the results of the Dhar pricing questions are not replicable unless and until he has made 35 or 36 attempts to replicate it. **SE PFF 815-17**. Again misunderstanding the burden of proof, SoundExchange also contends that, in the absence of 35 or 36 attempts to replicate it, there is no reason to give any less weight to Professor Dhar's survey. **SE PFF 818**. That is plainly incorrect. The Dhar Survey must stand on its own merits. When so tested, it fails for the numerous reasons elicited at trial.

223. Professor Dhar makes a final effort to save his survey by criticizing a screening question Professor Hauser added – in an attempt to ensure that his survey population did not include anyone who had taken Professor Dhar's survey or Mr. Boedeker's survey, he eliminated anyone who had taken any music or radio survey in the six months preceding his survey. Hauser WRT ¶ 41 n.44; 5/8/17 Tr. 2874:24-2875:5 (Dhar). According to Professor Dhar, this could be outcome determinative. 5/8/17 Tr. 2875:15-23 (Dhar) (the results of his survey could have depended on whether or not people who had taken a music survey in the last six months were eligible to take his survey). Without any evidentiary basis whatsoever, Professor Dhar speculated that these people might have been interested in music, and "might be different in terms of their responses." 5/8/17 Tr. 2875:24-2876:15 (Dhar). Professor Hauser explained that respondents generally do not know what kind of survey they are taking, so there is no reason to believe that people who have taken a survey about radio or music are more likely to be music listeners or music lovers. 5/9/17 Tr. 3077:20-3078:15 (Hauser). Moreover, as Professor Hauser pointed out, "if Professor Dhar wants to maintain that anybody who has taken a music survey is

going to be different than the general population, then the fact that they took his music survey in self-selection would make his survey biased. So it's sort of you just can't have it both ways." 5/9/17 Tr. 3081:3-12 (Hauser).

III. THE DIRECT LICENSES BETWEEN SIRIUS XM AND INDEPENDENT RECORD LABELS ARE AN INFORMATIVE BENCHMARK *(SE PFF § VII)*

224. In Section VII of its proposed findings, SoundExchange spends some 139 pages attempting to demonstrate that the direct licenses entered into between Sirius XM and numerous independent record labels do not constitute a reliable benchmark. **SE PFF 885-1212.** For all of its length, this section establishes, at most, that Sirius XM pitched to certain independent labels that they could benefit financially from signing a direct license at a rate lower than the statutory rate for a number of reasons other than steering, and that some labels likely signed the direct licenses in part to take advantage of these additional benefits. Contrary to the conclusion SoundExchange would have the Judges draw, the undisputed fact that steering was not the *exclusive* benefit offered by the direct licenses does not render them uninformative as to competitive rates in the target market. The weight of the record evidence demonstrates that many, if not most, of the direct licensors offered Sirius XM reduced rates from the prevailing statutory rates *with the expectation that Sirius XM might increase its plays of their music*. As Professor Shapiro explained, in such circumstances, the bargained-for direct license rates would be "indicative or suggestive" of "what a competitive rate would look like." 4/20/17 Tr. 270:11-25 (Shapiro); *see also id.* 283:7-24 (testifying that if the prospect of additional plays was a real benefit to the independents then the rates would be "quite informative" as to competitive market rates).

225. As discussed in Sirius XM's proposed findings, *see* SXM PFF ¶¶ 136-59, there is ample record evidence that Sirius XM's offer of greater access to programmers induced record

companies to sign direct license agreements at lower rates because they reasonably believed they would receive more plays as a result of such access. By way of example, in Sirius XM's negotiations with music distributor [redacted], direct access to programmers was central not only to the pitch that Sirius XM made to [redacted] but also to the pitch [redacted] then made [redacted] in encouraging them to sign onto the license. At one point, [redacted] Trial Ex. 186* (SXM_DIR_00043460 at 00043484); *see also generally* SXM PFF ¶¶ 136-59.

226. The length of SoundExchange's Section VII reflects an effort to obscure the evidence that actually matters (*i.e.*, the evidence of steering), including prolix citations to the highly selective testimony of Professor Lys and his mind-reading factual pronouncements as to what must have motivated direct licensors to sign those agreements. *See* **SE PFF 885-1212**. In the face of hard evidence contradicting his assertions, the Judges should decline to credit Professor Lys's unfounded factual assertions, whatever putative qualifications as "an expert in negotiations" he may be claimed to possess. **SE PFF 28.**

227. SoundExchange's reliance on Professor Lys's written testimony is also vulnerable for failing fully to account for the attacks on both his methodology and opinions made at his deposition, when he was cross-examined at trial, and in a pending *in limine* motion. *See* Motion by Sirius XM to Strike Improper Written Rebuttal Testimony of Thomas Lys, dated April 14, 2017. SoundExchange acknowledges that cross-examination revealed critical portions of Professor Lys's written testimony to be "inconsistent," "imperfect," and, euphemistically, not the "best possible summary" of the evidence, **SE PFF 1018**; **SE PFF 1019**; **SE PFF 1022**, yet it

appears to believe these concessions inoculate Professor Lys's work from criticism and justify presenting it as if it were free of its conceded inadequacies. They do not. Nor can the flaws in his testimony be masked by SoundExchange's attempt to bury the compelling evidence of steering, or by repeated and plainly inappropriate citations to (and even quotations from) documents not admitted into evidence or admitted only for a limited purpose. *See infra* § X.

228. Although Sirius XM fully addressed the reliability of the direct licenses as benchmarks in its proposed findings, *see* SXM PFF ¶¶ 137-88, certain of SoundExchange's mischaracterizations of the record on this issue warrant clarification and/or correction.

A. SoundExchange Argues Incorrectly That Because the Direct License Rates Track the Statutory Rate, They Cannot Be Viewed as Market Rates (*SE PFF § VII.A*)

229. In Section VII.A of its proposed findings, SoundExchange summarizes the opinions of Professor Lys to the effect that because the direct license rates (albeit lower than the statutory rates) have tracked the statutory license rates over time, the direct license rates cannot be viewed as market rates. *See* **SE PFF 897-914**. As Sirius XM explained in its proposed findings, this contention is wrong as a matter of basic economics. S*ee* SXM PFF ¶¶ 164-69.

230. There is no dispute that the direct license rates have tracked the statutory rate. As Professor Shapiro explained, however, the fact that the two are linked is "*completely unhelpful* regarding the key question: whether the rates in the direct licenses are informative regarding what Professor Lys calls the 'market value of the royalty rights.'" Shapiro CWRT at 40 (emphasis in original). If, as Professor Shapiro testified, the true competitive rate exceeded the statutory rate, there would be no incentive for the label to accept the discounted direct license rate. 4/20/17 Tr. 481:15-482:18 (Shapiro). If, on the other hand, direct license rates are below the statutory rate, and if steering is a "meaningful motivation for labels to enter into direct licenses with Sirius XM," then the direct license rate *does* reflect the forces of competition at

work. Shapiro WDT at 45; 4/20/17 Tr. 447:6-11 (Shapiro). In the latter case, "the reason direct license rates have been creeping up over the last few years is because the *statutory* rate has been increasing, *not* because the workably competitive rate has been rising." Shapiro WDT at 45 (emphasis in original).

231. In its effort to attack the probative value of the direct licenses on the basis of the "shadow" cast by the statutory license, SoundExchange argues that in *Web IV* the Judges rejected Professor Shapiro's explanation of the "magnet" effect that causes the statutory rate to pull the rates in Sirius XM's direct licenses up above the workably competitive level. *See* **SE PFF 907-09**. As an initial matter, Professor Shapiro has pointed out the limited evidence that the Judges had available on this point in the *Web IV* proceeding, most notably the absence of the sort of rigorous economic analysis of this issue that appears in Appendix E to his written direct testimony here. *See* Shapiro WDT at 44-45; Appx. E. Further, SoundExchange mixes analytic apples and oranges. Even if such a magnet or "shadow" effect causes the direct license rates to *overstate* the true competitive market level, that does not necessitate the conclusion that, as SoundExchange erroneously contends, those negotiated direct licenses are not indicative or informative of competitive market levels. *See* **SE PFF 914**. On this score, the Judges, in a portion of their *Web IV* opinion that SoundExchange ignores, squarely rejected any such notion, with its broad implications for benchmarking generally:

> [T]he presence of the so-called statutory shadow appears to reflect a trade-off and a second-best solution, rather than a distortion of an effectively competitive marketplace. . . . [T]he Judges emphasize that they find the ''shadow'' criticism to be both nihilistic and self-contradictory. If the ''shadow'' infects all benchmarks so as to disqualify that method of ratesetting, then the parties would need to adjust or abandon their benchmarking strategies and develop new bases for analysis. That could mean the wholesale abandonment of benchmarking, to be replaced by a valuation approach yet to be applied and accepted in these proceedings.

Web IV, 81 Fed. Reg. at 26331.

232. SoundExchange also mischaracterizes Professor Shapiro's Appendix E itself in numerous respects. *See* **SE PFF 909–11**. For example, the suggestion that Appendix E assumes that the statutory rate is set above the competitive rate is wrong, as Professor Shapiro repeatedly made clear, including on cross-examination:

> Q. Now, that model assumes that the statutory rate is above a competitive market right, correct?
>
> A. It assumes that we observe a -- it is addressing the question of when we observe a direct license at a rate below the statutory rate. That's what it does. It is not making any assumptions -- I don't think it is making the assumption you just described, if I am following you correctly.

4/20/17 Tr. 480:2-10 (Shapiro). SoundExchange simply ignores this testimony.

233. SoundExchange's related contention that direct licensors would somehow desire to have their music "understeered" in the circumstance where statutory rates were below the true market rate makes no economic sense, let alone refutes anything in Appendix E. As Professor Shapiro testified, if the statutory rate were below the competitive rate, there would be no direct licenses. 4/20/17 Tr. 482:8-16 (Shapiro) ("You wouldn't see a record company discounting below the statutory rate if they would set a higher rate without the statute.").

234. Similarly, in Section VII.J of its proposed findings, SoundExchange contends that the supposed absence of evidence of actual steering by Sirius XM towards direct licensors shows that the statutory rate must be above the true, competitive rate. *See* **SE PFF 1208-12**. As Sirius XM discussed in detail in its proposed findings (*see* SXM PFF ¶¶ 142-59) and further in Section

III.D, *infra*, SoundExchange's premise is contradicted by the record evidence, which establishes that steering has in fact played a material role in the rates found in the direct licenses.[29]

B. SoundExchange's Claim That This Litigation Drove Sirius XM To Sign Direct Licenses Lacks Evidentiary and Economic Support (*SE PFF § VII.B*)

235. In Section VII.B of its proposed findings, SoundExchange speculates that Sirius XM entered into direct licenses for the sole purpose of citing them as a benchmark in this proceeding, suggesting that fact undermines their value as benchmarks. *See* **SE PFF 915-20**. The record and economic logic suggest otherwise.

236. First, unrebutted testimony from senior Sirius XM executives over two separate SDARS proceedings sets forth the legitimate business reasons Sirius XM has engaged aggressively in direct licensing—most notably to contain its music license costs. *See* 5/17/17 Tr. 4218:20-4219:9 (White); *SDARS II*, 78 Fed. Reg. at 23061-62.

237. Regardless, even if Sirius XM had sought the rate-setting benefit of any direct licenses it was able to negotiate, that would hardly disqualify them as benchmarks. Whatever Sirius XM's motivations, no record company was forced to enter into a direct license with Sirius XM, and none would have an interest simply in handing Sirius XM a benchmark to use before the Judges. (Indeed, as we discuss below, that possibility *dissuaded* a number of potential direct licensors from doing deals with Sirius XM.) If a record company entered into a direct license with Sirius XM, surely it did so because it found the deal (including any steering inducements) to be in its economic interest; and if so, its willingness to do so would constitute *highly probative evidence of competitive market rates* warranting close review by the Judges, not a reason to

[29] We discuss in Section V.C, *infra*, SoundExchange's flawed argument, from Professor Lys's testimony, that one way to discern the "true market rate" today is to accept the "upper boundary" of *SDARS I* (13%) and then correct that for inflation, resulting in a present-day royalty rate above 15%. *See* **SE PFF 912-14**.

ignore them, as SoundExchange suggests. Indeed, Section 114(f)(1)(B) reinforces the appropriateness of considering such direct license evidence without regard to whether one or both parties to such agreements viewed them as favorable or unfavorable in terms of future CRB precedent. *See* SXM PCL ¶¶ 78-81.

238. SoundExchange's attempt to impugn the direct licenses as a product of "litigation motives" (**SE PFF 915-20**) is especially ironic given the record evidence of the Majors' effort to discourage direct licensing due to concern with setting "bad precedent." For example, Sony executive Jeff Walker, [redacted], wrote in his rebuttal testimony: "It is no secret that Sirius XM has in past rate-setting proceedings used direct licenses as part of its litigation strategy to lower rates, and it did not require a crystal ball to predict that Sirius XM would do so again." SXM PFF ¶ 171 (quoting Walker WRT ¶ 10). This major-label testimony was echoed by [redacted], who informed Sirius XM that they would not enter into direct licenses because they feared creating negative precedent and, in the case of [redacted] having a direct license used in this proceeding as the Merlin agreement was used in *Web IV*. *See* 5/17/17 Tr. 4253:3-4254:11, 4255:22-4257:25 (White) (discussing labels' decision to forego direct license opportunity due to fear of creating negative precedent); White WDT ¶ 30 (same). That other independent record labels forged ahead with direct licenses with Sirius XM in the face of such industry pressure makes them *more* probative for the Judges, not less.

C. <u>SoundExchange Fails To Acknowledge That Its Own Expert Withdrew His Contention That the Percentage of the Market Represented by Direct Licenses Is Too Small to be Representative (*SE PFF § VII.C*)</u>

239. In Section VII.C, SoundExchange labors for more than ten pages to revive an argument its own expert withdrew at the trial: that the percentage of the market represented by

direct licenses is too small to be representative. *See* **SE PFF 921-42**. Professor Lys conceded on cross-examination that he no longer held that view, which should take this argument off the table. 5/1/17 Tr. 1660:3-13 (Lys) ("Q. Professor Lys, it's your opinion that the percentage of overall plays that the direct licenses make up is too small to be a representative sample what the market rate is, right? A. No, I don't think so. . . . I don't think that's a part of my criticism.").

240. Professor Lys was right to withdraw the argument. *See* SXM PFF ¶¶ 170-71. In pressing this line of argument, SoundExchange mischaracterizes Professor Shapiro's trial testimony. *See* **SE PFF 931**. SoundExchange states that Professor Shapiro "conceded at trial that, '[a]s Sound Exchange has – has pointed out, many of the labels that have signed up . . . are very small, okay? Let's put it out there. That's a fact.'" (citing 4/20/17 Tr. 273:14-19) (Shapiro)). The untruncated question and answer shows that Professor Shapiro was simply describing why the percentage of overall plays is more meaningful than the raw number of direct license agreements:

> Q. How much – how much significance do you give to the sheer weight of the numbers as opposed to or in connection with the percentage coverage?
>
> A. I give much more weight to the percentage coverage. As SoundExchange has – has pointed out, many of the labels that have signed up – it's now up to around 500 as of the time this report was prepared, which was last fall. Many of those are very small, okay? Let's just put it out there. That's a fact. And so I think the percentage coverage is more meaningful economically than the number. And I've reported both.

4/20/17 Tr. 273:10-22 (Shapiro). In other words, Professor Shapiro was not conceding that the direct licenses are too insignificant to be probative; he was instead explaining that the number of plays associated with direct licenses is a better measure of their significance than the number of licenses.

D. SoundExchange Mischaracterizes Professor Shapiro's Model Relating to Steering and Ignores Evidence That Perceived Steering Benefits Were a Material Factor Motivating Direct Licenses (*SE PFF §§ VII.D-H*)

241. SoundExchange next attempts, repetitively, to rebut Sirius XM's arguments and evidence regarding steering by Sirius XM. *See* SE PFF §§ VII.D (**SE PFF 943-53**), VII.E (**SE PFF 954-56**); VII.F (**SE PFF 957-66**), VII.G (**SE PFF 967-77**), and VII.H (**SE PFF 978-1011**). SoundExchange's arguments have no merit.

242. SoundExchange starts by again misstating Professor Shapiro's methodology, asserting that he "presupposes that there is one and only one benefit to a label that signs a direct license at a royalty rate lower than the statutory rate . . . 'steering.'" **SE PFF 943** (citing Trial Ex. 8, Appx. E at E-1 (Shapiro WDT)). As noted above, Professor Shapiro's Appendix E makes no such assumption. He explained this in his written direct testimony:

> In Appendix E, I analyze in detail the relationship between the direct license rates and the statutory rates. More specifically, I study the rate that Sirius XM and a record company will negotiate in a direct license with steering, where both sides recognize that in the absence of a direct license, Sirius XM will pay the statutory rate . . . . As demonstrated in Appendix E, *if steering is a meaningful motivation for labels to enter into direct licenses with Sirius XM*, then the reason direct license rates have been creeping up over the last few years is because the *statutory* rate has been increasing, *not* because the workably competitive rate has been rising.

Shapiro WDT at 44-45 (initial emphasis added).

243. The balance of Professor Shapiro's testimony could not be clearer that he did not treat steering as the sole basis for the direct licenses. For instance, he acknowledged that "[i]n the end, I agree with Professor Lys that *some* of the labels that signed direct licenses likely did so in significant part because they anticipated that they would benefit from the different compensation methodology used in the direct licenses compared to the statutory license." Shapiro CWRT at 45-46. Similarly, Professor Shapiro testified at trial that he did *not* assume

labels were motivated *only* by steering. 4/20/17 Tr. 289:23-290:10 (Shapiro) ("So this creates – for a given label, there can be a reason to sign a direct license having nothing to do with steering, simply because the direct license indexing methodology favors them, and that can be quite significant.").

244. SoundExchange's distortion of Professor Shapiro's testimony continues at **SE PFF 967-77**, where it asserts erroneously that he was forced to concede that he had no basis to challenge Professor Lys's contention that there is no credible evidence of steering in this proceeding. **SE PFF 977**.[30] Professor Shapiro made no such concession. He did concede that he did not delve into hundreds of negotiation files or records detailing the pitches Sirius XM made to various labels, but he most certainly did not concede a complete absence of such evidence of steering. To the contrary, he identified specific examples of such evidence. *See, e.g.*, 4/20/17 Tr. 294:3-296:1 (Shapiro) (describing his conversations with Messrs. White and Blatter from Sirius XM); *id.* 296:2-299:2 (Shapiro) (describing Concord executive Mr. Barros's testimony regarding steering). Beyond citing the testimony of the actual participants in the direct license negotiations, Professor Shapiro also made a number of observations as an economist that support the conclusion that perceived steering benefits played a role in many of the direct license transactions. *See* Shapiro CWRT 39-40 & Appx. E. The first of these involved Professor Lys's spurious conclusion that the "over-indexing" phenomenon (i.e., higher performance counts on the internet reference channels) was a principal motivation for labels to sign direct licenses, and that steering therefore must have played no role at all in inducing the lower prices observed in

[30] In Section VII.G, SoundExchange argues also that Professor Lys demonstrated there was no evidence of steering based on his review of the materials purportedly reflecting negotiations between Sirius XM and the independent labels. *See* **SE PFF 967-77**. For a full response addressing all of the demonstrable flaws in Professor Lys's analyses, *see* SXM PFF ¶¶ 160-88, and Section III.E, *infra*.

the direct licenses, *see, e.g.*, **SE PFF 1122**. Professor Shapiro demonstrated that Professor Lys confined his analysis to only one side of the relevant factual equation (the over-indexers), while ignoring the fact that [redacted] "*under*-indexed" in terms of internet performances, *i.e.*, were *disadvantaged* by the payment methodology used for the direct license. As to this group, Professor Shapiro concluded that "it is reasonable to believe that at least some of them viewed this as a cost of signing a direct license." Shapiro CWRT at 45. "For this group of labels," he reasoned, "the under-indexing suggests more strongly that the prospect that Sirius XM would play their music more was a meaningful factor in their decision to sign a license with Sirius XM." *Id.* Indeed, this is the conclusion of Professor Lys's own logic: if one were to conclude that those who ended up benefiting from the over-indexing must have been motivated by that beneficial outcome *ex ante*, then one must also conclude that those who turned out to be *hurt* by the outcome must have been motivated to enter the agreement by other factors, like steering. As Professor Shapiro explained, "[F]or the labels that are under-indexed, they're actually disadvantaged by the direct license . . . if there's no change in . . . how much Sirius XM plays their music. So there's a stronger inference, other things equal, that the prospect of greater plays [was] a lure to signing the license to overcome the under-indexing problem." 4/20/17 Tr. 291:7-14 (Shapiro).

245. Professor Lys's skewed analysis of the implications of over- and under-indexing was further invalidated by Professor Shapiro's examination of that phenomenon across all direct licensing labels. Directly countering Professor Lys's exaggerated portrayal of over-indexing as near-definitive proof of a lack of steering incentive amongst direct licensors, Professor Shapiro showed that "according to Professor Lys's own data and analysis, the total royalties accrued by the labels signing direct licenses were [redacted] than what those labels would have received

had they opted for the statutory rate." Shapiro CWRT at 45. In other words, the direct licensors *under*-indexed on average rather than over-indexing. Mr. White's testimony underscores this point: Sirius XM conducted a comprehensive analysis of the potential impact of indexing for only 31 prospective direct licensors out of the hundreds they engaged, and only nine of those 31 labels ultimately signed a direct license. *See* 5/17/07 Tr. 4235:25-4236:21 (White).

246. The best SoundExchange can come up with in response are "conversations Professor Lys had with executives from indies" in which "those executives consistently described over-indexing as a focal point of Sirius XM's pitch to sign a direct license." **SE PFF 1105**. Those six conversations, of which there is no written record, reflect a tiny fraction of the more than 500 direct licenses. What is more, in those conversations, Professor Lys failed, apparently deliberately, even to ask the most pertinent question: whether steering, or the perceived ability to steer, played any role in those six licensors' decision to enter into a direct license. 5/1/17 Tr. 1669:25-1670:13; 1671:10-20 (Lys). And the six is really five: Professor Lys's report of his conversation with one of the executives, from [redacted] is directly contradicted by other, more probative record evidence. *See* SXM PFF ¶ 161.

247. Over-indexing aside, no more credible is SoundExchange's effort to read steering out of the picture by means of a highly selective view of the documentary and testimonial evidence as to what other factors motivated the parties to enter into direct licenses. *See generally* SE PFF §§ VII.F and VII.H. SoundExchange proclaims baselessly that Sirius XM has produced "no credible evidence that independent labels signed direct licenses because of 'steering.'" *See* SE PFF § VII.F (heading). This categorical dismissal of ***all*** of the steering evidence is refuted by (i) the testimony of SoundExchange's only witness on direct licensing; (ii) the unimpeached testimony of the Sirius XM witnesses most directly involved in the direct licensing effort of the

company; and (iii) the balanced testimony of Professor Shapiro based upon the full record concerning direct licensing.

248. Most notably, the only direct-licensor witness SoundExchange called at trial (and secured written testimony from), Concord Music Group CEO Glen Barros, testified that steering did, in fact, play a role in its decision to sign the license. *See* Barros WRT ¶¶ 7-8 (quoting White WDT ¶ 28). SoundExchange emphasizes Mr. Barros's claim that other factors played a more significant role in Concord's decision, but even if that were the case, Mr. Barros affirmatively attested that he was motivated, at least in part, to attain "greater access to and attention from [Sirius XM's] programming staff [that] would ultimately lead to increases in plays and therefore royalties." Barros WRT ¶¶ 7-8 (quoting White WDT ¶ 28); *see also* 5/16/17 Tr. 4143:17-4144:2 (Barros) (Concord "certainly hoped we would have a stronger, deeper relationship that would ultimately yield more plays and better interaction"). This testimony comports with that of Mr. White, who negotiated the Concord direct license with Mr. Barros and who testified that "we discussed ways that we might go about increasing Concord's plays so that their royalty earnings would continue to grow under a direct license." Tr. 5/17/17 4232:1-10 (White); *accord* White WDT ¶ 28.

249. SoundExchange urges the Judges to disregard that evidence on the ground that, unlike the type of steering at issue in *Web IV*, Sirius XM's offers of greater access to its programming staff did not "bind" Sirius XM to play more of Concord's or the other independent label's music. *See generally* **SE PFF 978-82**. As Sirius XM has discussed previously (SXM PFF ¶ 157), the relevant inquiry is not whether Sirius XM "promise[s] or guarantee[s] direct licensors a particular level of plays," **SE PFF 982** (quoting Trial Ex. 306), or the extent to which Sirius XM *has in fact* steered to a direct-licensing label in the wake of an agreement; it is

whether direct licensors, at the time they entered into their licenses, cut their price *with the belief that they were thereby gaining greater access to programmers and providing an incentive to Sirius XM to play their music more*. Indeed, as Professor Shapiro testified, in a workably competitive market, one may observe that "relatively little steering actually takes place, yet aggregators with the capability to steer will still pay lower prices." Shapiro WDT at 21.

250. SoundExchange dismisses such assurances of programmer access and potentially increased plays as nothing more than "cheap talk," **SE PFF 990** (quoting Professor Lys (5/1/17 Tr. 1683:19-23) (Lys)), citing examples of labels complaining they did not receive more plays after signing a direct license. *See* **SE PFF 992-93**. But isolated examples of direct licensors unhappy with their experience under the license does not speak to what these direct licensors valued when they agreed to accept lower royalty rates. Indeed, such complaints reinforce Sirius XM's argument, because if a label complained that it did not receive more plays after signing the direct license, it is reasonable to conclude that the label signed the deal with the expectation that it *would* lead to increased plays.

251. SoundExchange also dismisses Mr. White's testimony describing his conversations with direct licensors on this point on the ground that such testimony "consisted entirely of unsupported and unverified hearsay." **SE PFF 964**. This effort to blunt the force of such testimony disregards the parties' agreement to waive hearsay objections as to testifying fact witnesses.[31] It is also hypocritical, to say the least, for SoundExchange to challenge as hearsay Mr. White's testimony concerning conversations in which he personally participated while itself relying on Professor Lys's hearsay-strewn testimony regarding, *inter alia*, undocumented phone

[31] *See* Declaration of Randi W. Singer, filed June 29, 2017, Ex. A (May 10, 2017 agreement between SoundExchange, Sirius XM, and Music Choice regarding objections to fact witness testimony).

conversations with an unrepresentative group of direct licensors regarding past negotiations in which Professor Lys played no personal role. *See* **SE PFF 963** ("Professor Lys supported Mr. Barros's testimony, noting that he had conveyed similar motivations during a telephone interview. . ."). As between the testimonial weight to be afforded Professor Lys's undocumented conversations with a smattering of label representatives, all of which occurred after the direct licenses were executed, and Mr. White's account of years of *his own* contemporaneous conversations with hundreds of labels, there would seem to be no contest.

252. Finally, SoundExchange mischaracterizes the record by contending that Mr. Blatter's programming team's decisions to play tracks were never impacted by whether the tracks were licensed by a label that had signed a direct license. *See* **SE PFF 995**. This assertion ignores Mr. Blatter's unchallenged testimony that his team *did* in fact play certain labels' tracks because of the label's status as a direct licensor. *See, e.g.*, 5/10/17 Tr. 3363:11-3364:4 (Blatter) (discussing featuring Andy Grammer's single "Honey I'm Good" despite it being "quirky and maybe not all that mainstream-sounding for a pop channel" because Grammer's label, S-Curve Records, is a direct licensor); *see also* 5/10/17 Tr. 3365:1-11 (Blatter); 5/17/17 Tr. 4230:18-4231:11, 4233:17-4234:11 (White). As Mr. Blatter explained, Sirius XM's programming policy is that where there are several tracks that a programmer determines are appropriate to include in a playlist, the directly licensed track gets preference (or, as Judge Strickler put it, the "tie goes to the direct license"). 5/10/17 Tr. 3362:15-3363:9 (Blatter). The only reason to favor the direct licensor in that instance is because its tracks have been licensed for performance at a lower rate.

E. Professor Lys's Portrayal of the Reasons Labels Signed Direct Licenses Is Concededly Unreliable and In Any Event, Largely Irrelevant (*SE PFF § VII.I*)

253. In Section VII.I of its proposed findings, SoundExchange consumes some 85 pages essentially repeating Professor Lys's written testimony to drive home a fact that is not in

dispute: Sirius XM pitched to record labels that they could benefit from a direct license for a variety of reasons, including collecting both the artist and label share (which they would distribute per the terms of their artist agreements), the internet reference channel payment methodology, cash advances, and saving on the administrative fee. Because Sirius XM has already explained how the evidence demonstrates that the direct license rates serve as an informative benchmark regardless of whether Sirius XM pitched potential benefits other than steering, *see* SXM PFF ¶¶ 142-88, the Judges should not be diverted by the lengthy recitation in Section VII.I. Rather than responding point-by-point to this section of SoundExchange's proposed findings, Sirius XM instead directs the Judges to Professor Shapiro's written rebuttal testimony and to its proposed findings. *See* Shapiro CWRT at 39-49; SXM PFF ¶¶ 142-88.[32]

254. SoundExchange's summary of Professor Lys's written testimony should not be adopted as findings of fact for at least two additional reasons. *First*, a majority of the documents cited in this section were not admitted for their truth but rather on the limited basis that Professor Lys relied on them in forming his opinions. *See, e.g.*, Trial Ex. 164* (cited by SoundExchange at **SE PFF 1035**, **SE PFF 1046**, and **SE PFF 1052** but not admitted for its truth; *see* 4/27/2017 Tr. 1483:18-1484:16). For this reason alone, portions of this section are improper and not entitled to any weight. *See generally infra* Section X.

255. *Second*, as noted above, SoundExchange acknowledges that cross-examination revealed numerous flaws in Professor Lys's written testimony, yet it asks the Judges to adopt Professor Lys's written testimony as if its conceded flaws did not exist. Specifically, Professor

[32] For a full discussion on SoundExchange's administrative fee and a response to **SE PFF 1042-50**, *see* SXM PFF ¶¶ 162, 180. For a full discussion on artist share and a response to **SE PFF 1054-78**, *see* SXM PFF ¶¶ 176-80. For a full discussion on indexing and a response to **SE PFF 1079-1123**, *see* SXM PFF ¶¶ 172-175. For a full discussion on *post*-72 recordings and a response to **SE PFF 1124-67**, *see* SXM PFF ¶¶ 183-86. For a full discussion on advances and a response to **SE PFF 1168-81**, *see* SXM PFF ¶¶ 181-82.

Lys reproduced in chart form the fruits of his and his team's investigation as to the pitches Sirius XM made to the "top 30" direct licensors and the purported motivations leading those licensors to sign the agreements. *See* **SE PFF 1014**. This chart anchored hours of Professor Lys's direct testimony at trial and was the subject of extensive questioning by both the Judges and Sirius XM's trial counsel. SoundExchange now acknowledges that Professor Lys's chart:

- "is ***inconsistent*** in its use of the word 'pitched,'" **SE PFF 1018** (emphasis added); and
- "is also ***imperfect*** in its presentation of 'motivations,'" **SE PFF 1019** (emphasis added).

256. In other words, SoundExchange admits that on the core substantive issues described in the chart, Professor Lys's conclusions are unreliable. SoundExchange nevertheless argues that "[r]egardless of whether Professor Lys's chart is the best possible summary of his findings, his underlying point is both clear and unrebutted." **SE PFF 1022**. That is demonstrably not the case. Cross-examination of Professor Lys revealed the flaws in his testimony to be far more significant than adjectives like "inconsistent" or "imperfect" suggest. He admitted, for example, that he "saw a substantial amount of evidence in the record . . . that Sirius XM pitched to the independent labels greater access to programmers," 5/1/17 Tr. 1650:1-5 (Lys), but he did not credit those pitches at all and omitted them from his summary chart. *Id.* 1649:12-17 (Lys).

257. Professor Lys's "inconsistencies" and "imperfections" render his chart useless; his conclusions about what motivated the direct licensors simply were not grounded in a fair reading of the record evidence. Tellingly, in his hundreds of pages of written testimony and six-plus hours of direct testimony, Professor Lys failed to address the only written testimony offered in this case from a direct licensor, that of Mr. Barros. Mr. Barros's testimony and the pitches Professor Lys saw but did not see fit to credit expose the fact that he did not fairly summarize the

evidence of what may have motivated the direct licensors to sign the agreements. *Accord* 4/27/17 Tr. 1625:15-1626:2; 1633:6-23 (Lys) (testifying that he concluded [redacted] sole "motivations" for signing the license were "pitched on indexing" and "artist share," even though he was forced to concede he ignored documentary evidence demonstrating "Sony's business strategy was inconsistent with [redacted] signing a direct license"). In short, while Professor Lys claimed to have looked under every evidentiary rock, he recorded and testified as to only fragments of what was there to be unearthed.

258. The distortive effect of Professor Lys's selective culling of the record evidence was exacerbated by his unfounded interpretive spins on the limited evidence he chose to address. For example, in Section VII.I.3 of its proposed findings, SoundExchange spends twenty-five pages describing Professor Lys's conclusion that over-indexing motivated certain direct licensors to sign the deals. *See* **SE PFF 1079-1123**. But the basis for this conclusion is not any actual testimony from a label, but merely the inference drawn by Professor Lys from his/his team's review of numerous pitches in which Sirius XM told certain labels that they potentially could make more money for the same plays given their over-indexing. Professor Lys cites no evidence – nor does SoundExchange – demonstrating that this one element of a limited number of identified pitches, to the exclusion of other motivating factors, drove any label's decision to sign the deal. Professor Lys also cites the fact that "[i]ndies like [redacted] have succeeded in over-indexing" as support for the supposed causal link between the pitches and the labels' decisions to sign direct licenses. *See, e.g.*, **SE PFF 1105**. Professor Lys thereby attributes an outcome determined *ex post* as motivating the label *ex ante*. That is not only rank speculation rather than actual evidence, but supportive of the view, as described above, that those labels who *under*-indexed must have been motivated by the potential benefits of steering by Sirius XM.

259. On that point, SoundExchange adds its own speculative spin to Professor Lys's departure from the realm of admissible expert testimony. As noted above, Professor Shapiro showed that [redacted] of Professor Lys's "top 30" labels "under-indexed," providing "a stronger inference, other things equal, that the prospect of greater plays is a lure to signing the license to overcome the under-indexing problem." 4/20/17 Tr. 291:7-14 (Shapiro). In an effort to respond, SoundExchange argues that "Professor Shapiro's conclusion that steering motivated labels who underindexed simply does not hold for labels who *believed* they would over-index (even though they ultimately did not)." **SE PFF 1108** (emphasis in original). SoundExchange cites no evidence for this supposition. It nevertheless argues with a straight face that, on the one hand, Professor Lys can peer accurately into the minds of the labels that over-indexed and confidently conclude that they signed the direct license to benefit from over-indexing, while on the other hand, Professor Shapiro was incorrect to draw the logical corollary inference as to what may have motivated under-indexed labels, since SoundExchange contends that they might have really believed they were going to over-index. This "heads-SoundExchange-wins, tails-Sirius XM loses" reasoning underscores that Professor Lys's excursion into clairvoyance should be disregarded.

IV. SOUNDEXCHANGE'S VARIOUS CHALLENGES TO THE *WEB IV* BENCHMARK DO NOT LESSEN ITS VALUE AS AN IDEAL BENCHMARK FOR RATE-SETTING (*SE PFF § VIII*)

260. In an effort to undermine the probative force of Professor Shapiro's use of the subscription non-interactive webcasting rate derived by the Judges in *Web IV* (the "*Web IV* Benchmark") to derive a percentage-of-revenue rate for Sirius XM's satellite radio service, SoundExchange levels a number of baseless attacks. First, SoundExchange contends that there have been "material developments that substantially undermine the probative value of the per-play rate set in *Web IV*." **SE PFF 1217**. Next, SoundExchange takes issue with the use of per-

play rates at all to derive rates for Sirius XM's satellite radio service. Third, SoundExchange goes after the mechanics used by Professor Shapiro to convert the *Web IV* Benchmark rate into a percentage-of-revenue rate to be paid by Sirius XM. Fourth, SoundExchange contends that Professor Shapiro failed to properly account for certain differences between subscription non-interactive webcasters and satellite radio. Finally, SoundExchange contends that Professor Shapiro's use of the Lenski survey to confirm that the opportunity cost to a record label of licensing Sirius XM is less than that of licensing subscription non-interactive services is flawed. Amplifying on the responses to many of these arguments already presented (*see* SXM PFF § III.C.iv), we address each of these assertions in turn. As we continue to demonstrate, none of these criticisms in any way undermines Professor Shapiro's use of the *Web IV* Benchmark.

A. SoundExchange's Claim that the *Web IV* Benchmark Rate is Outdated Is Incorrect (*SE PFF § VIII.A*)

261. In its first effort to undermine Professor Shapiro's use of the *Web IV* Benchmark, in Section VIII.A of its proposed findings, SoundExchange continues to press the fiction that there have been material changes to the marketplace that render the *Web IV* subscription service rate obsolete. **SE PFF 1217**. SoundExchange is incorrect.

262. As noted in Sirius XM's proposed findings, the *Web IV* rate for subscription non-interactive webcasters was derived from two different benchmarks: (i) the effective rate from the Merlin/Pandora agreement for Pandora's then-available subscription non-interactive statutorily-compliant webcasting service – a rate that the Judges concluded plainly reflected the forces of competition at work; and (ii) the minimum per-play rates found in the subscription interactive service agreements, embracing (but for an additional 12 percent downward steering adjustment) the approach there proposed by SoundExchange. SXM PFF § III.C.i; **SE PFF 1213**.

263. But for a passing and unsubstantiated claim that the interactive agreements used by the Judges in *Web IV* are "underinclusive relative to the data analyzed by Mr. Orszag," **SE PFF 1213**, SoundExchange never even attempts to suggest that there have been changes of relevance to the interactive service agreements over the last few years. This comes as no surprise, as there have been none.

264. Despite claiming that the *Web IV* "rate was derived from marketplace data and information that, with the passage of time, has grown increasingly disconnected from current marketplace realities," Orszag WRT ¶ 42, Mr. Orszag never bothered to check whether, in fact, there have been any changes to the rates in the interactive service agreements used by the Judges in *Web IV* over the last few years. 4/26/17 Tr. 1160:14-25 (Orszag). Professor Shapiro did. As it turns out, those rates [redacted] The rates used by the Judges from the interactive services agreements in *Web IV*, following the approach proposed by SoundExchange, are [redacted] they were two years ago. Shapiro CWRT at 16 and n.55; SXM PFF ¶¶ 234-40. Indeed, [redacted] They acknowledged that [redacted] 5/16/17 Tr. 4024:4-23 (Harrison); 5/15/17 Tr. 3839:14-3840:8 (Walker); *see also* 4/20/17 Tr. 340:16-341:2 (Shapiro); SXM PFF ¶¶ 234-40. This record evidence, including from SoundExchange's own witnesses, plainly demonstrates that the rate derived by the Judges from the interactive services benchmark in *Web IV* is anything but "disconnected from current marketplace realities." **SE PFF 1217.**

265. With respect to the Merlin/Pandora agreement used by the Judges in *Web IV*, while SoundExchange is correct when it observes that the agreement is no longer operative, **SE PFF 1218**, it is not the case, as SoundExchange attempts to suggest, that the agreement has been

superseded by one which is informative for rate-setting here. As an initial matter, as Professor Shapiro explained, the new Merlin/Pandora agreement cited by SoundExchange, which covers, among other services, Pandora's mid-tier offering (Pandora Plus), involves *non-statutory* rights – "different types of rights that are necessary for *interactive* services." 4/20/17 Tr. 341:21-342:11 (Shapiro) (emphasis added); *see also* 4/26/17 Tr. 1145:2-1146:12 (Orszag) (acknowledging that [redacted] *id*. 1162:19-1165:17 (acknowledging same); **SE PFF 1223**. That agreement represents a "new data point[] in the interactive services market," not in the non-interactive market Professor Shapiro used for benchmarking. 4/20/17 Tr. 341:21-342:11 (Shapiro). The fact that Pandora "changed its mid-tier service to be more interactive," Professor Shapiro explained, "is not a change in [non-interactive] market rates"; rather, it is "a change in business strategy by Pandora." *Id.* 344:9-15; *see also* 4/26/17 Tr. 1167:17-1168:22 (Orszag). In fact, as Professor Shapiro explained, [redacted][33] 4/20/17 Tr. 349:19-24 (Shapiro). On cross examination, Mr. Orszag ultimately acknowledged as much. *See* 4/26/17 Tr. 1145:19-25 (Orszag) ("[redacted]

[33] SoundExchange attempts to undermine the force of this logic by asserting that "Professor Shapiro himself acknowledged… that 'the contractual rates upon which [the Judges] relied in *Web IV*' have 'been superseded.'" **SE PFF 1222**. This is a gross mischaracterization of the question and answer exchange SoundExchange cites. When asked whether he agreed with Mr. Orszag that "the contractual rates on which [the Judges] relied in *Web IV*[] *are no longer effective at this point*," Professor Shapiro answered that the "benchmark agreement has been superseded… So that is a fact. I don't – I agree with that. The – that has happened because Pandora decided they wanted to change their mid-tier service and make it more interactive, so they needed a different – they needed to change – to renegotiate. *I don't see that as a change in market rates, though. I see that as a change in business strategy by Pandora*." 4/20/17 Tr. 343:15-344:15 (Shapiro) (emphasis added).

[redacted] . . . "). As a result, it is undisputed that the Merlin/Pandora agreement relied on by the Judges in *Web IV* remains the most recent agreement that speaks to workably competitive rates for a statutorily-compliant subscription non-interactive webcasting service. SXM PFF ¶¶ 236-39.

266. Moreover, and in sharp contrast to the Merlin/Pandora agreement on which the Judges relied in *Web IV*, the new Merlin/Pandora agreement unquestionably does *not* reflect the forces of competition at work. Rather than embrace price competition [redacted] as the former agreement did, the new agreement eliminates the possibility of price competition entirely. In fact, [redacted] Trial Ex. 243 ¶¶ 1.l ([redacted]), 2.o ([redacted] As Judge Strickler put it, this "new" Merlin/Pandora agreement is [redacted] 4/20/17 Tr. 348:10-15 (Shapiro). As a result, the new Merlin/Pandora agreement demonstrates that, when the forces of competition are shut down, and a service is no longer able to avail itself of the statutory license, record labels are able to take advantage of their monopoly power and secure supra-competitive rates that in no way reflect those that would emerge in a workably competitive market. *See* 5/4/17 Tr. 2518:11-2520:7 (Shapiro).

267. In a related argument, SoundExchange attempts to make much of the fact that the current Merlin/Pandora agreement [redacted] **SE PFF 1220**. From this,

SoundExchange attempts to make the illogical leap that Mr. Orszag was correct to use the effective rates paid by the subscription interactive services and Professor Shapiro was wrong to use the minimum per-play rates found in those agreements to derive a rate from the subscription interactive services benchmark. SoundExchange is wrong on both counts. The issue presented is not whether, as a matter of abstract economics, benchmarking from effective rates may be a sensible way to proceed; it is, instead, the validity of Mr. Orszag's use of the effective rates *from the interactive services market in the first instance*, let alone inaccurately to profess in doing so that he was faithfully implementing the Judges' use of ratio equivalency in *Web IV*. As discussed at length in Sirius XM's proposed findings and as further elaborated on above, Mr. Orszag in fact reproduced the very benchmarking methodology *rejected* by the Judges in both their *SDARS II* and *Web III Remand* decisions. His effort, moreover, to do so surreptitiously (including by professing not to be aware of the identity of his models to those proffered by Professor Ordover in *SDARS II*) by asserting that all he was doing was following the *Web IV* methodology was proven at trial to be completely inaccurate. *See supra* §§ I.C-D; SXM PFF §§ IV.B.i; IV.B.v. In contrast, as we further discuss below, Professor Shapiro's use of the per-play rate derived by the Judges in *Web IV* to generate a reasonable *percentage-of-revenue* rate for Sirius XM was an entirely appropriate means of assuring, in Mr. Orszag's words, that the *Web IV* methodology "will continue to generate reasonable and reliable results" here. **SE PFF 1217**; SXM PFF ¶¶ 320-27.

B. Professor Shapiro's Use of The Per-Play Rate Derived By The Judges in *Web IV* Was Entirely Appropriate (*SE PFF §§ VIII.B-D*)

268. In Sections VIII.B through VIII.D of its proposed findings, SoundExchange attempts to demonstrate that Professor Shapiro erred in using the *Web IV* Benchmark per-play

rate to derive a percentage-of-revenue royalty rate for Sirius XM. Professor Shapiro made no such error.

269. SoundExchange first attempts to demonstrate that Professor Shapiro erred in starting with a per-play rate to derive a rate for Sirius XM's satellite radio service by pointing out that many agreements between record labels and subscription services [redacted] **SE PFF 1224-26**.

270. This argument is a classic red herring. SoundExchange is confusing two distinct concepts – having a per-play rate *structure* and using a per-play rate to derive an appropriate percentage-of-revenue (or per-subscriber) royalty. Professor Shapiro did not propose a per-play rate structure but, instead, a continuation of a percentage-of-revenue royalty structure. SXM PFF ¶ 97. As a result, SoundExchange's argument that subscription services [redacted] is of no moment. Any royalty payment made pursuant to the structure proposed by Professor Shapiro, by definition, will not directly relate to the number of performances per subscriber on Sirius XM's satellite radio service. Just like with the agreements that SoundExchange identifies, should Professor Shapiro's rate proposal be adopted, Sirius XM will pay royalties "[redacted] **SE PFF 1227**.

271. SoundExchange takes this fallacious argument even further by claiming that Professor Shapiro's approach here is inconsistent with his *Web IV* testimony. **SE PFF 1233**. Nothing could be further from the truth. Even putting to one side the spin that SoundExchange puts on the *Web IV* testimony that it cites, SoundExchange is saying that, according to Professor Shapiro, mature businesses should pay royalties on a percentage-of-revenue basis, and not on a

per-play basis. As just discussed, that is exactly what Professor Shapiro is proposing here – that Sirius XM pay a percentage of its revenue to SoundExchange.

272. When it does eventually come around to the foregoing recognition, SoundExchange claims that it was inappropriate for Professor Shapiro to use the *Web IV* subscription rate "'even for benchmark calibration,'" **SE PFF 1231**, because the "value" of a play on a subscription non-interactive service may be different from the "value" of a play on Sirius XM, and this difference in "value" will ultimately lead to different rates as between the two types of services. **SE PFF 1230**.

273. In support of its claim that performances on different services may have different "value," SoundExchange points to Mr. Orszag's speculation that in-vehicle listening – where, in contrast to subscription non-interactive services, most of the Sirius XM listening takes place – is likely to be more "valuable" than listening at home or at work because entertainment options are more limited in the car. **SE PFF 1228**.

274. As an initial matter, SoundExchange has not pointed to any evidence demonstrating that in-vehicle listening is, in fact, particularly valuable, and, as Mr. Orszag conceded, he did not even attempt to examine this issue empirically. 4/26/17 Tr. 1212:3-1213:14 (Orszag). But even if SoundExchange is correct that in-vehicle listening is more valuable than listening at home or at work, any such added value is the direct result of the contribution of Sirius XM separate and apart from its use of sound recordings. Were it not for Sirius XM's massive investments into its satellite delivery system, the content offered by Sirius XM would not be available in the car, and this added value would be lost. SoundExchange's claim that, without so much as a dollar of shared investment in the development of this unique service, it somehow should partner across the range of its value to consumers, **SE PFF 1230**, is wholly

inappropriate. It flies in the face of the 801(b)(1) factors, amounting as it does to an attempt to expropriate a portion of the value that directly results from Sirius XM's unique contributions. SXM PFF ¶¶ 241-44.

275. In its final effort to undermine Professor Shapiro's use of per-play rates to derive an appropriate percentage-of-revenue rate for Sirius XM, SoundExchange points out that Pandora, at the time of *Web IV*, paid approximately [redacted] for its subscription non-interactive service. **SE PFF 1234**. From this, SoundExchange concludes that Professor Shapiro's use of the *Web IV* Benchmark must be "distorting," apparently because Pandora's per-subscriber royalty was about [redacted] the royalty that Professor Shapiro calculated for Sirius XM here. But if Pandora subscribers had been listening to the same number of sound recordings per month as Sirius XM subscribers do, Pandora's royalty would have been [redacted] what Professor Shapiro calculated for Sirius XM. 4/24/17 Tr. 575:10-579:22 (Shapiro). It is only because Pandora subscribers listen to roughly [redacted] sound recordings per month than do Sirius XM subscribers that its royalty rate was [redacted] what Professor Shapiro calculated for Sirius XM.

276. While SoundExchange never comes out and says it directly, the logic of SoundExchange's position here is that the intensity of use of sound recordings on Sirius XM should not matter at all. According to SoundExchange, Sirius XM should pay *more* per subscriber than Pandora did for its statutorily-compliant subscription non-interactive webcasting service notwithstanding the fact that Pandora subscribers listen to [redacted] sound recordings per month as do Sirius XM subscribers. This plainly makes no sense. As Professor Shapiro explained, in a workably competitive market, a service that has many fewer

performances per month will pay *less* than a service that has significantly more performances per month, not *more*. 4/20/17 Tr. 317:11-19 (Shapiro); SXM PFF ¶¶ 245-47.

277. The absurdity of SoundExchange's position in this regard was perhaps made most clear during the cross-examination of Mr. Orszag. After acknowledging that Sirius XM's subscription webcasting service pays royalties pursuant to the *Web IV* rates, and agreeing that if the average subscriber to Sirius XM's webcasting service listened to the same number of sound recordings per month as do subscribers to Sirius XM's satellite radio service, that Sirius XM would pay $1.03 per subscriber per month in royalties for its webcasting service, Mr. Orszag still took the position that it would nevertheless be appropriate for Sirius XM to pay up to three times as much per subscriber for its satellite radio service. 4/26/17 Tr. 1258:5-1260:11 (Orszag). SoundExchange never even attempts to explain this anomaly away. In fact, SoundExchange entirely ignores that Sirius XM offers a subscription webcasting service, instead equating subscription non-interactive webcasters exclusively with Pandora. *See, e.g.*, **SE PFF 1234**.

C. Professor Shapiro's Conversion of the *Web IV* Benchmark Rate Into a Percentage-of-Revenue Rate Was Entirely Appropriate (*SE PFF § VIII.E*)

278. In Section VIII.E of its proposed findings, SoundExchange takes issue with the "methods" used by Professor Shapiro to derive a percentage-of-revenue rate for Sirius XM's satellite radio service. **SE PFF 1238**. The arguments SoundExchange makes in support of this claim – that Professor Shapiro's use of the Edison Share of Ear survey to estimate the number of hours of sound recording performances per subscription per week on Sirius XM's satellite radio service "should be discounted" and that Professor Shapiro should have used a measure of ARPU that matches the revenue definition adopted by the Judges – are repetitive of those SoundExchange has made elsewhere in its proposed findings. Sirius XM refers the Judges to Sections V.B.i and V.C of its reply findings.

279. The only point raised by SoundExchange here that is not elsewhere addressed by Sirius XM is that Professor Shapiro's estimate of 469 performances per subscription per month is lower than that estimated by Professor Willig. **SE PFF 1239**. SoundExchange does not, however, even attempt to suggest that there is a flaw with Professor Shapiro's calculation. Neither Professor Willig nor any of SoundExchange's myriad other expert witnesses even attempted to criticize Professor Shapiro's calculation, including during Professor Shapiro's two appearances on the witness stand. The same cannot be said of Professor Willig's estimate. As Professor Shapiro pointed out, there are numerous flaws in that analysis. Shapiro CWRT at 20 n.71. Moreover, Professor Willig's analysis is at odds with other advocacy from SoundExchange, where it attempts to make much of the fact that because Sirius XM's satellite radio service is used primarily in the car, that "*limits the average number of performances per-subscriber*, for the straightforward reason that time spent in-vehicle is, itself, limited." **SE PFF 1228** (emphasis in original).

D. Professor Shapiro's Benchmarking Analysis Accounted For All of the Relevant Differences Between Subscription Non-Interactive Webcasters and Sirius XM (*SE PFF § VIII.F*)

280. SoundExchange next asserts that Professor Shapiro ignored certain relevant differences between Sirius XM and subscription non-interactive webcasters that, according to SoundExchange, would result in Sirius XM paying higher royalty rates than do subscription non-interactive webcasters. With respect to the first two asserted differences – profitability and elasticity of demand – SoundExchange is wrong. As Professor Shapiro explained, in a workably competitive market, the two key factors for purposes of assessing whether a difference in buyer as between a benchmark and target market would lead to different royalty rates are: (i) possible differences between a record company's opportunity cost of licensing a performance on the benchmark and target services; and (ii) possible differences in ability to steer as between the

benchmark and target services. Shapiro WDT at 15-23, 50, 55-57; SXM PFF ¶¶ 211-28. To the extent that profitability comes into play at all, it is only the incremental profit for an additional subscriber, as measured by the contribution margin (which takes into account only variable costs) that enters into the analysis. *Overall* profit margins – the metrics that SoundExchange points to here – are entirely irrelevant. Shapiro CWRT at 51-52; 5/3/17 Tr. 2479:17-2480:13 (Shapiro); SXM PFF ¶¶ 116-18.

281. With respect to the third factor – difference in ability to steer – Professor Shapiro addressed this at length and concluded that no adjustment to the benchmark rate is warranted. Shapiro WDT at 56-57; *see also* SXM PFF ¶¶ 220-27. In contrast, Mr. Orszag ignored the reasons that Sirius XM can steer more effectively than can subscription non-interactive webcasters – most notably because it has complete control of every sound recording performed – and focused exclusively on the reason that it might be more difficult for Sirius XM to steer. *Compare* Shapiro WDT at 56-57 *with* Orszag AWDT ¶¶ 70-71. Such a skewed analysis should be rejected.

282. Moreover, SoundExchange's entire discussion of steering relates to potential differences between Sirius XM's satellite radio service and Pandora. **SE PFF 1244**. SoundExchange entirely ignores that Sirius XM itself offers a subscription non-interactive webcasting service that pays royalties pursuant to the *Web IV* rates. Given the similarities between the two services offered by Sirius XM, it is hard to see how there could be any meaningful difference in ability to steer as between those two services. SXM PFF ¶ 221.

283. Finally, and perhaps of greatest relevance, even if it were the case that Sirius XM could not steer to any meaningful degree, it does not follow that it should be forced to pay royalty rates well above the workably competitive level. The very purpose of this proceeding is

to ensure that the royalty rate paid by Sirius XM is one that would emerge between a willing buyer and a willing seller in a workably competitive market, as tempered by the 801(b) factors. *See* SXM PFF § II.

E. Professor Shapiro Appropriately Relied on the Results of the Lenski Survey (*SE PFF § VIII.G*)

284. In its final effort to undermine Professor Shapiro's *Web IV* Benchmark analysis, SoundExchange takes issue with Professor Shapiro's use of the Lenski survey, as well as with the Lenski survey itself. *See* **SE PFF 1245-1317**. As we now explain, these critiques evidence a complete misunderstanding of the purpose and use of the Lenski survey, which was methodologically sound and provided reliable empirical evidence for the use to which it was put.

i. It Was Entirely Appropriate From an Economic Perspective for Professor Shapiro to Rely on the Lenski Survey (*SE PFF § VIII.G.1*)

285. As discussed in Sirius XM's proposed findings, to assess whether an adjustment to the *Web IV* Benchmark is warranted to account for the difference in buyers as between the benchmark market and the target market, Professor Shapiro compared the opportunity cost to a record label of licensing Sirius XM's satellite radio service to the opportunity cost of licensing subscription non-interactive webcasters. SXM PFF ¶ 212. He noted that in a workably competitive market, a record label would agree to a lower royalty rate with Sirius XM than it would with a subscription non-interactive webcaster if Sirius XM is either more promotional than the webcaster or is less substitutional than the webcaster. SXM PFF ¶¶ 213-14. Based on empirical evidence from the survey conducted by Joe Lenski of Edison Research, Professor Shapiro concluded that Sirius XM listening cannibalizes other record label revenue streams to a lesser extent than does listening to non-interactive webcasters. SXM PFF ¶¶ 217-18.

286. SoundExchange takes issue with this conclusion – contending that the Lenski survey does not provide sufficient information to precisely calculate the difference in the

opportunity cost to a record label of licensing Sirius XM, on the one hand, and subscription non-interactive webcasters, on the other. **SE PFF 1254-58**. Specifically, SoundExchange asserts that the Lenski survey does not distinguish between (i) "purchasing a new subscription to a paid fully-interactive service"; (ii) "increasing listening to a paid fully-interactive service to which the respondent already subscribes"; and (iii) "increasing listening to an ad-supported fully-interactive service." **SE PFF 1257-59**. SoundExchange raises the same concern with respect to subscription non-interactive services, **SE PFF 1260**, and raises a similar concern with respect to CDs and downloads, namely, that the Lenski survey does not distinguish between new purchases and listening to CDs and downloads that have previously been purchased, **SE PFF 1261**.

287. There is no dispute that these different categories of behavior are relevant if one wants to calculate the opportunity cost of licensing either Sirius XM's satellite radio service or of licensing a subscription non-interactive service.[34] Of course, that is not what Professor Shapiro was doing – he was only interested in the relative difference. As the Lenski survey results demonstrate, that the opportunity cost of licensing Sirius XM is less than that of licensing subscription non-interactive webcasters is not a close call. As SoundExchange acknowledges, these results clearly demonstrate that Sirius XM substitutes for terrestrial radio to a far greater degree than does Pandora and substitutes to a far lesser degree for interactive and non-interactive services than does Pandora. **SE PFF 1251-52**.

[34] As noted in Sirius XM's proposed findings and as elaborated upon below, SoundExchange's criticisms of the Lenski survey have dramatic implications for Professor Willig's use of both the Dhar and Simonson surveys as, unlike Professor Shapiro, Professor Willig did claim to be estimating the opportunity cost of licensing Sirius XM (albeit the monopoly opportunity cost). Neither of those surveys offered respondents the option of using an existing paid subscription service (interactive or non-interactive), and Professor Dhar only offered certain respondents the option of increasing listening to an ad-supported fully-interactive service if they answered certain questions in a certain way. Nevertheless, Professor Willig – by his own terms, entirely improperly – purports to use both of these surveys to calculate the monopoly opportunity cost of licensing Sirius XM. *See* SXM PFF ¶¶ 383-84; *see also supra* §§ II.F.i; II.F.iii.

288. Indeed, the only relevant takeaway from the Lenski survey for Professor Shapiro's purposes – that when licensing Sirius XM's satellite radio service, a record label will incur a lower opportunity cost than when licensing subscription non-interactive services – was confirmed by SoundExchange's own witnesses. The Dhar and Simonson surveys came to the same conclusion, as did the (albeit otherwise flawed) analysis of monopoly opportunity cost performed by Professor Willig. SXM PFF ¶¶ 218-19. In short, despite all of SoundExchange's protestations, there is actually no dispute here on the sole aspect of the Lenski survey of relevance.

ii. The Lenski Survey Was A Reliable, Well-Designed Survey (*SE PFF § VIII.G.2*)

289. SoundExchange levels a number of criticisms at the Lenski survey methodology, essentially attacking it for not having elements that are used in Professor Willig's analysis. *See* **SE PFF 1269-1317**. For example, SoundExchange spends several pages criticizing Mr. Lenski for not including price information in his questions (**SE PFF 1288-93**), and not segregating his population in a way that would have been useful for Professor Willig's analysis (**SE PFF 1298-99**). But as Mr. Lenski's survey was not designed to be an input to Professor Willig's analysis, this is entirely irrelevant.

290. SoundExchange also attacks Mr. Lenski's use of a phone survey, and devotes pages of briefing to extolling the virtues of Internet surveys. **SE PFF 1270-75**; *see also* **SE PFF 591-98, 177-89**. Yet SoundExchange's own witness Professor Simonson testified that telephone surveys are an acceptable data collection methodology and that as recently as 2016, he used a telephone survey for litigation purposes. *See* 5/11/17 Tr. 3469:10-24 (Simonson). Ignoring Mr. Lenski's testimony that the average interview length was less than nine minutes, and that live interviewers are able to tell if a respondent is not giving full attention to a survey,

SoundExchange nevertheless speculates that it would have been better if Mr. Lenski had done a computer survey. **SE PFF 1270-75**; 5/4/17 Tr. 2645:5-14 (Lenski) (noting that the survey was "actually a relatively short survey in terms of length compared to most national telephone surveys"); 5/4/17 Tr. 2646:5-22 (Lenski) (discussing advantages of live interviewers).

291. SoundExchange also goes on to level attacks at Mr. Lenski that, ironically, are more applicable to the Dhar and Simonson surveys than they are to Mr. Lenski's survey. For example, in criticizing Mr. Lenski's survey, which offered more answer choices than Professor Dhar's survey, SoundExchange contends that Mr. Lenski's survey offered insufficient answer choices. *See* **SE PFF 1294-97**; Simonson WRT ¶ 44; Dhar WRT ¶¶ 16-17. Mr. Lenski explained that his answer choices represented the types of audio that, based on years of experience (including by running industry-wide surveys like the Infinite Dial that SoundExchange elsewhere relies on), Edison knows to be most used by consumers. 5/4/17 Tr. 2648:15-22 (Lenski). Yet, according to Professor Simonson – who had only done a handful of music surveys and did not pretest his own survey (5/11/17 Tr. 3473:8-3474:9 (Simonson); *id*. at 3468:8-15) – the failure to list YouTube as an option was "a major flaw that largely determined key survey results," Simonson WRT ¶ 45, notwithstanding his own omission of the choice of listening more to an existing subscription. *See supra* § II.F.iii. Professor Dhar, who had never done a music survey before, initially offered his own respondents only four choices (none of them YouTube or purchasing new CDs or music downloads), and likewise never offered them the critical choice of listening more to an existing subscription. He nevertheless appears to see nothing inconsistent in contending that Mr. Lenski's failure to include YouTube or purchasing new CDs or music downloads as answer choices essentially invalidates his survey. 5/8/17 Tr. 2917:4-21 (Dhar).

292. Finally, and perhaps tellingly, while SoundExchange goes on at length about the asserted flaws in Mr. Lenski's survey, it offers no empirical evidence to support any of its critiques. Professor Simonson made so many changes – the methodology, the universe, the questions and the answer choices – that he simply did a different survey and unremarkably, obtained somewhat different results, though they still showed that Sirius XM substitutes for terrestrial radio to a far greater degree than does Pandora and substitutes to a far lesser degree for interactive and non-interactive services than does Pandora. Simonson WRT ¶¶ 69, 71.

V. PROFESSOR SHAPIRO'S ASSESSMENT OF CHANGES SINCE *SDARS II* IS A USEFUL AND INFORMATIVE PIECE OF SIRIUS XM'S THREE-PRONGED ANALYSIS THAT STANDS UNREBUTTED BY SOUNDEXCHANGE (*SE PFF § IX*)

293. As detailed in Sirius XM's proposed findings, Sirius XM's rate proposal is based on a three-prong analysis that considers: (1) the current statutory rates established in *SDARS II* and any relevant market changes since those rates were set; (2) hundreds of direct license agreements entered into by Sirius XM with independent labels; and (3) a translation of the per-play rates recently set in *Web IV* into a percentage-of-revenue rate for Sirius XM's satellite radio service. *See* SXM PFF § III. All three of these reference points corroborate one another and lead to the same conclusion: that the rate for the upcoming 2018-2022 license period should be set toward the lower end of a range between 8.1% and 11% of Sirius XM's Gross Revenues. SXM PFF ¶ 97.

294. SoundExchange attacks the first of these approaches, the analysis of relevant changes since *SDARS II*, on three main grounds, none of which finds support in the record or the governing law. First, SoundExchange objects to the very *idea* of considering the existing statutory rates—arguing, nonsensically, that the Judges' statutory duty to "determine" rates anew for each license period effectively prohibits any reliance on their prior work in *SDARS II*. *See*

SE PCL § IX.A (**SE PCL 3-9**). As we discuss, SoundExchange's unsupported gloss on the statute has already been rejected by both the Judges and the D.C. Circuit. *See infra* §§ V.A-B.

295. Second, SoundExchange argues that Professor Shapiro failed to account for market changes since *SDARS II* that purportedly warrant higher rates today. *See* SE PFF § IX.C (**SE PFF 1326-1406**). But as set forth below in Section V.B, the market changes that SoundExchange asserts have taken place either are wholly unsupported by the record or, as a matter of economics, do not warrant an increase in the royalty rates paid by Sirius XM.

296. Third, despite insisting that the *SDARS II* rates are based on "stale" data, SoundExchange advocates looking back even *further* to the decade-old *SDARS I* decision, in which the judges found the market rate of $1.40 per subscriber to be an "upper boundary" as of the year 2006. **SE PFF 1409**; *see generally id.* § IX.D-E (**SE PFF 1407-32**). Even putting aside the inconsistency of SoundExchange's position, however, the Judges' calculation of $1.40 per subscriber was based on royalty rates paid by interactive streaming services at the time of *SDARS I*—rates that have *decreased* dramatically in the decade since. As Mr. Orszag acknowledged during the hearing, SoundExchange's proposed "updating" of the $1.40 per-subscriber rate fails to factor in that major decline in market rates. *See infra* § V.C.

A. The Judges Can and Should Consider the Current Statutory Rates As Part of Their Analysis, As They Have Done in the Past (*SE PCL § IX.A*)

297. In attacking Professor Shapiro's analysis of changes since *SDARS II*, SoundExchange appears to contend that it would be improper for the Judges to even *consider* the level of the prevailing statutory rates in setting the new ones. *See* SE PCL § IX.A (**SE PCL 3-9**). But this bizarre legal argument finds no support in the statute, is squarely at odds with the Judges' prior rulings, and indeed has been rejected by the D.C. Circuit. *See Music Choice v. Copyright Royalty Bd.*, 774 F.3d 1000, 1012 (D.C. Cir. 2014) ("[T]he Judges did not err when

they used the prevailing rate as the starting point of their Section 801(b) analysis.”). Unsurprisingly, SoundExchange fails to cite a single case that supports its position.

298. SoundExchange’s position hangs entirely by the thread that the language of the statute empowers the Judges to “determine” rates for each new license period, 17 U.S.C. § 114(f)(1)(A), rather than merely “adjust” the existing rates. SE PCL § IX.A (**SE PCL 3-9**). But Sirius XM does not dispute that the Judges should “determine” the rates for the 2018-2022 period, nor does it ask the Judges—as SoundExchange irresponsibly suggests—to “merely ratify” the *SDARS II* rates and call it a day. *Id.* **SE PCL 4**. To the contrary, Sirius XM presents the *SDARS II* rates as just one of three reference points—the two others being (1) the more recent *Web IV* rates, and (2) the latest marketplace evidence of Sirius XM’s own direct license agreements with hundreds of independent record labels. The fact that all three of these benchmarks, properly adjusted, point to the same conclusion—a reasonable royalty rate in the range of 8.1% to 11% of Sirius XM’s Gross Revenues—provides a strong foundation for the Judges’ rate-setting task here, as detailed in Sirius XM’s proposed findings.

299. Nothing in the governing statute, regulations, or prior determinations suggests that the Judges may not consider the existing statutory rates as a reference point, together with the latest marketplace information. *See* SE PCL § IX.A (**SE PCL 3-9**). Quite the contrary, the Judges have used the prevailing rates as an important reality check when faced with prior outlandish SoundExchange rate proposals. In *SDARS II*, the Judges considered the prevailing rate as one of their “guide posts” when evaluating the 801(b) factors, and cited the “yawning gap” between Dr. Ordover’s proposal and the prevailing rate as reason to believe that Dr. Ordover’s proposal fell “outside the zone of reasonableness.” 78 Fed. Reg. at 23065-66. Dissatisfied with the market benchmarks presented by both sides as to the PSS rates, the Judges

in *SDARS II* instead used the then-prevailing settlement rate as a starting point—a decision that the D.C. Circuit affirmed. *Music Choice*, 774 F.3d at 1012. Rejecting SoundExchange's contention that the rate-setting analysis must begin with current market evidence, the D.C. Circuit explained that Congress had permitted the Judges to "make 'adjustments' to the prevailing rate" and "consider 'prior determinations.'" *Id.* (quoting 17 U.S.C. §§ 801(b)(1), 803(a)(1)).

300. SoundExchange further argues that the current *SDARS II* rates are based on marketplace information that has gone "stale." SE PFF § IX.B (**SE PFF 1323-25**). But that argument begs the very question that Dr. Shapiro has carefully analyzed and answered: whether there have been any changes in the marketplace since *SDARS II* that warrant an increase in royalty rates. As we discuss in Section B immediately below, the answer is "no," but the point for immediate purposes is that the determination of that issue is one of fact and economics, not one of the legal propriety of examining the very rates said to have grown stale. The Judges clearly may examine those rates, notwithstanding SoundExchange's (erroneous) assertion that they are outdated. *Music Choice*, 774 F.3d at 1012 (rejecting SoundExchange's argument that the Judges may not begin their analysis with "outdated" rates and then adjust as appropriate).

B. SoundExchange Lacks Record Evidence of Any Relevant Market Changes That Would Support an Increase in Rates Since *SDARS II* (*SE PFF § IX.C*)

301. As discussed in Sirius XM's proposed findings, Professor Shapiro's assessment of the *SDARS II* rates included analyzing, in detail, whether there have been any marketplace changes of relevance that warrant a deviation—either upward or downward—from the 11% rate that the Judges concluded was reasonable for 2017 after accounting for the 801(b) objectives. *See* SXM PFF § III.A. Specifically, Professor Shapiro considered whether there were any changes of relevance to (i) Sirius XM's business; (ii) the recorded music industry, or (iii) the

dynamics of the "upstream" licensing markets in which music services secure necessary licenses from record labels. After carefully analyzing each of these changes, Professor Shapiro concluded that "none of the changes that have occurred since the *SDARS II* proceeding . . . provide a basis for making an upward adjustment to the 2017 statutory rate . . . . The changes that have taken place since *SDARS II* that do suggest that a change is warranted all point in the downward direction." SXM PFF ¶ 99 (quoting Shapiro WDT at 34); *see generally* SXM PFF § III.A.

302. SoundExchange challenges Professor Shapiro's conclusions on three main grounds, arguing that a rate increase is warranted because: (i) the growth of streaming since *SDARS II* has raised the opportunity cost of licensing sound recordings to Sirius XM; (ii) Sirius XM's financial performance has improved since *SDARS II*; and (iii) the interactive service benchmarks, rejected by the Judges in *SDARS II*, are no longer problematic. *See* SE PFF § IX.C (**SE PFF 1326-1406**). As we discuss below, however, the record does not support a rate increase on *any* of these grounds.

i. SoundExchange Fails to Support Its Conclusory Assertion That the Opportunity Cost of Licensing Sirius XM Has Increased Since *SDARS II* (*SE PFF § IX.C.1*)

303. SoundExchange's primary contention is that the growth of streaming since *SDARS II* has increased the record label's opportunity costs of licensing Sirius XM, and that "when opportunity costs rise, so too should royalties." **SE PFF 1327**; *see generally* SE PFF § IX.C.1 (**SE PFF 1327-61**). But there is simply no record evidence suggesting that there has been any material increase in opportunity costs over the last five years. To properly support such an assertion, SoundExchange would have had to perform a *comparative* calculation of the opportunity cost to an individual record label of licensing Sirius XM at the time of *SDARS II* versus today. All SoundExchange has provided, however, is an estimate of the *current*

opportunity cost to a monopoly label (or cartel of labels) that controls the rights to all sound recordings—an estimate that is, in any event, hopelessly flawed in its own right for the reasons discussed in Section II above and in Sirius XM's proposed findings. *See* SXM PFF § IV.D.

304. Thus, for thirteen pages of its proposed findings, *see* SE PFF § IX.C.1 (S**E PFF 1327-61**), SoundExchange dances in circles around the question of increased opportunity costs without pointing to any actual evidence that such an increase occurred. Nor does SoundExchange ever attempt to quantify, in those thirteen pages or elsewhere, the amount of the supposed increase.

305. SoundExchange begins with the uncontroversial fact that consumers' use of streaming services has grown in recent years, *see* **SE PFF 1329-30**—a fact that, by itself, "does not indicate that the opportunity cost of having music played on Sirius XM has gone up or down." 4/19/17 Tr. 242:1-9 (Shapiro). SoundExchange complains, at the same time, that Sirius XM substitutes for subscription streaming services, which generate higher royalties per subscriber. Specifically, pointing to Professor Dhar's survey, SoundExchange contends that 31% of Sirius XM subscribers would switch to a fully interactive service if they left Sirius XM, while 15% of Sirius XM subscribers would switch to a subscription non-interactive service. *Id.* **SE PFF 1332**. But even putting aside the severe methodological defects in Professor Dhar's survey that render it totally unreliable, *see supra* § II.F.i, nothing in Professor Dhar's survey purports to *compare* the degree of Sirius XM's substitution (or promotion) today of the subscription interactive and non-interactive services—or for that matter, any of the other record label revenue streams that Sirius XM might substitute for or promote—versus at the time of *SDARS II*. The same is true of the analyses by Professors Simonson and Willig that SoundExchange cites. *See* **SE PFF 1333, 1359**.

306. Next, SoundExchange argues that Sirius XM now competes more directly with streaming, as interactive streaming services add lean-back functionality and as technological advances improve access to streaming in the car. *See* **SE PFF 1334-40**. But to the extent there have been changes over the past five years in the intensity of competition between Sirius XM and other music services, those changes were shown at the hearing to be quite minor. 4/19/17 Tr. 242:10-18 (Shapiro); Shapiro WDT at 9 & Fig. 4 (noting that the presence of Internet-based music services in the car today is incredibly small); 5/15/17 Tr. 3723:16-3724:2 (Meyer). Indeed, there is ample record evidence—including from SoundExchange's own experts—that, just as in *SDARS II*, terrestrial radio remains the overwhelming primary competitor to Sirius XM. *See* SXM PFF ¶¶ 20-25, 103-05. This strongly suggests that the opportunity cost of licensing Sirius XM today is quite similar to what it was at the time of *SDARS II*, as the royalty earned by record labels today from terrestrial radio is exactly what it was five years ago: zero.

307. Though SoundExchange further complains that Professor Shapiro insufficiently analyzes how the growth of streaming has affected the opportunity cost of licensing Sirius XM, *see* **SE PFF 1341-59**, it cannot point to any sufficient analysis by its own experts that would demonstrate a material change since *SDARS II*. Instead, SoundExchange points to Professor Willig's analysis purporting to show only that the "growth of streaming" from 2010-2016 caused a shortfall in "creator compensation" of about $800 million per year—as if Sirius XM were to blame for the growth of streaming. *Id.* **SE PFF 1347**. Indeed, as discussed in Sirius XM's proposed findings, Professor Willig was able to demonstrate this "net loss in creator compensation" from 2010-2016 only by indiscriminately lumping Sirius XM together with various types of streaming services (both interactive and non-interactive, subscription and ad-supported) and assessing the revenue impact of all those services together. SXM PFF ¶ 411. As

Professor Willig acknowledged, his regression, even if valid, does not in fact demonstrate that Sirius XM has had any negative impact on "creator compensation." 5/2/17 Tr. 2162:16-2163:12 (Willig). Moreover, when Professor Shapiro partially corrected this regression, and disaggregated Sirius XM from the bundle of dissimilar "streaming" services analyzed by Professor Willig, the data showed that Sirius XM in fact had "a substantial *positive* impact on other record company revenue streams." SXM PFF ¶ 411 (quoting Shapiro CWRT at 27).

308. Similarly, though SoundExchange criticizes Professor Shapiro for insufficiently analyzing changes in the returns to music content creators, it fails to point to any probative analysis by its own experts, other than Professor Willig's erroneous assessment of creator compensation noted immediately above. *See* **SE PFF 1348-50**. Nor does SoundExchange identify any conclusions about the metric that actually matters here: the change (if any) since *SDARS II* in a record label's opportunity cost of licensing Sirius XM.

309. Finally, SoundExchange attempts to attack Professor Shapiro's well-supported conclusion—corroborated by Sirius XM's CEO and SoundExchange's own expert, *see* SXM PFF ¶¶ 20-25, 103-05—that Sirius XM's primary competition is not streaming but terrestrial radio, which occupies the lion's share of time spent listening in the car. *See* **SE PFF 1351-61**. It appears SoundExchange's counsel has suddenly decided that the Edison "Share of Ear" survey from which Professor Shapiro draws his data must be "unreliable." *See id.* None of SoundExchange's expert witnesses, however, ever questioned or criticized the Share of Ear survey. Though SoundExchange's counsel correctly notes that the survey itself is not in evidence, Professor Shapiro and Mr. Lenski both explained its methodology, *see* Shapiro WDT at 13; 4/19/17 Tr. 233:9-23 (Shapiro); Lenski WDT at 1-2; 5/4/17 Tr. 2629:19-2630:7 (Lenski), and Sirius XM provided it to SoundExchange during direct-phase discovery. Despite presenting

expert testimony from five different economists at the rebuttal stage, and testimony from two different survey experts, SoundExchange's rebuttal case had not one thing to say about the Share of Ear survey. What is more, multiple SoundExchange witnesses *praised* the work of Edison, noting that the work done by that firm is quite reliable. Indeed, both Mr. Orszag and Mr. Boedeker themselves relied on work done by Edison. 4/26/17 Tr. 1207:19-1208:1 (Orszag); 5/8/17 Tr. 2965:18-2967:25 (Boedeker) ("I am familiar with the company Edison Research . . . and I respect their work. It's typically professional and reliable.").

310. Though SoundExchange prefers to deflect the Judges' attention to a handful of other surveys, *see* **SE PFF 1355-57**, none of those exhibits contradict Professor Shapiro's core findings. For instance, as SoundExchange and Mr. Orszag both acknowledge, the 2015 Ipsos In-Car Audio Study merely addressed the percentage of consumers who use streaming services in the car *at all*, not the frequency or amount of time that they use them. **SE PFF 1357**; 4/26/17 Tr. 1201:18-1203:6 (Orszag). Similarly, the 2016 Edison Infinite Dial Survey merely reported that an increasing number of people *had ever* listened to internet radio in the car; it did not address the amount of time they listened, or to what extent their listening included subscription services (as opposed to free internet radio). *See* **SE PFF 1357**; 4/26/17 Tr. 1208:2-23 (Orszag).

311. As for the 2015 MusicWatch study, SoundExchange continues to mischaracterize its findings, even though Mr. Orszag corrected that same mischaracterization under cross-examination at the hearing. "Critically," says SoundExchange, "[redacted]" **SE PFF 1355**. What SoundExchange fails to mention is that this is true only among listeners *who already use streaming*, not among all types of listeners. 4/26/17 Tr. 1209:22-

1212:2 (Orszag) (admitting that the data addressed "only a population of streamers," not the "broader population").

ii. Sirius XM's Improved Financial Performance Does Not Warrant an Increase in Rates (*SE PFF § IX.C.2*)

312. SoundExchange also argues that Sirius XM's improved financial condition since *SDARS II* warrants a change in royalties, because Sirius XM's increased ability to pay should drive the willing buyer/willing seller rate upward. *See* SE PFF § IX.C.2 (**SE PFF 1362-85**). But as demonstrated by Professor Shapiro and discussed in Sirius XM's proposed findings, that argument, presented by Professor Lys, is wrong as a matter of both economic theory and empirical fact. *See* SXM PFF ¶¶ 112-119.

313. Sirius XM thoroughly explained in its proposed findings—and thus will not repeat here—the economic reasons that its overall profitability would *not* affect the willing buyer/willing seller rate. SXM PFF ¶¶ 115-117; *see also* 4/19/17 Tr. 216:25-222:10, 225:3-25 (Shapiro); 5/3/17 Tr. 2485:9-2486:18 (Shapiro). Indeed, Professor Lys's own testimony in the *Web IV* proceeding reveals his complete agreement with Professor Shapiro on this point as of two years ago. SXM PFF ¶ 117. The Judges should not credit Professor Lys's expedient, but otherwise unsupported, change of position in this proceeding.

314. To the extent the Judges are nonetheless inclined to engage Professor Lys's new position (and his attempts to rewrite Professor Shapiro's economic model, *see* **SE PFF 1364-75**), Professor Lys's faulty assumptions were exposed at the hearing. Specifically, Professor Lys's revision to the model assumes that in negotiating a direct license with Sirius XM, a record label could secure significant benefits that are *not* proportional to the share of plays that the label ultimately receives on Sirius XM. **SE PFF 1368-69**. The problem with this assumption is that such benefits, to the extent they exist at all, are marginal at best. For instance, although

SoundExchange claims Professor Shapiro "acknowledged" that Sirius XM theoretically could offer a label "cash advances" out of proportion to its share of plays, **SE PFF 1372**, Professor Shapiro also testified that in practice, the size of the cash advance generally would be proportional to the amount of royalties expectedly due under the license (and hence the number of plays). 5/4/17 Tr. 2577:25-2579:1 (Shapiro). Thus, at bottom, Professor Shapiro testified during cross examination, "I have not yet heard any significant benefits that wouldn't fit into my model." *Id.* 2583:25-2584:13.

315. Moreover, the direct license benefits that Professor Lys contends *are* significant—such as label's over-indexing in comparison to the play share that would be calculated under the statutory license—are creatures of a world *with* a statutory license to compare them against. 5/3/17 Tr. 2488:18-2490:2 (Shapiro). Without a statutory license for comparison, over-indexing would not exist. *Id.* 2490:9-14. Such benefits therefore do not belong in a model of negotiations between a willing buyer and a willing seller in a hypothetical market without a statutory license. *Id.* 2488:18-2490:2.

316. Professor Shapiro also demonstrated empirically that Sirius XM's improved financial performance is not relevant to the value of the rights at issue here. Examining the royalties negotiated between Sirius XM and providers of *non*-music content (for which no statutory license exists), Professor Shapiro showed that those royalties did not increase when measured as a percentage of Sirius XM revenue over the period when Sirius XM's overall financial picture improved (and have barely increased even in absolute terms). *See* Shapiro CWRT at 52. To the contrary, Sirius XM's non-music costs *declined* each year from 2009 to 2016 as a percentage of Sirius XM revenue and are projected to *continue* to decline over the next

five years, albeit more slowly. *See id.* at 52-53 & Fig. 4; 4/19/17 Tr. 229:21-230:8, 232:11-17 (Shapiro); 5/3/17 Tr. 2481:6-2482:2 (Shapiro); 4/27/17 Tr. 1378:7-1379:4 (Lys).

317. Though SoundExchange takes issue with Professor Shapiro's exclusion of Howard Stern royalties from his analysis of non-music content costs, *see* **SE PFF 1379-82**, Professor Shapiro explained his reason for doing so: as "truly exclusive content" that is available nowhere but on Sirius XM, Howard Stern is in a "qualitatively different" category from generally available music content and requires a different set of considerations about how much to pay for it. 4/19/17 Tr. 231:12-232:6 (Shapiro). SoundExchange simply ignores that trial testimony in its proposed findings. *See* **SE PFF 1380**.

318. Professor Shapiro's conclusion that Sirius XM's improved financial performance has not led to increased content costs is in no way undermined by the 2008 merger of Sirius and XM. Though SoundExchange suggests that Sirius XM's decline in content costs shortly after the merger could have been due to the absence of competition between Sirius and XM, *see* **SE PFF 1384**, Professor Lys's own trial demonstrative revealed that Sirius XM's projected non-music content costs *continue* to decline as a percentage of revenue through at least the year 2021, even as Sirius XM is projected to grow. 5/3/17 Tr. 2483:10-2485:8 (Shapiro). Thus, even if 'some or perhaps a lot of the decline shown from 2009 through 2013 may be attributable to the Sirius XM merger,' **SE PFF 1384** (quoting Professor Shapiro), the *continued* decline long after the merger fortifies Professor Shapiro's conclusion. 5/3/17 Tr. 2485:1-8 (Shapiro).

319. Finally, SoundExchange argues that Sirius XM's financial growth obviates any need to carry forward the "downward departure" from market rates that the Judges found appropriate in *SDARS II*. **SE PFF 1401-03**. This is a non-sequitur. In *SDARS II*, the Judges applied a downward adjustment not because Sirius XM was experiencing any financial distress

or disruption to its business, but rather in recognition of its relative contribution to the industry under the third 801(b) factor, specifically though investments in its satellite distribution system. *See* 78 Fed. Reg. at 23069. That contribution has not diminished as Sirius XM has grown; to the contrary, as detailed in Sirius XM's proposed findings, the company's anticipated investments over the 2018-2022 period are even greater than those made over the *SDARS II* rate period. SXM PFF ¶¶ 107-11.

iii. SoundExchange's Proposed Interactive Services Benchmark Remains as Deeply Flawed Today as When the Judges Rejected It in *SDARS II* (*SE PFF § IX.C.3-4*)

320. The third and last category[35] of "changes" since *SDARS II* that SoundExchange identifies is not so much a change in market conditions as it is a plea to change the benchmarks used in determining the statutory rates. In short, SoundExchange argues that the flaws in the interactive services benchmark that led to its rejection in *SDARS II* are no longer present, and therefore the Judges' guide here should be the rates presently paid by interactive services rather than the statutory rates established in *SDARS II*. *See* SE PFF §§ IX.C.4(i)-(ii) (**SE PFF 1389-1400**).

321. However, as exhaustively detailed in Sirius XM's proposed findings and above in this Reply, SoundExchange's proposed interactive benchmark remains as hopelessly flawed today as it was in prior proceedings. *See supra* § I; SXM PFF § IV.B. It remains an unacceptable basis for setting the SDARS royalty rates.

[35] Though SoundExchange separately attempts to criticize Professor Shapiro's analysis of changes in the upstream market for sound recording rights—arguably a fourth category—SoundExchange fails to cite any testimony supporting its positions and fails to identify any purported basis for a rate increase. *See* SE PFF § IX.C.3 (**SE PFF 1386-88**).

C. SoundExchange Fails to Support Its Bid to Use an *SDARS I* Metric of $1.40 Per Subscriber —An "Upper Bound" Now More Than a Decade Old (*SE PFF §§ IX.D-E*)

322. Remarkably, despite deriding the *SDARS II* rates as "stale," *see supra* ¶ 296, SoundExchange proposes an older reference point as an alternative: the $1.40 monthly royalty per subscriber that the Judges found in *SDARS I* to be "the upper boundary most strongly indicated by marketplace data" as of the year 2006. **SE PFF 1409** (quoting *SDARS I*, 73 Fed. Reg. at 4097); *see generally* SE PFF §§ IX.D-E (**SE PFF 1407-32**). According to Professor Lys, the $1.40 becomes $1.74 to $1.92 when adjusted for inflation to 2018-2022 dollars; that per-subscriber rate, in turn, converts to 15.7% of revenue. **SE PFF 1408**. At the hearing, Mr. Orszag claimed to support the approach adopted by Professor Lys. 4/26/17 Tr. 1263:3-15 (Orszag).

323. The fundamental problem with relying on the $1.40 "upper boundary" calculated by the Judges in 2006 is that the market rates on which that boundary was based—royalties paid by interactive streaming services—have declined dramatically in the decade since. As described in *SDARS I*, the $1.40 per-subscriber rate was derived by making an "interactivity adjustment" to the monthly per-subscriber rate paid by interactive services. 78 Fed. Reg. at 4093. At the time, the interactive rate was $7.50 per subscriber, according to SoundExchange expert Dr. Ordover. *Id.* But by January 2014 through June 2016—the time period for which Mr. Orszag analyzed interactive service royalties in *this* proceeding—the monthly per-subscriber rate paid by interactive services had declined to $[redacted] (which already accounts for any change in inflation between *SDARS I* and today), a [redacted]% decrease. Orszag AWDT ¶¶ 45-46 & Table 1. Were the Judges here to reduce the $1.40 monthly per-subscriber rate by the same [redacted]%, the result would be a monthly per-subscriber rate of $[redacted]—roughly the same as the $1.03 rate calculated by Professor Shapiro in his analysis of the *Web IV* benchmark. *See* **SE PFF 1424**; SXM PFF ¶ 208.

324. The decline in interactive royalty rates since 2006 also answers the "simple but critical question" posed by Professor Lys: "What has changed since 2006" that would support Professor Shapiro's $1.03 per-subscriber rate, down from the $1.40 calculated by the Judges in *SDARS I*? **SE PFF 1424** (quoting 4/26/17 Tr. 1313:12-13 (Lys)). The answer, as noted, is that the market rates on which the $1.40 was based have dropped by [redacted]%. *See supra* ¶ 323.

325. When cross-examined about this decline in the interactive royalty rates, Mr. Orszag acknowledged that his most recent calculation of the average monthly per-subscriber royalty for interactive services was indeed $[redacted], not $7.50. 4/26/17 Tr. 1266:16-1267:2 (Orszag). And he had no good answer for why Professor Lys—whose approach he claimed to support—failed to adjust for that decline in interactive royalty rates. *See id.* 1268:20-1270:22. Though he suggested that a proper adjustment of the $1.40 would require going even a step further by updating the "interactivity adjustment" factor used in *SDARS I*, he admitted that Professor Lys had done no such thing. *Id.* 1269:19-1271:8.

326. Thus, in sharp contrast to the currently effective *SDARS II* rates analyzed by Professor Shapiro, *see supra* ¶¶ 301-11, the $1.40 per-subscriber rate underlying the *SDARS I* decision is demonstrably stale, because it does not reflect the steep decline in interactive service royalties over the ensuing decade.

327. Finally, SoundExchange argues that if the Judges *do* use the decade-old $1.40 per-subscriber rate and convert it to a percentage of revenue, then they should divide by Professor Lys's preferred ARPU figure of $10.68, not Sirius XM's SEC-reported ARPU of $12.80. *See* SE PFF § IX.E (**SE PFF 1423-32**). But as Professor Shapiro testified, when using ARPU (Average Revenue Per User) to derive a percentage-of-revenue rate from a per-subscriber royalty, the ARPU should match the revenue base adopted by the Judges. 4/20/17 Tr. 313:23-

315:24 (Shapiro) (describing how to convert Professor Shapiro's calculated rate of $1.03 per subscriber into a percentage of revenue). Notably, SoundExchange has made no effort to determine an ARPU that would be consistent with its new proposed revenue definition.

VI. SOUNDEXCHANGE'S FLAWED 801(B)(1) ARGUMENTS ARE THE VERY PLEA FOR SUBSIDIZATION IT FALSELY ASCRIBES TO SIRIUS XM (*SX PFF § X*)

328. The parties agree that proposed market benchmark rates must be measured against the 801(b)(1) policy objectives to arrive at a determination of reasonable rates, which need not correspond to the market benchmark rates. *See* SXM PFF ¶ 76; **SE PCL 12**. The operative issue is whether the 801(b)(1) factors weigh in favor of a downward adjustment from the market benchmark rates. Sirius XM has not proposed a downward adjustment from the range of reasonable rates proposed through Professor Shapiro's testimony. Professor Shapiro instead concluded that the 801(b)(1) factors suggest that the *Web IV*-based benchmark rate is above the rate implied by the 801(b)(1) objectives and that, accordingly, a reasonable rate lies at the low end of his proposed range of rates. Shapiro WDT at 31-34, 59-60; SXM PFF ¶¶ 229-233. Thus, when in Section X of its briefing SoundExchange argues against a "downward deviation from the market rate," **SE PFF 1443**, without noting that Sirius XM has not actually proposed one, it is shooting at a non-existent target.

329. Not content to attack that strawman, SoundExchange tries to turn the tables entirely and argues for a legally-unprecedented and wholly unwarranted *upward* adjustment from its already wildly-inflated proposed benchmark rates. It bases this request not on sound legal principles or precedent but rather on an arbitrary notion of redistributive fairness that does not correlate to any of the 801(b)(1) policy objectives. SoundExchange's principal theme in this Section (and, in truth, of its entire case) is that Sirius XM is being unfairly "subsidized" by below-market rates and should instead be required to prop up the record companies with

dramatically increased royalties. SoundExchange acknowledges, however, that the first three 801(b)(1) objectives are met by market rates (i.e., by proper benchmarking). **SE PFF 1441.** In advocating for an upward adjustment, SoundExchange is therefore arguing for a sizeable additional share of Sirius XM's profits, not because it could obtain it in an unregulated SDARS market, but rather because it supposedly is "unfair" for Sirius XM to retain what SoundExchange portrays as excessive profits. The irony of SoundExchange decrying purported subsidization while begging for a monopoly-level lift from a company that already enriches its coffers and will continue to do so – through a sizeable percentage of its revenues; through promoting sales of sound recordings and artists; and through converting listeners from royalty-free terrestrial radio – should not go unremarked.

330. As a legal matter, SoundExchange's effort to justify an expropriation of Sirius XM profits should be rejected on the ground that Section 801(b)(1) is properly interpreted to permit only a potential *downward* adjustment of the benchmark rates. SXM PCL ¶¶ 87-96. This understanding of Section 801(b) was reflected in the Judges' decision to adjust the benchmark rate downward under Section 801(b)(1)(D) in *SDARS I* and under Section 801(b)(1)(C) in *SDARS II* SXM PFF ¶ 95.

331. Moreover, the assertion that Sirius XM pays far too little (and should pay far more simply because it can) is a critique of the Judges' benchmarking determination in *SDARS II*, not a credible evaluation of the 801(b)(1) factors in relation to the benchmark rates. If, as is the case, no sound economic basis exists to raise Sirius XM's rates above their existing level – let alone more than double them – then surely no basis for such a windfall to the record industry can be found in the Section 801(b)(1) factors.

332. Unlike SoundExchange, in applying the Section 801(b)(1) factors, Professor Shapiro confined himself, reasonably, to analyzing whether any developments since *SDARS II* warranted a change in the Judges' findings as to Section 801(b) in that proceeding. He identified none pointing upward and at least one pointing downward (under the "relative contribution" factor): expected greater investment by Sirius XM during the coming license term (in the form of the purchase of two new satellites and other infrastructure upgrades) as compared with the current license term. Shapiro WDT at 31-34. These investments, Professor Shapiro testified, generate "consumer surplus" arising from Sirius XM's "creation and continued operation of a nationwide content delivery system." 5/4/17 Tr. 2607:10-17 (Shapiro); Shapiro WDT at 32-33. Despite finding that the contribution of the record labels would be "almost certainly significantly less" than that of Sirius XM over the coming license period, SXM PFF ¶ 232 (quoting Shapiro WDT at 58), Professor Shapiro concluded that balancing the parties' contributions under the third factor did not lend itself to quantification of an appropriate downward adjustment. *Id.*

333. In addition, in his analysis of the first objective – "maximizing the availability of creative works to the public" – Professor Shapiro noted the evidence developed in this proceeding that Sirius XM is less substitutional for other record company revenues than the non-interactive webcasters whose agreements comprised his *Web IV*-derived benchmark, *see* Shapiro WDT, Appx. D, but (taking a conservative approach) he declined to make a downward adjustment because of the difficulty of quantifying it. SXM PFF ¶ 230.

334. As for the second factor – fair return for the copyright owners and fair income for the copyright user – Professor Shapiro found no basis for an adjustment in the absence of evidence that the *Web IV* benchmark, as translated into a percentage-of-revenue rate for Sirius XM, failed to meet this objective. SXM PFF ¶ 231.

335. And as for the fourth factor, "minimization of disruption," Professor Shapiro found no evidence that either Sirius XM or the record industry (for which Sirius XM royalties are a low single-digit percentage of its overall revenues) would be disrupted if the rates were set in the range proposed by Sirius XM, i.e., no higher than the current rate. SXM PFF ¶ 233.

336. In its proposed findings, SoundExchange does not even mention, much less engage with, Professor Shapiro's analysis. Instead, it urges the Judges to reverse their 801(b)(1) findings in *SDARS II* (and, for that matter, in *SDARS I*), despite the absence of any substantial shift in the parties' relative contributions to Sirius XM's service or a fundamental change in the nature of that service that is not captured in the benchmark rates or perhaps an imminent threat to the survival of the record industry.

337. SoundExchange's 801(b)(1) argument rests instead on the following faulty foundations: (i) the false premise that Sirius XM has been subsidized since *SDARS I* by rates far below market rates; (ii) the counterfactual assertion that the investments made and risks undertaken by the record companies in creating sound recordings outweigh the investments and risks undertaken by Sirius XM in connection with its satellite radio service; (iii) the legally unfounded claim that the record companies are somehow entitled to more than twice as large a share of Sirius XM's revenues as they currently receive in order to compensate for the impact of all manner of streaming services (i.e., other market participants) on their business models; and (iv) the legally irrelevant assertion that Sirius XM can afford to – and therefore should – pay drastically higher royalties to SoundExchange. As noted, none of these arguments is grounded in a defensible interpretation or application of Section 801(b)(1).

338. Rather than look at whether any changes had occurred since *SDARS II* that might warrant an adjustment from the benchmark rates under one or more 801(b)(1) factors as

Professor Shapiro did, SoundExchange instead trumpets the fact that Sirius XM has thrived financially under the *SDARS II* rate and tries to persuade the Judges to depart drastically from *SDARS II* on that basis alone.

339. Given the nakedly redistributionist nature of SoundExchange's 801(b)(1) argument, it is hardly well-positioned to exhort the Judges not to invoke the third 801(b)(1) factor "in a way that one party is compelled to prop up the risk-adjusted return on investment of another," **SE PFF 1440**. It is true, as the Judges observed in *Web IV*, that the statute "neither requires nor permits the Judges to protect any given business model proposed or adopted by a market participant," 81 Fed. Reg. at 26329, but it is SoundExchange's 801(b)(1) argument, not Sirius XM's, that contravenes these principles.

A. First Statutory Objective: Maximizing the Availability of Copyrighted Works (*SE PFF § X.B.1*)

340. In *SDARS II*, the Judges found "no probative evidence to warrant an adjustment from a market-derived benchmark" under this factor. 78 Fed. Reg. at 23067. This is consistent with SoundExchange's view that this objective is satisfied by a market rate, *see* **SE PFF 1441**, and with Professor Shapiro's analysis (although he notes the downward thrust of SoundExchange's demonstrable promotional value). Without identifying any material change from the evidence as to this factor that was before the Judges in *SDARS II*, SoundExchange argues that the Judges should "depart upwards from the benchmark rate, or at least set a rate at the upper end of the range of rates" on the ground that a higher rate "will incentivize record companies and artists to make more works available to the public." **SE PFF 1444**. Instead of offering a persuasive justification for the Judges to revisit their prior conclusion as to this factor, SoundExchange, in Section X.B.1, merely offers truisms such as that revenue "encourage[s] record companies to make sound recordings available to the public," **SE PFF 1444**, which not

only are not new evidence but also do not elucidate how properly determined market rates fail to ensure that record companies are fairly compensated. Hence, this argument, which runs from **SE PFF 1446-1461**, has no probative value and should be disregarded.

341. On the other side of the coin, SoundExchange erroneously ascribes to Sirius XM the claim that it is entitled to a downward adjustment based on its promotional effect. **SE PFF 1462**. But, as noted, Sirius XM is not seeking such a downward adjustment from market benchmarks – even though the record in this proceeding contains (i) stronger evidence of Sirius XM's promotional effect on CD and download sales than was available in *SDARS II* and (ii) evidence that Sirius XM is less substitutional for other record company revenues than non-interactive streaming services. *See* SXM PFF ¶¶ 56-65, 151-55, 213-19; Shapiro WDT at 55-56 & Appx. D.

342. SoundExchange also contends in **SE PFF 1464** that there is no evidence that Sirius XM would play more recordings if the statutory royalty rate were lower, but Sirius XM does not claim it would. Instead, Sirius XM argues – as the evidence shows – that its creation and programming of a new nationwide content-delivery platform has enhanced the public exposure of sound recordings and artists and thereby promoted sales of sound recordings and that (as all of the survey experts agree) it benefits the record companies by substituting primarily for terrestrial radio, which pays no royalties. SXM PFF § I.C; SXM PFF ¶ 217-18.

B. <u>Second Statutory Objective: Fair Return/Fair Income (*SE PFF § X.B.2*)</u>

343. In *SDARS II* the Judges found "no justification in this proceeding for an adjustment either up or down" pursuant to this factor, 78 Fed. Reg. at 23067 – a conclusion endorsed by SoundExchange, *see* **SE PFF 1441**, and shared by Professor Shapiro. SoundExchange nevertheless argues that the current statutory rate "does not afford a fair return

to copyright owners, especially given today's economic conditions," **SE PFF 1465**, but this critique goes to benchmarking and is, in any event, thoroughly refuted by Professor Shapiro.

344. The bulk of SoundExchange's argument concerning "fair income" in Section X.B.2 – centered on the claim that record companies "are increasingly dependent on the digital exploitation of sound recordings from services like Sirius XM," **SE PFF 1465** – is effectively a request for subsidization, which SoundExchange wrongly accuses Sirius XM of making and which the Judges have found to be improper. *See Web IV*, 81 Fed. Reg. at 26329 (the statute "neither requires nor permits the Judges to protect any given business model proposed or adopted by a market participant"). Specifically, in paragraphs **SE PFF 1468-1491**, SoundExchange claims that record companies are not being fairly compensated as a result of the rise of streaming services – a phenomenon largely unrelated to Sirius XM – which, it contends, has led consumers to embrace access to music rather than purchases of it. *See* **SE PFF 1480**. Whatever the actual effect of streaming on the record companies, SoundExchange's portrayal of this phenomenon does not support, let alone establish, the proposition that market rates do not provide the record companies with "fair" income, as the Judges found they did in *SDARS II*. And it certainly does not compel requiring Sirius XM to offset the impact of other market participants on record industry revenues.

345. The rise of streaming services is not a new development. In *SDARS II* the Judges noted SoundExchange's emphasis on the importance of digital revenues for copyright owners but found "no material change in that trend in the current record that would warrant an upward adjustment from a marketplace-derived benchmark rate." 78 Fed. Reg. at 23067. Nothing in the record here warrants a different conclusion: there is no sense in which any of the (overstated) changes that have occurred in how music is consumed since *SDARS II* have suddenly made the

rates set in *SDARS II*, and those dictated here by Professor Shapiro's benchmarking analysis, "unfair." Indeed, SoundExchange's acknowledgement that this objective is satisfied by market rates, *see* **SE PFF 1441**, is a concession that they are not.

346. Turning to "fair return to the copyright user," SoundExchange argues that Sirius XM "can well-afford an increase in rates," **SE PFF 1466**, and it devotes **SE PFF 1492-1552** to this irrelevant assertion. Ability to pay is not pertinent to either a willing buyer/willing seller negotiation (which turns on contribution margin, not overall profitability, *see* Shapiro CWRT at 50) or to any of the 801(b)(1) factors, at least where, as here, no disruption has been advanced. SXM PFF ¶ 233**.** Accordingly, SoundExchange's exhaustive (and exhausting) attempt to demonstrate, through regurgitation of Professor Lys's testimony, that Sirius XM earns more than a fair return, *see* **SE PFF 1492-1552**, should have no bearing on the Judges' rate-setting.

347. Moreover, SoundExchange does not even acknowledge that Professor Lys himself testified in *Web IV* that it is inappropriate to consider the overall profitability of the licensee under a willing buyer/willing seller analysis, which SoundExchange's own experts assert is synonymous with the first three 801(b) factors. *See* SXM PFF ¶ 117. Professor Lys's about-face on this issue defies satisfactory explanation, and SoundExchange does not even try to offer one.

348. In sum, as Professor Lys acknowledged in *Web IV*, at least as it relates to the first three factors, no defensible interpretation of Section 801(b)(1) justifies trimming Sirius XM's profit margin in accordance with SoundExchange's arbitrary notion of fairness.

C. Third Objective: Relative Contributions (*SE PFF § X.B.3*)

349. In *SDARS II*, the Judges found no basis for an adjustment pursuant to the third 801(b)(1) objective with the exception of Sirius XM's "substantial financial outlays" to support its satellite technology, which they found were unique to Sirius XM and were not similarly borne by the internet streaming services in SoundExchange's proposed benchmark market. *See* 78 Fed.

Reg. at 23069. On this basis, the Judges adjusted the 12%-13% upper bound of the range of reasonable rates down to 11%. *Id.* at 23069, 23071.

350. As noted, Professor Shapiro testified in this proceeding that Sirius XM's planned investments for the upcoming license period exceed those it made in the current license term, and this, coupled with the lack of evidence suggesting any increase in expenditures by the record labels on the creation of new sound recordings, points to a downward departure from the benchmark rates (although he refrained from attempting to quantify such an adjustment and did not factor one into his proposed range of reasonable rates). Shapiro WDT at 33.

351. SoundExchange – again contradicting its contention that the first three 801(b) factors are satisfied by market rates, *see* **SE PFF 1441** – argues that, contrary to *SDARS II*, the third objective "counsels for a rate above the benchmark, or at the high end of the benchmark range." **SE PFF 1554**. The "support" offered for this proposition consists of circumstances that have long prevailed in the recording industry, such as that "[t]he hunt for artistic talent is long, competitive, and unsuccessful far more often than not." **SE PFF 1554**. This, of course, was true at the time of *SDARS II* (and long before), and thus does not warrant departure from the benchmark rates.

352. In its recitation of the record evidence concerning record company costs in **SE PFF 1555-1563**, SoundExchange makes no effort to identify either a shift as compared to the record evidence in *SDARS II* or a shift in relation to the costs incurred by Sirius XM since *SDARS II*. Accordingly, these proposed findings are probative of nothing.

353. That Sirius XM's satellite costs "are a small percentage of its overall revenues," **SE PFF 1565**, is not relevant. The relevant inquiry concerns Sirius XM's investments in its service relative to the investments made by the record companies (and allocable to Sirius XM) in

creating sound recordings and relative to the investments made by the benchmark services. As to these issues, there is no evidence that the record companies are investing more to create sound recordings than they did at the time of *SDARS II* or that Sirius XM's satellite and other infrastructure costs do not continue to differentiate it from streaming services, as the Judges found in *SDARS II*. *See* 78 Fed. Reg. at 23069.

D. Fourth Objective: Minimizing Disruption (*SE PFF § X.B.4*)

354. In its discussion of disruption in Section X.B.4, SoundExchange argues that a more than doubling of the current rate would not be disruptive of Sirius XM because Sirius XM "is easily capable of paying SoundExchange's proposed rates." **SE PFF 1575**. The Judges need not be diverted by this claim, as Sirius XM is not arguing for a disruption adjustment in this proceeding (nor did the Judges make a disruption adjustment in *SDARS II* that requires revisiting in this proceeding). SoundExchange goes on, however, to make the misguided argument that *the record industry* faces disruption because "Sirius XM is paying below-market rates for the use of sound recordings which gives Sirius XM an unfair advantage relative to competing digital music services that pay higher royalty rates." **SE PFF 1584**.

355. Putting aside the inconvenient facts that Sirius XM is *not* paying below-market rates – if anything, the current rate is above the market rate, *see* Shapiro WDT at 31, and that higher royalty rates paid by other services reflect the value of the added functionality offered by those services, *see* SXM PFF ¶¶ 82, 236-38, SoundExchange makes no effort to tie its argument to the legal meaning of disruption under Section 801(b)(1)(D).

356. In *SDARS II* the Judges held that a rate could be considered disruptive if it "directly produce[d] an adverse impact that is substantial, immediate, and irreversible in the short-run because there is insufficient time for either the SDARS or the copyright owners to adequately adapt to the changed circumstances produced by the rate change and, as a

consequence, such adverse impacts threaten the viability of the music delivery service currently offered to consumers under this license." 78 Fed. Reg. at 23069 (quoting *SDARS I*, 73 Fed. Reg. 4097). As Professor Shapiro explained, Sirius XM royalties are too small to have a disruptive effect on the recording industry, Shapiro WDT at 59, and Sirius XM's revenue relative to that of other services has no logical bearing on disruption as the Judges have defined it. Accordingly, paragraphs **SE PFF 1584-1597** can safely be disregarded.

E. <u>Conclusion</u>

357. SoundExchange concludes its 801(b)(1) discussion by reiterating the (false) theme that record companies and artists have (involuntarily) been subsidizing Sirius XM by means of below-market statutory rates. *See* SE PFF § X.E. The remedy SoundExchange proposes for this purported injustice – that the record companies "should share in Sirius XM's current financial success," SE PFF at 648 (heading C) – is not grounded in Section 801(b)(1), and it fails glaringly to acknowledge that under the percentage-of-revenue rates in place during the current license term, the record companies and artists *have already benefitted substantially* (and automatically) from Sirius XM's financial success. *See* SXM PFF ¶ 114. Under Sirius XM's proposed rates, moreover, the record companies will *continue* to share handsomely in Sirius XM's success over the upcoming license term *even without a rate increase, let alone the unwarranted doubling SoundExchange seeks*.

358. In short, SoundExchange has failed to put forth any credible argument that might support an upward adjustment based on the Section 801(b)(1) objectives. There is no factual basis for SoundExchange's contention that the statutory rate "has resulted in what is essentially a one-to-one transfer of wealth from artists and copyright owners to Sirius XM shareholders," **SE PFF 1606**, nor is there any basis in the Section 801(b)(1) factors for the requested massive redistribution of revenue from Sirius XM to the record companies.

VII. SOUNDEXCHANGE'S PROPOSALS REGARDING TRIAL SUBSCRIPTIONS SHOULD BE REJECTED (*SE PFF § XI*)

359. SoundExchange has proposed a change to the way Sirius XM trial subscriptions are handled by the governing regulations. If Sirius XM offers unpaid trial subscriptions of 30 days or less, no payment is required. (These consumers are not considered "subscribers" under SoundExchange's definition.) That is limited, however, to one free month every two years. If Sirius XM offers unpaid trial subscriptions of more than 30 days, the first month is royalty free, then the second and third months require a per-subscriber royalty payment at specified amounts that are approximately 60% of the "standard" per-subscriber fee that SoundExchange proposes for Sirius XM. For unpaid trials in the fourth month or more, Sirius XM would owe the standard per-subscriber fee.[36]

360. SoundExchange proposes to treat *paid* trials (trials in which the OEM pays Sirius XM a fee for the trial) differently. Paid trials would require a full per-subscriber payment from day one: no royalty-free first month, and no reduced rate in months two and three.[37]

361. Finally, SoundExchange's proposed findings suggest how revenue from trial subscriptions should be reported in the event the Judges do not institute a monthly per-subscriber fee metric. SoundExchange suggests that in that instance, Sirius XM would need to impute ("gross up") a full payment from each trial subscriber and include that amount in its Gross

[36] It is not totally clear from SoundExchange's proposal whether or how the two-year limitation applies with respect to trials over 30 days.

[37] The difference in treatment between paid and unpaid trials is not explained and may be unintentional. In **SE PFF 1632**, SoundExchange writes that its "approaches are appropriate to both paid and unpaid trials," and at other points seems to assume that paid trials will be handled solely under its proposed percentage of revenue fee metric. *See, e.g.*, **SE PFF 1610**. In any event, for reasons we discuss below, SoundExchange has failed to demonstrate why paid trials should be treated differently under its proposed rates and terms than unpaid trials.

Revenues reported to SoundExchange. **SE PFF 1631**.[38] This "phantom revenue" approach, as Professor Shapiro has termed it, Shapiro CWRT at 54, does not appear in SoundExchange's actual Amended Proposed Rates and Terms.

362. Before addressing the merits of SoundExchange's proposal, it should be noted that it would have a *massive* financial impact on Sirius XM. If Sirius XM averages about [redacted] unpaid trial subscribers per month in 2018 (as projected), and pays SoundExchange's proposed $1.45 for the second and third months of each such subscription, that would add approximately [redacted] to Sirius XM's royalty burden for the year (before any direct license or pre-1972 reduction).[39] With respect to Sirius XM's projected [redacted] paid trials – for which Sirius XM would have to pay the full subscriber fee for every month of the trial – the annual per-subscriber royalty burden would be roughly [redacted] (again, before application of the Direct License and Pre-1972 Recording Shares).[40] By comparison, the payment for these paid trial subscribers at the current 11% of revenue rate would be approximately [redacted][41] Even assuming the Direct License Share and Pre-1972 Recording Share total 20% of performances, SoundExchange's free trial proposal alone would add roughly [redacted] ***per***

[38] More specifically, the full payment would be the so-called "royalty base ARPU," the average per-user revenue reported to SoundExchange. Whether that is intended to mean the *current* royalty-base ARPU or float with each reporting period is not specified.

[39] *See* Trial Ex. 663 (Consolidated Outputs tab) at row 31, column HP. [redacted]

[40] *See* Trial Ex. 663 (Consolidated Outputs tab) at row 30, column HP. [redacted]

[41] This assumes, based on recent experience (under the current Gross Revenues definition), that [redacted]% of Sirius XM's [redacted] in projected subscription revenue for 2018 is reportable revenue from paid trials. *See* Trial Ex. 663 (Consolidated Outputs tab) at row 150, column HP (projected 2018 subscription revenue); Trial Ex. 149 (SX Summary Sep16 tab) at row 5 (Promo Revenues of $[redacted] and row 16 (Total Subscription Revenue of $[redacted] [redacted] = $43 million. *See also* Frear WRT ¶ 11 (noting that [redacted] of Sirius XM's 2016 royalty payments to SoundExchange, or [redacted] was generated by paid trials).

year to Sirius XM's royalty burden as compared to current rates[42] – on its own about 40% of the [redacted] Sirius XM paid to SoundExchange in 2016. *See* Meyer WDT ¶ 19.

363. SoundExchange advances two flimsy arguments in favor of this rate increase. First, it argues that royalty-free trials are limited to [redacted] days when offered by interactive and mid-tier streaming services. **SE PFF 1612-15**. It claims there is "no sound economic basis" to treat Sirius XM differently, although, it does so without offering any rationale as to *why* the two service categories should be treated the same (other than Mr. Orszag's say-so), and in disregard of the many relevant distinctions identified by Mr. Frear. **SE PFF 1616**. Second, SoundExchange argues that Sirius XM can "game" the system by shifting from paid to unpaid trials. **SE PFF 1626-27**. Neither of these arguments can justify SoundExchange's confiscatory (and counter-productive to the music industry) proposal.

364. Most notably, SoundExchange has failed completely to demonstrate *why* Sirius XM's trials should be treated the same as streaming internet services. Indeed, it has not really tried. Instead, it offers only bald statements from Mr. Orszag and counsel that such treatment would be "consistent" with market benchmarks (**SE PFF 1611**) and that there "is simply no reason" for Sirius XM to be treated differently (**SE PFF 1616**).

365. Sirius XM, by contrast, provided detailed testimony – much of it previously summarized in Sirius XM's initial proposed findings – identifying the myriad ways that Sirius XM trials are different, and why a thirty-day limit would contravene sound commercial practice. *See generally* SXM PFF § IV.C. In both his written and oral testimony, Mr. Frear drew upon his 14 years of experience at the Company to explain precisely how Sirius XM's trial subscribers

[42] This represents [redacted] million in additional per-subscriber fees for unpaid trials, [redacted] in per-subscriber fees for paid trials, less [redacted] in fees that would be paid for the free trials at the current percent of revenue rate [redacted] reduced by [redacted], which equals [redacted]

differ from Spotify and other streaming services, and why the proposed 30-day trial limit for such service is unsuitable for Sirius XM.

366. Unlike the interactive services, Sirius XM spends massive amounts – $[redacted] in radio and chipset subsidies and $[redacted] in revenue share in 2016 alone – in order to provide trials and attempt to convert the trialers into paying subscribers. Frear WRT ¶ 13; SXM PFF ¶¶ 346-47. Even having made that massive investment, Sirius XM has determined that it is in its business interest also to forego payments from subscribers for three months (almost all unpaid trials are three months) so that consumers can sample the service and, it is hoped, convert into paying subscribers. *See* 5/17/17 Tr. 4446:16-4447:17, 4452:21-4454:4 (Frear). Sirius XM does so even though some [redacted] of trial subscribers do not convert, and Sirius XM is therefore spending hundreds of millions of dollars on radios and subsidies for consumers who do not become customers. Frear WRT ¶ 13.

367. There are fundamental, entirely legitimate reasons for proceeding in this fashion. As Mr. Frear testified, consumers need to "try before they buy." Frear WRT ¶ 9. As a matter of basic marketing, Sirius XM simply needs longer than 30 days to effectively allow that experience and maximize the prospects of converting trial subscribers into paying customers. Mr. Frear's written and trial testimony detailed the many practical reasons for this allowance, including: the lack of basic contact information for the trial subscriber until several weeks into the trial, *see* Frear WRT ¶¶ 14-16, 22; the limited direct engagement with trial subscribers as a result of Sirius XM's one-way interface, *id.* ¶¶ 23-24, 5/17/17 Tr. 4448:19-4449:12 (Frear); the reliance on direct mail and telephone marketing as opposed to in-app or email contact, Frear WRT ¶¶ 16-17; the reliance on car-dealership staff to set up and introduce consumers to the

service, *id.* ¶ 24; and the more gradual exposure of trial subscribers to the product given its in-car availability, *id.* ¶ 25. *See generally* SXM PFF ¶¶ 348-53.

368. Informed by these marketing and logistical realities, Sirius XM has continued to tweak and refine its trial program over the past fifteen years, carefully working to optimize the complicated interplay between (among many relevant factors) OEM subsidies, short-term revenue sacrifice, conversion rates, and long-term subscription payments, all in an effort to drive paid subscriptions and revenue:

> We're really not incented to do long unpaid trials because if we don't -- if we aren't charging the subscriber, we're not making any money. And that just doesn't work for us. So, you know, we're -- we want to keep the trial period as short as we can, but it has got to be long enough to engage the subscriber, get them using the service, and that takes a few iterations. And economically since I came from the Sirius side, I think long paid trials are probably a little bit better, but the problem with that is you have got an automotive partner on the other side whose job it is to minimize cost per car. They don't really want to pay for a year of service. So you have to balance all that out, which I think we have pretty successfully over 15 years.

5/17/17 Tr. 4453:13-4454:4 (Frear).

369. Complementing Mr. Frear's fact testimony – and in stark contrast to Mr. Orszag's unsourced *ipse dixit* that the same trial length for interactive services is necessarily "appropriate" for Sirius XM – Professor Shapiro developed a rigorous econometric model that carefully analyzed both the costs to a record label of offering trials as well as the benefits to the label if the consumer converts into a paying subscriber. His modeling showed that if it is in Sirius XM's business interest to offer free trials, it is in the record industry's interest to allow them, royalty free, for the period Sirius XM deems appropriate. *See* Shapiro CWRT at 55-56 & Appx. E. Notably, the same is not true of trials for interactive services. For clarity, it is worth quoting Professor Shapiro on this point at some length:

> Mr. Orszag has provided no reason why subscription interactive services are a good benchmark for Sirius XM when it comes to the duration of unpaid trials. Critically, he has not examined the costs and benefits of unpaid trials to understand how the unpaid trial duration for different music services is determined. I have performed that analysis. The details of my analysis are given in Appendix E.
>
> […]In effect, [Mr. Orszag] treats the waiver of royalties as a gift that record companies give to Sirius XM for the duration of the unpaid trial. This is not correct as a matter of economics. One could just as well say that Sirius XM is giving a gift to the record company by sacrificing its own revenue for the duration of the unpaid trial. Indeed, Sirius XM is sacrificing far more revenue than is any one record company, or even all of the record companies as a group.
>
> The proper way to analyze these unpaid trials is to view them as a joint effort by Sirius XM and the record company to attract more Sirius XM subscribers – especially since many of these customers would otherwise listen to terrestrial radio, which generates no royalties for record companies. For both Sirius XM and the record company, unpaid trials are a promotion designed to attract customers and thus increase their future revenue. In studying that joint promotion effort, and the negotiations between Sirius XM and a record company over how the royalties for recorded music will be treated during the unpaid trial, the key question is how long each party would like the unpaid trials to last.

Shapiro CWRT at 55. Professor Shapiro provides the answer to his "key question": because the labels get significant benefit when Sirius XM subscribers convert, and do so with little cost relative to that expended by Sirius XM, "the record company would agree to waive its royalties for as long as Sirius XM would choose to run unpaid trials. Since Sirius XM chooses to run unpaid trials for two to three months, this analysis implies that record companies would be willing to waive their royalties for that period of time as well." *Id.* at 55-56.

370. As Professor Shapiro's testimony makes clear, that approach is not "gaming" the system, and it is not just unfairly or inequitably giving away the record industry's product (or lining Sirius XM's pockets) without payment. *See* **SE PFF 1610-11, 1626-27**. It is following

sound and rational business practices that result in more revenue for Sirius XM *and also more revenue for SoundExchange and its members*.[43] *Accord* 5/17/17 Tr. 4461:4-11 (Frear) ("So 30 days definitely is not enough, it is not going to optimize what is, I think, a shared interest here, that as we to go to maximized the revenue that we can get out of our enabled vehicle fleet, that that is going to benefit the music industry. I think what we have here so far has actually served everybody pretty well over the years. . . . I wouldn't suggest changing it.")

371. Finally, Professor Shapiro also showed that the per-subscriber fees SoundExchange proposes for Sirius XM are *four times* the size of what interactive services pay for users who shift from their trial to the free, ad-supported tier. Shapiro CWRT at 56. In other words, SoundExchange is not even consistent in applying to Sirius XM what interactive services *actually pay* for most free users. *See also* Frear WRT ¶ 12 (discussing availability of free tier after Spotify trial concludes that Sirius XM does not offer).

372. SoundExchange's efforts to respond to Sirius XM's witnesses fall far short. SoundExchange's first attack is a reprise of its defense of Professor Willig's monopoly opportunity cost model, namely, that Professor Shapiro's model is wrong because it did not treat record labels as "must have" providers when calculating opportunity cost. **SE PFF 1617-20**. In Section II above (and the sources cited there), however, Sirius XM demonstrated that the opportunity cost calculation for a must-have label is the equivalent to the opportunity cost calculation of a monopoly seller of sound recordings or fully effective cartel, fails to allow for steering or competition between labels, and is fundamentally at odds with the CRB goal of

[43] SoundExchange claims in **SE PFF 1630** that trial subscribers are valuable to Sirius XM because they could turn into full paying customers, and that it "makes no sense" for Sirius XM not to pay the record industry for those trials. But as demonstrated by Professor Shapiro, it makes perfect sense: the value of the trial that SoundExchange readily acknowledges is valuable to SoundExchange as well, and should be encouraged.

identifying rates that would prevail in an effectively competitive market. In short, Professor Shapiro was completely correct to reject that assumption in his modeling.

373. SoundExchange also denies that the many differences Mr. Frear described between Sirius XM and interactive services either exist or are meaningful. **SE PFF 1621-25**. These critiques are not supported by any analysis, however, but instead amount to uninformed second-guessing of Sirius XM's marketing efforts. *See, e.g.*, **SE PFF 1622** (*i.e.*, that it is mere "conjecture" that Sirius XM needs more than 30 days to optimally convert subscribers); **SE PFF 1623** (claiming that Sirius XM could require credit card information by trial subscribers and automatically subscribe them at trial end if it wanted to); **SE PFF 1624** (that Sirius XM's planned 360L product will create a two-way interface with customers and eliminate the distinction with interactive services on that front).[44]

374. SoundExchange's Monday-morning quarterbacking of Sirius XM's trial strategy is coupled with presumptuous assertions about how Sirius XM should change its business practices in the ways Mr. Orszag and SoundExchange's lawyers think is appropriate. Sirius XM, according to SoundExchange, could "adjust its business" to "recalibrate its free trial program" and "increase its conversion rates"– as if it does not currently attempt to do so – and "simply . . . align[] its practices with the benchmark interactive services." **SE PFF 1625**. As Mr. Frear said best, this suggestion "sounds like something coming from a guy who hasn't worked a day in the satellite radio business and never tried to sell subscription to anybody." 5/17/17 Tr. 4455:8-11 (Frear). The Judges obviously will decide who is more credible and who is offering

[44] With respect to Sirius XM's plans for 360L, *see* Section VIII.C, *infra*, which describes the high degree of uncertainty around the timing and scope of the rollout of that product. For reasons discussed in that section, the gradual introduction of 360L over the next several years provides no justification whatsoever for imposing a royalty scheme from the interactive services on Sirius XM.

"conjecture": Mr. Frear with his years of in-the-trenches experience in the satellite radio business, or Mr. Orszag with his pat advice as to how Sirius XM can simply "adjust its business" on a dime to comply with the record industry's view of the world.

375. SoundExchange's proposal regarding trial subscriptions suffers from several other weaknesses that warrant discussion. As noted above, that proposal differentiates between paid trials (where Sirius XM receives some payment from the auto manufacturer) and unpaid trials (where there is no such payment). Sirius XM would need to pay a full per-subscriber fee for paid trials, no different than "regular" self-paying subscribers, from the very first month of the trial. For unpaid trials, by comparison, SoundExchange proposes a free first month, a discounted rate for months two and three, then full payment for any additional trial months. **SE PFF 1611**. SoundExchange has failed to justify these distinctions.

376. Mr. Orszag's explanation for the reduced per-subscriber royalty in the second and third months of an unpaid trial is that the trial subscribers reflect a mix of those who will convert into subscribers and have a willingness to pay for music, and those who will not convert and have no such willingness to pay; his proposed rate therefore weights for the presence of those two different groups within the universe of unpaid trial subscribers. *See* **SE PFF 1634-37**. But that same logic applies equally to paid as to unpaid trials: while the *automaker* may make a payment to Sirius XM, that payment is invisible to consumers and irrelevant to *their* ultimate willingness to pay for the service. The OEM-paid trial subscriber pool will still reflect a mix of consumers who *are* and those who *are not* willing to convert and pay on their own when the trial ends.[45]

[45] The revenue paid by the OEM will be included in the Gross Revenues used to calculate the royalties owed under the percentage-of-revenue royalty, but that is a separate issue and a separate calculation from the applicable per-subscriber royalty.

377. It is possible this is just an oversight – SoundExchange itself says in **SE PFF 1632** that "these approaches are appropriate with respect to both paid and unpaid trials." It could also reflect the ongoing discrepancies between SoundExchange's Proposed Terms and Mr. Orszag's testimony. For example, Mr. Orszag's amended written direct testimony argued for the *same treatment* for paid and unpaid trial subscribers: one month royalty-free followed by full payment beginning in the second month of the trial. *See* Orszag AWDT ¶ 90 & n.113 (arguing that parallel treatment would limit Sirius XM's incentive to switch from paid to unpaid trials). SoundExchange's original rates and terms, meanwhile, provided only that *unpaid* trials of 30 days or less would be royalty-free. It was not until the rebuttal round that Mr. Orszag outlined his "different willingness to pay" rationale (along with the suggestion that trials should be paid at a lesser per-subscriber rate), and that proposal did not make its way into SoundExchange's Proposed Terms until two weeks ago – and then, once again, only for *unpaid* trials.

378. In any event, Mr. Orszag has never explained, nor does SoundExchange now, why it would subject paid trials to a full per-subscriber payments from day one while offering a free month and discounted second and third months to unpaid trials. Nor does either explain why it would be appropriate to cut off the discounted per-subscriber fee after the third month. SoundExchange just "submits" that it should apply only in the second and third month, and that it would be "unnecessary and inappropriate" after the third month, **SE PFF 1634**, but nothing in Mr. Orszag's presentation would support such a distinction.[46] Similarly, neither Mr. Orszag nor

[46] Mr. Orszag's suggestion that Sirius XM "gross up" its revenue for discounted paid trials to full "royalty base ARPU," *see* **SE PFF 1631**, has *not* found its way into SoundExchange's proposed rates and terms. Nor should it. Professor Shapiro demonstrated in great detail that that "phantom revenue" proposal was mathematically unnecessary because the discounted revenue for paid trails was *already included in and accounted for* in the economists' rate-setting models, which are premised on the average revenue collected across subscribers, including those paying

Mr. Bender justified the two-year limitation on free trials that appears in its proposal (a limit that SoundExchange's Proposed Terms document suggests is drawn from the Section 115 regulations, of all places); as Professor Shapiro demonstrated, if Sirius XM is willing to forego subscription revenue for an additional month and offer a subscriber a new trial within 24 months of the first, it is in the economic interest of the record companies to allow that as well. *See* Shapiro CWRT at 55-56 & Appx. E.

379. For all the reasons above, Sirius XM proposes no change to current regulations regarding trial subscriptions. The current structure has served both Sirius XM and the record industry well for more than ten years, with Sirius XM's steadily growing subscriber base and revenues – owing in large part to Sirius XM's successful trial subscription strategy – resulting in ever-increasing royalties to SoundExchange and its members. SoundExchange's proposed radical change to the royalty treatment of trial subscribers would prove incredibly disruptive, both from a financial and business and marketing perspective; for reasons indicated by Mr. Frear and Professor Shapiro, it ignores the unique realities of Sirius XM's business and would likely prove to be counterproductive to the artists and record companies on whose behalf SoundExchange makes its proposal. Such radical changes should not be imposed on a record so thin as that developed by SoundExchange here, a record that reduces to SoundExchange simply stating that Sirius XM should be limited to 30-day trials like the interactive services, but not demonstrating why it should be so.

380. That said, if the Judges were to conclude that Sirius XM should not be able to offer trials without a royalty payment for an indefinite period, the appropriate royalty-free

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at discounts and those paying above the average (e.g., full-price subscribers). *See* Shapiro CWRT Appx. E at 2-4.

window would be three months, not 30 days, for all the practical reasons Mr. Frear explained. *See* Frear WRT ¶ 26; 5/17/17 Tr. 4461:23-4462:12 (Frear).

VIII. SOUNDEXCHANGE'S PROPOSED GREATER-OF RATE STRUCTURE AND DEFINITION OF GROSS REVENUES SHOULD BE REJECTED (*SE PFF § XII*)

A. SoundExchange's Proposed Greater-Of Rate Structure Should Be Rejected (*SE PFF § XII.A*)

381. In Section XII.A of its proposed findings (**SE PCL 25, SE PFF 1644-67**), SoundExchange requests a "greater of" rate formula, despite the fact that the Judges have consistently rejected such a structure throughout the past decade of Section 114 rate proceedings. *See Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 72 Fed. Reg. 24084, 24090 (May 1, 2007) ("*Web II*") (rejecting rate proposals based on the "greater of" a per-performance rate or a percentage of revenue, in favor of a straight per-performance rate); *SDARS I*, 73 Fed. Reg. at 4084-87 (rejecting SoundExchange's proposal based on the "greater of" a per-subscriber rate or a percentage of revenue, in favor of a percentage of revenue); *SDARS II*, 78 Fed. Reg. at 23071 (retaining percentage-of-revenue structure from *SDARS I*); *Web III Remand*, 79 Fed. Reg. at 23105 (retaining per-performance rate structure from *Web II*); *Web IV*, 81 Fed. Reg. at 26325-26 (rejecting "greater of" proposals by SoundExchange and Pandora, in favor of per-performance rate).

382. The economic advantages of retaining the current percentage-of-revenue structure for the SDARS are clear: as Sirius XM grows, SoundExchange shares equitably in that success by growing its royalties in proportion to the revenue; by the same token, both sides share the downside risk in the event that revenues for the service decline. *See* Shapiro CWRT at 2. By contrast, there is no sound economic basis for changing the rate structure to a "greater of" formula, as SoundExchange proposes. As Professor Shapiro explained, a "greater of" structure would shift the risk-sharing as between Sirius XM and SoundExchange asymmetrically in

SoundExchange's favor. It would have Sirius XM bear all of the risk of a decline in its revenue per subscriber (leaving the record industry fully protected from that risk) while, at the same time, allowing SoundExchange to share in any upside should Sirius XM's revenue per subscriber grow. *Id.*

383. Unsurprisingly, not a single one of the five economists who presented expert testimony on SoundExchange's behalf provided any rationale in support of changing the existing rate structure from a straight percentage of revenue to a "greater of" formula. In fact, Mr. Orszag, the one SoundExchange expert who did address the issue (but only when pressed on cross examination) stated that he was *not* proposing a "greater of" structure. As Mr. Orszag put it, "I am proposing one or the other." 4/26/17 Tr. 1261:20-24 (Orszag).

384. The Judges therefore should retain the percentage-of-revenue rate structure for the SDARS that has prevailed throughout the past decade—an arrangement that *SoundExchange itself proposed* in *SDARS II*. *See* 78 Fed. Reg. at 23061 (noting that SoundExchange and Sirius XM both proposed rates based on a percentage of revenue).

385. SoundExchange's new arguments in favor of a "greater of" formula are unpersuasive. First, SoundExchange notes that a number of its proposed benchmark agreements with interactive streaming services prescribe a royalty that is the greater of a percentage of revenue and an amount per subscriber. **SE PFF 1644-45**. As Professor Shapiro testified, however, the record labels' ability to demand a "greater of" rate structure in agreements with interactive services likely reflects their exertion of market power over those services. 4/20/17 Tr. 389:17-391:7 (Shapiro). As discussed at length in Section I above, the market to license interactive services demonstrates a complete absence of workable competition, rendering those benchmarks inappropriate for rate-setting here.

386. Second, SoundExchange contends that adding a per-subscriber prong to the rate structure would minimize the potential for disputes between Sirius XM and SoundExchange over the accounting of revenues. **SE PFF 1647-56**. While that would obviously be true if the royalty were structured *purely* as a per-subscriber fee (without regard to Sirius XM's revenues), *see* **SE PFF 1654** (citing 5/17/17 Tr. 4387:8-11 (Barry)), there is no reason to believe that a two-pronged "greater of" formula would accomplish that goal. Under a "greater of" structure, revenues still need to be calculated correctly in order to determine whether the revenue prong or the per-subscriber prong yields the greater royalty. Although SoundExchange misleadingly cites Mr. Orszag for its proposition that adding a per-subscriber "component" to the rate structure would minimize disputes over revenue, *id.*, Mr. Orszag merely observed that a "per-subscriber rate is easier to apply" than a percentage of revenue. Orszag AWDT ¶ 27. He did not opine that a "greater of" formula would or could minimize disputes over revenue, but in fact recognized that "utilizing a percentage-of-revenue metric" raises precisely those issues. *Id.*

387. Nonetheless, SoundExchange inappropriately uses this section of its proposed findings to rehash its one-sided portrayal of the parties' disagreements over revenue. *See* **SE PFF 1649-56**. As a part of this effort, SoundExchange violates the most basic evidentiary principles, relying on an audit report that the Judges rightly *refused* to admit as evidence of the truth of its contents. *See* **SE PFF 1652** (citing Trial Ex. 101*); 5/10/2017 Tr. 3177:9-20 (Bender) (Judges accepted the audit report not for its truth, but rather as "simply something that influenced the next actions that SoundExchange took"). As SoundExchange has freely admitted, the auditors who produced that report—none of whom were subject to cross examination in this proceeding—were retained by SoundExchange to participate in its litigation strategy to recover additional royalties from Sirius XM for the performance of pre-1972 sound recordings and non-

music Premier packages. *See* SoundExchange's Opposition to Sirius XM's Motion to Compel SoundExchange to Produce Audit-Related Communications Withheld on the Basis of Asserted Privilege, Docket No. 16-CRB-0001 SR/PSSR, at 4-5, 10 (Mar. 23, 2017); *see also* 5/10/17 Tr. 3229:21-3236:21 (Bender) (admitting that the auditor simply adopted SoundExchange's "legal" positions on the propriety of Sirius XM's revenue deductions). The Judges should disregard SoundExchange's improper and irrelevant assertions about the substance of the parties' revenue disputes.[47]

388. Third, SoundExchange argues that a per-subscriber rate would better capture the value Sirius XM receives from making sound recordings available to trial subscribers. *See* **SE PFF 1657-65**. As we discuss in Section VII, however, the value of sound recordings used in paid trials is already captured by a percentage-of-revenue structure. As to unpaid trials that generate no revenue for Sirius XM, the interests of sound recording owners would be served best by allowing unpaid trials to continue for whatever length of time Sirius XM determines is most advantageous. *See id*.

[47] We address in more depth the parties' disagreements over the definition of "Gross Revenues" in Section VIII.B below. For present purposes, suffice it to say that of the $[redacted] SoundExchange misleadingly claims Sirius XM owes based on the audit, nearly half (approximately $[redacted]) of that total is *interest* (given SoundExchange's indefensible position that interest should be charged at 18% per year back to January 2010), *see infra* ¶ 422, while the principle is almost entirely driven by the pre-1972 revenue exclusion that the Judges have since determined Sirius XM was entitled to take. *See* Trial Ex. 101* at 11 (audit report summary of pre-1972 exclusion); *Ruling on Regulatory Interpretation Referred by United States District Court for the District of Columbia*, No. 2006-1-CRB-DSTRA (Jan. 10, 2017), at 14 ("Finally, the Judges conclude that it would be anomalous to require Sirius XM to pay for pre-'72 recordings under a federal compulsory license when, by the unambiguous statutory language in section 301 of the Copyright Act, those recordings are not subject to federal copyright protection."); *id.* at 15 ("Although Sirius XM's use of internet listenership as a proxy may or may not have been the *optimal* method for tracking the value of pre-'72 recordings on the satellite service, it is *a* reasonable way to accomplish that task.").

B. <u>The "Gross Revenues" Definition (*SE PFF § XII.B*)</u>

i. SoundExchange's Proposed Changes to the Definition of Gross Revenues Should Be Rejected (*SE PFF § XII.B.1*)

389. SoundExchange begins its discussion by proposing that the definition of "Gross Revenues" be "clarified" to help avoid disputes and ease administration. It claims it is largely "retaining" the current definition, and acknowledges that its expert, Mr. Orszag, derived his rate proposal in the case in part on the revenue per user ([redacted]) reported by Sirius XM to SoundExchange under that current definition. **SE PFF 1668**.

390. Sirius XM agrees with SoundExchange that the current definition of "Gross Revenues" should be clarified, and has proposed certain refinements and changes itself. *See* SXM PFF ¶¶ 431-42, 480. Sirius XM takes exception, however, to the suggestion that SoundExchange is merely retaining and "clarifying" the current definition. SoundExchange is proposing significant, substantive changes to the definition that would remove previously available revenue exclusions and significantly increase the amount of reportable revenue (and thus royalties owed) by Sirius XM. Most notably, as discussed in Sirius XM's proposed findings, SoundExchange's proposed definition would eliminate Sirius XM's ability to allocate and exclude revenue from bundled packages attributable to data services and non-music programming. *See* SXM PFF ¶¶ 443-50. SoundExchange also proposes to eliminate the excludability of certain Sirius XM expenses (**SE PFF 1685-89**), to limit certain categories of excludable revenue to their underlying costs (**SE PFF 1690-97**), and to forbid fee exclusions that are not explicitly billed to customers (**SE PFF 1698-1705**). We discuss each of these in the sections that follow.

391. While it is difficult to estimate the precise effect of these changes, in September 2016 Sirius XM excluded [redacted] in non-music subscription revenue, [redacted] in data

service revenues, and [redacted] in transaction (credit card) fees [redacted] total). *See* Trial Ex. 149 ("SX Summary Sep16" tab). At the prevailing 10.5% royalty rate, those exclusions amounted to [redacted] in properly excluded royalties (before direct license and pre-1972 adjustments) that SoundExchange had no right to collect – the equivalent of [redacted] annually. At the 23% rate proposed by SoundExchange, including that revenue in reported Gross Revenues would have improperly increased Sirius XM's monthly royalty payment by [redacted] or [redacted] over a full year (again, before direct license and pre-1972 adjustments).

392. What is more, SoundExchange's Gross Revenues proposal has serious implications, not only for how much revenue will be reported by Sirius XM to SoundExchange going forward, but for the derivation of the percentage royalty rates themselves as calculated by the various experts in this proceeding. To explain, SoundExchange's experts, working from Sirius XM's payments during the last license period, have calculated Sirius XM's monthly per user payment to SoundExchange under the current Gross Revenues definition as $[redacted] per user per month. That $[redacted] figure was used directly by economists from both parties to convert monthly per-subscriber fees into proposed percent-of-revenue rates. (For example, Professor Shapiro divided $1.03 per-subscriber by $[redacted] to convert his *Web IV* benchmark into a rate of 9.6%.)[48]

393. If that monthly per user revenue figure were higher – as it would be under SoundExchange's proposed changes to the "Gross Revenues" definition – the derived percentage

[48] Professor Shapiro also calculated his *Web IV* benchmark using an ARPU of $12.80, which resulted in a proposed percent-of-revenue royalty of 8.1% ($1.03/$12.80). He explained that the appropriate ARPU to use in the calculation (and thus the appropriate rate between 8.1% and 9.6% derived therefrom) was that which matched the Gross Revenues that Sirius XM would have to report to SoundExchange during the forthcoming rate period. Shapiro CWRT at 2.

rate would, by simple math, have been *lower*. To ballpark this effect, adding an extra [redacted] in reported Sirius XM revenue in a month (as suggested above) would increase Sirius XM's reported per-subscriber revenue for that month by roughly $1.00 (given Sirius XM's over 31 million subscribers.) If one were to use that higher figure ($[redacted]) in Professor Shapiro's calculations, the suggested rate would be 8.8% rather than 9.6%.

394. Conversely, if the Judges were to set the rate at 9.6%, but then install the more expansive revenue definition proposed by SoundExchange, Sirius XM would unfairly be required to apply the statutory royalty rate against a *higher* measure of "gross revenues" (and pay more in royalties) than was assumed and used in the derivation of the 9.6%. Economists from both sides agreed that such a mismatch was inappropriate, and that the revenue definition used to derive the percentage rate should be the same as the revenue definition used to calculate payments during the upcoming license period. Lys WRT ¶ 154; 4/19/17 Tr. 212:5-213:21 (Shapiro); 4/25/17 Tr. 1000:16-1001:21 (Orszag). This, in addition to the reasons described below, counsels against the sort of expansive changes to the definition proposed by SoundExchange.

1. SoundExchange's Proposal to Limit Revenue Exclusions to Subscription and Advertising Revenue Should Be Rejected (*SE PFF § XII.B.1.i*)

395. SoundExchange proposes to limit the revenue exclusions in sub-paragraph (3) of the Gross Revenues definition (e.g., bad debt) to subscription and advertising revenue "otherwise included by paragraph (1) or (2)." **SE PFF 1669**. SoundExchange supports its proposal by identifying instances where Sirius XM allegedly reduced its reported revenue on account of

adjustments to revenue that was not part of the revenue base in the first instance ([redacted], *see* **SE PFF 1674, 1680-81**).[49]

396. As the parties' respective papers make clear, they do not disagree on the principal motivating this proposal, only its execution. As SoundExchange acknowledges, Sirius XM [redacted] **SE PFF 1677**. Sirius XM, meanwhile, takes SoundExchange at its word that it is not attempting to preclude the exclusion of revenue (equipment revenue, royalty revenue) that is not subscription or advertising revenue. *See* **SE PFF 1671, 1679**. The problem, however, is that SoundExchange's proposed language is at odds with, and sweeps more broadly, than the problem it purports to address, and introduces internal contradictions into the definition. *See* SXM PFF ¶ 475. Sirius XM submits that no change is necessary, and any issues will (as they have in the past) be identified and rectified as necessary in the audit process. SXM PFF ¶ 476.

2. The Current Revenue Exclusions for Certain Limited Expenses Should be Retained (*SE PFF § XII.B.1.ii*)

397. SoundExchange's new sub-paragraph (3)(v) of the Gross Revenues Definition adds the requirement that fees be "charged to subscribers" in order to be excluded. Sirius XM addressed this proposal in paragraph 479 of its proposed findings, explaining that it would have the effect of requiring Sirius XM to report revenue that it may record, but only collects net of the fees withheld by credit card companies for transaction fulfillment.

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[49] SoundExchange quotes from the audit report at **SE PFF 1674, 1679-81**, and **1683** to establish proposed facts about Sirius XM's reporting. This represents a flagrant violation of (a) the Judges' explicit ruling that the audit report was to be admitted not for the truth of matters asserted therein, but on the limited grounds that it "influenced" subsequent actions by SoundExchange, 5/10/17 Tr. 3177:9-18 (Bender); and (b) SoundExchange's counsel's representations to the court that it was not attempting to admit the report for the truth of the matters asserted therein or to lend support to its contentions about Sirius XM's alleged reporting violations. 5/10/17 Tr. 3176: 11-18 (Bender). These paragraphs should be completely disregarded.

398. SoundExchange's response is the unhelpful statement that the exclusion at issue is found in the definition of Gross Revenues, so it must forbid the exclusion of expenses. **SE PCL 31**.[50] But that does not mean that each identified *exclusion* must itself be revenue billed to a customer. The allowed exclusion of bad debt (booked as an expense) forestalls any such conclusion, and it would seem far-fetched to suggest that "credit card fees" was meant to be something billed to customers, as opposed to an expense of Sirius XM for processing the fulfillment of a customer revenue transaction. Indeed, in *SDARS II*, where SoundExchange made the same "expenses cannot be deducted" argument, the Judges explicitly distinguished between SoundExchange's proposal to remove the "current exclusions for credit card fees and bad debt expense" and its proposal to force Sirius XM to include in Gross Revenues "fees that Sirius XM collects for various activities related to customer account administration, such as activation fees." *See SDARS II*, 78 Fed. Reg. at 23071-72. The Judges *rejected* those proposals, concluding that "the Judges are satisfied that the current exclusions permitted in the current *Gross Revenues* definition remain proper." *Id.* at 23072. The same result is warranted here.

3. Fee Revenue Deductions Need Not Relate to Underlying Costs (*SE PFF § XII.B.1.iii*)

399. SoundExchange also proposes to change clause (3)(v) of the Gross Revenues definition to state that that excludable revenues must be "reasonably related to the Licensee's expenses to which they pertain." Sirius XM has already explained that this vague and undefined proposal will lead to inevitable disputes over how a "reasonable relation" is identified (SXM PFF

[50] SoundExchange also once again quotes from the audit report at **SE PFF 1686-87** to establish proposed facts about Sirius XM's reporting; as noted above, this represents a flagrant violation of the Judges' explicit ruling that the audit report was to be admitted not for the truth, but on the limited grounds that it "influenced" subsequent actions by SoundExchange, 5/10/17 Tr. 3177:9-18 (Bender), and should be disregarded.

¶ 477) and could preclude rightful deductions that may not tie directly to clearly identifiable and separate expense accounts (SXM PFF ¶ 478).

400. SoundExchange's justification for the change is the citation-free claim that the "theory" of excluding these administrative fees is "to enable Sirius XM to recover costs unrelated to the use of sound recordings." **SE PFF 1696**. That is wrong. If there is a "theory" for excluding these fees, it is that they do not reflect subscription or advertising revenue earned by Sirius XM for providing subscribers with sound recording transmissions, period. What it might *cost* Sirius XM to activate a radio or chase down a non-paying subscriber is beside the point. (And, of course, Sirius XM has all sorts of costs "unrelated to the use of sound recordings" that are not excludable here.) Nor is there a shred of evidence that Sirius XM will cut its subscription fees and re-label them as activation fees (or anything else) – or that its customers would tolerate such game-playing. **SE PFF 1697** (discussing a hypothetical $100 activation fee). Regulations should be crafted based on evidence, not on wild hypotheticals conjured up by SoundExchange's lawyers. *See SDARS II*, 78 Fed. Reg. 23072 (discussing SoundExchange's "attempts to demonstrate how Sirius XM *might* manipulate its revenue base to lower its royalty obligation," finding them to "lack merit," and concluding that a change to the regulation might be warranted "if any party were to present evidence to *demonstrate conclusively* that one or more of the exclusions facilitates manipulation of fees for the sole purpose of reducing or avoiding Sirius XM's statutory royalty obligation" (second emphasis added)).

401. SoundExchange also objects to Sirius XM's proposal to explicitly identify late fees as excludable, a proposal motivated by SoundExchange's ill-founded effort to include such fees (which are neither subscription nor advertising revenue) in a recent audit. Sirius XM previously explained that such fees are not charged for providing SDARS service, but to cover

the cost of collecting unpaid subscription revenues. SXM PFF ¶ 480. SoundExchange's suggestion in **SE PFF 1695** that such late fees are "payment for access to programming, paid late" appears to confuse late *payments* (actual subscription fees paid after the due date and reportable to SoundExchange) with late *fees* (the separate penalty charged by Sirius XM for the late subscription payment and meant to cover the costs of collection). *Id.*[51] SoundExchange's additional complaint that Sirius XM made this proposal in its rebuttal case, **SE PFF 1694**, should be swiftly rejected. The governing regulations allow for modification of rate proposals up to the time proposed findings of fact are filed, and SoundExchange had the opportunity to seek rebuttal discovery from Sirius XM to question Mr. Barry on the proposal in a deposition (as it did), and to cross-examine Mr. Barry at trial.[52]

4. SoundExchange Has Failed to Explain or Justify its Confiscatory "Standalone Sales" Requirement for Data Services and Non-Music Programming (*SE PFF § XII.B.1.iv*)

402. SoundExchange proposes a small but significant change to the data services and non-music revenue exclusions in sub-paragraph (3)(vi)(A) and (B): the addition of the phrase (and requirement that the excluded items be sold) "on a standalone basis." SoundExchange's short defense of this proposal in its proposed findings makes three points: that the new proposal has no different meaning or effect than the existing separate charge requirement, *see* **SE PFF 1699**; that the Judges confirmed in their recent underpayment decision that Sirius XM could not exclude the price difference between the Select package and the Premier package, *see* **SE PFF**

[51] SoundExchange yet again quotes from the Eisner audit report at **SE PFF 1695** to establish proposed facts about Sirius XM's reporting; for reasons noted above, these portions should be disregarded.

[52] SoundExchange itself included detailed rebuttal testimony from Mr. Orszag regarding his revised view as to rates to be paid by Sirius XM trial subscribers, Orszag WRT ¶¶ 61-63, and refrained from adding that revised proposal to its proposed rates and terms until its Amended Rates and Terms submitted on June 15, 2017, *four months after* Sirius XM made the late-fee clarification SoundExchange now claims was too late.

1700; and that Sirius XM's alternate proposal on this point is asking the Judges to allow an exclusion they have said is not allowed under the current language, *see* **SE PFF 1701**.

403. Sirius XM's proposed findings comprehensively addressed this topic generally and each of SoundExchange's arguments specifically. Sirius XM first explained why its proposal on this issue would help avoid the disputes created by the prior definition, and demonstrated that it is administrable, auditable, accommodating of Sirius XM's business practices, equitable (both to Sirius XM *and* SoundExchange), and consistent with the intent of the statutory license that Sirius XM not pay the record industry for non-statutory activities. *See* SXM PFF ¶¶ 431-39. Sirius XM also candidly acknowledged that while its proposal might give rise to certain concerns expressed by the Judges in their underpayment decision, its practical benefits – and lack of any discernible prejudice to SoundExchange – amply justified the change. *See* SXM PFF ¶¶ 440-41.

404. With respect to SoundExchange's "standalone sales" proposal, Sirius XM established four primary points: (1) that SoundExchange failed to provide any rationale or support for its proposed change, SXM PFF ¶ 444; (2) that SoundExchange (and the proponent of the proposal, Mr. Bender) had not explained and could not explain how the proposal would work in practice, SXM PFF ¶¶ 445-46; (3) that Mr. Bender's claim the proposal was merely a "clarification" of the existing regulation was (a) "unhelpful in the extreme" given the disputes engendered by the existing definition and (b) clearly incorrect given its apparent intention to eliminate any exclusion of revenue from bundled sales, SXM PFF ¶ 447; and (4) that SoundExchange's contention that its proposal merely formalizes the Judges' recent ruling in the underpayment litigation stretched the holding of that ruling way beyond its limits, and was, in

any event, beside the point of creating a fair and less ambiguous definition *going forward*, SXM PFF ¶¶ 448-50.

405. SoundExchange's current papers do not cure these problems or really even attempt to address them. SoundExchange continues to provide no support or explanation for its proposal, instead continuing to suggest that it is simply clarifying current practice and even going so far to say it is "probably unnecessary." **SE PFF 1700**. But for reasons noted by Sirius XM and in Mr. Barry's rebuttal testimony – chiefly, the prolonged litigation of the prior definition, and the extreme unfairness of effectively requiring Sirius XM to pay royalties on non-statutory content – it is simply not the case that SoundExchange's proposal is merely clarifying some settled understanding, and revision of this part of the Gross Revenues definition is sorely needed to ensure Sirius XM is not paying the record industry royalties for non-statutory content. SoundExchange's only other point, about the alleged conflict between Sirius XM's proposal and the Judges' recent Ruling (and Mr. Barry's alleged "concession" on the point, *see* **SE PFF 1703**) was, as noted above, fully addressed by Sirius XM in its proposed findings.[53]

406. In short, Sirius XM has made a fully supported, equitable, common-sense proposal. SoundExchange has not.

[53] Mr. Barry's comments about the GAAP rules governing multiple element arrangements (MEAs), *see* **SE PFF 1704**, lend no support to SoundExchange's position. Mr. Barry clearly explained that Sirius XM's subscription packages are *not* MEAs because the items are delivered coterminously. *See* 5/17/17 Tr. 4404:25-4405:7 (Barry). That Sirius XM "consults" GAAP guidance regarding MEAs in its internal allocation decisions is irrelevant to the interpretation of the existing regulation; as noted by Sirius XM at SXM PFF ¶ 449, the Judges' recent Ruling held that neither GAAP nor its MEA guidance provided a full answer as to how to allocated bundled revenue under the regulation.

ii. Sirius XM's Clarification of the Definition of GAAP Should Be Adopted (*SE PFF § XII.B.2*)

407. SoundExchange correctly notes that there was an inconsistency between Sirius XM's proposed change to the definition of GAAP (*see* SXM PFF ¶ 491) and the intention of that change as explained by Mr. Barry. As described at SXM PFF ¶ 491, Sirius XM's Second Amended Rates and Terms correct that discrepancy to clarify that the applicable GAAP rules are those governing during the month in which the performances giving rise to the payment obligation are transmitted.

C. The Direct License Share and Pre-1972 Recording Share Should Remain As Currently Written (*SE PFF § XII.C*)

408. SoundExchange advances three arguments with respect to the Direct License Share and Pre-1972 Recording Share. First, SoundExchange proposes to use actual satellite listenership data to calculate the direct license and pre-'72 exclusions, if "reasonably" reliable satellite usage data becomes available, which SoundExchange believes it will during this rate period. *See* **SE PFF 1718-34**. SoundExchange admits that the 360L listenership data will not be comprehensive, but suggests that whatever data may become available will be "good enough" for calculating the direct license and pre-'72 exclusions. **SE PFF 1731-34**. Second, in the absence of actual satellite listenership data, SoundExchange proposes to continue using the webcasting proxy to determine the direct license and pre-1972 exclusion percentages. **SE PFF 1735-44**. SoundExchange criticizes Sirius XM's proposal to base the exclusion on plays or "spins," and argues that any problems with the webcasting proxy are minor by comparison since it at least attempts to take listenership into account. **SE PFF 1743-44**. Third, SoundExchange proposes that until actual satellite listenership data is used to calculate the direct license share exclusion, the direct license share should be capped based on plays on the satellite service. **SE PFF 1745-54**.

409. Sirius XM addressed each of these arguments in its proposed findings. *See* SXM PFF ¶¶ 466-74. Contrary to SoundExchange's claim to know better, *see* **SE PFF 1723-30** (describing plans by certain automakers [redacted] satellite usage data [redacted] *See* SXM PFF ¶ 473. As Mr. Barry testified, the only thing assured if SoundExchange's proposal is adopted is that there will be disputes between the parties about whether or not the scant data that may become available is or is not "reasonably reliable," a phrase Mr. Bender was thoroughly unable to explain or defend at trial. *See* SXM PFF ¶ 474. SoundExchange's proposed findings suffer from the same flaw, hypothesizing that information from 360L will be preferable to the reference channel proxy once it "has achieved sufficient penetration" (but not saying how such "sufficiency" would be measured), **SE PFF 1731**, and claiming that a sample "*perhaps* in the range of tens of thousands of radios" should be "good enough" for calculating the two carve-outs. **SE PFF 1732** [redacted] (emphasis added). "Probably" is not grounds for instituting a costly and uncertain new requirement on Sirius XM.

410. Sirius XM does not dispute SoundExchange's second argument (**SE PFF 1735-44**) that the Internet Reference Channel proxy is the preferable metric for the Direct License Share and Pre-1972 Reduction. As described in its own proposed findings, Sirius XM has withdrawn its proposal to calculate those shares based on satellite plays. *See* SXM PFF ¶¶ 466, 68.

411. SoundExchange's arguments about the superiority of the reference channel measure – namely, that it weights for listenership (**SE PFF 1737**) and squares with the Judges' prior conclusions (**SE PFF 1736, 1740**) – provide the best response to SoundExchange's third

point: that Sirius XM's royalty reduction under the Direct License Share should be capped by the percent of plays of directly licensed material on the satellite channels. **SE PFF 1745-54**. Having catalogued the many alleged deficiencies of the "playlist" methodology, SoundExchange should not be heard to argue (apparently with a straight face) that Sirius XM's Direct License Share should nonetheless be capped by the playlist measure it concedes is so plainly inferior.

412. The real reason for this proposal, of course, as previously spelled out by Sirius XM, is that SoundExchange wants to throw another roadblock in the way of Sirius XM's direct license efforts. *See* SXM PFF ¶ 469 (describing how SoundExchange's proposal would result in the double-payment of directly licensed performances). Indeed, SoundExchange's Mr. Bender candidly described it as way to "limit the incentive" to Sirius XM to seek direct licenses from heavily performed labels. *Id.* (citing 5/10/17 Tr. 3194:6-3195:4, 3279:7-17 (Bender)). SoundExchange attempts to walk that testimony back (**SE PFF 1753**) by suggesting that because there is a good bit of [redacted] there is no (current) disincentive to Sirius XM to enter direct licenses with highly performing labels. That effort at justification not only proves that Sirius XM has not gamed the system as SoundExchange suggests (by only direct-licensing record companies that over-index on the internet reference channels), but underscores the improper motivation underlying this proposal: to artificially limit Sirius XM's opportunity to reduce its sound recording performance rights expense via direct licensing.

413. Sirius XM has already responded to the suggestion that non-direct-licensors are somehow punished (or deprived of a "fair return") by the current Direct License Share because their share of Sirius XM royalties (paid via SoundExchange) would be even higher if the Direct

License Share was capped based on satellite plays. *See* SXM PFF ¶¶ 470-71. As noted there, how much Sirius XM would pay SoundExchange (and how much those labels would split) under an alternative, inferior measure of activity is irrelevant, even if SoundExchange ultimately uses play data for distributing the non-direct-licensed portion. SoundExchange's suggestion in its current papers that Sirius XM is somehow manipulating or gaming the system by seeking direct licenses with those labels that perform well on its internet channels should be rejected for the same reason: there is absolutely nothing wrong with Sirius XM structuring its direct licenses to pay based on the same (superior) reference-channel metric as the Direct License Share, seeking licenses with those record labels that are performed heavily based on that metric, or (SoundExchange's fervent desire to the contrary notwithstanding) saving money from its SoundExchange payments on account of its direct licenses. One could just easily "blame" the problem on SoundExchange for distributing royalties based on playlist share rather than reference-channel share. *See* 5/10/17 Tr. 3278:5-3279:3 (Bender) (Judge Strickler observing that SoundExchange wants the "advantage of the arbitrage on its side" no different than Sirius XM).

414. In yet another attempt to throw a roadblock in the path of direct licensing, SoundExchange would hinge the availability of the Direct License and Pre-1972 Exclusions on Sirius XM providing reference channel performance counts on a track-by-track basis, as opposed to the *total* number of directly licensed and pre-1972 performances that Sirius XM currently provides, which is sufficient to compute each share. **SE PFF 1761-62**. SoundExchange has provided no reason it needs these track-by-track counts, or why the list of directly licensed and

pre-1972 tracks that Sirius XM already provides (as required by the current regulations) is insufficient. Its proposal should be rejected.[54]

IX. SOUNDEXCHANGE'S TERMS PROPOSALS SHOULD BE REJECTED (*SE PFF § XIV*)

A. SoundExchange's Proposed Reorganization of the SDARS Regulations is Unwarranted (*SE PFF § XIV.A*)

415. SoundExchange has proposed a major overhaul of the SDARS and PSS regulations along the lines implemented for webcasters in the *Web IV* decision. **SE PFF 2161-67**. SoundExchange argues that creating consistency between the SDARS, PSS and webcasting regulations will "promote efficiency" in the administration of the statutory licenses," **SE PFF 2168-73**, and that the *Web IV* regulations should be "assumed" as the de facto fallback – even where "not otherwise addressed by SoundExchange," **SE PFF 2175** – absent Sirius XM or Music Choice affirmatively demonstrating why each of the existing regulations should be retained instead. **SE PFF 2172, 2174-78**.

416. Sirius XM addressed SoundExchange's proposed reorganization of the regulations in its previous filing, explaining that the complete overhaul suggested by SoundExchange will undoubtedly create more disputes than it will avoid. *See* SXM PFF ¶¶ 427-30. Sirius XM also pointed out that for all SoundExchange's talk of "efficiency" and "consistency," it had done little to actually demonstrate why that was necessary for a single-service category like the SDARS, particularly when Sirius XM had spent ten-plus years operating under, refining, and litigating the existing regulations. SXM PFF ¶ 430. SoundExchange's filing, for all the verbiage devoted to this issue, does little to demonstrate the

[54] Sirius XM has no specific response to section XII.C.4 of SoundExchange's proposed findings (**SE PFF 1755-60)** other than to note that SoundExchange has improperly quoted portions of the Eisner audit report in **SE PFF 1758**; for reasons noted above, that paragraph is improper and should be disregarded.

actual "operational advantages" (**SE PFF 2168**) of completely upending the SDARS regulations, other than the lone fact that SoundExchange's staff has to field occasional phone calls from licensees. **SE PFF 2169**. That is simply irrelevant to Sirius XM, which is the only SDARS, is SoundExchange's largest licensee, and is operating under regulations that have been in place since 2006. SoundExchange will do more "extra work" if the SDARS regulations change than if they stay the same.

417. Contrary to SoundExchange's suggestion that Sirius XM should have the burden of showing why the current regulations should *not* be overhauled as SoundExchange proposes, **SE PFF 2172**, it is *SoundExchange's* burden to show why the existing regulations should be pulled up root and branch and replaced with new regulations sure to create disputes. SoundExchange has failed to carry that burden.

B. SoundExchange Should Be Required To Follow State Escheat Laws (*SE PFF § XIV.B*)

418. SoundExchange opposes Sirius XM's proposal to conform §382.17 to the change made in *Web IV* regarding unclaimed funds. **SE PFF 2199-2205**. As explained in Sirius XM's prior filing, its proposal simply seeks to have SoundExchange comply with state escheatment law, conforming with the change made in *Web IV*, and to provide an appropriate incentive to encourage SoundExchange to identify and pay all proper rights-holders. SXM PFF ¶ 494.

C. Audit-Related Terms (*SE PFF § XIV.C*)

i. SoundExchange's Proposed 18% Interest Rate for Audits Should Be Rejected (*SE PFF § XIV.C.1*)

419. SoundExchange's proposed Terms seek to add a provision to the regulations governing audits specifying that the penalty for late payments and late statements of account (currently found at §382.13(d)) be used at the rate of interest on underpayments discovered in audits. SoundExchange defends its proposal on three grounds. First, SoundExchange argues

that the separate late-payment penalty already applies to audit underpayments, and that its proposal is simply "clarifying" that current understanding. *See* **SE PFF 2212-15**. Second, SoundExchange suggests that an 18% per year penalty is warranted by the expenses that SoundExchange incurs trying to collect amounts due from Sirius XM. **SE PFF 2225**. Third, SoundExchange argues that a handful of license agreements entered into by Sirius XM for non-music programming, as well as some newly identified record company contracts with various digital services, support its position. **SE PFF 2233-48**. None of these arguments – each of which relies on blurring the distinction between a licensee's failure to make a timely payment and *correcting* that payment at a later date after an audit – justifies SoundExchange's confiscatory proposal.

420. Sirius XM's own proposed findings demonstrated the several reasons why the current regulations do *not* apply the separate late payment penalty to underpayments revealed in audits. SXM PFF ¶¶ 459-61. As the Judges rightly observed in the *Web IV* proceeding, the current audit regulation (which mirrors the pre-*Web IV* audit regulation) is silent regarding the amount of interest to be paid on audit results. SXM PFF ¶ 460 (citing Order Denying in Part SoundExchange's Motion for Rehearing and Granting in Part Requested Revisions to Certain Regulatory Provisions, Docket No. 14-CRB-0001-WR, at 19 & n.29 (Feb. 10, 2016)). In order for an interest rate to apply, the Judges need to *change* the audit regulation to specify what that rate would be. SoundExchange simply assuming otherwise does not make it so.

421. SoundExchange fares no better with its suggestion that Mr. Barry, Sirius XM's Controller, conceded that the 18% rate currently applies to audits. **SE PFF 2213-14**. To the contrary, the Judges sustained an objection to the improperly quoted testimony on the grounds that it sought a legal interpretation of a CRB regulation from a lay witness, stating that "[t]he

regs say what they say." 5/17/17 Tr. 4364:4-4365:8 (Barry). SoundExchange's resort to such evasion speaks volumes about the strength of its position on this point. It also overlooks the fact that Sirius XM has consistently taken the position, as SoundExchange itself recognizes (**SE PFF 2215**), that the 1.5% per month rate does not apply in the audit context, and that SoundExchange's audit of Sirius XM for the 2007-2009 period did not seek to impose any such interest charge. *See ,e.g.,* Trial Ex. 101* at Appx. B, p. 10 ([redacted])[55]; 5/17/17 Tr. 4349:9-25 (Barry).

422. SoundExchange's new (and unsourced) claim that the 18% fee is justified by the "difficulty and expense" SoundExchange incurs in attempting to collect underpayments from Sirius XM, **SE PFF 2225**, does not withstand scrutiny. First, SoundExchange has provided no evidence of how much it has spent in the referenced collection efforts. Even if it had, it is inconceivable that those costs amounted to even a small fraction of the [redacted] in interest SoundExchange's recent audit sought to charge. *See* SXM PFF ¶ 453. SoundExchange's argument here demonstrates the extremity of its position, not that it is "justified."

423. SoundExchange's final line of defense is a smattering of license agreements that allegedly apply the 1.5% interest rate to audit results in the fashion that SoundExchange

[55] Sirius XM's response to the audit results also addresses SoundExchange's detailed complaint regarding Sirius XM's failure to separate out bad-debt expenses related to equipment and other non-royalty-eligible revenue from its SDARS expenses. *See* **SE PFF 2223**. As Sirius XM told Eisner in the audit report (which was only delivered in mid-2016), "SXM accepts an adjustment to its payment obligation in the amount of $[redacted] , which SXM has calculated to be the proper amount owed if such an allocation is utilized." Trial Ex. 101* at Appx. B, p. 6. Sirius XM has now adjusted its monthly calculations to rectify this relatively minor issue (the disputed amount constitutes approximately a tenth of one percent of Sirius XM's $[redacted] million in reported royalties during the audit period, *see id.* at Schedule 5B).

proposes here. **SE PFF 2233-48**. With respect to the five Sirius XM agreements shown to Mr. Barry during the hearing, Sirius XM has already explained at some length why those agreements – in addition to the fact that they are the only ones, out of thousands produced, that SoundExchange could identify – do not support SoundExchange's position. *See* SXM PFF ¶¶ 457-58 (citing Barry testimony, 5/17/17 Tr. 4424:23-4425:6, that he was unaware that any other of Sirius XM's [redacted] of content agreements contained a similar provision). In short, only two of those cherry-picked agreements ([redacted]) actually specify the interest rate to be charged in audits, and in neither case has the audit provision ever been – or is likely to be – triggered. SXM PFF ¶ 457. As to the other referenced Sirius XM agreements, SoundExchange simply assumes, incorrectly, that the fee for "overdue" payments applies in the case of audits. *See* **SE PFF 2236-38**. As Mr. Barry testified, it does not. SXM PFF ¶ 458 (citing 5/17/17 Tr. 4426:11-4427:17 (Barry)).[56]

424. Having presented no evidence on the subject from Mr. Bender, any of its record label witnesses, or any of its five economists, SoundExchange's proposed findings, for the first time, unearths several record label agreements with interactive services that SoundExchange claims support its position. They do not.

425. First, out of the thousands of record company agreements produced in discovery in this case, SoundExchange has now identified a mere 14 it claims support its proposal. **SE PFF 2242-48**. Closer inspection reveals that even this belated cherry-picked batch overstates SoundExchange's position. Nearly half of those agreements (6) do not specify that the 1.5% late

[56] SoundExchange's observation that Sirius XM charges its customers a $5 late fee if they miss a payment shows the degree to which SoundExchange is blurring the key issue here: that late fee is a fixed penalty that applies when customers *fail to make their payments*, not an interest charge applied after an audit has been conducted. As SoundExchange's discussion makes clear, that fixed penalty bears no fixed percentage relation to the amounts owed. **SE PFF 2240**.

payment penalty contained therein actually applies as an interest rate to underpayments revealed in an audit. For example, the agreement between [redacted] and [redacted], *see* **SE PFF 2248**, dictates in Section 6.04(f) that [redacted] should pay a 1.5% fee "on any required payment that is not made on or before its due date." Trial Ex. 125 (SoundX_000038976 at 000039011). This provision is separate from and not cross-referenced by Sections 6.05 and 6.06, which specify audit terms and, with respect to underpayments, indicate only that [redacted] *Id.* at 000039011-12.

426. The same is true with respect to [redacted] agreement with [redacted], also cited at **SE PFF 2248**, which provides for a 1.5% late payment penalty in Section 2(e) and contains an independent audit provision in Section 3(a), addressing underpayments only insofar as they will serve to shift the cost of the audit where they exceed 10%. Trial Ex. 125 (SoundX_000030311 at 000030312-13). By the plain terms of the audit provisions in these agreements, this cost-shifting is the only penalty relevant to underpayments – interest is not referenced at all.

427. Other [redacted] agreements cited by SoundExchange tell the same tale. Its agreement with [redacted], cited at **SE PFF 2247**, contains a 1.5% late fee clause separate and apart from its audit provision, which is silent on any applicable interest rate. Trial Ex. 125 (SoundX_000035977 at 000035996, 000036003-04). [redacted] agreement with [redacted], cited at **SE PFF 2248**, neither ties its 1.5% late payment penalty clause to audit underpayments nor shifts audit costs at all. Trial Ex. 125 (SoundX_000010524 at 000010591-92). The same is true of [redacted] agreement with [redacted], cited at **SE PFF 2247**, and [redacted] agreement with [redacted], cited at **SE PFF 2248**. The former specifies in Section 6(i) that, upon [redacted] request, [redacted] shall pay the lesser of a 1.5% interest rate or the maximum allowable by law on late payments. Trial

Ex. 127 (SoundX_000020972 at 000020995). Multiple pages later, in Section 14, the contract contains an audit provision that lacks any specified interest on underpayments. *Id.* at 000021004-05. The [redacted] agreement specifies a 1.5% late payment penalty in Exhibit A, Section 7(b), but its separate audit provision, Exhibit A, Section 8(c), is totally silent on underpayments. Trial Ex. 126 (SoundX_000017174 at 000017187-88). There is no reason simply to assume that a late payment penalty found in sections of these contracts separate from the audit provision applies to audits and no principle of contract interpretation dictates that result. To the contrary, it appears that in those rare instances where the parties intend to apply interest to audit underpayments, the contract explicitly says so. Had SoundExchange provided testimony on this point, we would know more about these agreements and how they are interpreted by the parties involved, but, tellingly, it did not.

428. Other record company agreements in evidence – some mentioned by SoundExchange, some not – identify other, much lower, interest rates for audit underpayments than the 18% proposed by SoundExchange. For example, SoundExchange identifies an agreement between [redacted] and [redacted], cited at **SE PFF 2248**, that it claims supports its position. But that agreement was actually replaced by a more recent agreement that updated the applicable audit and interest provisions in significant ways. *See* Trial Ex. 126 (SoundX_000028053). Under the new terms, [redacted] is required to pay interest on underpayments discovered by an audit [redacted] -- nearly [redacted] *percentage points lower* than the 18% annual interest rate proposed by SoundExchange to be applied to Sirius XM. *See id.* at 000028109. The following agreements (each in Mr. Orszag's benchmark set) have similar provisions:

[57] http://www.barclays.co.uk/Savings/BarclaysBankBaseRate/P1242557964824/.

- The agreement between [redacted] and [redacted] sets interest on underpayments at no more than [redacted] Trial Ex. 127 (SoundX_000025617 at 000025640-41).
- The [redacted] agreement specifies interest on underpayments no more than [redacted] Trial Ex. 127 (SoundX_000027323 at 000027363).
- [redacted] agreement with [redacted] caps the interest rate on underpayments at [redacted] Trial Ex. 705 (SoundX_000458893 at 000458975).
- The [redacted] agreement requires interest be paid on underpayments at a rate of [redacted] Trial Ex. 126 (SoundX_000019761 at 000019783).
- [redacted] agreement with [redacted] does not specify interest for *either* late payments *or* audit underpayments. *See* Trial Ex. 127 (SoundX_000040106).

Notably, the majority of these agreements also specify that these interest rates (where specified) become applicable only if an audit unveils a certain percentage underpayment over the audited period (7.5%, 10%, etc.).

429. The remainder of SoundExchange's section XIV.C.i attacks Sirius XM's alternate proposal that the interest rate for audits be set at the post-judgment interest rate set forth in 28 U.S.C. § 1961. **SE PFF 2217-24, 2226-28**. Sirius XM has responded in its prior filing to those criticisms, which center around allegations that Sirius XM, if charged the low audit interest rate it seeks, will intentionally underpay SoundExchange as a source of low-cost borrowing (**SE PFF 2222-24, 2228-30**) or be stripped of any incentive to pay SoundExchange on time, **SE PFF**

2220-21. As to the first of these arguments, SoundExchange has adduced no evidence whatsoever that Sirius XM has engaged in the sort of bad-faith underreporting it suggests will be unleashed if Sirius XM's proposal is adopted. *See* SXM PFF ¶ 430 (addressing SoundExchange's contention that Sirius XM "flouts" ambiguous regulations); *id.* ¶ 464 (Mr. Barry testifying that Sirius XM would never treat its accounts payable as a form of borrowing). As noted above, the regulations should be based on evidence, not hypothetical abuses dreamed up by SoundExchange or its counsel. And as previously explained by Sirius XM, any such alleged incentive to abuse could be aligned by setting an interest comparable to Sirius XM's typical cost of debt. *See* SXM PFF ¶ 465.

430. SoundExchange's latter argument – that Sirius XM would, under its proposal, have "no incentive at all to pay statutory royalties on a timely basis," **SE PFF 2221** – displays SoundExchange's apparent confusion between the penalty for late payments and the interest rate to be applied in audits. To be clear, Sirius XM is not challenging the 1.5% late payment fee in 382.13(d). If Sirius XM fails to make a payment to SoundExchange on time, that penalty will continue to apply, and Sirius XM will continue to be incented to make timely payments (as is intended by that provision). Sirius XM's proposal involves only the interest rate that would be applied in audits, which involves adjustments to payments that were made *on time*. SoundExchange's argument that the late payment fee at 382.13(d) is intended to motivate *timely* payments is exactly right (*see* SXM PFF ¶¶ 454-55), and inadvertently underscores Sirius XM's position that it is too punitive to be applied to audit results determined years after the original payment.

ii. Net Overpayments Revealed in Audits Should Be Credited (*SE PFF XIV.C.2*)

431. SoundExchange asserts that Sirius XM's proposal that SoundExchange pay interest on any overpayments discovered in audits is an "imaginary issue" because no SoundExchange audit of Sirius XM has ever uncovered a net overpayment. **SE PFF 2249-51, 2257**. SoundExchange also criticizes the proposal because SoundExchange does not hold royalties in reserve, and thus clawing back royalties that were already paid or issuing a credit against future royalties would be unfair to those artists played in the later period when the credit was applied. *See* **SE PFF 2252-56**.

432. Sirius XM refers the Judges to its discussion of this issue at SXM PFF ¶¶ 487-88. Sirius XM notes, however, that fairness is a two-way street: just as Sirius XM should pay for any underpayment discovered in an audit, SoundExchange should pay for any overpayment discovered in an audit. SXM PFF ¶ 488. Moreover, SoundExchange's suggestion that the unfairness to artists of issuing a credit is an "insurmountable" issue is hyperbole: any modest diminution to Sirius XM's payment in a given period on account of a credit will be spread across the tens or hundreds of thousands of tracks performed in that period, not visited upon any single artist or group of artists, no different than the original overpayment.

iii. The Fee-Shifting Threshold Should Remain at the Current 10% Level (*SE PFF § XIV.C.3*)

433. SoundExchange proposes to change the fee-shifting threshold for audit costs from 10% to 5%, arguing that the current 10% threshold is "too high." **SE PFF 2258-60**. Aside from stating that even a 5% underpayment is large as compared to the audit costs, SoundExchange identifies a handful of contracts between Sirius XM and certain non-music providers, and between major record labels and music services, which contain a 5% fee shift threshold for audit costs. **SE PFF 2261-72**.

434. SoundExchange's position is unavailing. It has hand-selected a limited set of agreements, out of thousands produced throughout discovery in this proceeding, to bolster its argument. A more representative look at the universe of agreements, however, reveals that SoundExchange has failed to demonstrate that a 5% fee-shifting threshold is standard in the industry. In fact, SoundExchange has failed to show that it is standard even in Mr. Orszag's more limited benchmarking set of interactive services agreements, several of which specify a higher percent underpayment – including the current, and reasonable, threshold of 10% endorsed by Sirius XM in this proceeding – before requiring that the licensee bear the costs of the audit. [redacted] agreement with [redacted], for example, sets the threshold at an underpaid amount greater than 10% of the fees due over the audited period. Trial Ex. 125 (SoundX_000030311 at 000030313). Similarly, [redacted] agreements with [redacted] and [redacted] shift audit costs if the underpaid amount is equal to or greater than 10% of the amount due. Trial Ex. 125 (SoundX_000038976 at 000039011-12) ([redacted]); Trial Ex. 755 (SoundX_000036241 at 000036249) ([redacted]). The 10% threshold is further supported by the following agreements:

- [redacted] agreement with [redacted] shifts audit costs where an underpayment exceeds 10%. Trial Ex. 125 (SoundX_000006855 at 000006858).
- [redacted] agreement with [redacted]t shifts the cost if an audit unveils an underpayment of 10% or more. Trial Ex. 114 (SoundX_000107198 at 000107216).

Other interactive service agreements, though not setting the threshold at 10%, set it higher than 5%:

- [redacted] agreement with [redacted] dictates a threshold of more than 7%, while its agreement with [redacted] specifies a threshold of greater than 7.5%. Trial Ex. 706

(SoundX_000017355 at 000017377) ([redacted]); Trial Ex. 126 (SoundX_000028053 at 000028110) ([redacted]).

- [redacted] agreements with both [redacted] and [redacted] set the threshold at 7.5%. Trial Ex. 127 (SoundX_000025617 at 000025640) [redacted]); Trial Ex. 127 (SoundX_000027323 at 000027363) ([redacted]).
- [redacted] agreement with [redacted] also specifies a 7.5% threshold. Trial Ex. 112 (SoundX_000107287 at 000107308).

Even if the interactive service agreements fully supported SoundExchange on this point (which, as shown, they do not), they are not the right benchmark here because the costs and difficulty associated with an audit in the context of an interactive service agreement have not been shown to be comparable to those associated with an audit of Sirius XM. The only benchmark directly on point, therefore, exists in Sirius XM's 500 plus direct licenses, all of which specify a 10% threshold on underpayments before shifting the costs of an audit. SXM PFF ¶ 486.

iv. The Judges Should Adopt Sirius XM's Proposal Regarding Audit Finality (*SE PFF § XIV.C.4*)

435. SoundExchange opposes Sirius XM's originally proposed §382.15(i), arguing that it would cut off SoundExchange's right to sue for audit disputes after two years and therefore improperly override the three-year statute of limitations set out in the Copyright Act, 17 U.S.C. § 507(b). **SE PFF 2273-75**. As described in Sirius XM's proposed findings, *see* SXM PFF ¶¶ 489-90, Sirius XM has adjusted its proposal in its Second Amended Proposed Rates and Terms to address this concern. Specifically, the revised proposal states that "[i]n the event Licensee and the Collective are unable to reach resolution on disputed items identified in the course of an audit, Licensee's calculation of the disputed items shall be considered final on the earlier of (i) the date two years after delivery of the auditor's written report to Licensee, or (ii) the expiration

of any applicable statute of limitations, unless the Collective has initiated a legal action to compel payment of the disputed amounts." 37 C.F.R. § 382.15(i) (proposed). Sirius XM refers the Judges to the above-mentioned paragraphs of its proposed findings for further explanation of its proposal and citations to relevant record support.

v. Auditor Independence (*SE PFF § XIV.C.6*)

436. SoundExchange opposes Sirius XM's proposal to the "Qualified Auditor" definition to state that a Qualified Auditor be objective and independent of both the licensee and the Collective within the meaning of the AICPA Code of Professional Conduct. **SE PFF 2281-83**. SoundExchange's principal objection is that the proposal is redundant because CPAs are already required to be independent by virtue of their status as CPAs. *See* **SE PFF 2284-87**. Had SoundExchange's auditors shown even a shred of independence in prior audits, SoundExchange might have a point. But, as Mr. Barry testified at length and as Mr. Bender was compelled to concede, SoundExchange's auditors routinely take their direction directly from SoundExchange's legal staff, infusing their allegedly "independent" examinations with the self-interested legal views of SoundExchange and its lawyers. *See* SXM PFF ¶¶ 430, 455 n.47, 481-82. Clearly their status as CPAs is not having its intended effect, and a strengthening of the regulatory requirement of independence should be buttressed as Sirius XM recommends.

D. SoundExchange's Proposal to Require Satellite Usage Data Should Be Rejected (*SE PFF § XIV.E*)

437. SoundExchange reiterates its proposal that Sirius XM report actual performances, aggregate tuning hours, or other satellite usage data to SoundExchange if and when Sirius XM becomes capable of obtaining that data, thereby allowing SoundExchange to use that data in its royalty distributions. **SE PFF 2316-17**. Sirius XM refers the Judges to paragraphs 473-74 of its proposed findings and to Section VIII.C above, which fully addressed this issue in the context of

SoundExchange's proposal to require the reporting of Sirius XM satellite data for use in calculating the Direct License Share and Pre-1972 Recording Share. As discussed there, SoundExchange's vague proposal seeks data that will not be available in any meaningful volume during the forthcoming license period, and will only create further disputes between the parties.

X. THE JUDGES SHOULD DISREGARD SOUNDEXCHANGE'S MANY FACTUAL ASSERTIONS THAT ARE NOT PROPERLY SUPPORTED BY RECORD EVIDENCE

438. Throughout its proposed findings, SoundExchange repeatedly: (1) misuses trial exhibits admitted for a limited purpose as though they were admitted for the truth of the matters asserted therein; (2) introduces new facts that find no support in the evidentiary record; and (3) relies on improper and unsupported expert testimony that is subject to pending motions to strike. Attachment B hereto identifies, by paragraph, each instance of these improper citations, representative examples of which are described below. The Judges should disregard these citations, and the statements that rely upon them, because none of them provides a proper basis for a finding of fact.

A. SoundExchange Improperly Uses Certain Exhibits For Their Truth When They Were Admitted Only for a Limited Purpose

439. The Judges must decline to give weight to evidence that is admitted for a limited purpose when a party offers it for the truth of the matter asserted. *See* Fed. R. Evid. 105 ("If the court admits evidence that is admissible against a party or for a purpose—but not against another party or for another purpose—the court, on timely request, must restrict the evidence to its proper scope . . . .").

440. During the direct examinations of Professor Lys and Jonathan Bender, as well as the cross examinations of George White and James Meyer, the Judges admitted a number of exhibits for limited purposes only. As Attachment B shows, however, SoundExchange cites 66

such exhibits in its proposed findings for the truth of the matter asserted. Further, SoundExchange made no effort in its proposed findings to denote which exhibits were admitted for limited purposes, despite the Judges' order to do so. *See Order on Hearing Schedule* (April 4, 2017) ¶ 15 ("During post-trial briefing, any use of any written testimony or any exhibit admitted into evidence for limited purposes at trial shall be so designated in a convention agreed to by the participants.").[58]

441. Most of the exhibits that SoundExchange misuses (and failed to identify) are part of a larger group of exhibits regarding Sirius XM's negotiations with direct licensors. Though SoundExchange attempted to move these exhibits into evidence *en masse* during Professor Lys's direct examination, most of them were admitted not for their truth, but only for the fact that Professor Lys had relied upon them in drafting his written testimony. *See* Attachment B. SoundExchange later tried to admit many of the same documents, without so much as trying to lay a foundation for them, during Mr. White's cross examination. 5/17/17 Tr. 4325:15-4326:19 (White). Those exhibits, which are littered with hearsay, are now the subject of the pending letter brief submitted May 24, 2017.

442. As just one example, paragraph **SE PFF 917** cites directly to Trial Exhibit 161.1, an email from Ellen Ostrovsky, Sirius XM's Director of Finance, to George White. While the email was admitted only "as [a] document[] upon which Professor Lys relied, not for the truth of the matter asserted," 4/27/17 Tr. 1483:18-1484:11 (Lys), SoundExchange failed to note that limitation in its proposed findings. Instead, SoundExchange quoted Ms. Ostrovsky's email and

[58] Since the April 4 Order directed that exhibits admitted for a limited purpose be identified "in a convention agreed to by the participants," *id.*, counsel for Sirius XM emailed counsel for Music Choice and SoundExchange on June 13, 2017 with a proposed format for doing so. While Sirius XM and Music Choice both identified such exhibits in a manner consistent with that proposal, SoundExchange never responded to the proposal and ultimately failed to identify such exhibits in any fashion.

plainly relied on that quotation for the truth of the matter asserted, despite the fact that the statement is blatant hearsay.

443. Another example is proposed Trial Exhibit 101, the final report of an outside audit of Sirius XM's payments during the 2010-2012 period. Because Sirius XM had no opportunity to cross examine anyone involved in conducting the audit, the report was admitted "not for the truth" of its contents, but rather as "simply as something that influenced the next actions that SoundExchange took." 5/10/17 Tr. 3177:9-20 (Bender). Nonetheless, SoundExchange expends paragraph upon paragraph of its proposed findings improperly citing the contents of the report for their purported truth. *See* **SE PFF 1652, 1674, 1676-77, 1679, 1681, 1683, 1685-86, 1695, 1699, 1758**.

444. As a result of SoundExchange's flagrant and repeated misuse of exhibits admitted for a limited purpose—and its failure even to identify those exhibits in its proposed findings, as ordered by the Judges—Sirius XM respectfully requests that the Judges disregard the factual assertions in the exhibits identified in Attachment B to the extent they are offered for their truth.

B. <u>Proposed Findings Not Supported by Record Evidence Should Be Disregarded</u>

445. Attachment B also details numerous instances in which SoundExchange makes factual assertions with no record support. It is elementary that the Judges should not consider such assertions. *See, e.g.*, *Ass'n of Cmty. Orgs. for Reform Now v. Cox*, No. 1:06-CV-1891-JTC, 2006 WL 6866680, at *8 (N.D. Ga. Sept. 28, 2006) ("[T]he Court has not considered any of Defendants' Proposed Findings of Fact and Conclusions of Law that are unsupported by citations to the record or applicable legal authority."); *see also Footbridge Ltd. Trust v. Zhang*, 584 F. Supp. 2d 150, 155-56 (D.D.C. 2008) (holding that factual assertions for which plaintiff "cite[d] no evidence in the record" would be "summarily disregarded"), *aff'd*, 358 F.

App'x 189 (D.C. Cir. 2009). At the conclusion of the hearing, Judge Barnett reinforced this basic tenet in reminding the participants "in an abundance of caution" to "include citations to the record" in their proposed findings. *See* 5/18/17 Tr. 4763:20-4764:3.

446. Illustratively, in **SE PFF 919**, SoundExchange wildly speculates (*contrary* to the record evidence at that) as to Sirius XM's motives for pursuing direct licensing:

> Because of the perceived benefits of setting a benchmark in this proceeding, Sirius XM has been willing to [ ], relative to what it would earn under the statutory license. This means not only that Sirius XM has been willing to absorb [to sign direct deals. It means that, in order to persuade labels to accept a headline royalty rate below the statutory rate, Sirius XM has been willing to offer benefits that more than offset the difference. . . . Evidently, what matters more to Sirius XM is that their direct deals *appear* to be a reduction from the statutory rate. What matters less is whether the direct deals in fact present any savings relative to the statutory environment.

SoundExchange fails to include a single citation to any record or evidentiary material in support of these baseless assertions.

447. Elsewhere, SoundExchange attempts to support factual assertions by citing proposed exhibits, or portions thereof, that were not admitted into the record for any purpose. For instance, SoundExchange cites portions of the George White's deposition transcript (Trial Ex. 157*) that were ruled inadmissible by the Judges at the hearing. *See* **SE PFF 1092, 1096, 1104, 1114, 1134, 1174, 1205, 1750**; *see generally* Attachment B.

448. Sirius XM accordingly respectfully requests that the Judges disregard the unsupported factual assertions contained in the proposed findings identified in Attachment B.

C. <u>SoundExchange's Assertions That Rely on Improper Expert Testimony By George Ford and Thomas Lys Should Be Disregarded</u>

449. On April 14, 2017, Sirius XM and Music Choice moved to exclude portions of the written direct testimony, written rebuttal testimony, and proposed hearing testimony of George

Ford for failure to meet the Rule 702 standard of admissibility for expert testimony under *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 584-87 (1993). *See* Motion by Sirius XM and Music Choice to Exclude Portions of the Written Direct Testimony, Written Rebuttal Testimony, and Proposed Hearing Testimony of George Ford, dated April 14, 2017 ("Ford Motion"). As described in greater detail in the Ford Motion, Sirius XM and Music Choice moved to strike (1) Section VI of Dr. Ford's Written Direct Testimony ("Ford WDT") and Section I.D. of Dr. Ford's Written Rebuttal Testimony ("Ford WRT"), on the grounds that Dr. Ford is not qualified to provide expert testimony regarding the difference between interactive and non-interactive services without any supporting economic analysis, and is not qualified to opine on the legal proceedings of the CRB; (2) Sections I.C and II of the Ford WRT, wherein Dr. Ford relays his purported conversations with record label and music industry executives, on grounds that it is an improper recitation of hearsay and contains speculation about the knowledge, intent, motivations, or state of mind of others; (3) and Section III.D of the Ford WRT, which purports to summarize certain factual conclusions already drawn by Professor Lys and Professor Willig, without offering any economic analysis.

450. Sirius XM also moved to exclude Section IV of Professor Lys's Written Rebuttal Testimony ("Lys WRT"), entitled "Updating Analysis From My Initial Report," on grounds that it did not purport to respond to any testimony by the Services; rather, it merely updates Professor Lys's *own* written direct testimony. *See* Motion by Sirius XM to Strike Improper Written Rebuttal Testimony of Thomas Lys, dated April 14, 2017, at 1 ("Lys Motion"). As detailed in the briefing on the Lys Motion, Section IV of the Lys WRT constitutes improper rebuttal testimony because it lacks a "sufficient nexus" with Sirius XM's direct testimony—a connection

Professor Lys has not even *attempted* to draw and that SoundExchange essentially concedes does not exist.[59]

451. Both motions have been fully briefed and await the Judges' determination. In the face of these pending motions, SoundExchange has repeatedly cited this objectionable testimony in its proposed findings, as detailed in Attachment B. For example, in an effort to counter Sirius XM's abundant evidence of its promotional value to the record industry, SoundExchange relies on Dr. Ford to pass along hearsay from record-industry executives who never testified at the hearing. *See, e.g.*, **SE PFF 428** (Dr. Ford purportedly heard from executives that "assessing the promotional effect of Sirius XM is largely a speculative endeavor"). Dr. Ford's improper repackaging of hearsay by record labels should not be permitted as a basis for SoundExchange's proposed findings of fact. Similarly, the Judges should disregard Dr. Ford's pure speculation—not founded on any valid methodology or qualification—about the differences between interactive and non-interactive service, and about the intent, motivations, or state of mind of third parties (including record labels and even the Copyright Royalty Judges). *See, e.g.*, **SE PFF 447** (citing Section VI of the Ford WDT).

452. Sirius XM therefore respectfully requests that the Judges grant its pending motions to strike and disregard SoundExchange's proposed findings that are predicated on those portions of the record. *See* Attachment B.

CONCLUSION

For the foregoing reasons and those previously set forth in Sirius XM's proposed findings, the Judges should reject SoundExchange's Amended Proposed Rates and Terms and adopt Sirius XM's Second Amended Proposed Rates and Terms.

[59] *See* SoundExchange's Opp. to Lys Motion (filed Apr. 14, 2017) at 1-2; Sirius XM's Reply to Lys Motion (filed Apr. 14, 2017) at 2-3.

Dated: July 7, 2017

Respectfully submitted,

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ATTACHMENT A:
Exhibits Admitted for a Limited Purpose

Trial Exhibit	Purpose For Which It Was Admitted	Transcript Citation
101	Admitted as something that influenced the next actions that SoundExchange took; not for the truth of the matter asserted	5/10/2017 Tr. 3177:9-20
157	Portion admitted: 15:12-25; 16:9-18; 17:6-12 (subject to expansion for clarity)	4/27/17 Tr. 1457:11-19
164	Admitted as relied on by Thomas Lys; not for the truth of the matter asserted	4/27/2017 Tr. 1483:18-1484:16
186	Admitted as relied on by Thomas Lys; not for the truth of the matter asserted	4/27/2017 Tr. 1483:18-1484:16
604	Admitted to establish record label's contact with Mr. Blatter; not for the truth of the matter asserted	5/10/17 Tr. 3370:14-21
606	Admitted to establish artist management's contact with Mr. Blatter; not for the truth of the matter asserted	5/10/17 Tr. 3370:14-21
607	Admitted to establish record label's contact with Mr. Blatter; not for the truth of the matter asserted	5/10/17 Tr. 3371:19-25
609	Admitted to establish record label's contact with Mr. Blatter; not for the truth of the matter asserted	5/10/17 Tr. 3371:19-25
614	Admitted to establish record label's contact with Mr. Blatter; not for the truth of the matter asserted	5/10/17 Tr. 3370:14-21
618	Admitted to establish artist management's contact with Mr. Blatter; not for the truth of the matter asserted	5/10/17 Tr. 3371:19-25
678	Portion admitted: title page and Exhibit 16A (pending further designations)	5/4/2017 Tr. 2510:17-23

ATTACHMENT B:
Sirius XM's Objections to SoundExchange's Proposed Findings

Paragraph	Trial Exhibit	Basis For Objection	Transcript Citation to Judges' Ruling
SE PFF 257	130	Admitted for a limited purpose only	5/15/17 Tr. 3777:8-14 (Meyer)
SE PFF 297 at n. 11	110 (SoundX_0000 45626-61)	Exhibit was not admitted	
SE PFF 409-411; SE PFF 412 & n. 27-28; SE PFF 416; SE PFF 420-421; SE PFF 423-426; SE PFF 427 & Fig. 2, n.30; SE PFF 428-429; SE PFF 447-448; SE PFF 453		Subject to pending Ford MIL	
SE PFF 524	130, 242	Admitted for a limited purpose only	5/15/17 Tr. 3777:8-14, 3778:20-3779:3 (Meyer)
SE PFF 788, n.75	130	Admitted for a limited purpose only	5/15/17 Tr. 3777:8-14 (Meyer)
SE PFF 809		Lacks evidentiary support	
SE PFF 917	161.1, 162-163	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 918	158	Admitted for a limited purpose only	4/27/17 Tr. 1478:6-15 (Lys)
SE PFF 919		Lacks evidentiary support	

Paragraph	Trial Exhibit	Basis For Objection	Transcript Citation to Judges' Ruling
SE PFF 923; SE PFF 935	158	Admitted for a limited purpose only	4/27/17 Tr. 1478:6-15 (Lys)
SE PFF 970	199.2	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 993	220	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 999	215	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1001	217-219	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1025	312	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1035	164	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1045	237, 241	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1046	164	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1047	165	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1048	239	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1049	165, 183, 190, 235-236, 239-241, 312	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1052	164	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1075	165, 213, 234-238, 312	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)

Paragraph	Trial Exhibit	Basis For Objection	Transcript Citation to Judges' Ruling
SE PFF 1077	165	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1084	175	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1090	180.2, 193	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16, 1535:18-1536:4 (Lys)
SE PFF 1091	180.2	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1092	157	Citation to portion of exhibit not admitted	4/27/17 Tr. 1457:11-19 (Lys)
SE PFF 1095	179	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1096	157 180.1, 193	Citation to portion of exhibit not admitted Admitted for a limited purpose only	4/27/17 Tr. 1457:11-19 (Lys) 4/27/17 Tr. 1483:18-1484:16, 1535:18-1536:4 (Lys)
SE PFF 1100	182	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1101	183	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1103	179, 183, 184.1, 185-191, 228-233	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1104	157 194.2	Citation to portion of exhibit not admitted Admitted for a limited purpose only	4/27/17 Tr. 1457:11-19 (Lys) 4/27/17 Tr. 1483:18-1484:16 (Lys)

Paragraph	Trial Exhibit	Basis For Objection	Transcript Citation to Judges' Ruling
SE PFF 1110	201.1	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys); 5/17/17 Tr. 4318:14-20 (White)
SE PFF 1111	187, 196-197	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1112	175, 199.2, 200	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1114; SE PFF 1134	157	Citation to portion of exhibit not admitted	4/27/17 Tr. 1457:11-19 (Lys)
SE PFF 1164	170-171	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1165	173	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1173	186, 190, 203	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1174	157	Citation to portion of exhibit not admitted	4/27/17 Tr. 1457:11-19 (Lys)
SE PFF 1175	205-206	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1198	209	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1202	210-212	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1203	213	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1205	157	Citation to portion of exhibit not admitted	4/27/17 Tr. 1457:11-19 (Lys)
SE PFF 1233	319	Admitted for a limited purpose only	5/15/17 Tr. 3761:7-3762:2 (Meyer)
SE PFF 1402		Subject to pending Lys MIL	

Paragraph	Trial Exhibit	Basis For Objection	Transcript Citation to Judges' Ruling
SE PFF 1530		Hearing testimony discussing Lys WRT subject to pending Lys MIL	4/26/17 Tr. 1343:24-1344:5 (Lys)
SE PFF 1535	319	Admitted for a limited purpose only	5/15/17 Tr. 3761:7-3762:2 (Meyer)
SE PFF 1536 & n.148; SE PFF 1538		Subject to pending Lys MIL	
SE PFF 1540; SE PFF 1541		Hearing testimony discussing Lys WRT subject to pending Lys MIL	4/26/17 Tr. 1335:22-1336:2, 1337:8-18, 1339:21-1340:1, 1340:9-1341:1 (Lys)
SE PFF 1546-1548; SE PFF 1579-1582		Subject to pending Lys MIL	
SE PFF 1627	307-308	Admitted for a limited purpose only	4/26/17 Tr. 1331:11-17 (Lys)
SE PFF 1652	101	Admitted for a limited purpose only	5/10/17 Tr. 3177:9-20 (Bender)
SE PFF 1664		Lacks evidentiary support	
SE PFF 1674; SE PFF 1676; SE PFF 1677; SE PFF 1679; SE PFF 1681; SE PFF 1683; SE PFF 1685; SE PFF 1686; SE PFF 1695; SE PFF 1699	101	Admitted for a limited purpose only	5/10/17 Tr. 3177:9-20 (Bender)
SE PFF 1747	175	Admitted for a limited purpose only	4/27/17 Tr. 1483:18-1484:16 (Lys)
SE PFF 1750	157	Citation to portion of exhibit not admitted	4/27/17 Tr. 1457:11-19 (Lys)

Paragraph	Trial Exhibit	Basis For Objection	Transcript Citation to Judges' Ruling
SE PFF 1758	101	Admitted for a limited purpose only	5/10/17 Tr. 3177:9-20 (Bender)
SE PFF 2066; SE PFF 2079-2082		Subject to pending Ford MIL	
SE PFF 2083		Hearing testimony discussing Ford WRT subject to pending Ford MIL	5/1/17 Tr. 1853:7-1855:10 (Ford)
SE PFF 2085-2087; SE PFF 2092; SE PFF 2094; SE PFF 2109		Subject to pending Ford MIL	
SE PFF 2262	101	Admitted for a limited purpose only	5/10/17 Tr. 3177:9-20 (Bender)

CERTIFICATE OF SERVICE

I certify that a copy of the PUBLIC version of the foregoing document has been served by e-mail on this 7th day of July, 2017 on the following persons:

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Reed Collins/dg

Reed Collins

Certificate of Service

I hereby certify that on Friday, July 07, 2017 I provided a true and correct copy of the Sirius XM's Corrected Reply To SoundExchange's Proposed Findings of Fact and Conclusions of Law (Public) to the following:

Recording Industry Association of America, The, represented by David A. Handzo served via Electronic Service at dhandzo@jenner.com

SoundExchange, Inc., represented by David A. Handzo served via Electronic Service at dhandzo@jenner.com

Warner Music Group, represented by David A. Handzo served via Electronic Service at dhandzo@jenner.com

Music Choice, represented by Paul M Fakler served via Electronic Service at paul.fakler@arentfox.com

SAG-AFTRA, represented by David A. Handzo served via Electronic Service at dhandzo@jenner.com

Universal Music Group, represented by David A. Handzo served via Electronic Service at dhandzo@jenner.com

American Association of Independent Music ("A2IM"), represented by David A. Handzo served via Electronic Service at dhandzo@jenner.com

Sony Music Entertainment, represented by David A. Handzo served via Electronic Service at dhandzo@jenner.com

American Federation of Musicians of the United Sta, represented by David A. Handzo served via Electronic Service at dhandzo@jenner.com

Signed: /s/ Todd Larson