Electronically Filed
Docket: 16-CRB-0001-SR/PSSR (2018-2022)
Filing Date: 07/07/2017 03:17:22 PM EDT

Public Version

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

In the Matter of: Determination of Royalty Rates and Terms for Transmission of Sound Recordings by Satellite Radio and "Preexisting" Subscription Services (SDARS III)	Docket No. 16-CRB-0001 SR/PSSR (2018-2022)

SOUNDEXCHANGE, INC. AND COPYRIGHT OWNER AND ARTIST PARTICIPANTS' REPLIES TO SIRIUS XM RADIO INC.'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

July 7, 2017

TABLE OF CONTENTS

Page

REPLY TO INTRODUCTION 1

I. FACTUAL BACKGROUND 11

A. Sirius XM's Service Derives Significant Value From Music And Competes Directly With Subscription Streaming Services 11

i. Record Evidence Establishes That Music Drives The Value Of Sirius XM's Satellite Radio Service 11

ii. Sirius XM's Evidence Illustrates That Consumers Place Significant Value On Access To Premium Music Content In The Car And Would Be Reluctant To Return To Inferior Alternatives 18

iii. Sirius XM Competes With Subscription Streaming Services For Consumers With A Positive Willingness To Pay 21

B. Satellites 32

C. Sirius XM's Promotion of Sound Recordings 44

D. Sirius XM's Direct License Initiative 51

II. THE GOVERNING LAW 56

A. Benchmark Rates 57

i. Comparability 57

ii. Effective Competition 62

B. Section 801(b)(1) 64

III. SIRIUS XM'S PROPOSED BENCHMARKS DO NOT PROVIDE A MEASURE OF APPROPRIATE ROYALTY RATES AND SHOULD BE REJECTED 76

A. Developments Since *SDARS II* Demonstrate That The Prevailing Statutory Rate Is Far Too Low 76

i. The Prevailing Statutory Rate Is Far Too Low Because The Explosive Growth Of Streaming Has Brought Sirius XM Into Direct Competition With Subscription Streaming Services 78

ii. Changes In The Upstream Markets In Which Record Labels License Music Services Support An Upward Adjustment To The Prevailing Statutory Rate 99

B. Sirius XM's Direct Licenses Do Not Offer A Reliable Benchmark....105

i. Background 106

ii. There Is No Credible Evidence That Direct Licensors Were Motivated By Steering 109

iii. Professor Lys's Criticisms Of The Direct License Benchmark Are Valid....120

1. The Direct License Rates Are Tied To The Statutory Rates 123

2. The Direct Licenses Are A Non-Representative Sliver Of The Sound Recording Market 126

3. Indexing 128

4. Artist Share 131

5. Advances....134

6. Pre-'72....135

7. Steering And Access To Programmers 138

C. Sirius XM's Proposal To Use The *Web IV* Rates Is Fundamentally Flawed....139

i. Derivation of the *Web IV* Rates 143

ii. The *Web IV* Benchmark Is Inappropriate And Must Be Rejected....145

1. Converting the *Web IV* Per Play Rate Into A Percentage-Of-Revenue Rate Is A Flawed Exercise 145

2. Sirius XM's "Refinements to Account for Differences Between Subscription Noninteractive Webcasting Services and Satellite Radio" Are Wholly Inadequate....150

iii. The Section 801(b)(1) Factors Support An Increase – Not A Decrease – In Rates....156

iv. Sirius XM Has No Valid Response To SoundExchange's Objections To The *Web IV* Benchmark 160

IV. SOUNDEXCHANGE'S PROPOSED RATE LEVEL AND STRUCTURE SHOULD BE ADOPTED 168

A. SoundExchange's Proposed Change to the Prevailing Rate Structure Has Strong Support in the Record 170

B. Mr. Orszag's Benchmarking Approach Is A Reliable Method For Setting Rates For Sirius XM In A Manner Consistent With The 801(b)(1) Factors 174

i. Mr. Orszag's Approach Has Been Repeatedly Accepted By The Judges, Most Recently In *Web IV*, And The Concerns Expressed By The Judges In *SDARS II* No Longer Apply 176

ii. The Interactive Services Market Is Effectively Competitive 179

1. A Market With Must-Haves Can Be Effectively Competitive 179

2. Interactive Services Are Not Price-Takers 184

3. Sirius XM Mischaracterizes The Contractual Evidence It Relies On 188

iii. Sirius XM's Analysis Of Non-Price Competition Is A Straw Man 193

iv. Dr. Blackburn's Empirical Analysis Of Evidence Not Presented In *Web IV* Confirms That The Interactive Services Market Is Effectively Competitive 195

v. If The Judges Determine That The Interactive Services Market Is Not Effectively Competitive, Mr. Orszag's Proposed Competition Adjustments Produce Appropriate Royalty Rates 199

vi. Mr. Orszag Correctly Relied On The *Web IV* Decision 202

1. Mr. Orszag's Analysis Follows The Judges' Conception And Application Of "Ratio Equivalency" In *Web IV* 202

2. Ratio Equivalency Applies As Between Sirius XM And Subscription Interactive Services 204

3. Sirius XM's Insistence On Using Minimum Per-Play Rates Rather Than Effective Rates Is Misplaced 209

4. Sirius XM's Additional Criticisms Of Mr. Orszag's Benchmarking Approach Are Meritless 212

C. Sirius XM's Responses To SoundExchange's Free Trials Proposals Are Based On Conjecture And Flawed Economics 219

D. Professor Willig's Opportunity Cost Analysis Establishes An Appropriate Floor For The Rates To Be Set In This Case 226

i. Professor Willig's Opportunity Cost Analysis Is Consistent With The Outcomes In A Market That Is Effectively Competitive 227

ii. Professor Willig's Opportunity Cost Analysis Accepts The Markets For Alternative Modes Of Distribution As They Are, Without Adjusting Compensation For Any Of Those Modes Of Distribution Up Or Down 235

iii. Professor Willig Does Not Assume Tacit Collusion Or A Group Boycott 237

iv. Professor Dhar's Survey Was Properly Designed To Provide Data To Calculate Opportunity Cost And Its Results Are Confirmed By The Results Of The Simonson Survey 239

1. Professor Dhar's Survey Was Properly Designed 241

2. Professor Dhar's Survey Population Was Appropriate And Representative, As Confirmed By The Simonson Survey 253

3. The Dhar And Simonson Surveys Provided Clear And Sufficient Questions, Instructions, And Response Options 258

v. The Promotional Impact Of Sirius XM Was Examined By Professor Ford And Found To Be Immaterial 267

vi. Professor Willig Correctly Applied Ramsey Pricing Principles And The Nash Bargaining Solution 270

1. Ramsey Pricing Principles Strongly Indicate An Upward Departure From Opportunity Cost 271

2. Professor Willig's Nash Bargaining Solution Does Not Treat Record Labels As Monopolists 274

V. SOUNDEXCHANGE'S PROPOSED REGULATORY LANGUAGE, RATHER THAN SIRIUS XM'S, SHOULD BE ADOPTED 275

A. The Judges Should Complete The Revision Project They Started In *Web IV* By Restructuring And Harmonizing The PSS And SDARS Regulations 275

B. The Exclusions From Gross Revenues For Separate Data Services And Non-Music Programming Should Not Be Revised As Proposed By Sirius XM 279

i. Sirius XM's Proposal To Undo The Judges' Underpayments Decision Should Not Be Adopted 280

ii. SoundExchange's Proposed Clarification Should Be Adopted 285

C. The Judges Should Reject Sirius XM's Proposal to Drastically Reduce The Late Fee It Owes On Improperly Withheld Royalties 287

i. A 1.5% Per Month Late Fee Applies And Should Continue to Apply to Late Payments, Including Underpayments Discovered in Audits 288

ii. Sirius XM's Late Fee Proposal Should Be Rejected 295

D. Artists And Copyright Owners Whose Works Are Used Under The Statutory License Should Not Be Penalized When Other Copyright Owners Enter Into Direct Licenses To Exploit Regulatory Differences 298

E. The Direct License And Pre-'72 Exclusions Should Be Calculated Using Actual Satellite Listenership Data If Available 303

F. SoundExchange's Other Proposed Changes To The Definition Of Gross Revenues Should Be Adopted 306

G. Other Disputed Issues Related To The Audit Regulations 312

i. § 382.11 Definition Of "Qualified Auditor" 312

ii. § 382.15(c) Requirement That Audits Be "Binding On All Parties" 314

iii. SoundExchange's Proposed 5% Threshold For Audit Cost Fee-Shifting Should Be Adopted 315

iv. Treatment Of Underpayments In Audits 316

v. The Judges Cannot And Should Not Adopt Sirius XM's Proposed "Finality" Provision 319

H. Sirius XM's Other Proposed Changes To The SDARS Terms 320

i. Definition Of "GAAP" 320

ii. Ephemeral Recordings 322

iii. Payment Date 322

iv. Unclaimed Funds 322

REPLY TO INTRODUCTION

SoundExchange's case is based on current marketplace data, analyzed in a manner consistent with sound economic theory and the methodologies approved in prior Copyright Royalty Board cases. In contrast, Sirius XM assiduously avoids consideration of current marketplace agreements or data from unregulated markets. The closest Sirius XM comes to any discussion of the sound recording market as it exists today are the agreements it negotiated in the shadow of the statutory license with a small and unrepresentative sample of indie record labels who were induced to enter into direct licenses by promises of a variety of non-statutory benefits.

Sirius XM's aversion to current reality is born of necessity. Marketplace agreements between record companies and non-statutory services today feature effective rates between [ ] of revenue. No reasonable economic analysis of those agreements could possibly yield the rates that Sirius XM proposes. For the same reasons, Sirius XM eschews any effort to calculate the actual opportunity costs incurred by the copyright owners as a result of licensing Sirius XM, opting instead to offer models based on assumptions instead of facts. The recording industry's accelerating shift towards mobile streaming, coupled with the far higher royalties paid by subscription streaming services, rendered it infeasible for Sirius XM to offer any economically defensible analysis of opportunity costs based on hard evidence that would not suggest a substantial rate increase.

SoundExchange's rate proposal rests on the interactive services benchmark presented by Mr. Orszag and the opportunity cost analysis presented by Professor Willig. Sirius XM attacks both without effect.

Sirius XM begins its challenge to Mr. Orszag's analysis by suggesting that the interactive services benchmark has been discredited in prior proceedings. Nothing could be further from the

truth. The Judges relied on that benchmark in whole or in part in *Web II*, *Web III*, *Web IV* and *SDARS I*. The *SDARS I* decision is particularly worthy of note, because it dispels any argument that the Judges have accepted the interactive services benchmark only for webcasting cases and not for cases involving satellite radio. Sirius XM, of course, highlights the *SDARS II* decision, but entirely ignores the rationale for that decision and the fact that the concerns expressed by the Judges in that case (*e.g.*, that the interactive services market was in a "state of flux") no longer apply.

Sirius XM next challenges Mr. Orszag's methodology, asserting that it departs from the analytical approach accepted by the Judges in *Web IV*. Ironically, however, when Professor Shapiro purports to re-analyze the interactive services benchmark using what in his view is the "correct" and judicially approved methodology, he essentially adopts step-for-step one of Mr. Orszag's two analytical approaches, including the use of the *Web IV* competition adjustment of 12%. The singular difference in Professor Shapiro's analysis is his insistence on using headline per-play rates instead of effective rates. But Professor Shapiro could not offer an economic theory for why it is appropriate to do so, nor could he controvert the overwhelming marketplace evidence demonstrating that subscription streaming services almost never pay royalties based on a per-play rate.

The third leg of Sirius XM's stool, with respect to the interactive services, is its shopworn argument that the upstream market for licensing sound recordings to subscription interactive services is not effectively competitive. SoundExchange disagrees, but also points out that Mr. Orszag offered three different methods to calculate a competition adjustment should the Judges deem one necessary. Indeed, in his written rebuttal testimony Professor Shapiro endorsed a competition adjustment using the *Web IV* adjustment factor of 12%. Although he tried to cabin

this concession at trial by claiming that the adjustment would only apply if one started the analysis using headline per-play rates, it was clear from his trial testimony that his only rationale was that he did not like the end result if effective rates were used.

Sirius XM also takes aim at Professor Willig's opportunity cost analysis, and again shoots wide of the mark. Subscription fully interactive services pay royalties that are [▉] times what Sirius XM pays on a per-subscriber basis, and the subscription mid-tier services offered by Pandora and iHeart pay at least [▉▉] times what Sirius XM pays on a per-subscriber basis. Even modest levels of diversion of consumers by Sirius XM away from those services creates a significant opportunity cost. And Sirius XM admits, in court documents filed in its lawsuit against Spotify, in its SEC filings, and in its testimony before the Judges in this case, that it indeed competes with subscription fully interactive and mid-tier services. The only disputed question is how much. That question was answered by two independent surveys designed by two highly qualified survey experts, Professor Dhar and Professor Simonson, which established that the diversion levels are substantial.

Although Sirius XM criticized both surveys, the surveys are entirely sound and, importantly, both asked the central question that Sirius XM purposely side-stepped in the Lenksi survey – how consumers would spend their money if Sirius XM was unavailable, as opposed to how they would spend their time. Sirius XM may indeed compete with terrestrial radio, as it argues, and it may lose that competition for consumers with a low willingness to pay, but for those consumers who have demonstrated by their subscriptions to Sirius XM that they have a high willingness to pay for music, Sirius XM's diversion of those consumers away from other paid subscription services is substantial and very costly to the copyright owners.

Sirius XM also argues that Professor Willig calculated an industry-wide opportunity cost, and therefore a monopoly opportunity cost. As Professor Willig demonstrated (and as Professors Shapiro and Farrell had to admit), the opportunity cost incurred by a single must-have record label is equivalent to its pro rata share of an industry-wide opportunity cost. And the fact that one or more labels are must-haves does not mean they possess, much less exercise, monopoly power. Must-have record companies, as Professor Willig explained, can be disciplined by the threat or reality of steering to the same degree as labels that are not must-haves. Indeed, Professor Shapiro himself so testified in *Web IV*, although he tried unsuccessfully to walk back that admission in this case. Moreover, as Professor Willig pointed out and Professor Shapiro conceded, sellers exercising monopoly power would seek to extract all of the available surplus created by the service's offering of music, and would not be content to simply break even by recovering their opportunity cost. In short, there is no basis to disregard Professor Willig's calculation of the opportunity cost of licensing Sirius XM.

Last, Sirius XM offers Professor Shapiro's regression analysis as proof that Professor Willig's opportunity cost calculations are flawed. But Professor Shapiro's analysis produces results that are "squirrely." And lest that sound like hyperbole from SoundExchange, that is actually how Professor Shapiro described his own results. He also said "I don't really put weight on these high level regressions," "I just don't – I don't think its reliable," and "I don't put any weight on that number." Given Professor Shapiro's efforts to distance himself from his own analysis, the Judges should disregard it.

Mr. Orszag's benchmark analysis, including a competition adjustment, yielded per subscriber rates ranging from $2.40 to $2.82 per month, and Professor Willig's analysis resulted in an opportunity cost calculation of $2.55 per subscriber per month. Sirius XM protests that

these rates are double the rates determined for Sirius XM in *SDARS II* and for subscription noninteractive streaming services in *Web IV*. In reality, the *Web IV* rate as applied to Pandora One yields an effective per-subscriber rate of [redacted] – modestly lower but hardly out of line with SoundExchange's rate proposal. Similarly, the Judges in *SDARS I* calculated that the per-subscriber rate most strongly supported by the evidence was $1.40 per month, which when adjusted for inflation will equate to $1.74 at the start of the upcoming rate term. Here again, SoundExchange's proposed rates represent an increase but are far from double the rate that would result from simply updating the rate determined ten years ago, when opportunity costs were far lower and Sirius and XM were awash in red ink.

Sirius XM's benchmarks, on the other hand, fall far short of providing any useful basis to determine rates in this case. Sirius XM begins by asking the Judges to preserve the status quo and simply defer to the decision made five years ago in *SDARS II*. Sirius XM's proposal flies in the face of the law, which requires the Judges to "determine" rates and not just "adjust" rates, and common sense as well. Sirius XM asserts that Professor Shapiro "logically began his analysis" with the rates determined in *SDARS II*, but there is nothing logical about setting rates for today based on market information that is nearly ten years old.[1]

Much has changed. The interactive services market is no longer in flux, eliminating one of the Judges' concerns about the interactive services benchmark in *SDARS II*. The record in this case, unlike the record in *SDARS II*, contains abundant evidence about the rates paid by indie record companies, eliminating another of the Judges' concerns. The opportunity costs of licensing Sirius XM manifestly have changed as streaming has grown, as smart phones have

[1] The *SDARS II* rates were derived largely from the rates determined in *SDARS I*.

achieved increased penetration, as data networks have improved in speed and coverage, and as fully interactive services have embraced playlists and algorithmic streams suited to passive in-car listening. Sirius XM changed from a company only recently escaped from the threat of bankruptcy to a company that is distributing to its shareholders the billions of dollars it no longer needs to fund its operations or its capital expenses. The latter fact has implications both for the calculation of a market rate (the surplus to be divided in a hypothetical negotiation between Sirius XM and a record company obviously has grown) and for the application of the Section 801(b)(1) objectives (no downward adjustments are appropriate in light of Sirius XM's impressive profits). The important point, for present purposes, is that it is illogical to start with outdated marketplace evidence when the competitive landscape has changed and the Judges have available to them current and extensive marketplace evidence.

Sirius XM next offers its direct licenses as a benchmark. Even Professor Shapiro, however, will not say that the direct licenses represent rates that the rest of the market would agree to, rendering the direct licenses valueless from the start.

Worse, Professor Shapiro concedes that the direct licenses are economically uninformative if the sellers were not motivated by an offer (or threat) of steering, and the record demonstrates that steering simply was not a motivating factor. To begin, Sirius XM does not even offer to steer. Sirius XM candidly concedes that it will not prefer one sound recording over another based on price, except in the unlikely event that its programmers are utterly indifferent to the merits of one sound recording versus another. All Sirius XM offers is to give direct licensed indies the same access to programmers that it gives to non-direct licensed labels whose music it plays on a regular basis – an offer obviously of no benefit to record companies whose music

already is played on a regular basis. Not surprisingly therefore (and in stark contrast to the *Web IV* case) Sirius XM offers no empirical evidence that it has engaged in steering.

Sirius XM's only evidence that the threat/promise of steering motivated the direct licensors is the testimony of Sirius XM executives who offer hearsay statements purporting to identify the motives of the record companies that signed direct licenses. Sirius XM called no direct licensed indie representatives as witnesses, its experts did not interview any direct licensed indie representatives, and its lawyers fought aggressively to keep out of evidence the negotiating documents and emails exchanged between Sirius XM and the direct licensors. SoundExchange, however, provided the evidence that Sirius XM tried to hide. SoundExchange provided testimony by [[redacted]],[2] Professor Lys interviewed other direct licensors, and Professor Lys and his staff examined thousands of pages of negotiating documents. On the basis of this analysis, even Professor Shapiro had to concede that half of the direct licensors were motivated by the benefits of Sirius XM's method for calculating royalties (referred to during the trial as "indexing"), and that fully half of the direct licenses therefore are irrelevant to the rate-setting process.

As to the other half of the direct licensed indies, again Professor Shapiro had to concede that other factors (*e.g.*, receiving the artist share, obtaining payment for pre-72 recordings, advances) may have motivated the record companies, although he clung to the notion that steering also was a factor in some unquantifiable way. But Professor Shapiro could only rely on

[2] Sirius XM claims that the indie witness offered by SoundExchange confirmed that steering was one of the reasons it signed a direct license. Sirius XM can only make that claim by distorting the record. Sirius XM quotes [[redacted]] representative as having testified that [[redacted]] was motivated by its "belief that greater access to and attention from [Sirius XM's] programming staff would ultimately lead to an increase in plays and therefore royalties." In fact, the [[redacted]] representative was quoting Mr. White's written direct testimony for the purpose of refuting it: "Mr. White's testimony does not set forth the primary reason that [[redacted]] signed direct licenses with Sirius XM."

the self-serving hearsay statements of Mr. White and Mr. Blatter, having undertaken no investigation himself. Professor Lys's exhaustive examination of the documents and his interviews demonstrated beyond any real doubt that steering was not a factor, and the direct licenses therefore are meaningless for the purposes of this proceeding.

Finally, Sirius XM asks the Judges to use the per-play rates determined for subscription noninteractive webcasters in the *Web IV* proceeding, and convert them into a percentage of revenue rate for Sirius XM through a series of flawed calculations. Sirius XM states that "[t]his approach adopts the premise that the fundamental unit of value in the market for sound recording public performance rights is plays." That premise is demonstrably wrong. Essentially, Sirius XM is arguing that noninteractive plays of sound recordings should earn the same royalty no matter how they are used or how effectively they are monetized. Of course, Sirius XM and Professor Shapiro are entirely incorrect in asserting that there is somehow a single value for noninteractive plays of sound recordings that determines the royalty payments of music services. To the contrary, as Mr. Orszag testified without contradiction, the marketplace evidence demonstrates that record companies and subscription services negotiate over the revenues earned by the service, not over the number of plays consumed by the service. In only slightly over 1% of the agreements examined by Mr. Orszag were per-play rates the metric that determined the royalty payment. Given that undisputed fact, it is hard to understand how Sirius XM can contend with a straight face that plays are the "fundamental unit of value" for the purposes of this proceeding.[3]

[3] In an attempt to justify its arguments, Sirius XM cites the testimony of Michael Kushner. Mr. Kushner observed that a record company's pro rata share of the royalty rate paid by a service is based on the label's number of plays on the service. But that has nothing to do with how the royalty payment by the service is determined – it only affects how the record companies divide up that royalty payment.

Of course, it is not hard to understand why Sirius XM takes this position. Most listening to Sirius XM takes place in the car, and thus the listening time and number of plays is limited. But that does not mean that consumers do not place a high value on these plays – obviously they do, in light of the substantial subscription prices they pay. And those subscription revenues, not the number of plays, would be the consideration most relevant to a negotiation in the hypothetical market.

This fundamental problem in Sirius XM's *Web IV* benchmark approach is hardly the end of its flaws. Material marketplace developments since the *Web IV* proceeding substantially undermine the probative value of the per-play rate set in that case. Most notably, the agreement executed between Merlin and Pandora – used in setting the *Web IV* rate – was first amended and then replaced by a new mid-tier agreement under which Pandora pays Merlin members their *pro rata* share of $2.50 per-subscriber or 50 percent of revenue for its mid-tier service. These rates are far removed from those Professor Shapiro derives from his *Web IV* benchmark, and demonstrate that the benchmark is not informative.

Sirius XM's *Web IV* benchmark also suffers from other fatal faults. Professor Shapiro calculates the average number of plays per subscriber, and therefore the effective per-subscriber royalty rate, using a survey that Sirius XM never offered in evidence, and that produces results materially different than the number of plays per subscriber calculated by Professor Willig. Professor Shapiro also uses the wrong ARPU number when he translates his erroneous per-subscriber royalty into an even more erroneous percentage of revenue number.

In the end, none of Sirius XM's three benchmarks provide useful information. The inescapable reality is that Sirius XM currently pays royalties that are far below market, and for no reason that the 801(b)(1) objectives could possibly justify. The Judges should adopt SoundExchange's proposed rates.

I. FACTUAL BACKGROUND

A. Sirius XM's Service Derives Significant Value From Music And Competes Directly With Subscription Streaming Services

i. Record Evidence Establishes That Music Drives The Value Of Sirius XM's Satellite Radio Service

Response to ¶ 1. Sirius XM's assertions regarding the reasons it has experienced "growth and continued success" are supported almost entirely by self-serving testimony from the company's chief executive, James Meyer. Instead of offering independent surveys, studies, or research to support its claims about why Sirius XM is so immensely profitable, Sirius XM relies almost entirely on the say-so of a CEO with a keen interest in minimizing royalty payments to SoundExchange. Significantly, the cited testimony does not mention several factors that help make Sirius XM [[redacted]], SE FOF at ¶ 314, and much more profitable than several of its industry competitors, SE FOF at ¶¶ 1584-1597. These include Sirius XM's ability to leverage valuable music content at royalty rates [[redacted]], *see, e.g.*, Trial Ex. 32 at ¶ 26 (Harrison WDT); Trial Ex. 50 at ¶ 6 (Walker WRT), its ability to offer music content without providing any of the valuable non-monetary benefits that record companies ordinarily secure from streaming services, SE FOF at ¶¶ 570-575, and its ability to offer music content at statutory rates adjusted to reflect Sirius XM's past claims of poverty, SE FOF at ¶¶ 1598-1606, among others.

Response to ¶ 2. As Sirius XM acknowledges, consumers can obtain "anytime-anywhere" access to subscription on-demand services. SXM FOF at ¶ 2. And, although Sirius XM conspicuously omits reference to subscription mid-tier services like those offered by Pandora and by iHeart, consumers can obtain anytime-anywhere access to music through those services as well. SE FOF at ¶¶ 1334-1338. While it is true that music is available from a

number of subscription streaming services that compete with satellite radio, Sirius XM presents no empirical evidence that this diminishes the value that its subscribers place on the music content available through its service.

Response to ¶ 3. Mr. Meyer speculates that if Sirius XM subscribers were interested only in music, they could access music for free through terrestrial or ad-supported streaming services. However, there is substantial record evidence, including trial testimony from Mr. Meyer, that Sirius XM subscribers are willing to pay for its service in part because they are interested in a commercial-free music experience. 5/15/17 Tr. 3749:10-17 (Meyer). In fact, research prepared for Sirius XM, and cited in its findings, concludes that excising commercials from its music channels provides Sirius XM with a big advantage over terrestrial radio, Trial Ex. 242 at 24 (SXM_DIR_00027555), and is necessary to compete with other subscription streaming services. Trial Ex. 242 at 22 (SXM_DIR_00027553).

None of this is novel. Sirius XM has long recognized that its subscribers value a commercial-free experience. In *SDARS I*, Sirius told the Judges that a commercial-free experience "creates greater listener satisfaction and helps [Sirius] attract and retain subscribers even though music is available for free on terrestrial radio." Trial Ex. 15 at 4-5 (Blatter *SDARS* I WDT). In *SDARS II*, Sirius XM cited several third-party studies to support its assertion that "[t]he absence of commercials also translates into a listening experience that is more sustained and satisfying than advertiser-supported radio," and helps explain "why subscribers are willing to purchase Sirius XM radios and pay subscription fees when music can be heard for free on terrestrial radio." Trial Ex. 18 at 11-12 (Blatter SDARS II WDT).

Mr. Meyer also speculates that consumers interested only in music would turn to less expensive subscription streaming services instead of Sirius XM. Of course, the evidence

developed in this case illustrates that consumers do view Sirius XM and subscription streaming services as substitutes, SE FOF at ¶¶ 583-687.

Response to ¶ 4. Sirius XM presents no evidence — through subscribership percentages or otherwise — that customers value non-music content *more than* music content. The SoundExchange economic analysis conservatively assumes music and non-music are equally valued, SE FOF at ¶¶ 169, 172, 252-259, and nothing in Sirius XM's evidence suggests otherwise. In addition, although the exhibits Sirius XM cites in paragraph 4 do not even suggest non-music has a greater value than music, Sirius XM cannot be heard to cite those exhibits (130 and 242) for the truth of the matters contained therein, having successfully objected to those exhibits on that precise basis.

[[redacted]], *see* 5/15/17 Tr. 3775:17-3776:3, 3776:24-3778:5 (Meyer), the document supports the position of SoundExchange, not Sirius XM. Page 40 of Trial Exhibit 130, cited by Sirius XM, refers to the benefit of "variety" but never explicitly mentions non-music content (while variety of music is explicitly listed). Trial Ex. 130 at 40 (SXM_DIR_00024275). Moreover, in analyzing variety, the study emphasizes that "non-converts are twice as likely to say they can't always find the kinds of music they most like listening to on Sirius XM," Trial Ex. 130 at 39 (SXM_DIR_00024274), and that "non-converts see both stored and streamed [audio sources] as doing a better job at delivering variety than Sirius XM." Trial Ex. 130 at 42 (SXM_DIR_00024277). The study indicates that 53% to 55% of Sirius XM trial users who convert to the service ranked listening to music as the most important activity in the car, while only 17% ranked listening to news or other audio entertainment as the most important activity in the car. Trial Ex. 130 at 28

(SXM_DIR_00024263). And the study concludes that, "[w]hile improving conversion rates among demographic groups and those engaging in certain behaviors would help raise overall conversion to self-pay[,] the leverage *is in ensuring that Trialers can find enough of the music they most enjoy listening to.*" Trial Ex. 130 at 57 (SXM_DIR_00024292) (emphasis added).

Similarly, page 7 of Trial Exhibit 242, also cited by Sirius XM regarding the benefits of "variety," does not indicate whether the "variety" customers like refers to music content, non-music content, or both. Trial Ex. 242 at 7 (SXM_DIR_00027538). And Sirius XM conveniently omits reference to later portions of the document that emphasize that "variety needs to be focused first on music," Trial Ex. 242 at 12 (SXM_DIR_00027543), that "music is by far the most important type of audio content to stream," Trial Ex. 242 at 43 (SXM_DIR_00027574), and that "music from any genre dominates listening time both in and out of the vehicle." Trial Ex. 242 at 48 (SXM_DIR_00027579). Significantly, the same document notes that "high proportions of both self-pay customers and recent rejecters associate streaming with variety." Trial Ex. 242 at 42 (SXM_DIR_00027573).

This survey evidence, prepared for and relied on by Sirius XM, establishes that Sirius XM subscribers are willing to pay for the service in large because of the variety *of music* that the company offers, and belies any claim that subscribership is driven by non-music content.

Finally, Sirius XM argues that because it offers a "Mostly Music" package limited to music channels for $10.99 per month, which is less expensive than the standard Select package, and because only about 6% of its customers choose that package, that must mean Sirius XM's subscribers prefer a bundle of non-music with music. There are problems with this assertion: (i) Mostly Music offers only 80 music channels, compared to 140 on Select, Trial Ex. 707, and Sirius XM has not purported to analyze how much that significant difference in the *music* portion

of the service accounts for the difference in subscribership; (ii) for a more apples-to-apples comparison, one can examine the subscribership of "Mostly Music" vs. the "News, Sports & Talk" package. While 6% choose Mostly Music, the most recent data produced by Sirius XM show that [[redacted]] of the Sirius XM subscriber base subscribes to "News, Sports & Talk," amounting to [[redacted]] of the Mostly Music subscriber base — hardly an indication that customers value non-music more than music. *See* Trial Ex. 146, Tab "Subs By Package," Heading Selfpay, August 2016 data (native file). This is why a survey such as that conducted by Mr. Boedeker is needed to assess the value of music relative to non-music, and that survey, along with other evidence cited above, shows that the SoundExchange assumption of 50% value for music is highly conservative.

Response to ¶ 5. Sirius XM acknowledges that its satellite radio service "could not succeed without music programming." SXM FOF at ¶ 5. Mr. Meyer readily admitted this at trial. 5/15/17 Tr. 3752:14-17 (Meyer) ("Q: And you agree that Sirius XM's satellite radio services could not succeed without music programming, correct? A: Correct."). Sirius XM's speculation that the service could not succeed without non-music is unsupported by any actual evidence, and, in any event, beside the point. SoundExchange does not contend that non-music content has no value to Sirius XM. And even if Sirius XM could not succeed without non-music content, that says nothing about the *degree* to which customers value music vs. non-music content. SoundExchange has presented independent survey evidence, corroborated by substantial additional evidence, that music constitutes at least 50% of the value of the product. *See* SE FOF at ¶¶ 169, 172, 252-259.

Response to ¶ 6. The same study Sirius XM relies on in its proposed findings, *see* SXM FOF at ¶ 4, finds that Sirius XM's exclusive content does not drive subscribers' willingness to

pay for the company's satellite radio service. The study concludes that, though helpful, exclusive content is "by no means a primary driver of subscriptions today and is unlikely to be in the future." Trial Ex. 242 at 19 (SXM_DIR_00027550).

In any event, Sirius XM's economic expert, Carl Shapiro, recognized in his testimony that the only non-music content that Sirius XM offers on a "truly exclusive" basis is Howard Stern. 4/19/17 Tr. 230:21-232:5 (Shapiro). The other non-music content that Sirius XM offers is "generally available . . . through other distribution modes." 4/19/17 Tr. 231:22-232:5 (Shapiro). In fact, consumers can access much of the non-music content offered by Sirius XM on terrestrial radio, including play-by-play sports, talk radio, and news like NPR. Not so with respect to music. As Sirius XM acknowledges, the depth and breadth of its music content is not available on terrestrial radio, SXM FOF at ¶ 8, though it can be found on subscription streaming services. SE FOF at ¶ 686.

Response to ¶ 7. No response.

Response to ¶ 8. It is true that the breadth of Sirius XM's music offerings "far exceeds that of terrestrial radio." SXM FOF at ¶ 8. As Sirius XM notes, terrestrial radio typically provides listeners with access to only "five to fifteen music channels in a typical AM/FM market." SXM FOF at ¶ 8. This statement flies in the face of Sirius XM's assertions that its primary threat is terrestrial radio. Professor Simonson explained at trial that because of the well-known phenomenon of loss aversion, customers who can no longer use a product will be disinclined to choose a clearly inferior alternative. 5/11/17 Tr. 3438:2-8 (Simonson).

Moreover, in contrast to terrestrial radio, subscription services offer a similar variety of music channels, allowing subscribers to create stations or select playlists based on niche genres

or particular artists, *see, e.g.*, SE FOF at ¶¶ 685-686, and even allowing them to specifically seek out new music, *see, e.g.*, SE FOF at ¶ 447.

Response to ¶ 9. Sirius XM is right to emphasize the value of offering music "in a commercial-free environment." SXM FOF at ¶ 9. As discussed above, research prepared for Sirius XM, and cited in its findings, concludes that excising commercials from its music channels provides Sirius XM with a big advantage over terrestrial radio, Trial Ex. 242 at 24 (SXM_DIR_00027555), and is necessary to compete with other subscription streaming services. Trial Ex. 242 at 22 (SXM_DIR_00027553). As Mr. Meyer acknowledged at trial, if commercial-free access to music were not important to Sirius XM's subscribers, the company would include advertisements on its music channels. 5/15/17 Tr. 3749:12-21 (Meyer); *see also, supra*, Response to ¶¶ 3, 8.

Moreover, Sirius XM offers self-serving testimony that its music channels reflect expertise in programming, song sequencing, or any other aspect of production. On this point, the only evidence Sirius XM offers is testimony from the company's General Manager of Music Programming, that is, the Sirius XM employee whose very livelihood depends on the company's belief that its music channels are well-programmed and produced. SXM FOF at ¶ 9. Sirius XM offers no study or survey indicating whether and how subscribers value vague aspects of its musical channels, including the purported charisma of its DJs and the "interstitial elements that support the theme and 'feel'" of music stations.[4] SXM FOF at ¶ 9.

[4] Likewise, Sirius XM provides no empirical evidence that interviewing non-musicians on music channels adds meaningful value to its service, an assertion dealt with more fully below. *See infra* Response to ¶ 333. The singular example of an interview with Dr. Neil deGrasse Tyson cannot support a finding that Sirius XM subscribers meaningfully value non-music content, a finding belied by substantial record evidence. *See, e.g.*, SE FOF at ¶¶ 169, 172, 252-259; Response to ¶ 4.

Moreover, Sirius XM cites no evidence that its curation, song sequencing, or any other feature of its music channels is in a relative sense superior to what consumers find on subscription streaming services, SXM FOF at ¶ 9, [[redacted]], SE FOF at ¶ 153, as well as other features that may attract subscribers, such as the ability to focus on music discovery, SE FOF at ¶ 447.

Response to ¶ 10. Sirius XM's desire to broadcast live performances and music festivals underscores only that the company derives substantial value from music content. As Sirius XM recognizes, broadcasting concerts and performances "leads to more passion, excitement, and engagement" for Sirius XM's service. SXM FOF at ¶ 10. Sirius XM also recognizes that these events provide an "excellent opportunity to demonstrate [Sirius XM's] value to prospective and existing subscribers." Trial Ex. 5 at ¶ 65 (Blatter WDT).

Significantly, Sirius XM notes that festival coverage is not offered by any other "*radio broadcaster*." SXM FOF at ¶ 10 (emphasis added). Sirius XM does not, because it cannot, make the same assertion with respect to streaming services.

ii. Sirius XM's Evidence Illustrates That Consumers Place Significant Value On Access To Premium Music Content In The Car And Would Be Reluctant To Return To Inferior Alternatives

Response to ¶ 11. Sirius XM asserts that it retains customers by providing them with seamless nationwide coverage and ease of in-car use. If that is the case, it defies common sense and economic logic to assert that Sirius XM's only true competitor is terrestrial radio. *See e.g.*, 5/11/17 Tr. 3438:2-8 (Simonson); 4/24/17 Tr. 670:21-671:21 (Farrell). By acknowledging that its value proposition rests in part on seamless nationwide coverage (and a commercial-free

experience), Sirius XM only reinforces that terrestrial radio is not its only significant competitor, and that it substitutes for streaming services. *See infra* Responses to ¶¶ 20-25.

Response to ¶ 12. There is no evidentiary support for Mr. Meyer's self-serving testimony that its customers do not want to "assemble, on their own and from separate sources, the content package [Sirius XM] offers."[5]

Response to ¶ 13. No response.

Response to ¶ 14. No response.

Response to ¶ 15. No response.

Response to ¶ 16. [[redacted]], SE FOF at ¶ 155; 5/15/17 Tr. 3782:7-10 (Meyer), and have become more integrated into the dashboard. Trial Ex. 352 at 11 (SXM_DIR_00100576). As a result, it is clear that Sirius XM's technical infrastructure is not critical to delivering seamless nationwide programming in the car.

Moreover, Sirius XM's emphasis on past investments in technical infrastructure is misplaced. As the Judges made clear in *SDARS II*, analyzing relative contributions under Section 801(b)(1)(C) requires looking at costs, investments, and risks that will be incurred during the forthcoming period, as well as certain sunk costs that can be recouped during the forthcoming rate period.[6] *In re Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 78 FR 23054, 23069 (2013) (hereinafter "*SDARS II*"). The sum of Sirius XM's historical costs is not germane to the 801(b)(1)(C) analysis, particularly

[5] In Sirius XM FOF ¶ 12, Sirius XM also acknowledges that it markets to a "relatively affluent" demographic, which reinforces that customers who would lose their Sirius XM service (Professor Willig's substitution analysis) have both a willingness and ability to pay for alternative commercial-free subscription music services — yet another reason why Mr. Meyer's unsupported assertion that Sirius XM's principal threat comes from free services is nonsensical and contrary to the evidence of record.

[6] These might include, for example, amortization costs taken on existing satellites during the rate period.

given that Sirius XM has secured rate breaks for investments during previous rate periods, and has chosen a business model predicated on developing a satellite network. In addition, the total amount of Sirius XM's past investments should not entitle it to any competitive advantages over unregulated streaming services trying to compete in the car.

Response to ¶ 17. Sirius XM is no longer the only music service offering nationwide access in the car: streaming services also offer seamless nationwide access to music content. *See infra* Response to ¶ 22. To the extent automakers want music services to offer cross-country coverage,[7] research and analysis prepared for Sirius XM, as well as testimony at trial, demonstrate that streaming services now meet that expectation. *See infra* Response to ¶ 22.

Response to ¶ 18. Sirius XM emphasizes that its competitive advantage in the car comes in part from ease of use, noting its integration into the dashboard and lean-back functionality. If Sirius XM means that these features provide Sirius XM with a competitive advantage over subscription streaming services, any competitive advantage in the car has diminished during the current rate period, and will further diminish or dissolve during the next one. *See infra* Responses to ¶¶ 19, 21-22. In other words, Sirius XM acknowledges that it competes with streaming services, and ignores evidence that any competitive advantages that it might have are, at the very minimum, narrowing.

Response to ¶ 19. The evidence established that consumers are increasingly able to access subscription streaming services through convenient interfaces in the car, and that interfaces facilitating easy access to subscription streaming services will become standard over the coming rate period. *See infra* Response to ¶ 22. It is this integration into the dashboard —

[7] Of course, Mr. Meyer's assertion that auto makers wanted Sirius XM to develop nationwide coverage is not only irrelevant, but also hearsay.

together with the proliferation and improvement of other mechanisms for accessing subscription streaming services in the car — that account for the increased and increasing use of streaming in the car. *See infra* Response to ¶ 22.

Sirius XM's assertions to the contrary are disingenuous and at odds with evidence of major recent technological developments, including evidence from Mr. Meyer's own testimony. In its proposed findings Sirius XM asserts that "until recently" automakers have prohibited Apple and Google from introducing easy-to-use dashboard interfaces and instead relied on proprietary dashboard technology, which Sirius XM states have "proven to be clunky, overly complicated, and less than intuitive to use." SXM FOF at ¶ 19. Remarkably, Sirius XM fails to note that Mr. Meyer was referring to clunky interfaces [[redacted]]. 5/15/17 Tr. 3782:16-23 (Meyer) (emphasis added); *see also* Trial Ex. 352 at 11 (SXM_DIR_00100576). Mr. Meyer further recognized that, [[redacted]]. 5/15/17 Tr. 3782:24-3783:2 (Meyer).

iii. Sirius XM Competes With Subscription Streaming Services For Consumers With A Positive Willingness To Pay

Response to ¶ 20. The record developed in this proceeding demonstrates that Sirius XM competes directly with subscription streaming services. *See, e.g.*, SE FOF at ¶¶ 585, 640-641, 670, 676-686, 1357. Subscription streaming services offer *commercial free* access to music that Mr. Meyer acknowledges Sirius XM customers value. *See supra* Response to ¶¶ 3, 8. And like

Sirius XM, subscription streaming services offer access to a range of music that is much broader than terrestrial radio. *See, e.g.*, SE FOF at ¶¶ 685-686.

Indeed, as Professor Farrell readily admitted, consumers are willing to pay for Sirius XM's satellite radio service for one of two reasons: (1) they like some feature of Sirius XM's service; or, (2) they dislike some feature of terrestrial radio. 4/24/17 Tr. 670:21-671:21 (Farrell). But whether a particular subscriber is attracted to Sirius XM's service or repelled by terrestrial radio is irrelevant. In either case, the consumer is willing to pay a significant subscription fee in exchange for commercial-free access to a large library of music. For such a consumer, the choice is not between Sirius XM and free terrestrial radio, but between Sirius XM and other subscription services that offer ad-free listening to deep playlists across a wide range of musical genres, and are accessible in a vehicle. 4/24/17 Tr. 670:21-671:21 (Farrell); *see also* Trial Ex. 5 at 3 (Blatter WDT) (emphasizing that Sirius XM "attracts knowledgeable and sophisticated music fans who appreciate, and who are willing to pay for, [Sirius XM's] more tailored channel offerings and deeper playlists"). Put another way, customers willing to pay for Sirius XM are less likely to revert to a product they view as inferior, namely, terrestrial or commercial-laden ad-supported radio. 5/11/17 Tr. 3438:2-8 (Simonson).

Sirius XM nevertheless maintains — throughout its proposed findings of fact — that its primary competitor is terrestrial radio. This assertion is predicated on two types of evidence, one misleading and the other unreliable.

To assert that it competes primarily with terrestrial radio, Sirius XM first relies on figures that purportedly show consumers spend more time listening to terrestrial radio than to streaming

in the car. These figures, in all their iterations, are misleading and uninformative.[8] For purposes of assessing the extent to which Sirius XM substitutes for subscription streaming services, current overall listening time is not the correct measure. To calculate substitution (and opportunity cost), it is necessary to evaluate how consumers would *acquire* music *if Sirius XM was not available*, as opposed to how consumers as a whole allocate time listening to music. SE FOF at ¶¶ 1254-1264.

For example, Sirius XM in Paragraph 20 notes that among listeners who use streaming in the car, terrestrial radio still accounts for half their listening time, while streaming accounts for one quarter. SXM FOF at ¶ 20. But these figures are irrelevant. Once a consumer purchases a subscription streaming service, how the consumer allocates their listening time has no effect on the streaming services' revenues or on royalties. SE FOF at ¶¶ 1254-1264. This is also true for Sirius XM. The company competes for *subscriptions*, not for share of listening time.

Sirius XM also cites trial testimony from Mr. Meyer, who claims Sirius XM surveys indicate that, when Sirius XM customers abandon its satellite radio service, the vast majority of them go back to terrestrial radio. 5/15/17 Tr. 3717:5-23 (Meyer). Mr. Meyer's testimony is not credible because he proceeds on argument by assertion: he does not identify any of the surveys he purports to rely on, or offer them for the Judges and for SoundExchange to inspect. 5/15/17 Tr. 3717:5-23 (Meyer). Because Mr. Meyer's naked assertion that Sirius XM listeners "go back" to terrestrial radio offers no quantified insight into how consumers allocate their money after abandoning satellite radio, it has no probative value. *See also* Response to ¶ 21.

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[8] In paragraph 20, Sirius XM specifically asserts that streaming audio accounts for only 6% of in-car listening. SXM FOF at ¶ 20. For reasons thoroughly elaborated in SoundExchange's Proposed Findings of Fact, and below, there is no reason to believe this figure is accurate. SE FOF at ¶¶ 1351-1359; Response to ¶ 22.

Response to ¶ 21. Sirius XM has not given the Judges or SoundExchange an opportunity to scrutinize the "internal research" that it relies on to support a finding that terrestrial radio is the number one other source cited as a reason for canceling a Sirius XM subscription. Rather Sirius XM cites Mr. Meyer's assertion that such research exists.

The Judges should not credit Mr. Meyer's assertion because there is no way to know whether it is accurate, and, in any event, Mr. Meyer does not discuss alternative music acquisition, separated by ad-free and paid streaming services. There is no way to assess whether the research referenced was developed using sound methodology and no way to know whether Mr. Meyer has accurately characterized the results. Did the research allow subscribers abandoning Sirius XM's service to separately identify fully interactive, mid-tier, or ad-supported streaming services? These and other critical questions cannot be answered because Mr. Meyer did not cite to any particular research.[9]

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[9] Because Mr. Meyer did not cite to any particular document regarding what decisions Sirius XM subscribers make when they cancel their subscriptions, Sirius XM should not be permitted to do so for the first time on reply. To the extent Sirius XM is possibly relying on Trial Ex. 244, and to the extent the Judges allow it to do so even though Mr. Meyer did not cite that document, that document does not support Sirius XM's position on substitution for the following reasons:

- There is no discussion of the details of the survey methodology to confirm whether it is reliable. *See* 37 C.F.R. § 351.10(e).
- The sample consisted of 57.6% female, which is vastly different from the demographics of the actual Sirius XM population. Trial Ex. 129 at SXM_DIR_00023540 (44% of Sirius XM listeners are female).
- An economist would not rely on this document to assess opportunity costs (and *none* of the economists for either side have done so) because the questions are not structured to address opportunity costs — *e.g.*, to provide data on how many respondents purchase paid subscriptions, new CDs/downloads, etc. In addition, the survey population includes some customers who canceled their service for reasons other than the service disappearing (Lenski/Simonson construct) or the price increasing (Dhar). For example, some of the customers in the population canceled because of reception problems, because they are not using the service enough, or because of a commuting change.

Notwithstanding these limitations, a substantial percentage of respondents report switching to streaming services. For example, the data show that 36.35% listed Pandora, and over 30% listed Spotify, Apple Music, Google Play, or other streaming audio not listed, and 38.2% list "music stored on iPod/Smartphone/Tablet." The percentage of respondents who listed AM/FM does not state how many respondents are using *only* AM/FM and no streaming service, as opposed to AM/FM in addition to a streaming service.

To suggest that its satellite radio service competes primarily with terrestrial radio, Sirius XM also cites two additional figures, both unreliable. First, Sirius XM notes that consumers who recently rejected its service devote the majority of their listening time in the vehicle to terrestrial radio. However, as described above, figures regarding the allocation of time do not support any finding about the extent to which Sirius XM competes with subscription streaming services. *See* Response to ¶ 20.

Sirius XM also points to the survey conducted by Joe Lenski for use in this proceeding.[10] However, the reliability and relevance of the Lenski survey have been thoroughly discredited, for numerous reasons. *See* SE FOF at § VIII.G. In any event, Sirius XM's reliance on the survey's analysis of how Sirius XM subscribers allocated their listening time *before* subscribing to the service is perplexing, given that Sirius and XM satellite radio services launched several years before streaming services were available, *see* SE FOF at ¶ 1281, and given that no economist uses data on listening time prior to subscribing to Sirius XM or on what listening time Sirius XM mostly replaced.[11]

Response to ¶ 22. Substantial evidence demonstrates that use of streaming services in the car is growing and will continue to grow in the upcoming rate period. This growth will

[10] In its proposed findings, Sirius XM cites one additional study: Trial Exhibit 242. As discussed above, this exhibit lends no support to Sirius XM's assertion that it competes primarily with terrestrial radio. *See supra* Response to ¶ 4. In any event, Sirius XM relies on the survey for evidence about how consumers who reject Sirius XM's service allocate their listening time, an issue that is not germane to the Judges' analysis. *See supra* Response to ¶ 20.

[11] In addition to the fact that the Lenski survey is invalid and unreliable, Sirius XM in paragraph 21 of its proposed findings misstates its results. In purporting to compare the percentage of people who say they replaced terrestrial radio with Sirius XM, as opposed to replacing non-interactive and interactive streaming, Sirius XM neglects to mention that the survey asked respondents to identify the "ONE" source Sirius XM is "mostly" replacing. Trial Ex. 7 at 5, B-3 (Lenski WDT) (upper case in original). Thus, for example, if a Sirius XM subscriber used AM/FM radio 45% of the time and streaming services 40% of the time before subscribing to Sirius XM, the only allowable answer would be AM/FM radio. Moreover, what "one" service Sirius XM mostly replaced when respondents first signed up for Sirius XM (in many cases years ago) has no relevance to this proceeding and is not used by any economist on either side.

generate more competition between Sirius XM and streaming services, and the record developed in this proceeding demonstrates that subscription streaming services do and will continue to compete with Sirius XM directly for consumers with a positive willingness to pay for music. Each of these points is discussed below.

Growth of Streaming. Streaming services are now available nationwide, commercial-free, with seamless coverage. *See, e.g.*, SE FOF ¶¶ 156-158, 577-578. Moreover, research and analysis prepared for Sirius XM demonstrates that automotive companies have begun to integrate streaming services into the dashboard. Trial Ex. 352 at 11 (SXM_DIR_00100576). This trend will continue over the coming licensing period, culminating in near universal adoption by 2020. Trial Ex. 352 at 11 (SXM_DIR_00100576). [[redacted]]. 5/15/17 Tr. 3774:4-22 (Meyer).

Sirius XM's contrary evidence is not reliable or persuasive. As an initial matter, Sirius XM cites a 2015 "Infinite Dial" study indicating that 35% of cellphone owners had listened to internet radio in their cars by 2015. SXM FOF at ¶ 22 (citing Meyer testimony which in turn cites the "Infinite Dial" study). A more recent Infinite Dial study indicates that this figure is trending upward, having reached 40% by February 2017. Trial Ex. 294 at 19 (SoundX_000488945). [[redacted]]. 5/15/17 Tr. 3782:24-3783:2 (Meyer). To that end, the same survey indicates that the number of cellphone owners in the United States totaled 226 million people. Trial Ex. 294 at 5

(SoundX_000488931). This suggests that *over 90 million consumers* had by February 2017 used their cellphone to listen to internet radio in the car.

Sirius XM next relies on Edison's "Share of Ear" study, which purportedly indicates that streaming audio accounts for only 6% of in-car listening. SXM FOF at ¶ 22 (citing Shapiro WDT which cites the Share of Ear study). In its proposed findings, SoundExchange demonstrates that the "Share of Ear" survey is unreliable for several reasons. SE FOF at ¶¶ 1354-1358. Most critically, the survey is not in evidence. SE FOF at ¶ 1354. As a result, there is no detailed explanation of its methods and any conclusions based on that non-existent exhibit should be discounted. SE FOF at ¶ 1354. In addition, the figure is contradicted by other record evidence *that is cited by both parties*, SXM FOF at ¶ 103; SE FOF at ¶ 1355, namely, a 2015 Music Watch study finding that [[redacted]]. Trial Ex. 122 at 72 (SoundX_000033362). This figure casts serious doubt on the veracity of the Share of Ear Study.

Increased Competition. In its proposed findings, Sirius XM dramatically understates the amount of existing competition between its service and subscription streaming services. *See, e.g.*, SE FOF at ¶¶ 585, 640-641, 670, 676-686, 1357. The company's public filings clearly acknowledge that its satellite radio service competes directly with streaming services, in the car and elsewhere. For example, in its 2016 Form 10-K, Sirius XM represented that streaming services like those offered by Amazon, Apple, Google Play, Pandora, Spotify, and iHeart "compete directly with our services, at home, in vehicles, and wherever audio entertainment is consumed." Trial Ex. 357 at 6.

Sirius XM also dramatically understates the extent to which competition between it and streaming services is likely to increase during the rate period.[12] Research prepared for and relied on by Sirius XM indicates that "streaming is perceived positively as an in-vehicle audio entertainment source," particularly among consumers who reject Sirius XM's service. Trial Ex. 242 at 41 (SXM_DIR_00027572). And, as discussed above, the ease with which consumers can access streaming services in the car has improved and will do so even more dramatically during the coming rate period. *See* Response to ¶¶ 11, 19. [[redacted]]. 5/15/17 Tr. 3782:16-23 (Meyer); *see also* Trial Ex. 352 at 11 (SXM_DIR_001000576). [[redacted]]. 5/15/17 Tr. 3782:24-3783:2 (Meyer).

As Sirius XM acknowledges, demographics also favor increased use of streaming in the car. At/trial, Mr. Meyer agreed that streaming through mobile phones in the car is increasing and that growth would accelerate as a result of millennials. 5/15/17 Tr. 3798:4-10 (Meyer).

Subscription Streaming Services Compete With Sirius XM To A Significant Degree. The record evidence suggests that, as streaming becomes increasingly popular in the car, subscription services will compete even more directly with Sirius XM's satellite radio service. For example, surveys conducted by Professors Dhar and Simonson, and an econometric study conducted by

[12] Sirius XM acknowledges that competition with internet streaming services may increase over the upcoming rate period, SXM FOF at ¶ 22, but maintains that ad-supported services are likely to present the principal competition for satellite radio because both ad-supported and satellite services offer a lean-back experience. SXM FOF at ¶¶ 22, 24. The record lends no support for this finding. As Mr. Meyer indicated, Sirius XM subscribers value a commercial free experience, 5/15/17 Tr. 3749:10-17 (Meyer); *see also* Response to ¶ 3, which belies any claim that ad-supported services present Sirius XM's primary competition. And, as discussed elsewhere, record evidence establishes that consumers make significant use of lean-back functionality on subscription fully interactive services, as well as the lean-back experience offered by mid-tier, and non-interactive services. *See, e.g.*, SE FOF at ¶¶ 378-384.

Professor Willig, indicate that Sirius XM substitutes for subscription interactive services. SE FOF at § V.J.1-3; *see also* 5/15/17 Tr. 3782:16-23 (Meyer); 5/15/17 Tr. 3782:24-3783:2 (Meyer); Trial Ex. 352 at 11 (SXM_DIR_001000576); SE FOF at ¶ 158.

The only evidence that Sirius XM offers to support a finding that free ad-supported radio will present Sirius XM's primary competition is Mr. Meyer's speculative assertion that Sirius XM customers prefer a lean-back experience. SXM FOF at ¶ 22. This assertion says nothing about whether Sirius XM competes with ad-supported or subscription services. The record developed in this proceeding establishes that lean-back functionality is available on subscription interactive services, as well as subscription mid-tier and subscription non-interactive services. For example, [**[redacted]**] percent of plays on Spotify's fully interactive service and [**[redacted]**] percent of plays on Apple's fully interactive service come from playlists. Trial Ex. 32 at ¶ 28 (Harrison WDT). And as brought out by a question from Judge Strickler, whether playlists are created by a user, a service, or a third-party, the point is the same: subscribers can simply start the playlist and focus on driving. At trial, Mr. Meyer was forced to concede that he was concerned about competition from interactive services offering this functionality. 5/15/17 Tr. 3735:1-10 (Meyer).

Sirius XM also faces intense and growing competition from subscription mid-tier and non-interactive services. These services plainly offer the lean-back functionality that Sirius XM subscribers supposedly prefer. Trial Ex. 32 at ¶ 19 (Harrison WDT). Both types of service allow users to create internet radio stations that users can consume in the same linear style offered by Sirius XM. Trial Ex. 32 at ¶ 19 (Harrison WDT).

Significantly, subscription interactive, mid-tier, and non-interactive services offer this lean-back functionality in a commercial-free environment, something critically important to Sirius XM's subscribers. *See* Response to ¶¶ 3, 8. Given the increased and increasing use of

these services in vehicles, subscription streaming services now compete even more directly with Sirius XM for consumers with a positive willingness to pay.

Response to ¶ 23. As discussed above, substantial evidence supports a finding that fully interactive services offer lean-back functionality that competes directly with Sirius XM. *See supra* Response to ¶ 22. Mr. Meyer acknowledged that competition at trial. 5/15/17 Tr. 3735:2-10 (Meyer). When Judge Strickler asked whether he was concerned about in-car competition from interactive services that allow users to create their own playlists, or use playlists created by others, Mr. Meyer responded, "yes." 5/15/17 Tr. 3735:2-10 (Meyer).

In discussing services that offer lean-back functionality, Sirius XM conspicuously avoids any mention of subscription mid-tier and non-interactive services, SXM FOF at ¶ 23, both of which offer a linear radio experience, with some opportunity to customize through functionality like skips and replays. Trial Ex. 32 at ¶ 19 (Harrison WDT). Consumers can plainly listen to subscription mid-tier and non-interactive services in a strictly lean-back format. *See supra* Response to ¶ 18.

In sum, the record developed in this proceeding indicates that the use of subscription mid-tier and non-interactive services, coupled with the explosion of lean-back usage on fully interactive services, has brought those services in direct competition with Sirius XM. *See* SE FOF at § V.J.4. Sirius XM does not offer credible evidence to the contrary.

Ignoring subscription mid-tier and non-interactive services completely, Sirius XM focuses on fully interactive services and asserts that they are not close competitors because of "lean-forward," an assertion that cannot be credited in light of Mr. Meyer's admitted concern

about competition from playlisting.[13] Indeed, at trial Mr. Meyer also conceded that Spotify competes with Sirius XM. 5/15/17 Tr. 3769:8-10 (Meyer). And the record is replete with additional evidence that Sirius XM in fact believes that it competes with fully interactive services, including representations made in a complaint filed against former programmer John Marks — who left the service for Spotify — and representations made in Sirius XM's filings with the SEC. *See, e.g.*, SE FOF at § V.J.4.

Response to ¶ 24. Sirius XM offers no reliable support for its assertion that interactive streaming is complementary to its satellite radio service. SXM FOF at ¶ 24. Mr. Meyer's testimony on the issue is pure speculation, and not credible in light of his admitted concern about competition from interactive services, 5/15/17 Tr. 3735:2-10 (Meyer), his concession that Sirius XM competes with Spotify, 5/15/17 Tr. 3769:8-10 (Meyer), and the overwhelming record evidence that Sirius XM believes that it competes directly with both Spotify and other fully interactive services. *See, e.g.*, SE FOF at ¶¶ 676-687.

Sirius XM likewise fails to provide any meaningful or reliable support for its assertion that very few customers cite interactive streaming as a reason for cancelling their subscription, but often cancel their subscription to return to terrestrial radio. SXM FOF at ¶ 24. Putting aside a cross-reference to the discredited Lenski survey, which did not even ask why customers cancel Sirius XM subscriptions and which is otherwise unreliable for reasons elaborated thoroughly in SoundExchange's Proposed Findings of Fact, SE FOF at §§ VIII.G.1-3, the only evidence offered is testimony from Mr. Meyer, whose unsubstantiated and anecdotal account has little, if

[13] Sirius XM also points to a purported *correlation* between the decline of album and download sales and the growth of on-demand streaming services. SXM FOF at ¶ 23. Of course, Sirius XM identifies no empirical analysis of the extent to which on-demand streaming services, rather than other streaming services, *caused* a decrease in physical and digital sales.

any, probative value. Sirius XM provides no corroborating study, survey, or analysis, instead resting on Mr. Meyer's say-so. *See also* Response to ¶ 21 & n.6.

Response to ¶ 25. Sirius XM readily admits that its value proposition consists of offering "an incredible variety of commercial-free content" wherever consumers drive. SXM FOF at ¶ 25. This, of course, is precisely the same value offered by subscription streaming services, and substantial evidence demonstrates that Sirius XM is a substitute for subscription streaming services. SE FOF at § V.J.

As the record in this case makes plain: Sirius XM competes with subscription streaming services for consumers with a willingness to pay for commercial-free music. Sirius XM cites testimony to assert that competition from free terrestrial and ad-support radio keeps Mr. Meyer up at night. But Sirius XM omits subsequent testimony indicating that Mr. Meyer is concerned about competition from paid interactive services offering playlists that are easy to use in the car. 5/15/17 Tr. 3735:1-10 (Meyer). And as Mr. Meyer acknowledged, the software that he touts as making it much easier to stream commercial-laden ad-supported internet radio in the car, also makes it much easier to stream subscription streaming services in the car. 5/15/17 Tr. 3748:8-18. Like Sirius XM, these subscription streaming services are commercial free. And Sirius XM subscribers not only value commercial free radio, *see* Response to ¶ 3, but value it enough to dissuade Sirius XM from introducing any advertisements onto its music channels. 5/15/17 Tr. 379:12-21. This makes plain that Sirius XM faces significant competition from subscription streaming services.

B. Satellites

Response to ¶ 26. Sirius XM states that "[s]ince its founding, [it] has made a cumulative investment of $14.8 billion in developing, maintaining, and servicing its satellite delivery

business." Sirius XM FOF at ¶ 26. At trial, Mr. Meyer confirmed that the investments referred to in this figure [[redacted]]. 5/15/17 Tr. 3794:23-3795:9 (Meyer). Sirius XM's historical investments are in no way relevant to this proceeding.

Sirius XM claims it is still entitled to the downward departure for satellite costs that the Judges found in *SDARS II*. SXM FOF at ¶ 26. Of course, during the *SDARS II* proceeding, SoundExchange disagreed that any downward adjustment from the benchmark rate was necessary under the 801(b) objectives. But even assuming an adjustment was proper then, it is certainly not proper now. As explained in SoundExchange's Proposed Findings of Fact and Conclusions of Law, [[redacted]]. *See* SE FOF at ¶¶ 1564-1573.

Specifically, Sirius XM's [[redacted]] investment in building and launching new satellites is small in relation to just the most recent year's EBITDA of $1.9 billion, free cash flow of $1.5 billion, or net income of $746 million. Trial Ex. 42 at ¶ 229 (Lys WRT). Perhaps most importantly, Sirius XM's anticipated [[redacted]]. Trial Ex. 663 (native file) (tab "Consolidated Outputs," cells HO214, HP214). Mr. Meyer confirmed at trial that for the coming rate period Sirius XM projects *revenue of around* [[redacted]]. 5/15/17 Tr. 3794:11-22 (Meyer).

The Judges have recognized that, rather than making Sirius XM special, Sirius XM's satellite expenditures are analogous to the capital investment of other digital music services. In particular, "[t]his type of investment spending has a useful life that typically extends beyond the limited period of a single licensing period as currently defined by statute; therefore, all of the costs of spending on this technology cannot properly be ascribed to a single licensing period." *In re Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 73 FR 4080, 4096-97 (2008) (hereinafter "*SDARS I*").

Indeed, although Sirius XM would have the Judges depart downward from the interactive services benchmark due to Sirius XM's satellite costs, Sirius XM did not investigate — and does not present evidence of — the costs incurred by other music services. 5/11/17 Tr. 3675:4-7, 3675:13-3676:1 (Neville) (Ms. Neville "absolutely do[es] not" know "whether Sirius XM's transmission costs are greater or less than the transmission costs of other Services, either on a per-user basis or in total").

Response to ¶ 27. If Sirius XM's satellites require maintenance and upgrading, that is because the company has chosen to provide satellite radio to its customers and has decided that such investments are a worthwhile investment in its business model. As Sirius XM's Senior Vice President of Satellite and Terrestrial Engineering and Operations agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [[redacted]]. *See* Response to ¶ 26.

Response to ¶ 28. Sirius XM states that "[i]t is the only company in North America delivering content via satellite to very small antennas located in vehicles." Sirius XM FOF at ¶ 28. That is because, in July 2008, Sirius and XM merged to form Sirius XM, a company that now holds a virtual monopoly in this market segment. *See* Trial Ex. 25 at ¶ 43 (Lys Corr. WDT) (citing Sirius XM Radio Inc., 2012 Form 10-K Annual Report at 1). As detailed further in SoundExchange's Proposed Findings of Fact, *see* ¶¶ 1495-1530, that merger had a dramatic impact on Sirius XM's financial fortunes. Not only did the merger eliminate price competition between the two satellite radio services for subscribers and non-music content, but it also allowed the combined company to take advantage of the economies of scale that are central to its business model. Trial Ex. 25 at ¶ 44 (Lys Corr. WDT).

Response to ¶ 29. If Sirius XM is arguing that it incurs significant costs relating to obtaining patents, that is because the company has chosen to provide satellite radio to its customers and has decided that such investments are a worthwhile investment in its business model. As Sirius XM's Senior Vice Presidents of Satellite and Terrestrial Engineering and Operations agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [[redacted]]. *See* Response to ¶ 26.

Response to ¶ 30. Sirius XM may produce content at its studios in New York City and Washington, DC, but an essential part of that content is the artists' and record companies' product: music. Music is essential to Sirius XM's business: Sirius XM's CEO James Meyer

testified that Sirius XM "could not succeed without music programming." 5/15/17 Tr. 3752:14-17 (Meyer).

Response to ¶ 31. Sirius XM must operate two separate networks of satellites for the foreseeable future as a result of the merger between Sirius and XM, *see* Sirius XM FOF at ¶ 31, in which those companies agreed it was to their mutual benefit to become one company. Not only did the merger eliminate price competition between the two satellite radio services for subscribers and non-music content, but it also allowed the combined company to take advantage of the economies of scale that are central to its business model. Trial Ex. 25 at ¶ 44 (Lys Corr. WDT). If the merger *also* means that Sirius XM has to operate two separate satellite networks, that is a price Sirius XM decided it was worth paying in order to reap the benefits of the merger.

Response to ¶ 32. The approximately [[redacted]] Sirius XM incurred for retiring its original three Sirius satellites and replacing them with new satellites (FM-5 and FM-6) is entirely irrelevant in this proceeding. FM-5 and FM-6 were launched years ago: in 2009 and 2013, respectively. Trial Ex. 2 at ¶ 14 (Neville WDT); 5/11/17 Tr. 3674:1-7 (Neville). These are costs that Sirius XM has already incurred. 5/11/17 Tr. 3674:9-11 (Neville). And these are costs that Sirius XM has already presented to the Judges, in *SDARS II*. 5/11/17 Tr. 3674:12-15 (Neville).

Response to ¶ 33. The fact that Sirius XM maintains a fifth satellite as an in-orbit spare has allowed it to "go the self-insure route," thus saving the company money. 5/11/17 Tr. 3679:6-8 (Neville). Further, Sirius XM apparently made the strategic business decision that it was worthwhile to have an in-orbit spare in order to best serve its customers. [[redacted]

[redacted]]. *See* Response to ¶ 26.

Response to ¶ 34. That Sirius XM's satellite network requires terrestrial repeaters is, again, merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [[redacted]]. *See* Response to ¶ 26.

Response to ¶ 35. That Sirius XM's satellite network requires receivers is merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [[redacted]]. *See* Response to ¶ 26.

Response to ¶ 36. That Sirius XM designs its own chipsets is merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [[redacted]

[redacted]]. *See* Response to ¶ 26.

Response to ¶ 37. Sirius XM's costs are likely significantly lower than the [[redacted]] figure cited in Mr. Meyer's written testimony and restated by Sirius XM in its Findings. *See* Sirius XM FOF at ¶ 37 (citing Trial Ex. 1 at ¶ 12 (Meyer WDT)). That figure was based largely on the written testimony of Ms. Neville, Sirius XM's Vice President in charge of its satellite operations. And although Ms. Neville's written testimony stated that the cost of building its two new satellites would be [[redacted]], at trial she testified those costs could fall by nearly 20%, or to [[redacted]]. 5/11/17 Tr. 3691:4-3692:1 (Neville). [[redacted]]. 5/11/17 Tr. 3691:4-17 (Neville).

Sirius XM raises the cost of extending "subsidies and revenue-shares to automakers to put Sirius XM chipsets into their vehicles." Sirius XM FOF at ¶ 37. But these costs should not be borne by copyright holders. This is a choice that Sirius XM has made to further its business interests. [[redacted]]. *See* Response to ¶ 26.

Response to ¶ 38. No response.

Response to ¶ 39. Sirius XM's satellite costs are actually "going down," as Ms. Neville testified. 5/11/17 Tr. 3678:5-7 (Neville). It cost Sirius XM [[redacted]] to launch its last two

satellites, FM-5 and FM-6. Trial Ex. 2 at ¶ 14 (Neville WDT). Ms. Neville estimates that the cost of the two satellites to be launched during the rate period at issue in this proceeding, SXM-7 and SXM-8, will cost roughly 20% less, or [ ]. 5/11/17 Tr. 3691:4-3692:1 (Neville). [ ]. 5/11/17 Tr. 3691:4-17 (Neville). And assuming the costs of the satellites and launch vehicle go down, insurance will go down as well. 5/11/17 Tr. 3678:9-12 (Meyer) ("insurance is based on a percentage of your total satellite plus launch vehicle cost. So, ultimately, the total insurance cost . . . would also come down").

Response to ¶ 40. Much of the increased functionality of SXM-7 and SXM-8 is irrelevant to the SDARS compulsory license and costs spent in such endeavors should not be considered by the Judges. Sirius XM notes that these new satellites have [ ] These [ ] are not part of the SDARS license. Indeed, Ms. Neville testified that if Sirius XM decides to use this capability [ ] 5/11/17 Tr. 3683:11-14 (Neville).

Response to ¶ 41. That Sirius XM cannot lease space on existing satellites is merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [ ]. *See* Response to ¶ 26.

Response to ¶ 42. No response.

Response to ¶ 43. Sirius XM's satellite costs are closer to [ ] than [ ]. *See* Response to ¶ 39, above.

Response to ¶ 44. That it costs money for Sirius XM to monitor and adjust its satellites is merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [ ]. *See* Response to ¶ 26.

Response to ¶ 45. Any costs Sirius XM incurs related to retiring its satellites is merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [ ]. *See* Response to ¶ 26.

Response to ¶ 46. The [ ] in upgrades to terrestrial repeaters that Sirius XM claims in Paragraph 46 will not be incurred during the rate period. As Sirius XM's Proposed Findings of Fact and Conclusions of Law state, this project was "launched in 2011 and [is] to be finished in 2017," during the *current* rate period. Sirius XM FOF ¶ 46. Ms. Neville testified at

trial that "we certainly expect to finish the ongoing work related to this traditional repeater buildout this year." 5/11/17 Tr. 3671:22-24 (Neville).

In addition, any costs Sirius XM incurs related to updating its terrestrial repeaters is merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [[redacted]]. *See* Response to ¶ 26.

Response to ¶ 47. Any costs Sirius XM incurs related to adding new repeaters is merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [[redacted]]. *See* Response to ¶ 26.

Response to ¶ 48. The costs of deploying a national Internet-fed repeater network in Paragraph 48 of Sirius XM's Findings of Fact are highly speculative. Ms. Neville, Sirius XM's Vice President in charge of its satellites, testified at trial that she did not know how many Internet-fed repeater sites will actually be required. 5/11/17 Tr. 3665:5-7 (Neville). She also explained that Sirius XM is "very much hoping that we can come up with a solution . . . with a

much smaller deployment scale." 5/11/17 Tr. 3666:12-16 (Neville). Ms. Neville was further "not sure yet" whether "these Internet-fed repeaters [would] replace any of the existing repeaters," and described this question as "the big gray area." 5/11/17 Tr. 3666:18-23, 3667:25-3668:1 (Neville). Overall, Ms. Neville agreed that "there are a lot of open questions here relating to Sirius XM's Internet-fed repeater network." 5/11/17 Tr. 3670:6-9 (Neville). The Judges should not consider these highly speculative costs.

In addition, any costs Sirius XM incurs related to updating its terrestrial repeaters is merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [[redacted]]. *See* Response to ¶ 26.

Response to ¶ 49. Any costs Sirius XM incurs related to its chipsets is merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). [[redacted]]. *See* Response to ¶ 26.

Response to ¶ 50. *See* Response to ¶ 49, above.

Response to ¶ 51. *See* Response to ¶ 49, above.

Response to ¶ 52. Sirius XM is developing the 360-L wireless platform because it will allow it to create "a single, cohesive in-vehicle entertainment offering," Trial Ex. 13 at ¶ 18 (Barry WRT), which it [[redacted]]. 5/15/17 Tr. 3783:6-11 (Meyer). Among other things, 360-L will allow Sirius XM to supplement its core satellite radio product with personalized recommendations, preset preference profiles for each car user, and alerts about sports scores while listening to other content. Trial Ex. 1 at ¶ 34 (Meyer WDT). [[redacted]]. SE FOF at ¶ SEPFF1624 (citing Meyer trial testimony).

Response to ¶ 53. As Sirius XM explains, "[t]wo-way communication via 4G LTE will open up a range of potential ways to supplement Sirius XM's core radio product." SXM FOF at ¶ 53. It is no surprise then that Sirius XM management has expressed confidence that the introduction of the 360-L wireless platform product will improve the company's performance in the future. Trial Ex. 25 at ¶ 233 (Lys Corr. WDT). Specifically, the company expects that it will be able to "sell more premium [subscriptions] as a result of" the 360-L platform, and it will mean that "people are more engaged with the product" and therefore "churn less." Sirius XM also expects that 360-L will "improve conversion" rates because it will enable the company to "know more about what's going on with the trials." Trial Ex. 25 at ¶ 233 (Lys Corr. WDT) (quoting David Frear, Senior EVP and CFO, Sirius XM, JPMorgan Technology, Media and Telecom Conference at 6 (May 23, 2016)).

Response to ¶ 54. As explained above in Response to Paragraph 53, Sirius XM management has expressed confidence that the introduction of the 360-L wireless platform

product will improve the company's performance in the future. Thus, any costs incurred relating to 360-L are a rational business choice that Sirius XM has willingly incurred to advance strategic business interests and Sirius XM will continue to receive a fair return for its investment.

Response to ¶ 55. *See* Responses to ¶¶ 52-54, above.

C. Sirius XM's Promotion of Sound Recordings

Response to ¶ 56. SoundExchange vigorously disputes Sirius XM's claim regarding the views of record companies and artists with regard to the alleged promotional value of play on its service. Section IV.H.2 of SoundExchange's Proposed Findings of Fact describes in great detail the type of evidence that would be required to determine whether a service had a promotional effect relative to benchmark services, and the numerous deficiencies in Sirius XM's purported "evidence" of promotion. SoundExchange refers to that Section of its Proposed Findings of Fact and incorporates those arguments herein. As the Judges have previously found and as Dr. Ford and Mr. Orszag both testified, the only relevant question for benchmarking purposes is whether there is any reason to believe that the target market (Sirius XM) and the benchmark market (interactive services) have different promotional or substitutional effects compared to one another. *See, e.g.*, *SDARS II*, 78 FR at 23066-67 (only relative difference matters); *In re Determination of Royalty Rates and Terms for Ephemeral Recording and digital Performance of Sound Recordings (Web IV)*, 81 FR 26316, 26327 (2016) (hereinafter "*Web IV*") (same). Sirius XM has not performed this analysis, and none of Sirius XM's citations speak to this issue. SE FOF ¶¶ 386-454.

Furthermore, the quotations Sirius XM cites in this paragraph are badly misleading. They omit necessary qualifications and additional statements from each of these witnesses that are directly contrary to the Service's claim:

Mr. Kushner testified that Atlantic "promotes its recordings" to numerous services, including Sirius XM — not that Sirius XM has net promotional value vis-à-vis other modes of consumption. In fact, his testimony makes clear that the label is "paid when Sirius XM uses [its] recordings"; that Atlantic does not waive statutory royalties when Sirius XM hosts in-studio performances and other "promotional" events; and that "[i]t would be a mistake to view such promotions as a favor that Sirius XM is doing for us, because . . . [i]t is in Sirius XM's interest to have appearances by popular artists, so that the artist's fans will associate Sirius XM with the artist, and Sirius XM can trade on the fans' loyalty to the artist to build and maintain their subscriber base." Trial Ex. 34 ¶¶ 66-67 (Kushner WDT).

Although Mr. Barros did indeed testify that he views Sirius XM as providing promotional value for labels and artists, Sirius XM skews the meaning of this statement. In his immediate next statement (which Sirius XM misleadingly omits), Mr. Barros makes clear that he is not talking about a net promotional effect: He notes that Sirius XM has "millions of customers that are simply content to use Sirius XM as their primary source for music and that, even when they hear music that they enjoy via a Sirius XM channel, there is little or no call to action for these customers to stream, download or buy a physical copy via some other service." Trial Ex. 47 ¶ 23 (Barros WRT). Mr. Barros then analogized to other distributors such as physical retailers that prominently display one of his labels' recordings in their stores, or a streaming service that includes one of his tracks on a prominent play list. He testified that although these are, in his view, "all promotional benefits . . . each of these distributors also pays [copyright owners] a fair percentage of the revenue generated from [their] music — indeed significantly higher than the rates SoundExchange has proposed be paid by Sirius XM. And moreover, the only reason for our music to be included in such promotions is if the distributor deems it to be desirable to their

customers, which thereby promotes the distributor's business as well." Trial Ex. 47 ¶ 23 (Barros WRT). Thus, Mr. Barros did not testify that Sirius XM has an overall promotional effect, even if play on the service does have some promotional value.

Finally, the entire thrust of Dr. Ford's written and oral testimony is that there is no evidence that Sirius XM has a promotional effect, and that no adjustment to the rate is warranted on this basis. He further testified that the available evidence indicates that Sirius XM is likely more substitutional than the benchmark services. *See, e.g.*, Trial Ex. 23 at 18-20 (Ford WDT); Trial Ex. 41 at 1, 24 (Ford WRT). Dr. Ford's acknowledgement that Sirius XM has "special channels" does not undercut his conclusions or in any way support Sirius XM's claims regarding promotion.

If there is any uniform view to be drawn from the testimony of industry witnesses, it is that, whatever value Sirius XM may have to certain artists, such value is not quantifiable and does not justify a downward adjustment relative to benchmark services. *See, e.g.*, Trial Ex. 34 ¶ 57 (Kushner WDT) (label's promotional efforts are tailored to the specific artist and recording, and "not all plays by every service are promotion"), ¶¶ 69-71 (marketing efforts work when there is a "mutually beneficial fit" between the label and the service); Trial Ex. 47 ¶ 23 (Barros WRT) (Sirius XM plays music that their subscribers want to hear, and should not pay a lower rate than other distributors); *see also* Trial Ex. 41 (Ford WRT) (testifying based on interviews with over two dozen record label executives, that labels do not see Sirius XM as uniquely promotional relative to other services).

Response to ¶ 57. SoundExchange disputes both the relevance and the credibility of these statements. Mr. Blatter's testimony is nearly identical to testimony he has provided in past proceedings, and is the type of anecdotal evidence that the Judges have consistently rejected with

good reason. SE FOF ¶¶ 407-414; *see, e.g.*, *Web IV*, 81 FR at 26327 (finding the "observational and anecdotal testimony of industry witnesses" including Mr. Blatter to be "unhelpful and essentially self-serving"). Here again, Sirius XM cites a single witness — Mr. Blatter — whose testimony can be easily read as a self-serving justification of both his company's value and his own job. It fails to acknowledge evidence that Sirius XM regularly approaches labels and artists, and that Sirius XM views "promotional" events as beneficial to the service. *See* SE FOF ¶¶ 430-438 (music promotes Sirius XM); Trial Ex. 23 at 10 (Ford WDT) (income of the music service (*i.e.*, the extent to which music promotes the service's business) is an important input in the bargain between the service and record label). Moreover, whereas artists, managers and even record labels may have reason to push a particular track or artist (*i.e.*, in order to try to get a greater share of airtime for that individual recording or artist), this type of attempt tells us nothing about Sirius XM's overall promotional effect. *See* Trial Ex. 23 at 15-16 (Ford WDT); Trial Ex. 41 at 4 (Ford WRT) (what matters in analyzing promotional effect "is catalog-level income, not sales of a specific recording or even an individual artist's sales"). The deficiencies in Mr. Blatter's testimony are further detailed in Section IV.H.2 of SoundExchange's Proposed Findings of Fact.

Response to ¶ 58. SoundExchange refers to Section IV.H.2 of its Proposed Findings of Fact, which details the deficiencies of this type of anecdotal "evidence" of promotion. In short, Sirius XM conflates promotional events (that may benefit one artist over others) with promotional effects (that relate to the industry overall). Many of the activities that Mr. Blatter cites — such as free copies of new releases and waivers of the performance complement — are

low cost or cost-free for record labels.[14] And, in any case, Sirius XM falls far short of establishing a causal relationship between play on its service and an increase in record label income. SE FOF ¶¶ 419-429; 5/1/17 Tr. 1844:15-1845:8, 1860:22-1861:3 (Ford).

To the extent that Sirius XM's citation to Mr. Barros's testimony is intended to suggest a causal connection between its pop-up channel and the commercial success of an artist whose decades-long stardom is unquestionable, such a claim is both frivolous and at odds with Mr. Barros's testimony. *See* Trial Ex. 47 at ¶ 29 (Barros WRT) (discussing multifaceted, major marketing campaign surrounding James Taylor album discussed in Mr. Blatter's testimony, and noting that Mr. Taylor had a "worldwide following" long before this release or Sirius XM's corresponding pop-up channel); SE FOF ¶¶ 419-429.

Response to ¶ 59. SoundExchange does not dispute that Sirius XM offers a broad range of channels, including in some genres that are underserved on terrestrial radio. However, it offers no support for its leap from that observation to the conclusion that its array of channels is inherently "promotional" and "widely recognized as a leader in music discovery." Despite the fact that numerous industry representatives testified as fact witnesses, Sirius XM cannot identify any testimony other than that of Mr. Blatter, which supports this purportedly "widely recognized point." In fact, evidence in the record suggests sources *other than* Sirius XM are important to music discovery, including playlists on interactive services. SE FOF ¶¶ 381-384, 445-454.

Response to ¶ 60. SoundExchange disputes both the conclusion that the record is replete with examples of Sirius XM's promotional impact and that "S.O.B" is one such example. As discussed in ¶ 424 of SoundExchange's Proposed Findings of Fact, Sirius XM's uncritical focus

[14] Notably, Sirius XM does not waive its right to statutory royalties in these contracts, Trial Ex. 34 ¶ 67 (Kushner WDT); and Sirius XM has not cited a single example to the contrary.

on its own contributions obscures the multiple reasons for this release's success — most notably an appearance by the band on *The Tonight Show* with Jimmy Fallon. Trial Ex. 41 at 23 (Ford WRT) (noting with respect to Nathaniel Rateliff & the Night Sweats' "S.O.B.," that prior to Sirius XM's play, the band had already developed a substantial fan base, was touring, had made the track available for streaming, and was getting positive press coverage); Trial Ex. 47 at ¶¶ 24-27 (Barros WRT) (discussing the numerous factors that led to sales of "S.O.B." including Nathaniel Rateliff's critical acclaim and an appearance on *The Tonight Show* during which Jimmy Fallon "gushed enthusiastically" about him); 5/16/17 Tr. 4120:3-4126:25 (Barros) (song "went viral" after Jimmy Fallon appearance, which had a greater effect on sales than Sirius XM). SoundExchange's Proposed Findings of Fact further discuss problems with Sirius XM's reliance on purported expressions of gratitude, such as the *Billboard* advertisement it cites here. SE FOF ¶¶ 409-412; *see generally* Section IV.H.2 (discussing deficiencies with Sirius XM's "evidence" of promotional effect).

Response to ¶ 61. SoundExchange refers to Section IV.H.2 of its Proposed Findings of Fact, which details the deficiencies of this type of anecdotal "evidence" of promotion. Sirius XM's implicit suggestion that its play caused the increase in sales of "Chillin' It" is overly simplistic and is undermined by other relevant evidence. For instance, as Dr. Ford testified, Sirius XM generally will not play new releases until after they become available for sale. 5/1/17 Tr. 1858:18-1859:2 (Ford). This means that upticks in sales following play on Sirius XM may simply be attributable to the recording becoming available for purchase. Although Mr. Blatter claims that Sirius XM was the first radio station to play "Chillin' It," he does not address what other activities (*e.g.*, touring, advertising, appearances, interviews, playlisting, online promotions, social media, etc.) were happening at the same time — nor does he explain how

much time elapsed before other stations began playing the song. As experts for both SoundExchange and the Services acknowledged, promotion is multifaceted and it is impossible to quantify the promotional effect of any one service in an environment where multiple factors are at play. *See, e.g.*, Trial Ex. 41 at 7 (Ford WRT); 5/1/17 Tr. 1854:7-1855:2, 1858:7-1861:3 (Ford) (describing "multiple treatment problem" in assessing promotional effect); 5/18/17 Tr. 4755:12-17 (Williams) [[redacted]]; *see also* SE FOF ¶¶ 419-423 (discussing Sirius XM's failure to establish causal relationship between its play and sales); SE FOF ¶ 427 (discussing problems with scale in Sirius XM's graphs of sales data).

Response to ¶ 62. SoundExchange refers to Section IV.H.2 of its Proposed Findings of Fact, which details the deficiencies of this type of anecdotal "evidence" of promotion. Specifically, paragraphs 409-412 of SoundExchange's Proposed Findings of Fact discuss "expressions of gratitude" cited in Mr. Blatter's testimony. Sirius XM frequently solicits thank you emails from record labels and artists, 5/1/17 Tr. 1853:7-1855:10 (Ford); and, as the Judges rightly found in *Web IV*, these and other expressions of gratitude can be reasonably understood as displays of "common courtesy," not evidence of promotional effect. *Web IV*, 81 FR at 26322 n.41 (citations omitted). Moreover, Mr. Blatter does not and cannot speak to *relative* promotion, as he acknowledges that he has no basis for determining what promotional activities record labels direct at other services. 5/10/17 Tr. 3389:7-19 (Blatter).

Response to ¶ 63. SoundExchange repeats its Responses to ¶¶ 61-62, and incorporates those Responses herein.

Response to ¶ 64. SoundExchange repeats its Response to ¶ 62, and incorporates the Response herein. SoundExchange further states that no expert for any party has attempted to quantify the promotional effect of Sirius XM or claimed that doing so would be feasible.

Response to ¶ 65. Sirius XM has offered no useful evidence of its alleged promotional value. The "real-world examples" that Sirius XM notes are nothing more than the kind of self-serving anecdotal evidence that the Judges have consistently and correctly found not to be probative evidence in the past. *See* SE FOF at § IV.H.2.iv. Mr. Blatter does not claim to track record sales or promotional impact, and even his cherry picked examples do not show that Sirius XM has a positive promotional effect. The only "unanimous" verdict that can be drawn from the record on promotion is that there is no support for a finding that Sirius XM is more promotional than the services for which it substitutes. SoundExchange refers to Section IV.H.2 of its Proposed Findings of Fact and its Reponses to ¶¶ 56-64 *supra*.

D. Sirius XM's Direct License Initiative

Response to ¶ 66. It is true that Sirius XM has primarily relied on the statutory license for most of its uses of recorded music. In fact, even after a concerted effort during the course of more than six years to sign as many direct licenses as possible, Sirius XM still relies on the statutory license for approximately [[redacted]] of its SDARS performances. SE FOF at ¶ 930. Sirius XM's reliance on the statutory license thus has not materially changed since the *SDARS II* proceeding. *SDARS II*, 78 FR at 23063 & n.28 (direct licenses represented "no more than [[redacted]] of the total number of works performed by Sirius XM").

Sirius XM claims that it undertook its direct license initiative as a cost-saving measure, but its [[redacted]]. SE FOF at ¶ 915. Sirius XM's true motive appears to be its desire to fabricate a benchmark for use in this

proceeding. SE FOF at ¶¶ 916-920. Sirius XM's Mr. White candidly admitted that [ ]. SE FOF at ¶ 916.

Response to ¶ 67. Sirius XM's claim that it has reduced costs [ ]. *See* Response to ¶ 66. Sirius XM also claims that it has strengthened its relationships with direct licensors by facilitating access to its programmers, and that a selling point to direct licensors was more plays than they would otherwise receive under the statutory license. But the record does not support these claims. To the contrary, and as set forth in detail in SoundExchange's Findings of Fact, the overwhelming weight of evidence shows that direct licensors were not motivated by an expectation of greater access to programmers or promises of more plays. SE FOF at §§ VII.F-H. Notwithstanding Sirius XM's claims to the contrary, Mr. White freely admitted that Sirius XM [ ] if they signed direct licenses. [ ]. SE FOF at ¶ 969. Instead, direct licensors were motivated by a host of other non-statutory benefits, which are detailed in SoundExchange's Findings of Fact. SE FOF at § VII.I. And though some direct licensors may have experienced an increase in plays of their recordings, the majority of direct licensors [ ]. SE FOF at ¶¶ 931-934.

Response to ¶ 68. Sirius XM overstates the number of direct licenses in its benchmark. Sirius XM refers to 558 direct licenses. But in its written direct case, Sirius XM claimed its benchmark included direct licenses with 498 record companies. Trial Ex. 4 at ¶ 5 (White WDT). Even the 498 figure appears to be inflated — as Professor Lys testified, the data produced by Sirius XM in discovery indicate that there are only [ ] current direct licenses. *See* Trial Ex. 42 at ¶ 38 (Lys WRT).

In its written rebuttal case, Sirius XM vaguely suggested that it had executed more than 498 direct licenses. Its written rebuttal testimony, however, failed to specify how many more direct licenses had been executed or to identify them. Trial Ex. 12 at ¶ 10 (Frear WRT). Sirius XM also refused to subject its additional direct licenses to full discovery. Indeed, after Sirius XM's rebuttal case referred to additional direct licenses, SoundExchange moved to compel discovery related to any direct licenses in excess of the 498, arguing that if "Sirius XM is at this late stage in the proceeding unwilling to provide discovery related to direct licenses executed since the submission of direct cases, it should be foreclosed at trial from presenting testimony concerning those additional direct licenses." *See SoundExchange's Motion to Compel Sirius XM's Production of Certain Documents Directly Related to Its Written Rebuttal Statement and a Response to Interrogatory* No. 20, at 10 (Mar. 22, 2017). Having denied SoundExchange full discovery into the new direct licenses, Sirius XM should not be allowed to rely on them or to inflate the number that comprise its benchmark.

Regardless of the precise number, the direct licenses are a small sliver of SoundExchange's approximately 41,000 rights owner members; and Sirius XM artificially inflated the number of direct licenses by signing many of them with labels that receive virtually no plays on Sirius XM. SE FOF ¶¶ 923, 931-934, 938. *See also generally* SE FOF at Section VII.C.

Sirius XM also overstates the extent to which directly licensed tracks are part of its programming. SE FOF at ¶ 926. Sirius XM refers to the percentage of "plays" or "spins" represented by directly licensed recordings, but the more meaningful figure is the percentage of performances. SE FOF at ¶¶ 927-928. In fact, over a twelve month period, direct licenses accounted for only [[redacted]] of SDARS performances. SE FOF at ¶ 930. Similarly, since 2013,

royalties paid under direct licenses have accounted for only [ ] of the total royalties paid by Sirius XM for its satellite radio service. SE FOF at ¶ 921. Recent data shows that the percentage of inactive direct licenses (*i.e.*, direct licenses not generating royalties) is increasing. For example, in November 2016, [ ]. SE FOF at ¶¶ 932-933. Most of the direct licenses are therefore economically meaningless. SE FOF at ¶ 938.

Furthermore, even if spins are used to measure the direct license share, Sirius XM has overstated the total spins. Sirius XM claimed directly licensed recordings accounted for 6.4% of spins on Sirius XM. Trial Ex. 4 at ¶ 5 (White WDT). But as Professor Shapiro conceded, [ ] of the direct licensors he examined over-indexed, and when those labels are removed from the analysis, the total number of directly licensed plays relevant to his benchmark falls [ ]. SE FOF at ¶ 1118.

Response to ¶ 69. SoundExchange does not dispute that the particular labels and recordings are part of Sirius XM's direct licenses. But any implication that the direct licenses are representative of the sound recordings performed by Sirius XM is misleading. *See generally* SE FOF at § VII.C. While Sirius XM cites a handful of independent labels with commercially successful recordings, the fact is that [ ]. SE FOF at ¶ 941. And of course Sirius XM has not signed a direct license with any of the major labels, whose market share by distribution is over 86%. SE FOF at ¶ 521. *See SDARS II*, 78 FR at 23063-64 ("The Direct Licenses do not include any of the major record labels whom, by virtue of the depth and breadth of their music catalogues, make up a critical portion of the sound recording market. . . . It would

be difficult to imagine a successful SDARS service that did not have access to the types of recordings that the major labels possess.”).

Response to ¶ 70. *See* Response to ¶ 69.

Response to ¶ 71. SoundExchange does not dispute that the direct licenses share certain provisions in common. [[redacted]]. SE FOF at ¶¶ 969, 982, 991.

Response to ¶ 72. Sirius XM’s summary of the range of rates in its direct licenses is accurate, but the evidence is clear that the direct license rates have increased over time, such that the [[redacted]]. SE FOF at ¶¶ 905-906. *See also generally* SE FOF at § VII.A.

Response to ¶ 73. No response.

Response to ¶ 74. No response.

Response to ¶ 75. The direct licenses’ metadata provision is a non-statutory benefit that enables direct licensors to earn more in royalties without any increase in their number of plays on Sirius XM. SE FOF at ¶¶ 1190-1195. Sirius XM offers its direct licensors the opportunity to provide content feeds and metadata directly to Sirius XM, including the International Standard Recording Code, which is a unique identifier for a recording, which Sirius XM does not provide to SoundExchange. This metadata provision fosters greater reporting accuracy, which can lead to increased royalties for a label. SE FOF at ¶ 1191. In fact, getting Sirius XM to accept a direct

metadata feed was the primary motivation for at least one significant company that signed a direct license ([redacted]). SE FOF at ¶ 1195.

II. THE GOVERNING LAW

Response to ¶ 76. Because the Judges are required in this proceeding to "determine" statutory royalty rates, and not merely adjust them, SE FOF at § IX.A, SoundExchange agrees that the Judges' task in this proceeding is to follow the path that has been "well laid out" for deciding rates in a case subject to Section 801(b)(1) – first seeking to ascertain a current market rate for the rights subject to the statutory license by considering "benchmarks and testimony," and then "measur[ing] the rate . . . yielded by that process against the statutory objectives" to determine whether any adjustment of the market rate is necessary to achieve the Section 801(b)(1) objectives. *SDARS I*, 73 FR at 4084; SE FOF at ¶ 93.

In doing so, the Judges "*may* consider 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) (emphasis added). However, the statute's permission to consider such agreements does not mandate that weight be given to any particular agreements or override the requirement that rates "be calculated to achieve" the Section 801(b)(1) objectives. 17 U.S.C. §§ 114(f)(1)(B), 801(b)(1). Here, the interactive services agreements that form the basis for SoundExchange's proposed benchmark are agreements as described in Section 114(f)(1)(B) that provide a reliable benchmark. SE FOF at § IV. Sirius XM's direct licenses are not a reliable benchmark. SE FOF at § VII.

A. Benchmark Rates

i. Comparability

Response to ¶ 77. Benchmarking is a standard way for economists to estimate reasonable royalty rates. SE FOF at ¶ 90. Decisions by the Judges in past proceedings and testimony from the economists in this proceeding all agree that a benchmark should be as comparable as practicable to the target market for which rates are being set, and if necessary, adjustments should be made to account for material differences. *E.g.*, SE FOF at ¶ 90. In their past discussions of comparability, the Judges have emphasized taking into account comparability of buyers and sellers and rights transacted for (including differences in the functionality and the nature of the downstream distribution of the benchmark and target services). *SDARS II*, 78 FR at 23058, 23063-66; *SDARS I*, 73 FR at 4088-94.

The Judges have also explained that "a rate that was negotiated in the shadow of the statutory licensing system . . . cannot properly be said to be a market benchmark rate." *SDARS II*, 78 FR at 23058. However, they have relied on agreements negotiated in the shadow of the statutory license when no other satisfactory benchmarks were available, so the alternative would be "the wholesale abandonment of benchmarking." *Web IV*, 81 FR at 26331.

Sirius XM mentions "intensity" of use as a possible further "[s]alient consideration." Sirius XM FOF at ¶ 77. However, the Judges have not been persuaded that intensity of use is a salient consideration in previous proceedings, and have held that intensity of use is not a necessary consideration in evaluating the comparability of a benchmark. *See Web IV*, 81 FR at 26395-96. Indeed, in *Web IV*, the Judges observed that "[w]illing buyers and willing sellers may, and often do, agree to rates that are not strictly proportional to usage." *Web IV*, 81 FR at 26395-96; *see also Web IV*, 81 FR at 26351 (noting that willing sellers in subscription markets

compete for users with positive willingness to pay and finding that those sellers focus on average revenue per user rather than revenue per play).

SoundExchange agrees that in *Web IV*, the Judges concluded as a matter of law that when setting rates under the willing buyer/willing seller standard of Section 114(f)(2), they are required "to set a rate that reflects a market that is effectively competitive." *Web IV*, 81 FR at 26332. That conclusion of law is currently on appeal. *SoundExchange, Inc. v. Copyright Royalty Board*, No. 16-1159 (D.C. Cir.).

Response to ¶ 78. Section 114(f)(1)(B), which refers to the consideration of "rates and terms for comparable types of subscription digital audio transmission services . . . under voluntary license agreements," 17 U.S.C. § 114(f)(1)(B), does not mean that all such agreements are equally good benchmarks. Sirius XM's direct licenses are an entirely unreliable benchmark, and they are non-comparable for many of the same reasons they are unreliable. SE FOF at § VII; *SDARS II*, 78 FR at 23063 (direct licenses "have the surface appeal of a comparable benchmark" but "closer examination . . . reveals the weaknesses").

First, there are structural differences between the direct license market and the hypothetical statutory license market. In fact, the discount reflected in the direct licenses is largely accounted for by just two of those structural differences – SoundExchange's administrative fee and the non-featured artist share. SE FOF at ¶¶ 887, 1028-1053. Differences in the treatment of the featured artist share also may be significant in many cases. SE FOF ¶¶ 1054-1078. Those structural differences make the direct license benchmark non-comparable. While one could potentially try to adjust for those differences, doing so would cause the direct license benchmark to mirror the statutory license, which Professor Shapiro agreed at trial would indicate that the benchmark is uninformative. SE FOF at ¶ 886.

Second, Sirius XM and direct licensors negotiated the terms of the direct licenses under a regime in which copyright owners do not have the option of withholding a license. Trial Ex. 26 at ¶ 109 (Orszag Am. WDT). Accordingly, the direct licenses are non-comparable in that they do not approximate the results of negotiation between a willing buyer and a willing seller. SE FOF at ¶¶ 894, 898-914.

Third, the direct licensor indie record companies are not necessarily representative of the sellers in the larger statutory license marketplace. *SDARS II*, 78 FR at 23063-64; SE FOF at ¶¶ 921-942. As one example, Sirius XM's offer of "access to programmers" would not make any difference to a major label, or inspire a major label to accept a discounted royalty rate. SE FOF at ¶¶ 1005-1011. Because the direct licensors are not comparable sellers to the full range of record companies in the statutory license marketplace, the benchmark is non-comparable. Numerous other problems with the direct licenses as a benchmark are addressed in detail in SE FOF § VII.

Response to ¶ 79. Sirius XM makes too much of the Register's decision in *Web IV*. That decision interpreted Section 114(f)(5)(C), the provision of the Webcaster Settlement Act barring consideration in rate proceedings of the terms of certain agreements entered into pursuant to that Act. *In re Scope of the Copyright Royalty Judges' Continuing Jurisdiction* [sic], 80 FR 58300, 58306 (2015). Because Sirius XM's direct licenses are not patterned on a Webcaster Settlement Act agreement, Section 114(f)(5)(C) is plainly irrelevant here.

Of course Section 114(f)(1)(B) identifies voluntary license agreements conveying sound recording rights to "comparable types of subscription digital audio transmission services" as being among the evidence that the Judges may consider. That does not mean that all such agreements are equally good evidence. Here, the interactive services agreements that form the

basis for SoundExchange's proposed benchmark are agreements as described in Section 114(f)(1)(B) that provide a reliable benchmark. SE FOF at § IV. Sirius XM's direct licenses are not a reliable benchmark. SE FOF at § VII.

Response to ¶ 80. The Register's reference to "voluntary *noninteractive* direct license agreements" is inapposite here because Section 114(f)(1)(B) refers to "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) (emphasis added). The interactive services agreements that form the basis for SoundExchange's proposed benchmark are agreements as described in Section 114(f)(1)(B) that provide a reliable benchmark. SE FOF at § IV. Sirius XM's direct licenses are not a reliable benchmark. SE FOF at § VII.

Response to ¶ 81. To avoid repetition, SoundExchange incorporates its responses to ¶¶ 78-80 *supra*.

Response to ¶ 82. The interactive services agreements that form the basis for SoundExchange's proposed benchmark cover "comparable types of subscription digital audio transmission services" and so are exactly the type of agreement described in Section 114(f)(1)(B). The interactive services benchmark is an excellent benchmark that has been accepted by the Judges in prior cases, including *SDARS I*, *Web II*, and *Web IV*. SE FOF at ¶¶ 96-104. While the Judges rejected the interactive services benchmark in *SDARS II*, the reasons they had for doing so do not apply to the benchmark proffered by SoundExchange in this proceeding. SE FOF at ¶¶ 105-108, 153-161, 1389-1400.

It would be inappropriate in this proceeding for the Judges to draw any conclusions about what might or might not constitute a market rate based on how close a benchmark is to the

current statutory royalty rate. First, in *SDARS I* and *SDARS II*, the Judges very deliberately adjusted the statutory royalty rates down from what they perceived to be marketplace levels pursuant to Section 801(b)(1). *SDARS II*, 78 FR at 23069; *SDARS I*, 73 FR at 4096-98. It would be surprising if there were *not* a gap between the current statutory rate and a fresh determination of a market rate, when the Judges specifically created a gap between the current statutory rate and their last determination of a market rate.

Second, the marketplace has changed since *SDARS II*, and even more so since *SDARS I*. Changes such as the increasing opportunity cost that record companies would incur in licensing Sirius XM suggest that a marketplace rate for SDARS would be higher than perceived in *SDARS II*. SE FOF at § IX.C. Thus, and again, a gap between the market rate and the current statutory rate is to be expected.

Finally, the gap between SoundExchange's proposed rate and the market rate on which the current statutory rate for SDARS was based is less than meets the eye. To make the proper comparison, one should begin with the per-subscriber rate of $1.40 that the Judges found in *SDARS I* to be "most strongly indicated by marketplace data." *SDARS I*, 73 FR at 4097. Converting that to today's dollars or a percentage of Sirius XM's current relevant ARPU yields a per-subscriber rate of $1.74 to $1.92 during the coming rate period, or a 15.7% percentage-of-revenue rate in 2016. SE FOF at ¶¶ 1407-1420.

ii. Effective Competition

Response to ¶ 83. As noted above, SoundExchange agrees that in *Web IV*, the Judges concluded as a matter of law that when setting rates under the willing buyer/willing seller standard of Section 114(f)(2), they are required "to set a rate that reflects a market that is effectively competitive." *Web IV*, 81 FR at 26332.

That conclusion is inapposite here, where the Judges are required to set a rate under the different standard of Section 801(b)(1). Effective competition is a relevant consideration in evaluating potential benchmarks in the first stage of a Section 801(b)(1) analysis. *E.g.*, Trial Ex. 26 at ¶¶ 62-79 (Orszag Am. WDT). However, the Judges may adjust market benchmark rates either upward or downward if necessary to achieve the Section 801(b)(1) objectives. Response ¶¶ 88-95. Thus, the rate finally to be determined by the Judges in this proceeding might potentially be either higher or lower than the rate that would prevail in a market with effective competition, if necessary to achieve the policy objectives specified by Congress.

Response to ¶ 84. SoundExchange agrees that in *Web IV*, the Judges found, based on the record before them, that the market for subscription interactive services was not effectively competitive, and therefore made a downward adjustment to the rate suggested by SoundExchange's interactive services benchmark as presented in that proceeding. *Web IV*, 81 FR at 26344. However, the record in this proceeding establishes that the market for subscription interactive services *is* effectively competitive. SE FOF at ¶¶ 278-339. Assessing whether a market is effectively competitive requires evaluating the relative bargaining power of parties to a bilateral negotiation, and considering market evidence to determine whether negotiated royalties reflect a fair market rate. SE FOF at ¶¶ 280-284, 304-306. Based on evidence not submitted in *Web IV*, it is clear that companies offering prominent interactive services have considerable

leverage and, in negotiations with record companies, use that leverage to [ ]. SE FOF at ¶¶ 280-339.

With respect to steering, the record in this proceeding establishes that Sirius XM has the *ability* to steer, but shows no evidence that Sirius XM *does* steer, or that direct license agreements were entered into because of steering. SE FOF at §§ VII.F-.H. Instead, the evidence shows that the direct licenses were entered into for a host of reasons having nothing to do with steering. SE FOF at §§ VII.I. Even Professor Shapiro agrees that Sirius XM's licenses are economically irrelevant if they were not motivated by the threat or promise of steering. SE FOF at ¶¶ 954-956.

The record of this proceeding shows that SoundExchange's interactive services benchmark is an excellent benchmark. SE FOF at § IV.C. That benchmark does not need to be adjusted for competition, because the market for subscription interactive services is effectively competitive. SE FOF at ¶¶ 278-339. However, to the extent that the Judges believe it may be necessary to adjust it to reflect the alleged lack of effective competition in the interactive services market, Mr. Orszag identified three potential ways to do so.[15] SE FOF at ¶¶ 341-361.

Response to ¶ 85. For reasons already discussed, Sirius XM's focus on tit-for-tat price competition in the market for interactive services is misplaced. *See supra* Response to ¶ 84. Additionally, the testimony of record company witnesses in this proceeding demonstrates that [ ]. *See, e.g.*, SE FOF at 300, 302; 5/15/17 Tr. 3836:12-14 (Walker).

[15] The Judges have previously declined to find that effective competition required a hypothetical market in which the majors were deprived of whatever market power exists due to the size of their repertoires. *Web IV*, 81 FR at 26368.

Sirius XM also makes too much of previous analysis regarding how anti-steering provisions might affect effective competition. In *Web IV*, the Judges assessed the *potential* effect of anti-steering provisions in a *hypothetical* market for non-interactive services. *Web IV*, 81 FR 26374. When Judges performed that analysis, they had no marketplace evidence to rely on. *Web IV*, 81 FR 26374. This has changed. After *Web IV*, [ ]. SE FOF at ¶¶ 861-869. The record companies [ ]. SE FOF at ¶¶ 844-847, 859, 861-869; *see also* 4/26/17 Tr. 1152:15-1153:18 (Orszag). This marketplace evidence demonstrates that anti-steering provisions reflect an effectively competitive market, namely, one in which the threat of steering induces record companies to accept lower rates. SE FOF at ¶ 868.

Response to ¶ 86. To avoid repetition, SoundExchange incorporates its response to ¶¶ 84-85 *supra*.

B. Section 801(b)(1)

Response to ¶ 87. This proceeding is governed by the rate-setting standard set forth in Section 801(b)(1) of the Copyright Act. 17 U.S.C. §§ 114(f)(1)(B), 801(b)(1). Accordingly, the Judges' duty in this proceeding is to faithfully apply Section 801(b)(1) in accordance with the statutory text and generally-applicable principles of statutory interpretation. It most emphatically is *not* the Judges' duty – and it would not be proper – for the Judges to put a thumb on the

Section 801(b)(1) scale based on something Sirius XM thinks it perceives in legislative history written decades after the enactment of Section 801(b)(1).

When the Judges apply the Section 801(b)(1) objectives, they "begin with a consideration and analysis of the benchmarks and testimony submitted by the parties, and then measure the rate or rates yielded by that process against the statutory objectives to reach [their] decision." *SDARS I*, 73 FR at 4084. The Judges are not required to – and should not – make departures from the benchmark rates unless necessary to achieve the Section 801(b)(1) objectives. The Judges may well decide that, after making appropriate adjustments to account for differences between the benchmark and target markets to best reproduce a rate that would represent hypothetical marketplace transactions between a willing SDARS buyer and a willing record company seller, no further adjustment is necessary based on the Section 801(b)(1) objectives.

Consideration of the Section 801(b)(1) objectives warrants an adjustment to the benchmark rate only when a "relative difference between the benchmark market and the hypothetical target market would necessitate an adjustment." *SDARS I*, 73 FR at 4094-95. Where a marketplace benchmark adequately addresses the statutory objectives, adjustments to that benchmark are unnecessary. *See, e.g.*, *In re Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding*, 74 FR 4510, 4523 (2009) (hereinafter "*Phonorecords I*" or "*Mechanicals II*") ("available evidence . . . related to these policy objectives does not reasonably weigh in favor of any further adjustments"); *SDARS I*, 73 FR at 4094-95 (finding that the record does not support any adjustment for the first objective); *In re 1980 Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players*, 46 FR 884, 889 (1981) (hereinafter "*Jukeboxes*") (same). An adjustment under Section 801(b)(1) must be supported by sufficient evidence in the record. *SDARS II*, 78 FR at 23066.

Response to ¶ 88. Sirius XM misperceives the history and rationale of Section 801(b)(1) and the past decisions made pursuant to it. The Section 801(b)(1) objectives were enacted in substantively their current form in 1976, when promoting satellite radio could not have been further from the mind of anyone in Congress. Copyright Act of 1976, Pub. L. No. 94-553 § 801(b)(1), 90 Stat. 2541, 2594-95.

The Judges' interpretation of the Section 801(b)(1) objectives should end, where it begins, with the statutory text. It is appropriate to consult legislative history as an aid in the interpretation of a statutory provision only if the statute is ambiguous. *E.g.*, *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 568 (2005) ("[T]he authoritative statement is the statutory text, not the legislative history or any other extrinsic material. Extrinsic materials have a role in statutory interpretation only to the extent they shed a reliable light on the enacting Legislature's understanding of otherwise ambiguous terms."). Sirius XM has not suggested that there is any ambiguity in Section 801(b)(1). *See* SXM FOF at ¶ 88.

Section 801(b)(1) does not apply only to the participants in this Section 114 proceeding. It also applies to rate proceedings under Section 115, in which Sirius XM and Music Choice do not participate. The words of Section 801(b)(1) mean the same thing in both a Section 114 and Section 115 context.

Contrary to Sirius XM's argument, the Judges may adjust market benchmark rates either upward or downward if necessary to achieve the Section 801(b)(1) objectives. Sirius XM does not even suggest that the *text* of Section 801(b)(1) requires a downward adjustment, or prohibits an upward adjustment, from a benchmark rate. Its argument is based solely on its incorrect reading of legislative history subsequent to the enactment of Section 801(b)(1). *See* SXM FOF at ¶ 88. However, even if the text of Section 801(b)(1) were ambiguous (and it is not), it would

not be proper to consult post-enactment legislative history to discern the proper meaning of Section 801(b)(1). *Bruesewitz v. Wyeth LLC*, 562 U.S. 223, 241-42 (2011) ("[p]ost-enactment legislative history (a contradiction in terms) is not a legitimate tool of statutory interpretation"); *District of Columbia v. Heller*, 554 U.S. 570, 605 (2008) ("'[p]ostenactment legislative history' . . . could have had no effect on the congressional vote"); *Sullivan v. Finkelstein*, 496 U.S. 617, 628 n.8 (1990) (noting the "difficulties inherent in relying on subsequent legislative history"). Even the legislative actions of a subsequent Congress are "a hazardous basis for inferring the intent of an earlier one." *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825, 840 (1988) (quotation marks omitted).

In Section 801(b)(1) Congress merely provided that "[t]o make determinations and adjustments of reasonable terms and rates of royalty payments" the rates determined pursuant to it "shall be calculated to achieve the following objectives." 17 U.S.C. § 801(b)(1). Congress did not prescribe an adjustment in any particular direction. To the contrary, the Judges' discretion to adjust upward as well as downward if they see fit is underscored by the evenhandedness of the 801(b)(1) objectives. For example, the second factor requires the Judges to set a rate that will "afford the copyright owner a fair return for his or her creative work" while at the same time affording "the copyright user a fair income." 17 U.S.C. § 801(b)(1)(B). Likewise, the third factor requires consideration of "the relative roles of the copyright owner and the copyright user" in making the product available to the public. 17 U.S.C. § 801(b)(1)(C). As set out in the unambiguous statutory text of Section 801(b)(1), Congress gave the Judges discretion to adjust the marketplace benchmark rates *in whatever direction* is necessary to achieve the statutory objectives.

Application of the Section 801(b)(1) objectives in particular proceedings sometimes has resulted in decisions expressly to set below-market rates, including in *SDARS I* and *SDARS II*. However, those decisions were each the result of applying Section 801(b)(1) to the particular facts in the record of those proceedings, not a determination that as a matter of law Section 801(b)(1) always requires below-market rates. The facts in the record of this proceeding are different from the facts in the record of those proceedings. The Judges should apply the text of Section 801(b)(1) to the facts in this record.

Response to ¶ 89. As stated above in response to Paragraph 88, the Judges need not and should not consult legislative history to interpret Section 801(b)(1), because it is unambiguous. And if it were ambiguous, the legislative history they should consult is the legislative history of the Copyright Act of 1976 in which the Section 801(b)(1) objectives were enacted, not the legislative history of the Digital Performance Right in Sound Recordings Act ("DPRA") that merely referenced the Section 801(b)(1) objectives almost 20 years after their enactment (and says almost nothing about them).

However, Sirius XM does not accurately portray the purposes of the DPRA. The first sentence of explanatory text in both the House Report and Senate Report accompanying the DPRA could not be clearer that "[t]he purpose of [the DPRA] is to ensure that performing artists, record companies and others whose livelihood depends upon effective copyright protection for sound recordings, will be protected as new technologies affect the ways in which their creative works are used." H.R. Rep. No. 104-274, at 10 (1995); *see also* S. Rep. No. 104-128, at 10 (1995), *as reprinted in* 1995 U.S.C.C.A.N. 356, 357. The linkage between protection and compensation was made explicit by the Congressional Budget Office, which said the "[b]ill['s] purpose" was to "create a system to ensure that recording artists and companies are compensated

for public performances of their works by means of certain types of digital audio transmissions." S. Rep. No. 104-128, at 46, *reprinted in* 1995 U.S.C.C.A.N. at 393.

Foreseeing the shift to performance-based services that is now occurring, Congress explained:

> [I]n the absence of appropriate copyright protection in the digital environment, the creation of new sound recordings and musical works could be discouraged, ultimately denying the public some of the potential benefits of the new digital transmission technologies. Current copyright law is inadequate to address all of the issues raised by these new technologies dealing with the digital transmission of sound recordings and musical works and, thus, to protect the livelihoods of the recording artists, songwriters, record companies, music publishers and others who depend upon revenues derived from traditional record sales.

H.R. Rep. 104-274, at 13; *see also* S. Rep. 104-128, at 14, *reprinted in* 1995 U.S.C.C.A.N. at 361.

Similarly, Senator Feinstein, a co-sponsor of the DPRA, stated upon the occasion of its passage:

> Why should the digital transmission businesses be making money by selling music when they are not paying the creators who have produced that music?
>
> If this should occur without copyright protection, investment in recorded music will decline, as performers and record companies produce recordings which are widely distributed without compensation to them. This would result in the decline of what presently constitutes one of America's most important, productive and competitive industries.

141 Cong. Rec. 22,790 (1995) (statement of Sen. Feinstein).

Congress' concern for protecting artists and record companies was not limited to threats posed by interactive services, but included securing compensation for them from noninteractive subscription services like Sirius XM and the PSS. The legislative history of the DPRA

specifically notes that such services, as well as interactive services, "might adversely affect sales of sound recordings and erode copyright owners' ability to control and be paid for use of their work." S. Rep. 104-128, at 15, *reprinted in* 1995 U.S.C.C.A.N. at 362.

The D.C. Circuit recently confirmed the protective purposes of the DPRA. After noting that the absence of a performance right allowed the services now known as the PSS to use sound recordings without obtaining a license, the court explained, "sensing that emerging technology posed a threat to copyright owners' interests, Congress stepped in." *SoundExchange, Inc. v. Muzak LLC*, 854 F.3d 713, 714 (D.C. Cir. 2017).

Response to ¶ 90. Congress certainly intended "to strike a balance among all of the interests affected" by the new performance right. H.R. Rep. 104-274, at 14; *see also* S. Rep. 104-128, at 14, *reprinted in* 1995 U.S.C.C.A.N. at 361. Part of that balance was the creation of the Section 114 statutory license. However, Congress never suggested that copyright owners should get less than full and fair compensation for the use of their recordings under the statutory license, or that digital music services should receive the benefit of below-market rates for their exploitation of the labor, creative efforts, and financial investment of artists and copyright owners.

The choice of the Section 801(b)(1) rate standard to set rates under the statutory license is barely mentioned at all in the legislative history of the DPRA, and no rationale for its selection is specified. S. Rep. 104-128, at 30, *reprinted in* 1995 U.S.C.C.A.N. at 377. That standard had governed Section 115 statutory royalty rates for almost 20 years by that time and had been noncontroversial. Copyright Act of 1976, Pub. L. No. 94-553 § 801(b)(1), 90 Stat. 2541, 2594-95.

The Section 801(b)(1) objectives were originally enacted to provide additional specificity concerning the concept of a reasonable rate, and thereby avoid possible constitutional issues as to the delegation of rate-setting authority to the Copyright Royalty Tribunal. *SDARS I*, 73 FR at 4082. The broader purpose of the rate adjustment mechanism of which it was part was to increase the then-existing statutory mechanical royalty rate to ensure fair compensation to copyright owners. H.R. Rep. No. 94-1476, at 107 (1976) (acknowledging the unfairness of the then-existing statutory mechanical royalty rate); *see also In re Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords; Rates and Adjustment of Rates*, 46 FR 10466, 10478 (1981) (hereinafter "*Mechanicals I*").

By the time of the DPRA, there had been only two litigated proceedings under Section 801(b)(1). In the 1980 Section 116 proceeding, the Copyright Royalty Tribunal gave scant consideration to the Section 801(b)(1) objectives, and simply concluded that the rate it had derived from "marketplace analogies" was consistent with each of the objectives. *SDARS I*, 73 FR at 4082 (citing *Jukeboxes*, 46 FR at 889). In the 1981 Section 115 proceeding, the Copyright Royalty Tribunal "nearly doubled the existing rates" after applying the objectives to marketplace evidence. *SDARS I*, 73 FR at 4083. Nothing in those decisions would have caused Congress in 1995 to think that by referring to Section 801(b)(1) in the DPRA, it was favoring the services or requiring that rates could only be adjusted downward from a marketplace benchmark. That would have been contrary to its expressed purpose of protecting artists and record companies. H.R. Rep. No. 104-274, at 10; *see also* S. Rep. No. 104-128, at 10, *reprinted in* 1995 U.S.C.C.A.N. at 357. Certainly in its consideration of the DPRA, Congress never suggested that copyright owners should get less than full and fair compensation for the use of their recordings under the statutory license.

In fact, Congress has expressly recognized when enacting statutory licenses that they are an exception to the usual exclusive rights of a copyright owner and should be interpreted in a way that minimizes the effects of government intrusion into the marketplace. S. Rep. No. 106-42, at 10 (1999) ("in creating compulsory licenses, [Congress] is acting in derogation of the exclusive property rights granted by the Copyright Act to copyright holders, and . . . it therefore needs to act as narrowly as possible to minimize the effects of the Government's intrusion on the broader market in which the affected property rights and industries operate); *see also* H.R. Rep. No. 108-660, at 9 (2004) (compulsory licenses constitute an "abrogation of copyright owners' exclusive rights"); *Fame Publ'g Co. v. Ala. Custom Tape, Inc.*, 507 F.2d 667, 670 (5th Cir. 1975) (§ 115 compulsory license is "a limited exception to the copyright holder's exclusive right to decide who shall make use of his composition . . . [and] must be construed narrowly, lest the exception destroy, rather than prove, the rule").

Response to ¶ 91. After enactment of the DPRA, it quickly became apparent that there was a lack of agreement concerning how it applied to webcasters, who were just emerging at the time and had not been a focus of the DPRA. H.R. Rep. No. 105-796, at 80 (1998) (Conf. Rep.), *as reprinted in* 1998 U.S.C.C.A.N. 639, 656; Section-by-Section Analysis of H.R. 2281 as Passed by the United States House of Representatives on August 4, 1998, H. Comm. on the Judiciary, 150th Cong. 50-52 (Comm. Print 1998). As part of the legislative negotiations leading to enactment of the Digital Millennium Copyright Act ("DMCA"), a compromise was reached to accommodate webcasters within the statutory license structure. However, the predecessors of Sirius XM and the services now known as the PSS opposed having those changes apply to them. Accordingly, an agreement was reached to "grandfather" certain of their service offerings under the statutory license conditions and rate standard that had applied under the DPRA. H.R. Conf.

Rep. 105-796, at 80-81, 85, 88-89, *reprinted in* 1998 U.S.C.C.A.N. at 656-57, 661, 664-65. The Section 801(b)(1) rate standard remained unchanged, and rates remained subject to periodic re-determination in proceedings like this one.

The legislative history describing the DMCA's bifurcation of Section 114(f) into separate parts for the SDARS/PSS and webcasters could hardly devote less attention to the difference in rate standards. The two rate standards are noted only in passing. H.R. Conf. Rep. 105-796, at 85-86, *reprinted in* 1998 U.S.C.C.A.N. at 661-62. Congress specified no rationale for the different rate standards other than continuing the status quo as to the preexisting services. H.R. Conf. Rep. 105-796, at 85, *reprinted in* 1998 U.S.C.C.A.N. at 661.

Response to ¶ 92. It is absolutely *not* the case that the difference in rate standards for the SDARS/PSS and webcasters has been "uniformly recognized" as placing a market level "cap" on royalty rates determined pursuant to Section 801(b)(1). *See* SXM FOF at ¶ 92.

As purported support for this baseless statement, Sirius XM cites an argument made by RIAA almost 20 years before the difference in Section 114 rate standards arose – in the first litigated proceeding under Section 115 – and it takes that argument woefully out of context and misrepresents it. In that proceeding, music publishers argued that the Copyright Royalty Tribunal "should adopt a royalty rate at the high level of a range within which there would be marketplace bargaining." *Mechanicals I*, 46 FR at 10478. Had it adopted this so-called "bargaining room" theory, the Tribunal would have set a statutory royalty rate that was deliberately above market specifically to allow marketplace actors to arrive at a lower rate through negotiations outside the statutory license structure. *Mechanicals I*, 46 FR at 10478. In rejecting this approach, the Tribunal quoted the RIAA's argument against it. In quoting from that passage of the Tribunal's decision, Sirius XM misleadingly omitted an essential clause

(italicized here): "A rate that is deliberately fixed above the level that the market can bear—*so that a lower rate can be negotiated in the marketplace*—cannot be 'reasonable.'" *Mechanicals I*, 46 FR at 10478 (emphasis added). In context, with that critical phrase included, it is clear that RIAA was merely arguing that setting rates above market solely to allow for bargaining, *and entirely apart from the Section 801(b)(1) objectives*, was unreasonable.

Response to ¶ 93. Similarly, Sirius XM makes too much of SoundExchange's testimony before Congress. In 2014, SoundExchange observed that the Section 114 rates have been consistently set at below-market rates for the SDARS and PSS. That shouldn't be a surprising observation. The Judges were clear about what they were doing when they adjusted Sirius XM's royalty rates down from marketplace levels in *SDARS I* and *SDARS II* by applying Section 801(b)(1) to the perceived economic conditions at the time. *SDARS II*, 78 FR at 23069; *SDARS I*, 73 FR at 4096-98. PSS rates have also been set at below-market levels for the last 20 years. SE FOF at ¶¶ 1889-1947.

Neither should it be surprising that SoundExchange's constituents are upset that there are middle-class artists living royalty check to royalty check, Trial Ex. 31 at 4-6 (Hair WDT), while Sirius XM has received a royalty rate subsidy that by any measure is at least [[redacted]], SE FOF at ¶ 1598-1606, and used the money to buy back its stock. SE FOF at ¶ 1571-1572. Music Choice has also been very profitable. SE FOF at ¶ 2152.

However, observing that Sirius XM and the PSS are no longer financially struggling startups, and no longer need to be subsidized by artists and record companies, is not an acknowledgement that below-market rates are *required* by Section 801(b)(1). It also is not an acknowledgement that above-market rates are proscribed by Section 801(b)(1). Rather, it was a statement that, *in practice*, in deciding the cases before them, the Judges have set the SDARS

rates at below-market rates through consideration of the Section 801(b)(1) objectives. *See SDARS II*, 78 FR at 23069 (adjusting rate downward based on third Section 801(b) factor); *SDARS I*, 73 FR at 4097 (finding fourth factor called for below-market rate). If Congress were to require all Section 114 rates to be set under the willing buyer/willing seller standard, as SoundExchange advocated, it would remove the possibility of the subsidy that the Judges have afforded Sirius XM and the PSS through lower-than-market rate-setting that is *allowed*, but not *required*, by Section 801(b)(1).

Response to ¶ 94. Likewise, the statements by RIAA Chairman Cary Sherman and Recording Academy President Neil Portnow about the below-market rates enjoyed by the Sirius XM and the PSS simply note the explicit past *practice* of the Judges and their predecessors in setting below-market rates in deciding particular cases, not any fictional legal requirement that royalties set under Section 801(b)(1) be at or below market levels. *See* Response to ¶ 93, *supra*.

Response to ¶ 95. Needless to say, Sirius XM's litigation advocacy does not change the law or the Judges' obligation to apply it faithfully and to impose rates at or above market levels if necessary to achieve the Section 801(b)(1) objectives. As set out fully in Section X.B. of SoundExchange's Proposed Findings of Fact and Conclusions of Law, the Section 801(b)(1) objectives require an SDARS rate that represents an upward departure from the market, or at least a rate at the upper end of the range of market rates.

Response to ¶ 96. SoundExchange addresses Professor Shapiro's opinion regarding the applicable rates as they relate to the 801(b)(1) objectives in § III(C)(iii), *infra*. SoundExchange addresses Sirius XM's critiques of Professor Willig in § IV(D), *infra*.

III. SIRIUS XM'S PROPOSED BENCHMARKS DO NOT PROVIDE A MEASURE OF APPROPRIATE ROYALTY RATES AND SHOULD BE REJECTED

Response to ¶ 97. The three benchmarks that Sirius XM proposes are not reliable, do not provide a measure of appropriate royalty rates, and should be rejected. SE FOF at ¶¶ 885-1432; Responses to ¶¶ 98-248. By contrast, SoundExchange offers two benchmarks that are supported by substantial evidence and establish that royalty fees for the upcoming licensing period should be set at the greater of $2.48-$2.79 per-subscriber and 23% of gross revenues, as outlined in SoundExchange's Amended Rate Proposal.

A. Developments Since *SDARS II* Demonstrate That The Prevailing Statutory Rate Is Far Too Low

Response to ¶ 98. Congress has determined that the statutory rates payable by Sirius XM should be determined anew for each licensing period. SE COL at § IX.A. Accordingly, Sirius XM's assertion that the Judges should in this proceeding begin with rates set in *SDARS II* should be rejected as a matter of law. SE COL at § IX.A.

Beginning with the rates set in *SDARS II* is also problematic because the rationale underlying the *SDARS II* decision is no longer supported. For example, concerns with the interactive services benchmark presented in that proceeding no longer hold. SE FOF at ¶¶ 1391-1400. Because subsequent data illustrate that the interactive services benchmark provides a reasonable measure of the rates appropriate for Sirius XM's satellite radio service, it would be improper to anchor analysis to a decision that did not rely on that benchmark.

Changes in the marketplace since the time of the *SDARS II* decision provide further reason to reject Sirius XM's approach. For example, there is little question (Sirius XM's protestations to the contrary notwithstanding) that the opportunity costs of licensing Sirius XM have grown over time. The growth of streaming generally, the increased ability to use streaming

services in the car using smartphones and enhanced network coverage, and the expanding "lean-back" listening offered by fully interactive services, all have made subscription streaming services closer substitutes for Sirius XM's service. Those subscription services, both fully interactive and mid-tier, pay per-subscriber royalties that are multiples of what Sirius XM pays. Consequently, even a modest increase in the degree to which Sirius XM diverts consumers from those services has a significant negative financial impact on the copyright owners.

Additionally, the prevailing *SDARS II* rate reflects a downward adjustment for Sirius XM's satellite costs under Section 801(b)(1)(C). *SDARS II*, 78 FR at 23069. Because Sirius XM has experienced tremendous financial growth since the *SDARS II* decision, its satellite costs now comprise a much smaller and steadily decreasing percentage of the company's overall revenue, and beginning analysis with a rate that reflects a downward adjustment for satellite costs is improper. SE FOF at ¶¶ 1401-1403. Sirius XM's current impressive profitability impacts the rate-setting calculus in another way as well. The surplus over which parties to a negotiation would bargain indisputably has grown since the time of *SDARS II*, suggesting higher rates.

For these and other reasons discussed below, beginning with the extant statutory rate and then attempting to identify and quantify the impact of every change over the past five years makes no sense. Sirius XM prefers to push forward rates determined at a time when Sirius XM had just emerged from years of losing money, when the interactive services market was deemed to be "in flux" and thus unsuitable as a benchmark, and when subscription streaming services offered far less competition in the car. SoundExchange contends that the Judges should start afresh and analyze the market as it exists today.

Response to ¶ 99. Professor Shapiro's analysis of market developments certainly should not be characterized as careful. He analyzes only three issues: the growth of streaming, the

growth of Sirius XM, and developments in upstream licensing markets. Trial Ex. 8 at §§ 8.A-C. The entire analysis comprises approximately four pages, Trial Ex. 8 at §§ 8.A-C, and is often conclusory.

For example, after acknowledging and describing the growth of streaming, its increased importance to record company revenues, and the likelihood that these trends will continue in the upcoming rate period, Professor Shapiro concludes, without any analysis whatsoever, that the "shift in record-company revenue toward streaming does not, in and of itself, warrant any change in the rate currently charged to Sirius XM under the 801(b)(1) objectives." Trial Ex. 8 at 28-29. This, as SoundExchange demonstrated in its Proposed Findings of Fact, is inaccurate. SE FOF at ¶¶ 1327-1361.

Professor Shapiro's analysis of market developments is not only cursory, but also incomplete. For example, Professor Shapiro does not consider how the growth of streaming affects opportunity cost or how subscription streaming services now compete more closely with Sirius XM, SE FOF at ¶¶ 1331-1350; *see also* Response to ¶ 103. Importantly, he also fails to consider whether each of the factual findings that undergird the *SDARS II* decision remain accurate. SE FOF at ¶¶ 1389-1406. For these and other reasons detailed in SoundExchange's Proposed Findings of Fact, Professor Shapiro's *SDARS II* analysis is unreliable and should be rejected.

i. The Prevailing Statutory Rate Is Far Too Low Because The Explosive Growth Of Streaming Has Brought Sirius XM Into Direct Competition With Subscription Streaming Services

Response to ¶ 100. No response.

Response to ¶ 101. No response.

Response to ¶ 102. The cost of maintaining and upgrading satellites over the *SDARS II* rate period is not pertinent to an analysis of whether the prevailing statutory rate is appropriate because the costs reflect a small and decreasing percentage of Sirius XM's overall revenues. *See* Response to ¶ 26; SE FOF at ¶¶ 1564-73.

Response to ¶ 103. Sirius XM furnishes no relevant and reliable evidence to support the assertion that it competes primarily with terrestrial radio for the consumers who are relevant to this proceeding — consumers who have demonstrated a substantial willingness to pay for an alternative to terrestrial radio. Sirius XM simply ignores the overwhelming evidence of direct competition between it and commercial-free subscription streaming services. Both issues are discussed below.

Nearly all of Sirius XM's evidence on the issue of competition concerns allocation of listening *time*. SXM FOF at ¶ 103. This evidence is unreliable. Sirius XM competes for subscription dollars, not for listening time. SE FOF at §§ V.J.2, VIII.G.

Even if listening time were the measure of opportunity cost (it indisputably is not, *see* SE FOF at ¶¶ 1245-1268), evidence cited by Sirius XM supports a finding that it competes directly with subscription streaming services. As an initial matter, Sirius XM is just wrong when it claims that "the only record evidence" of listening time in the car shows 3% of time devoted to webcasting services and 2% to interactive services. SXM FOF ¶ 103. In fact, *Sirius XM itself cites other record evidence*, namely, a 2015 Music Watch study, which found that [[redacted]

[redacted]]. Trial Ex. 122 at 72 (SoundX_000033362). This Music Watch study is cited by both parties and is in evidence.[16]

Sirius XM also misapprehends the relevance of its additional evidence, which refers to the fact (rather than the amount) of usage. For example, the referenced Ipsos study indicates that [redacted]], demonstrating that use of streaming services now exceeds use of Sirius XM in the car. Trial Ex. 123 at 2 (SoundX_000034822).

Similarly, Sirius XM cites a 2016 Edison "Infinite Dial" study indicating that [redacted]]. *See* SE FOF at ¶ 1357 n.138. As an initial matter, the record contains the 2017 iteration of this study, which finds that [redacted]]. This demonstrates that more and more consumers are using streaming services, and thus may be allocating their dollars to subscription streaming services, irrespective of the manner in which they allocate their time. How users would alter their spending on music in the absence of Sirius XM, is, of course, the relevant question in assessing substitution.

To that end, there is no dispute that Sirius XM subscribers have a positive and significant willingness to pay for music. 4/24/16 Tr. 670:21-671:21 (Farrell). This willingness to pay reflects that there is something about Sirius XM's service that subscribers prefer to terrestrial radio, or something about terrestrial radio that repels them. 4/24/16 Tr. 670:21-671:21 (Farrell). This alone suggests that terrestrial radio is not Sirius XM's main competitor for those consumers who are willing to pay for access to a high-quality music service.

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[16] Sirius XM's main source of this data, the "Share of Ear" study, is not in evidence. This matters because there is no evidence that the "Share of Ear" survey is reliable, nor has any Sirius XM witness explained in any detail the methodology used to conduct it. SE FOF at ¶ 1354.

There is also ample expert testimony indicating that Sirius XM substitutes for subscription streaming services. SE FOF at §§ V.J.1-3. Professor Dhar's survey demonstrates that 31% of Sirius XM Select subscribers who would cancel their subscription due to a price increase would switch to a subscription fully interactive service while 14% would switch to a subscription not fully interactive service. SE FOF at ¶ 585 & n.44. Professor Simonson's survey shows that if Sirius XM subscribers were deprived of their satellite radio subscription, 31% of them would choose a subscription fully interactive service and 33% would choose a subscription not fully interactive service. SE FOF at ¶ 641. Professor Willig's econometrics analysis confirms the opportunity costs he calculated based on the survey results. SE FOF at ¶¶ 667-670.

There is additional evidence confirming that Sirius XM has over the *SDARS II* rate period come to compete more closely with subscription services. For example, Sirius XM admits that its subscribers place significant value on commercial free music. *See supra* Response to ¶ 3. In light of the growth of streaming in the car — which Professor Shapiro acknowledges and is discussed at length in SoundExchange's Response to ¶ 22 above — consumers now can access subscription services that also offer a commercial-free experience, along with the depth and breadth of music content that distinguishes Sirius XM from terrestrial radio. SE FOF at ¶ 686.

The record also supports a finding that consumers with increased access to streaming in the car are now more likely to use interactive services because of the shift towards use of playlists. Whereas service-curated playlists on Spotify accounted for no more than [▇] percent of plays in 2014,[17] they accounted for as much as [▇] percent of plays in 2016. SE FOF at ¶ 379. More broadly, [▇] percent of plays on Spotify's fully interactive service and [▇] percent

[17] This figure is not limited to service-curated playlists, but also includes playlists created by third parties and record companies. SE FOF at ¶ 379.

of plays on Apple's fully interactive service now come from user, service, and third-party playlists. Trial Ex. 32 at ¶ 28 (Harrison WDT). And whether playlists are created by a user, a service, or a third party, the point is the same: subscribers can simply start the playlist and focus on driving. Indeed, at trial, Mr. Meyer conceded that he was concerned about competition from interactive services because of this functionality. 5/15/17 Tr. 3735:1-10 (Meyer).

Moreover, although Sirius XM wants to position terrestrial radio as its only significant source of competition for purposes of this proceeding, it has told the Courts, the SEC, and its investors that it competes directly with streaming services. *See, e.g.*, Trial Ex. 357 at 6; SE FOF at ¶¶ 677-679. The expert testimony and additional evidence confirm that Sirius XM now competes closely with subscription streaming services for users with a positive willingness to pay.

Response to ¶ 104. Sirius XM cites the self-serving and conclusory testimony of Mr. Meyer to assert it competes primarily with terrestrial radio. It is telling that the quoted testimony does not contain any analysis or empirical support. Mr. Meyer resorts to argument by assertion because the record developed in this proceeding demonstrates that Sirius XM competes directly with subscription streaming services. *See* Response to ¶ 103.

To support assertions about its competitors, Sirius XM also references surveys conducted by Joe Lenski and John Hauser. However, the Lenski survey is methodologically unsound. SE FOF at ¶¶ 1245-1317. In any event, it has no probative value on the issue of competition because it focuses entirely on how consumers allocate their time instead of their dollars. SE FOF at ¶ 1254. Sirius XM's reliance on Professor Hauser's survey is similarly misplaced. Professor Hauser's surveys are methodologically unsound. SE FOF at ¶¶ 614-621, 634, 808-813. In fact,

Professor Hauser conceded unequivocally that he does not hold out his own surveys as reliable, representative of the marketplace, or scientifically valid. SE FOF at ¶ 633.

Response to ¶ 105. Sirius XM's reference to Professor Simonson's study is incomplete. The survey establishes that if Sirius XM subscribers did not have their satellite radio subscription, 31% would choose a subscription fully interactive service and 33% would choose a subscription not fully interactive service, SE FOF at ¶ 640, definitively showing that Sirius XM competes with paid streaming services, even if many customers would also use terrestrial radio in the car.

Response to ¶ 106. The marketplace in which Sirius XM competes for subscribers has changed dramatically since *SDARS II*. The availability of subscription streaming services in the car has increased dramatically,[18] *see* Response to ¶ 22, and these services compete directly with Sirius XM. *See supra* Response to ¶ 103. Sirius XM's casual assertion to the contrary has no merit.

Sirius XM's assertion in Paragraph 106 of how little the market will change over the coming license period is contradicted by the record evidence and its own admissions. Research and analysis prepared for Sirius XM demonstrate that automotive companies have begun to integrate streaming services into the dashboard and that this trend will continue over the coming licensing period, culminating in near universal adoption by 2020. Trial Ex. 352 at 11 (SXM_DIR_00100576). [[redacted]]. 5/15/17 Tr. 3774:4-22 (Meyer). [[redacted]

[18] Sirius XM's focus on the car is too narrow. If, in the absence of Sirius XM, a consumer reallocates money to a subscription streaming service, that contributes to the opportunity cost of licensing Sirius XM, whether or not the consumer listens to their subscription streaming service in the car. Trial Ex. 46 at ¶ 52.

[redacted]]. 5/15/17 Tr. 3782:16-23 (Meyer); Trial Ex. 1 at ¶ 29.

Growing adoption of dashboard technology that is already making streaming more accessible in the car is important: other research prepared for and relied on by Sirius XM indicates that "streaming is perceived positively as an in-vehicle audio entertainment source," particularly among consumers who reject Sirius XM's service. Trial Ex. 242 at 152 (SXM_DIR_00027572). Because subscription streaming services will during this licensing period become fully integrated into the dashboard and even easier to use, they will compete even more closely with Sirius XM's satellite radio service. Indeed, Sirius XM admits that streaming will become more prevalent. At trial, Mr. Meyer agreed that streaming through mobile phones in the car is increasing and that growth would accelerate as a result of millennials. 5/15/17 Tr. 3798:4-7 (Meyer).

The increased and increasing use of playlists on interactive services will also heighten competition between subscription interactive services and satellite radio during the coming rate period. *See* Response to ¶ 20. In fact, at trial Mr. Meyer admitted that he was concerned about competition from interactive services offering playlists that are easy to use in the car. 5/15/17 Tr. 3735:1-10 (Meyer).

In sum, overwhelming record evidence indicates that Sirius XM's commercial-free satellite radio service already competes with commercial-free subscription streaming services for users with a positive willingness to pay. Over the coming licensing period, subscription streaming services will become even more readily accessible in the car, generating increased competition with satellite radio. Because direct competition between Sirius XM and subscription

services has and will continue to increase — and because subscription services generate significantly more per-subscriber royalties than Sirius XM, Trial Ex. 32 at ¶ 26 (Harrison WDT); Trial Ex. 50 at ¶ 6 (Walker WRT) — the opportunity cost of licensing Sirius XM has risen and the prevailing statutory rate is far too low.

Response to ¶ 107. Sirius XM furnishes no support for a finding that its historical and any future investments in technical infrastructure justify any adjustment to the currently applicable rate. As discussed above, Sirius XM's historical costs are in no way relevant to this proceeding. *See* Response to ¶¶ 16, 26. Similarly, any costs that Sirius XM may incur in the upcoming license period will represent a small and diminishing percentage of its overall revenues. *See* Response to ¶ 26. To the extent Sirius XM would be permitted to save on royalties because of its costs, those savings would be used to buy back stock and pay dividends.[19] *See* Response to ¶ 26; SE FOF at ¶¶ 1564-73. And Sirius XM's costs are no greater than those incurred by music services that do not rely on satellites, like Pandora. *See* Response to ¶ 1569.

In any event, Sirius XM makes no showing that its costs represent, on a relative basis, a more significant proportion of its revenue than did costs during the *SDARS II* licensing period. *See* SXM FOF at ¶¶ 100-119. Moreover, Sirius XM performs absolutely no meaningful analysis of record company costs, the extent to which they have or will change, and the extent to which they outweigh Sirius XM's expected contributions. *See infra* Response to ¶ 127; *see also* SXM

[19] Relying on Ms. Neville's written testimony, Sirius XM initially estimated it would spend [[redacted]] to replace certain satellites during the upcoming rate period. Trial Ex. 2 at ¶ 20. However, at trial, Ms. Neville offered a revised and reliable estimate, indicating that costs could fall to [[redacted]] million. *See* Response to ¶ 37. During her oral testimony, Ms. Neville also indicated that Sirius XM expects to execute contracts for additional satellites during the upcoming rate period. *See* SXM FOF at ¶ 107. However, Ms. Neville supplied no cost estimates and her testimony is, in any event, speculative. Accordingly, Sirius XM supplies no reliable support for a finding regarding additional satellite costs.

FOF at ¶¶ 100-119. Accordingly, Sirius XM's capital investments, of no value without music content, do not justify any downward adjustment to the existing statutory rate.

Response to ¶ 108. For reasons discussed above, any costs of deploying a national Internet-fed repeater network do not support adjusting the prevailing statutory rate. *See supra* Response to ¶ 107. Moreover, these costs are highly speculative. Ms. Neville, Sirius XM's Vice President in charge of its satellites, testified at trial that she did not know how many Internet-fed repeater sites will actually be required. 5/11/17 Tr. 3665:5-7 (Neville). She also explained that Sirius XM is "very much hoping that we can come up with a solution . . . with a much smaller deployment scale." 5/11/17 Tr. 3666:12-16 (Neville). Ms. Neville indicated that she was "not sure yet" whether "these Internet-fed repeaters [would] replace any of the existing repeaters," and described this question as "the big gray area." 5/11/17 Tr. 3666:18-23, 3667:25-3668:1 (Neville). And Ms. Neville agreed that, broadly speaking, "there are a lot of open questions here relating to Sirius XM's Internet-fed repeater network." 5/11/17 Tr. 3670:6-9 (Neville). Such highly speculative costs should have no bearing on the rate calculations in this case.

Response to ¶ 109. For reasons discussed above, any costs Sirius XM incurs related to adding new terrestrial repeaters do not support adjusting the prevailing statutory rate. *See supra* Response to ¶ 107. In any event, such costs are merely a function of its choice of business model. As Ms. Neville agreed, "using satellites is just a choice that Sirius XM made." 5/11/17 Tr. 3676:14-16 (Neville). These costs should not figure in any assessment of the appropriate rate for the upcoming licensing period.

Response to ¶ 110. Sirius XM raises the cost of extending "subsidies and revenue-shares to automakers to put Sirius XM chipsets into their vehicles." SXM FOF at ¶ 110. For reasons discussed above, these costs do not support adjusting the prevailing statutory rate. *See*

supra Response to ¶ 107. In any event, these costs reflect strategic decisions that Sirius XM has made to further its business interests and should not be borne by copyright owners and artists.

Response to ¶ 111. Broadly speaking, Professor Shapiro's cursory analysis of the relative contribution factor is unreliable and should be disregarded. *See* SE FOF at ¶¶ 1554-1583. And Professor Shapiro's assertion that the costs Sirius XM may incur during the upcoming licensing period justify a reduction in the prevailing rates does not withstand scrutiny, for several reasons.

First, Professor Shapiro fails to recognize that the costs associated with Sirius XM's distribution platform now represent a very small and still diminishing percentage of Sirius XM's revenues. SE FOF at ¶¶ 1401-1403. The costs Sirius XM identifies pale in comparison to its 2016 EBITDA, which totaled $1.9 billion; free cash flow, which totaled $1.5 billion; or net income, which totaled $746 million. Trial Ex. 42 at ¶ 229 (Lys WRT). Indeed, Mr. Meyer confirmed at trial Sirius XM projects *revenue of around* [[redacted]] for the coming rate period. 5/15/17 Tr. 3794:11-22 (Meyer). And Sirius XM's anticipated costs are especially irrelevant given that the company will [[redacted]]. Trial Ex. 663 (native file) (tab "Consolidated Outputs," cells HO214, HP214).

Second, Professor Shapiro fails to offer any empirical evidence that, on a relative basis, the costs it will incur during the coming licensing period represent a more significant proportion of revenue than did its costs during the *SDARS II* licensing period.

Third, Professor Shapiro fails to conduct any meaningful assessment of record company investments. After looking at two record company documents, and assessing a single category of costs in each, Professor Shapiro concludes that record company investments are constant across rate periods and moves on. Trial Ex. 8 at 33 n.45. This is woefully inadequate, particularly

given that one of the documents does not contain any information about planned spending in fiscal years 2018-2022. Trial Ex. 8 at 33 n.45. As demonstrated in SoundExchange's Proposed Findings of Fact, record companies make significant outlays on talent acquisition, on marketing, on promotion, and on distribution. SE FOF at ¶¶ 1557-1563. Professor Shapiro's failure to conduct any meaningful empirical analysis of whether record company investments will grow in the coming licensing period, in absolute terms or relative to the *SDARS II* licensing period, renders his analysis incomplete and unreliable.

Response to ¶ 112. Sirius XM's assertion that investments generating increased subscribership constitute a "change" in the marketplace has no merit. As an initial matter, Sirius XM does not explain why or how investments made during the *SDARS II* rate period should affect adjustment of the prevailing statutory rate. The Judges weighed Sirius XM's relative contribution in determining the *SDARS II* statutory rate and Sirius XM offers no basis for crediting any investments for a second time.

In any event, Sirius XM's emphasis on investments that increase subscribership is misplaced for two additional reasons. First, Sirius XM has acknowledged that its network has no value without content. SE FOF ¶¶ 261-262. Insofar as Sirius XM's investments result in an offering that is more highly valued by consumers, that value will be reflected in the service's price and demand, generating benefits for the service and for content owners and artists. SE FOF ¶ 263. Second, Sirius XM fails to consider record company investments made during the *SDARS II* rate period. Its analysis is therefore incomplete and unreliable.

Response to ¶ 113. Sirius XM attributes its increased revenue and its financial health to subscriber growth. However, Sirius XM omits several key factors that have contributed to dramatic growth in its revenues and profitability, namely, its ability to leverage valuable music

content at royalty rates [[redacted]], *see, e.g.*, Trial Ex. 32 at ¶ 26 (Harrison WDT); Trial Ex. 50 at ¶ 6 (Walker WRT), its ability to offer music content without providing any of the valuable non-monetary benefits that record companies ordinarily secure from streaming services, SE FOF at ¶¶ 570-575, and its ability to offer music content at statutory rates adjusted to reflect Sirius XM's past claims of poverty, SE FOF at ¶¶ 1598-1606, among others.

Sirius XM's assertion that its "overall financial health has improved" is also a dramatic understatement. After significant financial growth in the years spanning 2009 to 2015, SE FOF ¶¶ 1503-1530, Sirius XM is easily able to fund its CapEX needs. SE FOF ¶ 1530. And in 2016, Sirius XM set records for subscribers, revenue, adjusted EBITDA, and free cash flow, beating its guidance in all those metrics. SE FOF at ¶ 1532. Its 2016 revenue grew by 10% compared to 2015, topping $5 billion, its EBIDTA grew by 13% to $1.9 billion, its free cash flow per share grew 26% to $.30, and its net income grew a staggering 46% to $746 million. SE FOF at ¶ 1534. These trends will continue during the coming rate period. SE FOF at ¶¶ 1539-1552. Under Section 801(b)(1)(B), this exceptional financial performance supports a substantial increase in the prevailing statutory rate. SE FOF at ¶ 1503.

Response to ¶ 114. Sirius XM has experienced unparalleled financial success since *SDARS II*, beating its forecasted guidance for four years running, setting records for revenue, adjusted EBITDA, and free cash flow, and dwarfing the profits of companies that it considers its primary competition. SE FOF at ¶¶ 1501, 1532, 1534, 1537.

At trial, Judge Strickler asked whether Sirius XM's increased profits provide a larger surplus to be divided between Sirius XM and the record companies. 4/19/17 Tr. 217:20-218:8. The answer is yes: in an unregulated market, labels would negotiate for a portion of the increased

surplus, which would manifest in a higher royalty rate. SE FOF at ¶¶ 1376-1377. Sirius XM offers no principled response on this point, instead insisting that the Judges abandon any attempt to model actual market negotiations, *see* Response to ¶ 116, and ignore the Section 801(b)(1)(B) factor requiring fair income and fair return.[20] SE FOF at § X.B.2.

Response to ¶ 115. As Professor Lys demonstrated, Sirius XM's financial performance supports a substantial increase in the prevailing royalty rate. *See* SE FOF at ¶¶ 1337, 1465-1467, 1492-1552. The theoretical and empirical evidence that Sirius XM references here, and elaborates below, is incomplete, unreliable, and does not in any way undermine the conclusion that Sirius XM's tremendous profits counsel in favor of raising the prevailing statutory rate. *See* Response to ¶¶ 116, 118.

Response to ¶ 116. Professor Shapiro's assertion that profitability would not affect the outcome of an arms-length negotiation is based on a flawed theoretical analysis. Professor Shapiro argues that contribution margin is the key financial metric that drives the rate that would be negotiated between record companies and Sirius XM under conditions of workable competition. But as explained in SoundExchange's Proposed Findings of Fact, Professor Shapiro's analysis is based on an unfounded and erroneous assumption in his modeling, which fails to describe the general conditions under which a record label would bargain with Sirius XM free of regulatory overhang. SE FOF at ¶ 1364. SoundExchange explained this error in detail in its Proposed Findings of Fact. SE FOF at ¶¶ 1363-76.

Once Professor Shapiro's model is corrected, it is clear that when a larger surplus exists, Sirius and the record companies would negotiate over how to apportion it. SE FOF ¶¶ 1374-

[20] In this regard, Sirius XM's citation to an increase in royalty payments over the *SDARS II* licensing period is misdirection. No Participant disputes that royalty payments should rise as revenues increase. But Sirius XM elides the critical question: by what amount royalty payments should rise.

1376. In other words, when arms-length negotiations are properly modeled, it is clear that Sirius XM can and would pay higher royalties as a result of its increased profits. SE FOF at ¶ 1374. This is consistent with fair market outcomes and with Section 801(b)(1)(B), which contemplates a fair share of additional returns. *See* SE FOF at § X.B.2.

Response to ¶ 117. The testimony that Professor Lys offered in *Web IV* is entirely consistent with his testimony in this proceeding. Sirius XM's attempt to show otherwise is disingenuous and relies, expediently, on sheering quotes from context.

[[redacted]]. 5/01/17 Tr. 1679:6-11 (Lys). Summarizing his conclusions in *Web IV*, Professor Lys stated:

> [[redacted]].

5/01/17 Tr. 1678:5-16 (Lys) (emphasis added). [[redacted]]. 5/01/17 Tr. 1679:6-11 (Lys).

In this proceeding, Professor Lys again concluded that profitability matters. [[redacted]]. 5/01/17 Tr. 1679:1-5 (Lys). In this approach, there is nothing remotely inconsistent.

Response to ¶ 118. In support of his misguided assertion that profitability does not and should not affect appropriate royalty rates, Professor Shapiro also offers empirical analysis. This analysis is also flawed for several reasons.

First, Professor Shapiro's data is incomplete. Professor Shapiro excludes payments made to Howard Stern on the basis that Stern's content has been offered exclusively by Sirius XM throughout the period of analysis. But Professor Shapiro never explains why this exclusivity matters, and never explains why there is a meaningful distinction between Mr. Stern's content and semi- or quasi-exclusive content. SE FOF at ¶¶ 1380-1382.

Second, Professor Shapiro's analysis fails to consider [[redacted]]. SE FOF at ¶ 1383.

Finally, Professor Shapiro failed to consider the reasons why certain non-music costs may have decreased, namely, the cost savings achieved as a result of the merger of Sirius and XM. At trial, Professor Shapiro conceded that "some or perhaps a lot of the decline shown from 2009 to 2013 may be attributable to the Sirius XM merger." 5/3/17 Tr. 2484:18-24 (Shapiro).

Response to ¶ 119. Since *SDARS II*, there have been significant changes in the competitive landscape for distribution of music content and significant changes in Sirius XM's financial performance. Over that period, Sirius XM has come into closer competition with subscription streaming services, a trend that will continue over the coming licensing period. *See*

supra Response to ¶¶ 103, 106. And Sirius XM has, since *SDARS II*, experienced tremendous financial growth culminating in record profitability. *See supra* Response to ¶ 113. Both changes support a substantial increase in the prevailing statutory rate. *See* SE FOF at ¶¶ 1327-1361, 1362-1385.

By contrast, Sirius XM's supposed need to increase investments in its satellite system do not support any adjustment to the currently applicable rate. As discussed above, these costs now present a smaller and diminishing percentage of Sirius XM's revenue. *See* Response to ¶ 26; SE FOF at ¶¶ 1564-73. Moreover, Sirius XM has not shown that, on a relative basis, the costs it will incur during the coming licensing period represent a more significant proportion of its revenue than did costs during the SDARS II licensing period. *See* SXM FOF at ¶¶ 100-119. Finally, Sirius XM performs absolutely no meaningful analysis of record company costs, the extent to which they have or will change, and the extent to which they outweigh Sirius XM's expected contributions. *See infra* Response to ¶ 127; *see also* SXM FOF at ¶¶ 100-119. Accordingly, Sirius XM's capital investments, of no value without music content, do not justify any downward adjustment to the existing statutory rate.

Response to ¶ 120. Marketplace developments since the *SDARS II* decision support a substantial increase in Sirius XM's royalty payments, and Professor Shapiro's cursory analysis does not undermine that conclusion. SE FOF at ¶¶ 1326-1361; *see also* Response to ¶ 103.

Response to ¶ 121. As Sirius XM acknowledges, the share of record company revenues attributable to streaming services has risen considerably over the *SDARS II* rate period. SXM FOF at ¶ 121.

Sirius XM aggregates growth in revenues attributable to subscription and ad-supported streaming to conceal an important fact: paid streaming models are growing at a much faster pace

than ad-supported models. [[redacted]].[21] Trial Ex. 8 at 28 & Fig. 5. [[redacted]]. Trial Ex. 8 at 28 & Fig. 5.

Response to ¶ 122. Sirius XM's observation that record company gross revenues remained stable from 2012 to 2015 has no relevance in assessing whether marketplace changes since *SDARS II* support an adjustment to the prevailing statutory rate. As Professor Willig explained in his rebuttal testimony, this is so for three reasons.

First, gross revenues are not the pertinent measure of compensation to record companies. To the contrary, the pertinent measure is returns. Trial Ex. 46 at ¶ 67 (Willig WRT).

Second, examining compensation using a simple time trend is not the appropriate methodological approach for measuring the effect of shifts in how music is consumed. This is because the change in compensation can, and almost inevitably will, be affected by changes in factors other than the shift in distribution mix, such as macroeconomic trends. As a result, the correct approach is to examine the actual value of creator compensation in 2016 relative to the value that would have been generated in 2016 but for the shift in means for consuming music. Trial Ex. 46 at ¶ 67 (Willig WRT).

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[21] Because Professor Shapiro's data was collected after the first half of 2016, he relied on projected revenues for the second half of 2016 to provide full-year figures. Trial Ex. 8 at 28 & Fig. 5. Using the same data source, Professor Blackburn updated Professor Shapiro's analysis at trial. As it turns out, subscription and on-demand services comprised 40% of record company revenues in 2016. In other words, growth in the second half of 2016 outpaced that projected in Professor Shapiro's data, and the growth of streaming continued at a pace faster than expected. 5/01/17 Tr. 1713:13-17.

Third, in examining trends it is important to pick the correct baseline. Because Professor Shapiro's data may not capture how the market has evolved for the entire period following the collection, submission, and review of data in *SDARS II*, that data does not constitute the appropriate baseline.[22] Trial Ex. 46 at ¶ 67 (Willig WRT).

Significantly, Professor Willig makes none of these mistakes in analyzing how the explosive growth of streaming has affected creator compensation. *See* SE FOF at § V.K.4.i.b.

Response to ¶ 123. Sirius XM recognizes that the explosive growth of paid subscription streaming since *SDARS II* supports an adjustment to the prevailing statutory rate if such growth has affected the opportunity cost of licensing Sirius XM. Substantial evidence supports a finding that the use of paid subscription streaming services has increased since the *SDARS II* decision, and that this phenomenon has increased the opportunity cost of licensing Sirius XM. *See infra* Response to ¶ 124. As a result, the currently applicable statutory rate should rise.

Response to ¶ 124. The record developed in this proceeding contains overwhelming evidence that the opportunity cost of licensing Sirius XM has increased materially since *SDARS II*. *See, e.g.*, SE FOF at ¶¶ 1329-1361. Rather than acknowledge and confront this evidence, Sirius XM simply claims it does not exist. This claim is specious.

As Professor Shapiro correctly notes, streaming services have achieved substantially greater consumer acceptance relative to 2012, when *SDARS II* was decided. Professor Willig quantified the growth associated with this trend, analyzing changes in the volume of distribution by compensatory mode by month. [[redacted]

[22] That record company revenues may rise between 2017 and 2020 is irrelevant for the same reasons. Additionally, Sirius XM does not explain how these projected revenues could be relevant to an assessment of what has changed between the *SDARS II* decision and this ratemaking proceeding.

[23] Professor Willig ran his analysis from 2010 to 2016 to ensure that he captured growth that occurred after the Participants collected evidence for *SDARS II*. Trial Ex. 46 at ¶ 67.

[redacted]. Trial Ex. 28 at Table 1 (Willig WDT). [redacted]. Trial Ex. 28 at Table 1 (Willig WDT). Significantly, Sirius XM does not dispute this analysis, which is depicted visually and more granularly in Figure 2 to Professor Willig's Written Direct testimony.[24]

The record contains additional empirical information that corroborates the extraordinary growth of streaming services. For example, research prepared for and introduced by Sirius XM in this proceeding indicates that, in 2014, 26% of cell phone owners had streamed online radio in a car by connecting their cell phone to the car's audio system. Trial Ex. 664 at 10 (SXM_DIR_025533). When the same study was conducted in January and February of 2017, that figure had already risen to 40%. Trial Ex. 294 at 19 (SoundX_000488945). Moreover, the 2017 study indicates that the number of cell phone owners in the United States had by that time risen to 226 million people. Trial Ex. 294 at 5 (SoundX_000488931). This suggests that *over 90 million consumers* had by February 2017 used their cellphone to listen to internet radio in the car.[25]

Professor Shapiro acknowledges that this growth has had a significant effect on record company revenues. SE FOF at ¶ 287. Based on Professor Shapiro's data, revenue from subscription streaming services has grown from 8 percent of record label revenue to 40 percent of record label revenue since 2012. SE FOF at ¶ 287.

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[24] The data underlying Professor Willig's calculation, and the methodology used to perform it, are presented in Appendix A to Professor Willig's WDT.

[25] This growth is unsurprising. As previously discussed, streaming services are now available nationwide, commercial-free, with seamless coverage, *see, e.g.*, SE FOF ¶¶ 156-158. And streaming services are increasingly available in the dashboard as well. Trial Ex. 352 at 11 (SXM_DIR_00100576); *cf.* Trial Ex. 664 at 31. (SXM_DIR_02554) (indicating that, in 2013, only [redacted] of cars had in-dash information and entertainment systems).

The growth of subscription streaming services since the *SDARS II* decision has also increased the opportunity cost of licensing Sirius XM because subscription streaming services generate significantly more per-user revenue than does Sirius XM, SE FOF at ¶ 1332, and because Sirius XM competes directly with subscription services for consumers who have positive willingness to pay (*e.g.*, consumers interested in a commercial-free experience). *See, e.g.*, SE FOF at ¶¶ 1332-1340.

Sirius XM has long recognized that it competes with streaming services. SE FOF at ¶ 1336. For example, in its 2013 Form 10-K, Sirius XM stated that internet radio services were already competing directly with Sirius XM. Trial Ex. 353 at 5. But Sirius XM also recognized that internet radio services and smartphone applications might become more integrated into the car in the future and were also likely to become an increasingly significant competitor as a result of other technological developments, including improvements from higher bandwidth mobile networks. As discussed above, the projected increase in competition has come to pass. And Sirius XM has recognized it in subsequent public statements. In its 2014 Form 10-K, the company stated that services like Spotify and Pandora were "increasingly becoming integrated into vehicles." Trial Ex. 354 at 5. By 2015, Sirius XM represented that the same services now "are easily integrated into vehicles." Trial Ex. 356 at 6.

In sum, there is substantial record evidence to support a finding that streaming services generally, and subscription streaming services specifically, have experienced explosive growth since the *SDARS II* decision. Based on the record developed in this proceeding, it is also clear subscription streaming services generate much larger per-subscriber royalties than does Sirius XM, and that Sirius XM substitutes for those services. In light of this evidence, it is plain that

the opportunity cost of Sirius XM has increased substantially over the course of the *SDARS II* rate period.

Response to ¶ 125. Substantial record evidence establishes that the opportunity cost of licensing Sirius XM has risen since the *SDARS II* decision. *See* Response to ¶ 124. Sirius XM's blithe assertion about the complete absence of record evidence on this issue should be disregarded.

So should Sirius XM's attacks on Professor Willig. SoundExchange has already demonstrated that the opportunity cost of licensing Sirius XM is properly calculated on an industry-wide basis. SE FOF at ¶¶ 496-536. And Sirius XM improperly faults Professor Willig for calculating the existing opportunity cost of licensing Sirius XM. Unlike Sirius XM, Professor Willig set out to analyze the rate recommended by *current marketplace data*. SE FOF at ¶¶ 470-485. This is what the law and sound economics require, *see, e.g.*, SE FOF at §§ IX.A-C, and Sirius XM has made no effort to calculate the opportunity cost of licensing its satellite radio service today, or historically.

Response to ¶ 126. Sirius XM acknowledges that assessing the extent to which the opportunity cost of licensing Sirius XM has changed since *SDARS II* requires assessing the extent to which Sirius XM competes with other modes of distribution. As discussed above, Sirius XM competes directly against subscription streaming services, and that competition has intensified over the *SDARS II* rate period. *See, e.g.*, Response to ¶¶ 21-25, 103. Accordingly, an increase in the prevailing statutory rate is necessary to reflect the increased opportunity cost of licensing Sirius XM.

In Paragraph 126, Sirius XM offers no new or reliable evidence to support its claim. The testimony that it cites offers no empirical analysis.[26] SXM FOF at ¶ 126. The survey that Sirius XM cites is unreliable for several reasons, most notably because it focuses on allocation of time rather than dollars, and thus says nothing about substitution patterns. Response to ¶ 103; *see also* SE FOF at ¶¶ 1351-1359.

Response to ¶ 127. Professor Shapiro fails to conduct any meaningful assessment of record company investments. After looking at two record company documents, and assessing a single category of costs in each, Professor Shapiro concludes that record company investments are constant across rate periods and moves on. Trial Ex. 8 at 33 & n.45. This is woefully inadequate, particularly given that one of the documents does not contain any information about spending in the fiscal years 2018-2022. Trial Ex. 8 at 33 n.45. As demonstrated in SoundExchange's Proposed Findings of Fact, record companies make significant outlays on talent acquisition, on marketing, on promotion, and on distribution. SE FOF at ¶¶ 1557-1563.

ii. Changes In The Upstream Markets In Which Record Labels License Music Services Support An Upward Adjustment To The Prevailing Statutory Rate

Response to ¶ 128. No response.

Response to ¶ 129. Sirius XM's campaign to execute direct licenses does not support any downward adjustment to the statutory rate for several reasons, discussed in SoundExchange's Proposed Findings of Fact and Conclusions of Law and below. SE FOF at § VII; Response to ¶¶ 136-188.

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[26] Mr. Meyer's assertion that streaming has not been popular in the car is belied by substantial record evidence. *See, e.g.*, SE FOF at ¶¶ 156-158; Response to ¶ 22.

First of all, there has been no change since *SDARS II* (or for that matter, *SDARS I*) in Sirius XM's technical ability to steer. Unlike Pandora at the time of *Web IV (see Web IV,* 81 FR 26367 n. 140*)*, it cannot be said that the ability to steer is a new development for Sirius XM. Of course, having the ability to steer does not mean that a service has the financial incentive to steer, and as we point out elsewhere (*see* SE FOF at ¶¶ 957-1011), Sirius XM does not have that incentive and has not in fact engaged in any steering. In this regard, there has been no change since *SDARS II*.

In any event, Sirius XM's direct licenses do not support any downward adjustment because Professor Shapiro concedes that he "cannot quantify the value of steering." 4/20/17 Tr. 448:20-21 (Shapiro). Nor has Professor Shapiro reviewed or produced any quantitative evidence that rate discounts in Sirius XM's direct licenses are attributable to steering. 4/20/17 Tr. 450:13-17 (Shapiro). Indeed, when Judge Strickler asked Professor Shapiro how, if he could not quantify the value of steering, he knew the value of steering was not zero, Professor Shapiro was unable to respond with any quantitative or empirical evidence. 4/20/17 Tr. 449:9-21 (Shapiro).

Response to ¶ 130. With respect to changes in the upstream market for non-interactive webcasters, Sirius XM ostensibly directs the Judges and SoundExchange to Professor Shapiro's *Web IV* benchmark, which is unreliable and should be disregarded for several reasons discussed in SoundExchange's Proposed Findings of Fact and Conclusions of Law, and below. SE FOF at § VIII; Response to ¶¶ 189-248.

Response to ¶ 131. With respect to its *SDARS II* benchmark, Sirius XM fails to address critical developments in the market for fully interactive services. To elide material changes in the market, each of which support a substantial upward adjustment to the prevailing statutory rate, Sirius focuses on two narrow and misleading observations.

First, Sirius XM asserts that effective rates paid by subscription interactive services have been stable since *Web IV*. Importantly, Sirius XM says absolutely nothing about developments since *SDARS II*. This is unsurprising. As discussed in SoundExchange's Proposed Findings of Fact, the *SDARS II* rates are based in large part on data from the market for interactive services that is now a decade old. SE FOF at ¶¶ 1323-1325. Since that data was presented to the Judges, in *SDARS I*, the digital distribution of sound recordings has undergone rapid and material changes along numerous dimensions, including the terms of royalty compensation found in license agreements, how consumers allocate their spending across distribution channels, the entry and exit of services, and consumer prices. SE FOF at ¶ 1325. These developments are highly relevant to assessing whether the prevailing statutory rate is appropriate, and counsel strongly in favor of examining current marketplace data.[27] SE FOF at ¶¶ 1323-1325. Professor Shapiro fails to address any of them when analyzing how changes in the market for interactive services should affect the prevailing statutory rate, and offers no defensible explanation for choosing to rely on stale and increasingly outdated market information.

Next, Sirius XM offers observations about tit-for-tat price competition between record companies. SXM FOF at ¶ 131. Sirius XM's insistence that tit-for-tat price competition is a necessary rather than sufficient condition for workably competitive markets finds no support in the record. Response to ¶ 275. And because Sirius XM is focused on price competition between

[27] As discussed in SoundExchange's Proposed Findings of Fact, the market for interactive services has also changed in other important ways since *SDARS II*. For example, the market is now mature and comprised of large and financially stable companies. SE FOF at ¶¶ 1391-1395. Moreover, it is now clear that [ ]. SE FOF at ¶¶ 1396-1400. For these reasons, it is critical that the Judges reexamine agreements to license interactive services, rather than relying on the decade-old data that underlies the *SDARS II* rate.

record labels, it ignores substantial evidence, not presented in *Web IV*, demonstrating that the market for interactive services has been and remains effectively competitive. Response to ¶ 275.

First, Sirius XM ignores evidence that interactive services are not price takers, and in fact elicit [[redacted]]. Responses to ¶ 275; SE FOF at ¶¶ 300-302, 325-327. Second, Sirius XM ignores recent evidence of price competition — [[redacted]] — in recent agreements for interactive and mid-tier deals. Response to ¶ 275. Third, Sirius XM ignores market evidence that record companies are not able to obtain supra-competitive rates, and will be even less able to do so when they renegotiate existing agreements to license interactive services. Response to ¶ 278, SE FOF at ¶¶ 307-322. Finally, Sirius XM ignores evidence that [[redacted]]. Response to ¶ 275. This [[redacted]] is consistent with the operation of an effectively competitive market and underscores the error of adopting Sirius XM's narrowing focus on tit-for-tat price competition.

For all of these reasons, Sirius XM's analysis of how developments in the market for interactive services affect the prevailing statutory rates is incomplete and unreliable, and the *SDARS II* benchmark should be disregarded.

Response to ¶ 132. Sirius XM's selective quotation of Mr. Harrison's trial testimony is misleading. In the portion of Mr. Harrison's response that Sirius XM omitted from its findings, Mr. Harrison indicated that UMG [[redacted]]

[redacted]]. 5/16/17 Tr. 3939:16-17 (Harrison). In the very same response, he further testified that:

> [redacted]
> [redacted]
> [redacted]]. 5/16/17 Tr. 3939:16-3940:18 (Harrison).

Sirius XM also omits other relevant testimony, including portions of Mr. Harrison's response to other cited material. For example, asked whether Sirius XM engages in price competition with other labels when negotiating with interactive services, Mr. Harrison indicated that [redacted]]. 5/16/17 Tr. 4034:17-23 (Harrison); *see also* 5/16/17 Tr. 4029:20-21 (Harrison) (emphasizing that UMG [redacted]]).

In sum, Mr. Harrison made clear that tit-for-tat price competition with other record companies, while feasible in the sales context, is not feasible in the market for subscription interactive services. Importantly, Mr. Harrison clarified that other price competition in the

market for fully interactive services may occur, noting that [[redacted]]. 5/16/17 Tr. 4035:8-4036:4 (Harrison).

Response to ¶ 133. At trial, Mr. Walker confirmed that Sony [[redacted]], further illustrating that Sirius XM's misguided focus on direct tit-for-tat price competition provides an incomplete view of competitive dynamics in the market for interactive services. 5/15/17 Tr. 3836:12-14 (Walker).

Response to ¶ 134. With respect to its *SDARS II* benchmark, Sirius XM elides critical developments in the market for fully interactive services. It does this by adopting a substantive and temporal focus that is narrow and misleading. *See* Response to ¶ 131. The proper question is how the interactive services market has changed since submission of the marketplace data that underlies the prevailing statutory rate. *See* Response to ¶ 131. During the decade that has passed, the market for interactive services has undergone rapid and material changes along numerous dimensions, including the terms of royalty compensation found in license agreements, how consumers allocate their spending across distribution channels, the entry and exit of services, and consumer prices. *See* Response to ¶ 131. For this critical reason, and others discussed above, it is critical to examine current agreements to license interactive services, which counsel in favor of a substantial increase in the statutory rate. *See* Response to ¶ 131; SE FOF at ¶¶ 88-455.

Response to ¶ 135. The Judges should reject Sirius XM's *SDARS II* benchmark as a matter of law. SE COL at § IX.A. The Judges should also reject the *SDARS II* benchmark because Sirius XM provides no defensible explanation for ignoring current marketplace

agreements and instead beginning analysis with a rate predicated on decade-old data. SE FOF at ¶¶ 1323-1325.

If the Judges do adopt the framework outlined in the *SDARS II* benchmark, then substantial evidence supports a significant increase in the prevailing statutory rate for several reasons. For example, a significant increase in the prevailing rate is appropriate because the opportunity cost of licensing Sirius XM has increased since *SDARS II*. Response to ¶ 124, SE FOF at ¶¶ 1329-1361. A significant increase is also warranted because of the dramatic growth in Sirius XM's profitability, which expands the surplus over which parties would negotiate in market transactions and also obviates the need to reduce Sirius XM's royalty rate to account for satellite costs. Response to ¶¶ 98, 113-116. Finally, a substantial increase is warranted because of critical developments in the market for interactive services, which has changed substantially since the submission of market data underlying the prevailing statutory rate, and which has developed in ways that address concerns that the Judges expressed in *SDARS II*. Response to ¶ 131.

B. Sirius XM's Direct Licenses Do Not Offer A Reliable Benchmark

Response to ¶ 136. As discussed at length in SoundExchange's Findings of Fact, Sirius XM's direct licenses with independent record labels do not offer a reliable benchmark or justify a rate reduction. SE FOF at Section VII.

In addition, Sirius XM over-states the number of direct licenses in its benchmark. Sirius XM refers to "more than 500" independent record companies. But in its written direct case, Sirius XM claimed its benchmark included direct licenses with 498 record companies. Trial Ex. 4 at ¶ 5 (White WDT). Even the 498 figure appears to be inflated — as Professor Lys testified, the data produced by Sirius XM in discovery indicate that there may have been only [[redacted]]

"current" direct licenses at the time Sirius XM submitted its written direct case. *See* Trial Ex. 42 at ¶ 38 (Lys WRT).

In its written rebuttal case, Sirius XM vaguely suggested that it had executed more than 498 direct licenses. Its written rebuttal testimony, however, failed to specify how many more direct licenses had been executed or to identify them. Trial Ex. 12 at ¶ 10 (Frear WRT). Sirius XM also refused to subject its additional direct licenses to full discovery. Indeed, after Sirius XM's rebuttal case referred vaguely to additional direct licenses, SoundExchange moved to compel discovery related to any direct licenses in excess of the 498, arguing that if "Sirius XM is at this late stage in the proceeding unwilling to provide discovery related to direct licenses executed since the submission of direct cases, it should be foreclosed at trial from presenting testimony concerning those additional direct licenses." *See SoundExchange's Motion to Compel Sirius XM's Production of Certain Documents Directly Related to Its Written Rebuttal Statement and a Response to Interrogatory* No. 20, at 10 (Mar. 22, 2017). Having denied SoundExchange full discovery into the new direct licenses, Sirius XM should not be allowed to rely on them or to inflate the number that comprise its benchmark.

Regardless of the precise number, the direct licenses are a small sliver of SoundExchange's approximately 41,000 rights owner members; and Sirius XM artificially inflated the number of direct licenses by signing many of them with labels that receive virtually no plays on Sirius XM. SE FOF ¶¶ 923, 938. *See also generally* SE FOF at Section VII.C.

i. Background

Response to ¶ 137. Sirius XM has overstated the extent to which directly licensed tracks are part of its programming. SE FOF at ¶ 926. Sirius XM refers to the percentage of "spins" represented by directly licensed recordings, but the more meaningful figure is the percentage of

performances on the reference channels. SE FOF at ¶¶ 927-28. In fact, over a twelve month period, direct licenses accounted for only [] of performances. SE FOF at ¶ 930. Similarly, since 2013, royalties paid under direct licenses have accounted for only [] of the total royalties paid by Sirius XM for its satellite radio service. SE FOF at ¶ 921. Recent data shows that the percentage of inactive direct licenses (*i.e.*, direct licenses not generating royalties) is increasing. For example, in November 2016, [ ]. SE FOF at ¶¶ 932-33. Most of the direct licenses are therefore economically meaningless. SE FOF at ¶ 938.

Furthermore, even if spins are used to measure the direct license share, Sirius XM has overstated the total spins. Sirius XM claimed directly licensed recordings accounted for 6.4% of spins on Sirius XM. Trial Ex. 4 at ¶ 5 (White WDT). But as Professor Shapiro conceded, [] of the direct licensors he examined did not over-index, and when those labels are removed from the analysis, the total number of directly licensed plays relevant to his benchmark falls []. SE FOF at ¶ 1118.

In *SDARS II*, the Judges concluded that one of the "weaknesses" of Sirius XM's direct license benchmark was that they represented "no more than 2%-4% of the total number of works performed by Sirius XM." *SDARS II*, 78 FR at 23063 & n.28. As demonstrated by the figures above and discussed more fully in SoundExchange's Findings of Fact, the current benchmark suffers from the same infirmity. SE FOF at ¶¶ 922-23. In fact, a smaller percentage of labels accepted direct licenses in this proceeding than in *SDARS II*. SE FOF at ¶ 923.

Response to ¶ 138. Sirius XM states that the direct license royalty rates "range in virtually all cases from 7 to 9.5%." But this ignores that at least one direct license [ ]. SE FOF at ¶ 1148. Moreover, the evidence is clear that the direct license

rates have increased over time, such that the [[redacted]]. SE FOF at ¶¶ 905-06. *See also generally* SE FOF at Section VII.A.

Response to ¶ 139. The direct licenses are not representative of the sound recordings performed by Sirius XM or of the rights holders represented by SoundExchange. *See generally* SE FOF at Section VII.C. While Sirius XM cites a handful of independent labels with commercially successful recordings, the fact is that [[redacted]]. SE FOF at ¶ 941. And of course Sirius XM has not signed a direct license with any of the major labels, whose market share by distribution is over 86%. SE FOF at ¶ 521. *See SDARS II*, 78 FR at 23063-64 ("The Direct Licenses do not include any of the major record labels, whom, by virtue of the depth and breadth of their music catalogues, make up a critical portion of the sound recording market. . . . It would be difficult to imagine a successful SDARS service that did not have access to the types of recordings that the major labels possess.").

Response to ¶ 140. SoundExchange agrees with Sirius XM's finding that the direct licenses "were negotiated against the backdrop of a statutory license." However, as SoundExchange has explained, the fact that the direct licenses are tied to the statutory rate undermines their utility as a benchmark. SE FOF at Section VII.A. Furthermore, as noted in Response to ¶ 139, the fact that Sirius XM's benchmark lacks the major record labels' recordings renders it less representative of the sound recordings played by Sirius XM. Sirius XM's suggestion that the direct licenses "bake in" the parties' perceptions of the Section 801(b) factors because they were negotiated against the backdrop of the statutory license is unfounded.

Response to ¶ 141. SoundExchange agrees that the cost savings to direct licensors from avoiding the SoundExchange administrative fee had an upward impact on the effective royalty rate in the direct license contracts to 9.87%. SE FOF at ¶ 1038. However, SoundExchange disagrees that the resulting benchmark rate is 9.87%, because that adjusted rate fails to account for other non-statutory benefits. *See generally* SE FOF at Section VII.I. Even Professor Shapiro admitted that "it would be useful . . . if you could quantify more of the benefits that were associated with non-statutory benefits." 4/20/17 Tr. 447:13-18; SE FOF at ¶ 1039. However, Professor Shapiro failed to do so. Nor did Professor Shapiro consider the benefit to direct licensors of receipt of the non-featured artist share of royalties, even though George White testified that this was a benefit that Sirius XM pitched to prospective direct licensors. SE FOF at ¶ 1053.

ii. There Is No Credible Evidence That Direct Licensors Were Motivated By Steering

Response to ¶ 142. Sirius XM states that if record companies entered into direct licenses at rates below the statutory rate "at least in part with the expectation that such marketplace conduct might lead Sirius XM to increase its use of music, that would be 'indicative or suggestive' of 'what a competitive rate would look like.'" (quoting Shapiro). There are at least two problems with this theory. First, and as addressed more fully in response to Sirius XM's Findings below, there is no credible evidence that record companies entered into direct licenses in order to gain increased plays. *See generally* SE FOF at Section VII.F. Second, Professor Shapiro admitted that if there were multiple reasons a record label signed a direct license, one would need to untangle how much was steering and how much was non-statutory benefits. 4/20/17 Tr. 445:15-446:18 (Shapiro). But "the problem," according to Professor Shapiro, is that "in order to quantify it, you need evidence." 4/20/17 Tr. 448:8-9 (Shapiro). And Professor

Shapiro testified that while he could quantify the value of the administrative fee, "I cannot quantify the value of steering," and "I don't have quantitative evidence [of steering] that I could use for further adjustment." 4/20/17 Tr. 448:20-24, 450:1-2 (Shapiro).

Response to ¶ 143. Sirius XM fails to point to any credible evidence that independent record companies signed direct licenses because they expected to benefit from steering. Instead of pointing to documentary evidence, Sirius XM cites repeatedly to the testimony of its employee, George White. But his assertions about what motivated record companies to sign direct licenses are wholly unsupported and unverified hearsay. Sirius XM effectively bases its direct license benchmark on what Mr. White says that third parties must have been thinking (classic unreliable hearsay) — and then utterly fails to support his speculation with documentary evidence. To make matters worse, at the hearing Sirius XM was determined to keep as much documentary evidence (contemporaneous emails) about direct licensors' motivations out of the record by aggressively objecting to SoundExchange's efforts to introduce such evidence. *See, e.g.*, SoundExchange's letter brief re motion to admit into evidence emails sent or received by George White and spreadsheets (May 24, 2017).

As a result, Sirius XM does not point to contemporaneous emails or other documents that would support Mr. White's assertions. Indeed, Mr. White conceded that his testimony did not cite or include any emails with record labels. 5/17/17 Tr. 4275:10-4276:2 (White). This utter lack of contemporaneous evidence to support Mr. White's hearsay testimony speaks volumes. SE FOF at ¶ 964. In the words of Professor Shapiro, the record is clear that, unlike in the *Web IV* proceeding, "[t]here is no quantitative evidence relating to Sirius XM steering or its effects on listener hours." 4/19/17 Tr. 202:16-19 (Shapiro). SE FOF at ¶ 960.

By contrast, the documentary evidence that is in the record shows overwhelmingly that record labels signed direct licenses for a host of reasons having nothing to do with steering. SE FOF at Section VII.I.

Response to ¶ 144. Notwithstanding Sirius XM's claims to the contrary, Mr. White freely admitted that Sirius XM [ ] if they signed direct licenses. [ ]. SE FOF at ¶ 969. *See also* 4/27/17 Tr. 1439:5-20 (Lys) (noting that the direct licenses [ ]). Professor Lys spoke with numerous executives who signed direct licenses — none of them mentioned that steering played any role in their decision to sign a direct license. SE FOF at ¶¶ 970-72. And neither George White nor anyone else at Sirius XM [ ]. SE FOF at ¶ 982.

The block quote from Mr. White about the alleged promotional benefits of plays on Sirius XM also lacks evidentiary support. Again, Sirius XM is simply relying on the assertions of Mr. White, without any data, documents or quantification to support them. Sirius XM is citing the same kind of anecdotal evidence that the Judges have previously rejected. SE FOF at ¶¶ 407-12. As SoundExchange discussed in its Findings of Fact, there is no reliable evidence that plays on Sirius XM are net promotional of sales. SE FOF at Section IV.H.ii.4. To the contrary, the evidence shows that Sirius XM substitutes for subscriptions to paid internet streaming services. SE FOF at Section IV.H.ii.3.

Response to ¶ 145. The record shows no credible evidence that record labels signed direct licenses to obtain greater access to programmers. *See generally* SE FOF at Section VII.H. As an initial matter, Sirius XM relies on trial exhibits that were not admitted for the truth of the matter asserted (which Sirius XM has marked with an asterisk) — for the truth of the matter asserted. But Sirius XM cannot have it both ways. Having objected to SoundExchange's attempt to admit these documents into evidence for the truth of the matter asserted, it is improper for Sirius XM now to rely on the very same documents. In any effort, the documents cited by Sirius XM are to no avail. They show merely that in a handful of instances, Sirius XM (or MRI) stated that Sirius XM viewed direct license labels as "partners" who could try to "develop deeper business relationships with Sirius XM and programmers." But as SoundExchange extensively explained in its Findings of Fact, such access is very different from the steering that was at issue in the *Web IV* proceeding. SE FOF at ¶¶ 978-84.

Response to ¶ 146. Sirius XM makes vague assertions about the benefits of access to its programmers, but the record is replete with evidence that this is nothing more than "cheap talk." SE FOF at ¶ 990. [[redacted]]. SE FOF at ¶¶ 990-994. Furthermore, the testimony from Sirius XM's programming witness, Mr. Blatter, makes clear that Sirius XM's programmers are [[redacted]] and that there is no effort by Sirius XM to track whether directly licensed labels obtain greater access to programmers. SE FOF at ¶¶ 995-96. For his part, Mr. White conceded that [[redacted]]. SE FOF at ¶ 997. When Sirius XM's programmers decide which

recordings to play, they decide based on the merits, not based on whether the recordings are directly licensed. SE FOF at ¶¶ 998-1001.

Response to ¶ 147. Sirius XM's misleading reliance on Concord does not support Sirius XM's claims about steering. As Concord's Mr. Barros testified — and as Sirius XM's Mr. White confirmed — [ ]. SE FOF at ¶¶ 1129, 1132-34. While Concord estimated that in 2016 it would earn about the same in direct license royalties as it would under the statutory license for post-'72 recordings ([ ]), and while Sirius XM estimated Concord would earn slightly less ([ ]), that is only half the picture. The record is clear that Concord would not sign a post-'72 direct license unless and until it also signed a pre-'72 license. SE FOF at ¶¶ 1132-34. Under both the pre-'72 and post-'72 direct licenses, Concord earned substantially more in 2016 than it would have under the statutory license — [ ]. SE FOF at ¶ 1151. In addition, Concord received protection that its post-'72 royalties would not be significantly less through [ ]. SE FOF at ¶ 1145. Sirius XM's suggestion that Concord was willing to accept lower royalties for access to programmers is thus squarely contradicted by the record evidence.

Response to ¶ 148. To support its position, Sirius XM blatantly distorts the record. Sirius XM presents a quotation that Concord was "motivated at least in part" by its "belief that greater access to and attention from [Sirius XM's] programming staff would ultimately lead to increase in plays and therefore royalties." Sirius XM creates the misleading impression that the quote is from Mr. Barros. It is not. The quotation is of Mr. White's testimony. In fact, Mr.

Barros referred to that quote in his written testimony so that he could respond to it. *See* Trial Ex. 47 at ¶ 8 (Barros WRT) ("Mr. White's testimony does not set forth the primary reason that Concord signed direct licenses with Sirius XM."). [[redacted]]. *See* 5/16/17 Tr. 4104:18-4105:1 (Barros) ("Q: Before Concord signed the direct licenses, did Concord have any problems getting access to Sirius XM's programmers? A: No. We have an experienced and sophisticated radio staff who has relationships throughout Sirius XM with programmers. Also we like to think that our artists are significant enough to open the door to meaningful *dialogue* throughout the industry.").

Sirius XM also mispresents Mr. Barros's oral testimony. Sirius XM claims that Concord was motivated by a desire for access to Sirius XM's programmers by taking snippets of his testimony out of context. But the full exchange makes clear that Concord did not sign the direct license because it was promised or expected greater access to programmers. *See* 5/16/17 Tr. 4143:17-4144:2 (Barros). Specifically, Mr. Barros was asked whether Concord recognized that a direct license "would afford Concord greater access to and attention from Sirius XM Programmers." Sirius XM omits the first part of Mr. Barros's response: "I didn't know if that was the case. It is certainly not guaranteed in our agreement. It was not the motivating factor." *See* 5/16/17 Tr. 4143:17-4144:2 (Barros). Similarly, in citing another snippet of Mr. Barros's oral testimony in response to a question about access to programmers, Sirius XM omits the following portion of Mr. Barros's response: "Again, we looked at the facts. There were no guarantees of additional plays. There was no guarantee of additional access. So we — we

essentially made the decision based on the facts that went into the deal." 5/16/17 Tr. 4153:23-4154:7 (Barros).

In footnote 16, Sirius XM asserts — without any citation to the record — that steering was a consideration in Concord's decision to sign a direct license. As discussed above in this Response and more extensively in SoundExchange's Findings of Fact, that assertion is contradicted by the evidence. SE FOF at Section VII.I.iv. But even if steering was one motivating factor (which it was not), Professor Shapiro has made clear that the "prospect of additional plays" is relevant only if it was a "significant benefit to the label." SE FOF at ¶ 955. Sirius XM has not alleged (nor could it) that the prospect of additional plays was a "significant benefit" to Concord.

Response to ¶ 149. The fact that Sirius XM's stations are curated by human programmers does not bolster Sirius XM's steering claims. Regardless of how the stations are programmed, Sirius XM has made it clear that it does not steer based on whether a recording is directly licensed. SE FOF at ¶¶ 986, 995-1001. The human curation makes it more difficult for Sirius XM to implement targeting steering. SE FOF at ¶ 352. In addition, Sirius XM states that it is "impossible" for its programmers to pay attention to all of the record labels that seek plays on Sirius XM — but that claim undermines Sirius XM's steering argument. [[redacted]]. 5/17/17 Tr. 4284:1-6 (White). *See also* 5/17/17 Tr. 4278:15-25 (White) [[redacted]].

Response to ¶ 150. Sirius XM has failed to provide any empirical data that it actually steers in favor of directly licensed content. SE FOF at ¶ 957. In fact, as discussed above in

Response to ¶ 149, the record shows that Sirius XM's programmers do not steer to directly licensed recordings. SE FOF at ¶¶ 994-1001. And while Sirius XM now tries to claim that "Mr. White and Mr. Blatter's personnel provide direct licensors with a level of attention and responsiveness that they cannot offer to every label," [ ]. 5/17/17 Tr. 4284:1-13 (White). Mr. White likewise told programmers that [ ]. SE FOF at ¶ 1001.

The best support that Sirius XM can muster is a quote from *Judge Strickler* that, when choosing between equally appropriate tracks, "tie goes to the direct license." But to be clear, what *Mr. Blatter* said was that "the merits of the artist and the song will always come first." 5/10/17 Tr. 3363:2-3 (Blatter). Moreover, Sirius XM points to no instance in which a tie actually went to a directly licensed recording, and no policy or instruction to programmers to that effect. Instead, Mr. Blatter testified that Sirius XM's "philosophy" is that "we have to believe in the particular artist and their song first before anything." 5/10/17 Tr. 3365:18-23 (Blatter). Indeed, and in response to footnote 17, there is documentary evidence of numerous instances in which direct licensors' recordings were not played. *See, e.g.*, SE FOF at ¶ 1000.

Response to ¶ 151. Once again, Sirius XM provides no documentary evidence or data to substantiate its allegation that programmers have steered to directly licensed content. Instead, Sirius XM relies solely on the unverified claims by Mr. Blatter and Mr. White about three directly licensed labels (Hopeless Records, S-Curve Records and Z Entertainment). But there is

no evidence that access to programmers motivated any of these three labels to sign direct licenses. To the contrary, the evidence suggests that these labels were motivated by other factors. For example, all three of these labels over-indexed substantially. *See* SE FOF at ¶ 1119 (S-Curve Records over-indexed by [[redacted]], Hopeless Records over-indexed by [[redacted]], Z Entertainment over-indexed by [[redacted]]). In addition, S-Curve Records received a [[redacted]], which Mr. White conceded was important to S-Curve Records. SE FOF at ¶ 1171 ([[redacted]]), SE FOF at ¶¶ 1172, 117. [[redacted]]. SE FOF at ¶¶ 1025, 1014.

Response to ¶ 152. Sirius XM focuses on Hopeless Records as a purported example of a label that has "benefitted directly from their relationship with Sirius XM." But as set forth in Response to ¶ 151, Sirius XM points to no evidence that Hopeless Records was motivated by access to programmers, and in fact Hopeless Records had other motivations for signing a direct license. Moreover, SoundExchange more fully explains Hopeless Records' motivations in its Findings of Fact. SE FOF at ¶¶ 1002-04.

Response to ¶ 153. Sirius XM's reliance on the track "Circe," is also unavailing. This track was recorded by a band that is on one of Concord's labels (Loma Vista Records). Sirius XM does not seem to contend that the band or label had increased access to programmers. Instead, Sirius XM appears to argue that it is responsible for the track's success in the marketplace. Mr. Barros (Concord) addressed this claim directly, testifying that it is "overly simplistic to say that the track's success, let alone its Grammy Award, can solely be attributed to plays on Sirius XM." Trial Ex. 47 at ¶ 28 (Barros WRT). As described in Mr. Barros's testimony,

the track benefitted from exposure on a number of outlets, including most notably on *The Late Show With Stephen Colbert*. Trial Ex. 47 at ¶ 28 (Barros WRT).

Response to ¶ 154. Sirius XM also makes a promotional claim related to [[redacted]]. Like Sirius XM's similar claims, it is based on nothing more than Mr. Blatter's assertions, with no documentary support. There is simply no credible evidence in the record that Sirius XM would not have been aware of [[redacted]] recordings absent a direct license. And as discussed in Response to ¶ 151, [[redacted]] had other reasons to sign a direct license.

Response to ¶ 155. SoundExchange agrees that Sirius XM has the ability to steer, but contends that Sirius XM has less incentive to steer than Pandora and that there is no credible evidence Sirius XM has actually steered in favor of direct licensors. SE FOF at ¶¶ 352-53.

Response to ¶ 156. The only "evidence" cited by Sirius XM that "actual steering by Sirius XM has taken place," is an assertion by Professor Shapiro that Mr. Barros (Concord) believed steering was a benefit of signing a direct license. As discussed in Responses to ¶¶ 147-48, Professor Shapiro and Sirius XM have grossly mischaracterized Mr. Barros's testimony. The evidence is clear that Concord did not expect and was not motivated by more plays or better access to Sirius XM's programmers. *See* Responses to ¶¶ 147-48. Moreover, Sirius XM fails to cite any contemporaneous evidence that any steering has actually occurred or that any label was motivated by the prospect of steering to sign a direct license.

Response to ¶ 157. There is a plain lack of evidence of actual steering. SoundExchange agrees that the motivations of direct licensors are relevant, but there is also a plain lack of evidence that direct licensors were motivated by steering. *See generally* SE FOF at Sections VII.F-G. With respect to Professor Shapiro's theoretical point that the threat or prospect of

steering may induce price competition even if "relatively little steering actually takes place," it is important to understand that, as Professor Shapiro acknowledged, in order for steering-induced competition to take hold, the prospect of steering must be "credible." 4/20/17 Tr. 465:17-22 (Shapiro). See also 4/27/17 Tr. 1434:10-13 (Lys) ("[F]or a threat to have an effect, it has to be credible. So either you have to occasionally follow through or I have to reasonably believe that you will.").

In other words, in order to induce price competition among record labels, Sirius XM would need to demonstrate to prospective direct licensors that it was actually steering in favor of directly licensed recordings. But there is no evidence that Sirius XM was steering or that direct licensors believed Sirius XM would steer. As Professor Shapiro freely admitted, "[t]here is no quantitative evidence relating to Sirius XM steering or its effect on listener hours." 4/19/17 Tr. 202:12-18 (Shapiro). SE FOF at ¶¶ 376-77. *See also* 4/20/17 Tr. 448:20-21 ("I cannot quantify the value of steering."). And as discussed above in Responses to ¶¶ 142-54, the unverified assertions and anecdotes offered by Mr. White and Mr. Blatter fail to show that steering actually occurs, much less that prospective direct licensors expected it would occur.

Response to ¶ 158. SoundExchange agrees that even if steering was a motivating factor for a label, the steering is irrelevant unless it was a "significant benefit to the label." SE FOF at ¶ 955. Sirius XM has failed to show that any label viewed steering as a "significant benefit." *See generall*y SE FOF at Section VII.F-G.

Response to ¶ 159. Professor Shapiro's conclusion that a "significant portion of the gap between the statutory rate and the direct-license rate is attributable to record labels' belief that signing a direct license will lead to increased performances" is utterly lacking in any evidentiary support. In fact, it is contrary to the abundance of evidence in the record that direct licensors

were not motivated by the prospect of more plays, *see* SE FOF at Sections VII.F-G, and that they were motivated by a host of other non-statutory benefits. *See* SE FOF at Section VII.I. In particular, the "gap" referred to by Professor Shapiro can be explained entirely by two benefits that were offered to all of the direct licensors — avoidance of SoundExchange's administrative fee and of contributing to the fund for the non-featured artists' share of royalties. SE FOF at Section VII.I.i.

iii. Professor Lys's Criticisms Of The Direct License Benchmark Are Valid

Response to ¶ 160. While SoundExchange certainly agrees with Professor Shapiro that the direct license benchmark has "shortcomings," SoundExchange disagrees with the general statement that the direct licenses are informative of competitive rates, for all the reasons detailed in SoundExchange's Findings of Fact. *See* SE FOF at Section VII. Unlike Professor Shapiro's assessment of the direct licenses, Professor Lys's assessment of them is well supported by documentary evidence and data, and SoundExchange stands by his conclusions. Indeed, it is disingenuous for Sirius XM to suggest that Professor Lys should have reviewed even more documentary evidence, given that Sirius XM aggressively opposed SoundExchange's efforts to move precisely such evidence into the record.

Sirius XM tries to tar Professor Lys as "assum[ing] the role of behavioral psychologist" in opining on the motives of direct licensors. This criticism is easily refuted. First, the Judges qualified Professor Lys as an expert in "financial economics, behavioral economics, and negotiations." SE FOF at ¶ 28. Accordingly, there can be no question he was qualified to opine on the motivations of the direct licensors and their negotiations with Sirius XM. Second, unlike Professor Shapiro who relied on nothing more than the unverified assertions of Mr. White and Mr. Blatter, Professor Lys relied on a host of documentary evidence and data, as well as

interviews with record company executives, to reach his conclusions. *See, e.g.*, SE FOF at ¶ 968 (Professor Lys reviewed over [[redacted]] produced by Sirius XM and conducted interviews of record label executives); SE FOF at ¶ 971 (Professor Lys and his team reviewed all of the direct licenses produced by Sirius XM); SE FOF at ¶ 969 (Professor Lys and his team reviewed [[redacted]]).

Response to ¶ 161. Sirius XM's critique of Professor Lys's interviews of record label executives also ring hollow. First, Professor Lys's efforts must be contrasted with Professor Shapiro's. Even though Sirius XM is the business partner of all 498 direct licensors and therefore presumably has open lines of communication with them, Sirius XM failed to arrange for Professor Shapiro to speak with any of the directly licensed labels. If Sirius XM believed that information from the direct licensors would have supported its case, then Sirius XM of course would have had Professor Shapiro speak with them. Sirius XM's failure in this regard speaks volumes. Second, while Sirius XM has 498 direct licenses, the record shows that 30 of them account for the vast majority of the plays. Professor Lys spoke with a meaningful number of those 30 direct licensors. Sirius XM implies that the open-ended way in which Professor Lys asked questions of the record company executives was somehow improper. But Professor Lys appropriately avoided asking leading questions that could prejudice the answers. He asked open-ended questions about why the labels entered into direct licenses in order to give the executives the opportunity to explain their reasons. 5/1/17 Tr. 1670:14:24 (Lys).

Professor Lys reviewed thousands of documents, including emails between Sirius XM and record labels. SE FOF at ¶ 968. Sirius XM suggests that Professor Lys "misportrayed" one of those emails — an email exchange between [[redacted]] and Sirius XM/MRI. *See* Trial Ex. 189. This claim is a red herring. That email exchange does not relate to the factors that motivated [[redacted]] to sign a direct license. Rather, it relates to [[redacted]] decision not to renew (and to terminate) its direct license. *See, e.g.*, Trial Ex. 189 (email subject line: "[[redacted]]"). That is significant because the chart in which Sirius XM believes Professor Lys "misportrayed" [[redacted]] motivations (Trial Ex. 42, ¶ 139, Figure 17 (Lys WRT)) relates to [[redacted]] motivations at the time it originally signed the direct license, not at the time it chose not to renew it. Specifically, Figure 17 identifies [[redacted]]. Trial Ex. 42 at ¶ 139, Figure 17 (Lys WRT). Thus, the email exchange in Trial Exhibit 189 had no bearing on what originally motivated [[redacted]].

Moreover, Sirius XM objected to the admission of this exhibit into evidence for the truth of the matter asserted (as indicated by Sirius XM's marking it with an asterisk), but now asks the Judges to consider the truth of what is said in the document (the reasons the label did not renew its direct license). Sirius XM cannot have it both ways.

In any event, Professor Lys did not "misportray" anything. Mr. Walker of Sony, which acquired [[redacted]]. 5/15/17 Tr. 3816:14-3817:23 (Walker). While Sony [[redacted]

[redacted]].

Trial Ex. 50 at ¶ 11 (Walker WRT); 5/15/17 Tr. 3822:17-24 (Walker).

Response to ¶ 162. Sirius XM also challenges Figure 17 in Professor Lys's written rebuttal testimony on the ground that Professor Lys did not credit Sirius XM's pitch emails in which Sirius XM referred to access to programmers. SoundExchange squarely addressed this issue in its Findings of Fact. *See* SE FOF at ¶¶ 990-93, 1026. As described more fully therein, the documentary evidence shows that [[redacted]]. Moreover, for the reasons discussed above in Responses to ¶¶ 147-48, Concord certainly was not motivated by promises or prospects of access to Sirius XM's programmers. *See also* 5/16/17 Tr. 4154:3-7 (Barros) ([[redacted]]).

Response to ¶ 163. Sirius XM's summary conclusion of this portion of its Findings of Fact does not require a point by point factual response, except to note that the characterizations of Professor Lys's and Professor Shapiro's testimony with respect to the direct licenses are wrong, for all the reasons set forth in SoundExchange's Findings of Fact and in the Responses above. *See generally* SE FOF at Section VII.

1. The Direct License Rates Are Tied To The Statutory Rates

Response to ¶ 164. No response.

Response to ¶ 165. Professor Shapiro conceded that the statutory rate functions as a ceiling on what Sirius XM is willing to pay. SE FOF at ¶ 899. Professor Shapiro has stated that the key question is why the direct license rates are lower than the statutory rate. Professor Lys

provided an extensive and detailed analysis that shows the various non-statutory reasons that direct licensors were willing to accept rates below the statutory rate. SE FOF at Section VII.

Professor Lys also developed an economic model that shows the relation between royalty rates in the direct licenses and the statutory rate. *See* Trial Ex. 25 at 90 (Lys Corr. WDT). Sirius XM contends that the model fails to distinguish between discounted rates motivated by steering and discounted rates motivated by other benefits. But that criticism is entirely misplaced, as it ignores the extensive analysis Professor Lys conducted — in both his written direct and written rebuttal testimony — of all of the various benefits that may have motivated record labels to sign direct licenses. Trial Ex. 25 at Section III.D ("Value That Direct Licensors Obtain By Signing A Direct License") (Lys Corr. WDT); Trial Ex. 42 at Section II.C ("Why Independent Labels Enter Into Direct Licenses With Sirius XM") (Lys WRT). Sirius XM's criticism of Professor Lys is especially peculiar given that Professor Shapiro's analysis completely ignored any benefits other than steering.

Response to ¶ 166. Sirius XM points to Professor Shapiro's model in support of its steering theory, but that model is fundamentally flawed because it fails to account for any non-steering benefits to direct licensors. SE FOF at ¶ 943; *see also generally* SE FOF at Section VII.D. Even though Professor Shapiro acknowledged that non-statutory benefits exist, his model does not include any variable that represents them. SE FOF at ¶ 946. Nor does his model account for benefits that are not proportional to a label's share of plays on Sirius XM, such as advances, even though the evidence is clear that several of the more prominent direct licensors received advances. SE FOF at ¶¶ 948, 1171-72. As Professor Lys demonstrated, once Professor Shapiro's model is re-written to account for the non-statutory benefits, the model shows that labels may enter into direct licenses even in the absence of steering. SE FOF at ¶¶ 950-51.

Professor Shapiro's claim that the statutory rate "pulls up" the rates in the direct licenses does not withstand scrutiny. The statutory rate functions as a *ceiling* on what Sirius XM is willing to pay, *see* SE FOF at ¶ 899, and the royalty rates in the direct license agreements are dependent on the statutory royalty rate but *are not* dependent on the market value of the royalty rights conveyed. SE FOF at ¶¶ 897-914. Indeed, Professor Shapiro's "magnet" argument is recycled unchanged from his *Web IV* testimony, and in *Web IV* the Judges rejected it.

> Dr. Shapiro argues that the statutory shadow not only exceeds the marketplace rate, but also acts like a "focal point," or "magnet," pulling [up] a freely negotiated rate higher than it would be in the absence of the statutory shadow. Shapiro WDT at 36-37. However, neither Dr. Shapiro nor any other expert provides a sufficiently detailed explanation as to how the statutory rate would pull up a below-statute consensual rate that is otherwise mutually beneficial. . . . In sum, the Judges do not credit his conjecture as sufficient to affect their determination of the rate in this proceeding.

Web IV, 81 FR at 26330; *see also Web IV*, 81 FR at 26373 n.154 ("However, although this theoretical effect is discussed in the economic literature, Professor Shapiro acknowledged that it is not an 'ironclad' economic law, and there is scant evidence in this proceeding why such a potential 'focal point' or 'magnet' effect would cause unconstrained licensees to eschew a lower market rate that would produce greater revenue.").

Response to ¶ 167. Sirius XM's conclusions about the so-called magnet effect of the statutory rate are incorrect. The Judges rejected Professor Shapiro's "magnet theory" in *SDARS II*, and they should do so again in the current proceeding. SE FOF at ¶¶ 908-09. While Professor Shapiro assumed that the statutory rate has been above the true competitive rate, that assumption is wholly unsupported. Professor Lys demonstrated that the assumption is incorrect and that the direct license rates are uninformative for purposes of establishing a market-based benchmark. SE FOF at ¶¶ 910-14.

Response to ¶ 168. The quotation from Mr. Orszag is beside the point and taken out of context. The direct license royalty rates are a reflection of the statutory rate, and not indicative of market rates. SE FOF at ¶ 906. Even if there were steering (which there is not), it would not explain the difference between the statutory rate and the direct license rates. SE FOF at ¶¶ 910-11.

Response to ¶ 169. Sirius XM's contention that Professor Lys incorrectly added "factor B" to Professor Shapiro's model in Appendix D, instead of to his model in Appendix E, is wrong. The record is clear that Professor Lys added factor B to Appendix E, as well. SE FOF at ¶ 943. As Professor Lys explained in detail, Professor Shapiro's Appendix E, which models the relationship between direct license rates and the statutory rate, fails to account for any non-steering benefits to direct licenses. SE FOF at Section VII.D. There is nothing improper about the addition of factor B to this model.

In addition, Sirius XM ignores the fact that there are benefits to direct licensors that are not proportional to a label's share of plays on Sirius XM, such as cash advances and artist's share — and that Professor Shapiro's model fails to account for them. SE FOF at ¶¶ 948-49. Professor Shapiro conceded that his model fails to account for such benefits. SE FOF at ¶ 948. And as discussed more fully in SoundExchange's Findings of Fact, once non-statutory benefits are taken into account in a re-write of Professor Shapiro's model, it is clear that labels may enter into direct licenses even if there is no steering benefit. SE FOF at ¶ 951.

2. The Direct Licenses Are A Non-Representative Sliver Of The Sound Recording Market

Response to ¶ 170. Professor Lys explained in his written testimony that the direct licenses "could not be considered informative as to the market as a whole" because they account for "only a small fraction of the sound recordings that Sirius XM's business relies upon." Trial

Ex. 25 at ¶ 277 (Lys Corr. WDT). Sirius XM now tries to suggest that Professor Lys "withdrew" that criticism at the hearing. He did no such thing. The hearing testimony to which Sirius XM points was part of a long colloquy with opposing counsel. Professor Lys did not concede that the direct licenses were a representative sample; rather, he simply debated the semantics, arguing that "the term 'representative sample' is actually a wrong way of looking at this," and that he believed the direct licenses are a "biased sample." 5/1/17 Tr. 1660:3-1661:5 (Lys). There is no basis to disregard Professor Lys's written testimony on this topic, and it remains SoundExchange's position that the direct licenses are an insufficiently small sliver of sound recordings to constitute a reliable benchmark.

Response to ¶ 171. Sirius XM over-states the market share of its direct licenses. As discussed above in Response to ¶ 137, the market share when measured by webcasting reference channel performances is substantially lower than the range claimed by Sirius XM.

Sirius XM also refers to the major labels' "reluctance" to sign direct licenses with Sirius XM. But the majors are not opposed to direct licenses in principle (in fact, they have signed direct licenses with numerous digital music services, including services like Pandora that have also used statutory licenses). *See* Trial Ex. 50 at ¶ 4 (Walker WRT) ("Sony does not in principle oppose direct licenses with Sirius XM"); Trial Ex. 32 at ¶¶ 26, 29 (Harrison WDT) ("The current rate . . . is far below anything we would agree to in a market not constrained by a statutory license and other regulation"; "[w]e would not willingly give Sirius XM the competitive advantage it now enjoys in the form of below market rates"); 5/15/17 Tr. 3818: 15-17 (Walker) ([[redacted]]).

Rather, the majors are "reluctant" to sign direct licenses because they will not agree to below-market rates. Trial Ex. 50 at ¶ 4 (Walker WRT); Trial Ex. 32 at ¶¶ 26, 29 (Harrison

WDT). This "is simply good business." Trial Ex. 50 at ¶ 4 (Walker WRT); Trial Ex. 32 at ¶¶ 26, 29 (Harrison WDT). As Mr. Walker explained, [ ]. 5/15/17 Tr. 3818:22-24 (Walker).

To be sure, Mr. Walker expressed concern that Sirius XM was seeking to artificially inflate the number of its direct licenses in an effort to fabricate a benchmark for use in this proceeding. In particular, he was concerned about any implication that Sony accepted the low rates in the direct licenses, because "Sony would never willingly license its recordings at rates like those in the direct licenses." Trial Ex. 50 at ¶ 10 (Walker WRT). His concern was well-founded: as Sirius XM's Mr. White conceded, [ ]. SE FOF at ¶ 916. *See also generally* SE FOF at Section VII.B.

Otherwise, the only evidence Sirius XM points to in support of its claim that record companies were concerned about creating CRB precedent is the unverified hearsay testimony of Mr. White, who testified about what he says a handful independent labels said. Mr. White said these labels were "concerned that any agreement they signed would be used 'against them' in this proceeding." Putting aside the unreliability of Mr. White's hearsay (which again Sirius XM failed to support with any documentary evidence), their concerns were entirely justified given that Sirius XM did in fact intend to use the direct licenses as a benchmark to advocate for lower rates, as noted above.

3. Indexing

Response to ¶ 172. SoundExchange agrees that over-indexing was a reason that many labels signed direct licenses, and that [ ] of the top thirty direct licensors benefitted from

over-indexing between September 2015 and June 2016, per Professor Lys's testimony. An additional [[redacted]] labels in the top thirty were pitched on the benefits of steering. SE FOF at ¶ 1121. Thus, [[redacted]] of the top thirty either benefitted from or were pitched on the benefits of over-indexing. SE FOF at ¶ 1122. These [[redacted]] labels alone account for [[redacted]] of Sirius XM's average monthly royalty payments to direct licensors. SE FOF at ¶ 1122.

Response to ¶ 173. Sirius XM's assertion that Professor Lys failed to tie his conclusion that labels were motivated by the prospect of over-indexing to the record evidence is demonstrably false. Sirius XM routinely pitched prospective direct licensors on the benefits of over-indexing as an inducement to sign direct licenses — and Professor Lys's written testimony and SoundExchange's Findings of Fact discuss the evidence, which includes numerous contemporaneous emails, in great detail. SE FOF at ¶¶ 1094-1106. Indeed, SoundExchange's Findings of Fact contain two tables that quote numerous examples of Sirius XM's pitching labels in writing on the benefits of over-indexing. SE FOF at ¶ 1103.

Professor Shapiro agreed that the evidence supports SoundExchange's conclusion that some labels were motivated by the prospect of over-indexing. Professor Shapiro testified that many of the direct licensors benefitted from over-indexing and that it is "reasonable to believe that at least some of them viewed this as a significant benefit of signing a direct license," especially because, as Professor Shapiro explained, "Sirius XM in some cases pointed out to a label that it would benefit from over-indexing as part of Sirius XM's efforts to encourage that label to sign a direct license." SE FOF at ¶ 1115. Thus, Professor Shapiro himself squarely contradicted Sirius XM's contention that there is no evidence tied to the position that labels were motivated by over-indexing.

Response to ¶ 174. Professor Shapiro observed that [] of the direct licensors he examined over-indexed. He acknowledged that when those labels are removed from the analysis, the total number of directly licensed plays relevant to his benchmark falls from [ ]. SE FOF at ¶ 1118.

Sirius XM now contends that because [] of the direct licensors did not in fact over-index, those labels signed direct licensors even though they would be "disadvantaged" by doing so. That supposition is incorrect. First, as discussed at length in SoundExchange's Findings of Fact, there are numerous other non-statutory benefits that motivated labels to sign direct licenses, such as avoiding the administrative fee and the non-featured artist share, getting paid for pre-'72 recordings, getting paid advances, the direct provision of metadata, and other reasons. SE FOF at Section VII.I. Second, while Professor Shapiro focuses on how many labels actually under-indexed, the more relevant inquiry is whether labels were motivated to sign direct licenses because of the prospect of over-indexing. SXM FOF at ¶ 157. The evidence shows that Sirius XM pitched many labels on the benefit of over-indexing even though they did not actually over-index after they signed direct licenses. *See, e.g.*, SE FOF at ¶ 1121 ([ ]). Sirius XM is therefore incorrect in suggesting over-indexing was not a motivating factor for the [] of the direct licensors who did not actually over-index.

Moreover, Sirius XM's continued reference to Concord is entirely misplaced. As discussed above, Concord earned substantially more under the direct licenses [] than it expected to earn under the statutory license []. *See* Response to ¶ 147. Concord was not

motivated by any promise of over-indexing; rather, its analysis and Sirius XM's analysis predicted that, as a result of indexing, Concord would not be materially worse off under a direct license with respect to its post-'72 repertoire than under the statutory license. The financial guarantees that Concord received in its post-'72 license helped protect Concord and its artists on post-'72 repertoire, so that Concord could receive the benefit of compensation for pre-'72 recordings. Trial Ex. 47 at ¶¶ 13-14 (Barros WRT).

Response to ¶ 175. Sirius XM's effort to downplay over-indexing as a motivating factor cannot be squared with the evidence that Sirius XM routinely used the prospect of over-indexing as an inducement to labels to sign direct licenses. *See* Response to 173. *See also, e.g.*, SE FOF at ¶ 1103 (tables showing numerous examples of Sirius XM's pitching labels on the benefits of over-indexing). The fact the Mr. White believes otherwise should carry little (or no) weight, given the overwhelming amount of documentary evidence to the contrary.

4. Artist Share

Response to ¶ 176. SoundExchange agrees that Professor Lys concluded that some labels signed direct licenses in order to obtain the 50% artist share of royalties. SoundExchange disagrees that this conclusion was unsupported by the evidence. There is ample evidence in the record to support this conclusion. SE FOF at ¶¶ 1056, 1059-78. Indeed, the Judges reached this very same conclusion in *SDARS II*. *SDARS II*, 78 FR at 23064 n.29 ("receipt of 100% of the royalties upfront is clearly attractive to certain record labels and was a selling point in negotiations with independent record labels"). And while it is true that Mr. Kushner's testimony supports this claim, that is hardly the sole basis for SoundExchange's position. The extensive

evidence that shows that some labels were motivated by this factor is set forth in Section VII.I.ii of SoundExchange's Findings of Fact.

Response to ¶ 177. Sirius XM is wrong that there is not evidence to show that artist contracts generally share [redacted] of royalties with artists. First, regardless of the share that artists receive from record companies pursuant to their recording contracts, the evidence is clear that streaming royalties (such as direct license royalties from a service such as Sirius XM) are subject to recoupment — thus, even if an artist is entitled to a 50% share, receipt of 100% of the royalties is still advantageous to the record label, because the artist does not receive his/her 50% share until after the album has recouped. SE FOF at ¶¶ 1060-68. A label that previously signed a direct license with Sirius XM confirmed the point: [redacted]. SE FOF at ¶ 1062. *See also* FOF at ¶ 1063 (quoting Darius Van Arman) ("Royalties are typically subject to recoupment. . . . if the artist's album had not yet recouped, 100% of the artist's share of the royalties would go to offsetting any unrecouped balance, instead of some portion flowing through to the artist."). And the evidence shows that most artists and albums do not recoup. In fact, research shows that industry-wide, only one out of every five or six albums recoups. Trial Ex. 34 at ¶ 41 (Kushner WDT).

Second, there is ample evidence that artist contracts do in fact provide that artists receive well less than 50% of streaming royalties. SE FOF at ¶¶ 1069-74. Professor Lys reviewed artist contracts from majors and indies and found rates generally in a range of [redacted], with at least one closer to [redacted], and at least one direct licensor that pays its artists [redacted] of the Sirius XM

royalties. SE FOF at ¶¶ 1070, 1072. RIAA data corroborates Professor Lys's finding that artists receive well less than 50%, as it showed that artists receive [ ]. SE FOF at ¶ 1070.

Indeed, if receipt of the artist's share were truly irrelevant to labels, then one would expect that Sirius XM would not pitch the benefit of receiving the artist's share to prospective direct licensors. But the record is clear that Sirius XM pitched this benefit to a number of labels. SE FOF at ¶ 1075 (tables quoting pitch emails). And the artist's share was in fact a motivating factor for some direct licensors, including some within the top thirty. SE FOF at ¶¶ 1077-78.

Response to ¶ 178. Professor Shapiro's alleged review of artist contracts does not withstand scrutiny. *See* Response to ¶ 177. Professor Shapiro is incorrect as an analytical matter that the split between record company and artist is irrelevant to a record company's motivation for signing a direct license. The increase in the percentage of royalties that a record company retains can justify acceptance of a lower rate in a direct license. This incentive is easily explained as a matter of arithmetic, which Professor Lys set forth in his testimony. SE FOF at ¶¶ 1071-74. His analysis led to the conclusion that any label with an artist share of [ ] fared better under a direct license than it would have under the statutory license. SE FOF at ¶ 1074.

Response to ¶ 179. Sirius XM tries to minimize the importance of the artist share by asserting that Sirius XM did not pitch the benefits of the artist share to all labels. But the vast majority of the direct licenses are irrelevant given that they have no or virtually no performances on Sirius XM. And the fact is that Sirius XM did pitch receipt of the artist share to many of the largest direct licensors, including [ ] among others in the top thirty, as well as other labels not among the top thirty. SE FOF

at ¶ 1075. Several of the labels indicated that receipt of the artist share was a crucial part of the license. SE FOF at ¶¶ 1076-77.

Response to ¶ 180. Sirius XM quotes Judge Strickler in support of the notion that the benefit to a direct licensor of obtaining the artist share might be offset by the cost assumed by the label to administer the artist share. To be clear, there is no evidence whatsoever in the record that any such administrative cost would offset the benefit of the artist share. Indeed, given that record companies already account to artists for various revenue streams, it stands to reason that the incremental cost of adding an additional revenue stream (direct license with Sirius XM) to that accounting would be trivial. In any event, Sirius XM's speculation is no substitute for facts.

5. Advances

Response to ¶ 181. No response.

Response to ¶ 182. Sirius XM cannot downplay the significance of the advances. Advances are not available under the statutory license. Some of the advances were for [ ]. SE FOF at ¶ 1172 (showing advances of [ ]). For some direct licensors, advances were a significant incentive to sign the direct license. SE FOF at ¶¶ 1169, 1174. Moreover, Sirius XM fails to mention that the advances are [ ]. SE FOF at 1169. *See also* 5/16/17 Tr. 4106:25-4107:22 (Barros) ([ ]). And while the advances may seem "trivial" to a large company like Sirius XM that

has a lot of cash at hand, the evidence shows they can be [[redacted]] to smaller companies like the direct licensors. SE FOF at ¶ 1169.

6. Pre-'72

Response to ¶ 183. Sirius XM misrepresents the testimony of Professor Lys and Mr. Barros. In the paragraphs cited by Sirius XM, Professor Lys testified that by signing direct licenses for pre-'72 recordings, "indies earn extra royalties that Sirius XM would otherwise not have paid (absent litigation)." Trial Ex. 25 at ¶ 315 (Lys Corr. WDT). Sirius XM claims that Concord signed a pre-'72 direct license "primarily because of Sirius XM's willingness to pay for pre-'72 recordings" — perhaps the distinction is purely semantic, but what Mr. Barros actually testified is that Concord was motivated by a desire to get paid for pre-'72 recordings. Trial Ex. 47 at ¶ 8 (Barros WRT).

Response to ¶ 184. Sirius XM dramatically over-simplifies and misrepresents the status of the various litigation settlements related to its use of pre-'72 recordings. The facts related to the litigation as they relate to Concord are set forth in detail in SoundExchange's Findings of Fact. *See* SE FOF at ¶¶ 1138-42. Concord's pre-'72 direct license was a [[redacted]]. SE FOF at ¶ 1138. [[redacted]]. In fact, Sirius XM's appeal of a ruling in the New York *Flo & Eddie* case was pending, and even Mr. Frear acknowledged that Concord avoided risk by settling its pre-'72 dispute with Sirius XM. SE FOF at ¶ 1140. That is, Concord was not otherwise assured of getting paid by Sirius XM for pre-'72 recordings. Moreover, while Sirius XM did eventually settle the *Flo & Eddie* litigation, the royalty rate in

that litigation settlement is [ ] and the rate in that litigation could ultimately be reduced to [ ] depending on the outcome of remaining appeals. SE FOF at ¶ 1141. By contrast, Concord is guaranteed the [ ] in its pre-'72 direct license, regardless of the outcome of any appeals. SE FOF at ¶ 1142.

Response to ¶ 185. It is therefore true that Sirius XM would have paid Concord at [ ] if Concord had not signed a direct license for pre-'72 recordings and instead had waited to opt in to the *Flo & Eddie* settlement (which again, was not final at the time). SE FOF at ¶¶ 1138-42. Sirius XM misrepresents the rate in the *Flo & Eddie* settlement — it is not 5.5%. As Mr. Frear himself testified, while that was the initial headline rate, the *Flo & Eddie* settlement rate "can be reduced if courts do not recognize a right in Pre-72 Recordings." SE FOF at ¶ 1141. In fact, as Mr. Frear acknowledged, it has already been reduced to [.] SE FOF at ¶ 1141.

Response to ¶ 186. As discussed in Response to 184, Sirius XM mischaracterizes the circumstances of Concord's pre-72 direct license and is careless with the facts. In addition, Sirius XM misrepresents Mr. Barros's testimony at the hearing: Sirius XM now says that Mr. Barros testified that Concord was "demanding it be paid for pre-72 recordings commensurate with Sirius XM's settlement with the major labels." But Mr. Barros said no such thing. In fact, the testimony cited by Sirius XM shows only that Concord's understanding of the majors' settlement played a role in Concord's valuation of a potential settlement with Sirius XM. 5/16/17 Tr. 4139:1-6 ("Q: The fact and your understanding of the financial terms of the Majors' agreement played a role in your company's valuation of a potential resolution of the pre-72 claims with our client, did it not? A: It did."). Sirius XM is also wrong that "at the time

Concord entered into its direct licenses . . . it could have chosen to join the indie-label class action settlement." As discussed above, that settlement did not yet exist at that time, and thus Concord by definition could not have joined it. *See* Response to ¶ 184. And as discussed repeatedly above, Concord did not sign direct licenses because it expected more plays on Sirius XM. Rather, it was motivated by a desire to get paid for pre-'72 recordings, which Sirius XM had previously refused to pay. *See* Responses to ¶¶ 147-48. *See also* SE FOF at ¶ 1132 (when Sirius XM first approached Concord about a direct license in 2012, [[redacted]]).

Sirius XM also misconstrues Mr. Barros's concern about compensation for Concord's artists under the direct licenses. While Concord was motivated to sign the two direct licenses so that Concord could get paid for pre-'72 recordings, Mr. Barros was concerned that Concord's [[redacted]]. Trial Ex. 47 at ¶ 12 (Barros WRT); 5/16/17 Tr. 4103:1-17 (Barros). Accordingly, Concord sought assurances from Sirius XM that Concord "would not receive significantly less for our Post-72 recordings under the terms of a direct license as compared to what we would otherwise receive from SoundExchange via the prevailing statutory license." Trial Ex. 47 at ¶ 12 (Barros WRT). Sirius [[redacted]]. Trial Ex. 47 at ¶ 14. In reality, in 2016 Concord ended up earning the same amount under the post-'72 direct license as it had expected it would have earned under the statutory license ([[redacted]]). SE FOF at ¶ 1152.

Sirius XM's notion that Concord's post-'72 direct license rates reflected fair market rates is contrary to the facts. Concord's two direct licenses were "negotiated side by side and are

inextricably linked." Trial Ex. 47 at ¶ 8 (Barros WRT); SE FOF at ¶ 1136. The pre-'72 license expressly states that it is a [[redacted]]. SE FOF at ¶ 1138. Concord viewed the post-'72 and pre-'72 direct licenses as a [[redacted]]. As Mr. White conceded, Concord would [[redacted]]. SE FOF at ¶¶ 1133-34, 1136-37. Concord never suggested that the post-'72 agreement reflected market rates. To the contrary, Concord simply wanted to make sure that it would not be materially worse off than the statutory rate for post-'72 recordings, *see* Trial Ex. 47 at ¶ 14 (Barros WRT), which of course is not a market rate in any respect.

7. Steering And Access To Programmers

Response to ¶ 187. Sirius XM's claim that Professor Lys failed to consider steering is demonstrably false. In fact, Professor Lys considered steering, which is discussed at length in three subsections of SoundExchange's Findings of Fact. *See* SE FOF at Section VII.F, VII.G and VII.H. It is true, as cited by Sirius XM, that none of Sirius XM's direct licenses [[redacted]]. It is also true that there is no credible evidence of steering in the record.

Response to ¶ 188. For all the reasons set forth above in Responses to ¶¶ 142-59 with respect to steering, and in Sections VII.F-H of SoundExchange's Findings of Fact, Professor Lys reached the correct conclusion that there is no credible evidence that direct licensors signed direct licenses because of steering. Nor was Concord in particular motivated by steering. *See* Responses to ¶¶ 147-48; SE FOF at ¶¶ 1129-52. *See also* 5/16/17 Tr. 4104:18-4105:1 (Barros) [[redacted]]

[redacted]]; 5/16/17 Tr. 4143:17-4144:2 (Barros) (access to programmers "was not the motivating factor").

C. Sirius XM's Proposal To Use The *Web IV* Rates Is Fundamentally Flawed

Response to ¶ 189. For the reasons just explained, and as covered in detail in SoundExchange's Proposed Findings of Fact, Sirius XM's direct licenses are an unreliable benchmark. SoundExchange incorporates by reference its response to Sirius XM's discussion of a direct license benchmark above and in SE FOF at ¶¶ 885-1212.

Sirius XM claims that the direct licenses are agreements between the same buyers and the same sellers who will pay the royalties set by the Judges in this case. In reality, of course, the direct licenses were entered into by a very small percentage of the sellers in the relevant market, and Professor Shapiro carefully avoids any claim that the direct licensors are representative of the market as a whole. [redacted] 4/20/17 Tr. 274:3-18 (Shapiro).

Having acknowledged that Professor Shapiro avoids any claim that the direct licenses are representative of the entire market, Sirius XM then suggests that the statutory license is a "magnet" that pulls up rates, as though the direct licenses are unrepresentative *because* of the supposed magnet effect of the statutory license. But Professor Shapiro never connected those two entirely separate ideas. Professor Shapiro simply said he cannot conclude that the direct licenses are representative of the broader market, full stop. This concession alone dooms the direct licenses as a benchmark.

Professor Shapiro's "magnet" argument is recycled unchanged from his *Web IV* testimony, and in *Web IV* the Judges rejected it.

> Dr. Shapiro argues that the statutory shadow not only exceeds the marketplace rate, but also acts like a "focal point," or "magnet," pulling [up] a freely negotiated rate higher than it would be in the absence of the statutory shadow. Shapiro WDT at 36-37. However, neither Dr. Shapiro nor any other expert provides a sufficiently detailed explanation as to how the statutory rate would pull up a below-statute consensual rate that is otherwise mutually beneficial. . . . In sum, the Judges do not credit his conjecture as sufficient to affect their determination of the rate in this proceeding.

Web IV, 81 FR at 26330; *see also Web IV*, 81 FR at 26373 n.154 ("However, although this theoretical effect is discussed in the economic literature, Dr. Shapiro acknowledged that it is not an 'ironclad' economic law, and there is scant evidence in this proceeding why such a potential 'focal point' or 'magnet' effect would cause unconstrained licensees to eschew a lower market rate that would produce greater revenue."). There is no reason to reach a different conclusion here.

The idea that direct license rates are inflated because the statutory license acts as a magnet that pulls directly negotiated rates up above competitive levels is insupportable. To the contrary, the statutory rate functions as a *ceiling* on what Sirius XM is willing to pay. *See* SE FOF at ¶ 899; *see also, e.g.*, *SDARS I*, 73 FR at 4093, 4097. While the royalty rates in the direct license agreements are dependent on the statutory royalty rate, they *are not* dependent on the market value of the royalty rights conveyed. SE FOF at ¶¶ 897-914.

Response to ¶ 190. Sirius XM vaguely suggests that record companies seek to promote new releases on Sirius XM and this somehow establishes that the current rate is too high. Sirius XM's evidence of promotion is far too flawed to address here. SoundExchange debunked that

evidence at length in its Proposed Findings of Fact, and refers the Judges to the relevant paragraphs of that document. *See* SE FOF at ¶¶ 402-438.

The assertion that "Professor Shapiro was not able to conclude with certainty that those labels that did not enter into direct licenses would agree to a rate at or below 9.87 percent in a workably competitive market in the absence of the statutory license" requires no response and is simply a lead-in to the *Web IV* discussion below. Nevertheless, it should be noted that Professor Shapiro did not merely state that he could not make such a conclusion "with certainty" – he added that "I simply do not have sufficient information to answer this question with confidence one way or the other." Trial Ex. 8 at 49 (Shapiro WDT).

Response to ¶ 191. Striking out on the direct licenses front, Sirius XM tries a different benchmark: the *Web IV* rates. Sirius XM starts by asserting that "[t]he only difference of significance between the *Web IV* benchmark market and the target market here is the buyer." That is wrong and contrary to the evidence. The differences are laid out in SoundExchange's Proposed Findings of Fact, but two differences are worth repeating here.

First, Professor Shapiro's approach of importing per-play rates from the webcasting market to the satellite radio market relies on the assumption that value of a play on Sirius XM is equivalent to the value of a play on Pandora or other webcasting services. This is demonstrably untrue. Sirius XM subscribers may listen to fewer plays compared to Pandora subscribers – because listening time is limited to the time spent in the car – yet Sirius XM subscribers pay a higher subscription price. SE FOF at ¶¶ 1227-1235. And this fact is critical, because market data and economic theory both confirm that marketplace actors now negotiate over revenues for subscription services, not per-play consumption. SE FOF at ¶¶ 1224-1226.

Response to ¶ 192. Professor Shapiro asserts that the elasticity of demand for the music input is similar for Pandora and Sirius XM, in large part because both services have the ability to steer. On this critical point, however, Professor Shapiro was content with the assumption that because Pandora and Sirius XM have the *ability* to steer, they both have the same financial *incentive* to steer. Had Professor Shapiro dug a bit deeper, he would have discovered the substantial evidence showing that Sirius XM has a lower incentive to steer compared to Pandora.

To begin, there is no evidence that Sirius XM has in fact engaged in steering, in contrast to the record evidence of steering by Pandora in the *Web IV* case. SE FOF at ¶¶ 957-966. Second, Sirius XM does not even suggest to record labels that it will prefer their sound recordings based on price. SE FOF at ¶¶ 978-1004. Third, there are good reasons why Sirius XM does not actually steer even though technically it could. The cost of steering for Sirius XM is higher than the cost of steering for Pandora. Sirius XM risks losing highly valuable subscribers if they are unsatisfied with a price-driven selection of music, whereas Pandora risks primarily a diminution in listening time by users of its ad-supported service who produce far less revenue. Moreover, unlike Pandora, Sirius XM cannot minimize the potential subscriber dissatisfaction, because it lacks the "optimizing algorithm" that Pandora used to tailor its steering decisions based on individual preferences. SE FOF at ¶ 1244. Consequently, Professor Shapiro not only erred in assuming that a play on Pandora has the same value as a play in Sirius XM (compounding his foundation error of assuming that marketplace actors negotiate rates based on plays rather than revenues), he also erred in assuming that the upstream elasticity of demand is the same for Sirius XM and Pandora.

Response to ¶ 193. This is a summary paragraph that cites no data or evidence. The *Web IV* proposed benchmark is inappropriate for the reasons discussed in SE FOF at ¶¶ 1213-

1317. And even if the Judges were to give some credence to *Web IV* rates as a benchmark, those rates should be applied using the effective per-subscriber rates that resulted from the *Web IV* decision – [[redacted]] – per subscriber per month. SE FOF at ¶¶ 1234-1236.

i. Derivation of the *Web IV* Rates

Response to ¶ 194. This is a high-level and incomplete characterization of portions of the *Web IV* decision. Other pertinent aspects of the decision are discussed below and in the SoundExchange's Proposed Findings of Fact. *See* SE at FOF ¶¶ 103, 144, 148, 151, 341, 1213, 1219, 1232, 1233 & 1236.

Response to ¶ 195. Sirius XM claims that the Judges based the *Web IV* rates on the headline minimum per-play rates in the fully-interactive services agreements, not effective rates. Sirius XM baldly states that in *Web IV* "the per-play prong in the interactive service agreements *generally was not the binding prong*" (emphasis added). That statement is flatly inconsistent with the *Web IV* decision, where the Judges concluded that precisely the opposite was true: "The Judges first note that none of the percentage-of-revenue prongs in the greater-of agreements in the record has been triggered, which may suggest that *the parties to those agreements viewed the per-play rates as the rate term that would most likely apply for the length of the agreement*." *Web IV*, 81 FR at 26325 (emphasis added).

Moreover, Sirius XM's suggestion that the Judges in *Web IV* based their rate determination on headline rates that appeared in contracts, but did not actually govern the economic relationship between the parties, flies in the face of the multiple occasions where the Judges stated that they were interested in rates that "fully account[] for the economic value of the licenses to the parties" and *not* just the "headline rate." *Web IV*, 81 FR at 26320; *see also Web IV*, 81 FR at 26384 (explaining that the "average, stated per-play rate is not necessarily

applicable, standing alone, as a benchmark, if it is subject to necessary upward or downward adjustments to account for other forms of consideration or to more accurately account for probative evidence related to the rights available under the statutory license.”).

Sirius XM’s assertion that the Judges ignored the real economic substance of the fully-interactive service agreements in favor of inapplicable headline per-play rates rests on Exhibit 16A of Professor Rubinfeld’s *Web IV* written direct testimony. That exhibit contains several columns of numbers labeled “effective rates,” only one of which Sirius XM points to, and it is not clear how any of those numbers were actually used in the analysis or how they were explained to the Judges.

Response to ¶ 196. As discussed above, the *Web IV* decision indicates that the Judges found that the per-play rates, as adjusted for non-rate compensation, were in fact the effective rates. *See* Response to ¶ 195.

Response to ¶ 197. This is a characterization of a portion of the *Web IV* decision. Other pertinent aspects of the decision are discussed in SoundExchange’s Proposed Findings of Fact. *See* SE FOF at ¶¶ 103, 144, 148, 151, 341, 1213, 1219, 1232, 1233 & 1236.

Response to ¶ 198. This is a characterization of a portion of the *Web IV* decision. Sirius XM is correct that the Judges concluded that they had not set the rates too low. What Sirius XM ignores in its selective reading of *Web IV* is the *reason* the Judges gave for their conclusion that they had not set the rates too low; the Judges found that the per-play rates, as adjusted, were the governing metric in the greater-of formula, and percentage of revenue rates would have yielded a lower royalty. *Web IV*, 81 FR at 26325 (“none of the percentage-of-revenue prongs in the greater-of agreements in the record has been triggered . . .”).

Other pertinent aspects of the decision are discussed in SoundExchange's Proposed Findings of Fact. *See* SE FOF at ¶¶ 103, 144, 148, 151, 341, 1213, 1219, 1232, 1233 & 1236.

Response to ¶ 199. This is a summary paragraph regarding the alleged validity of the *Web IV* benchmark. SoundExchange incorporates by reference its Response to ¶ 191 above and SE FOF at ¶¶ 1213-1317 as to why the proposed benchmark is inappropriate and should be rejected.

ii. The *Web IV* Benchmark Is Inappropriate And Must Be Rejected

1. Converting the *Web IV* Per Play Rate Into A Percentage-Of-Revenue Rate Is A Flawed Exercise

Response to ¶ 200. This paragraph simply re-states Professor Shapiro's methodology for "converting" the *Web IV* rate into a percentage of revenue rate. As a threshold matter, the premise of even *starting* with the *Web IV* rate is flawed, for the reasons summarized in the Response to ¶ 191 above and in SE FOF at ¶¶ 1213-1317. Moreover, even if the Judges found that the *Web IV* rates provided useful information, it is the effective per-subscriber rate and not the per-play rate that resulted from the *Web IV* decision that is relevant, given the undisputed marketplace evidence that record labels and services bargain over revenues and not plays. SE FOF ¶¶ at 1224-1236. Below we address the mistaken premise of using the *Web IV* rate as a baseline and additional problems with Professor Shapiro's conversion methodology and assumptions.

Response to ¶ 201. Sirius XM's assertion that SoundExchange has not challenged Professor Shapiro's conclusion that the Sirius XM subscribers on average listen to 469 plays per month is incorrect. That figure rests entirely on the results of a "Share of Ear" survey *which is not in evidence* – and for good reason. No Sirius XM witness explained the methodology used to

conduct the survey in any detail,[28] and because it is not in evidence, the Judges cannot examine its validity or give it any weight. *See* SE FOF at ¶¶ 1238, 1354, 1355. The regulations governing these proceedings require detailed information on a study's methodology, assumptions, and techniques of estimation and testing, among other things. *See* 37 C.F.R. § 351.10(e) ("If studies or analyses are offered in evidence, they shall state clearly the study plan, the principles and methods underlying the study, all relevant assumptions, all variables considered in the analysis, the techniques of data collection, the techniques of estimation and testing, and the results of the study's actual estimates and tests presented in a format commonly accepted within the relevant field of expertise implicated by the study. The facts and judgments upon which conclusions are based shall be stated clearly, together with any alternative courses of action considered."). Here Sirius XM not only failed to provide this information, *it did not even offer the survey itself into evidence.* Had it done so, SoundExchange would have objected because Sirius XM never provided the required detailed information about the survey methodologies, screening criteria, etc. Sirius XM thus has no defensible basis for its estimate of the number of plays per month per subscriber.

The only estimate of this number supported by evidence of record is the figure of [[redacted]] derived by Professor Willig – a figure that Professor Shapiro barely addresses and altogether fails to discredit in his testimony. *See* SE FOF at ¶ 1239.

Once the Share of Ear Survey is properly disregarded, Professor Shapiro's "conversion" calculation must be rejected.

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[28] Mr. Lenski discussed the survey only at a superficially high level as background for the type of work his firm does. Trial Ex. 7 at 1-2 (Lenski WDT).

Response to ¶ 202. See Response to ¶ 201.

Response to ¶ 203. See Response to ¶ 201.

Response to ¶ 204. See Response to ¶ 201.

Response to ¶ 205. SoundExchange incorporates by reference its Response to ¶ 201. All of the calculations in this paragraph are premised on manipulations to the original figures Professor Shapiro supposedly derived from the Share of Ear survey which is not in evidence and whose reliability has not been established.

Response to ¶ 206. SoundExchange incorporates by reference its response to ¶ 201. All of the calculations in this paragraph are premised on manipulations to the original figures Professor Shapiro supposedly derived from the Share of Ear survey which is not in evidence and whose reliability has not been established. In addition, Professor Shapiro does not even refer to a specific document from which he obtained the internet usage data he relied on, as discussed in SE FOF at ¶ 206.

Response to ¶ 207. SoundExchange incorporates by reference its Response to ¶ 201. The final number described in ¶ 207 is premised on manipulations to the original figures Professor Shapiro supposedly derived from the Share of Ear survey which is not in evidence and whose reliability has not been established. In addition, Professor Shapiro does not even refer to a specific document from which he obtained the internet usage data he relied on. Although the entire premise of relying on *Web IV* rates is invalid, Professor Willig's calculation of [ ] is more reliable than Professor Shapiro's calculation.

Response to ¶ 208. SoundExchange incorporates by reference its Response to ¶ 201, which explains why the figure of 469 performances per subscription per month should be rejected.

Response to ¶ 209. Professor Shapiro's final step, multiplying his derived $1.03 per subscriber per month royalty figure by the average Sirius XM revenue per subscriber per month, compounds the errors in his analysis. In addition to improperly relying on the *Web IV* per-play rate as a base and then deriving the 469 figure from a study not in evidence and whose reliability was not established pursuant to applicable regulations, Professor Shapiro compounds these errors by using the wrong ARPU figure to derive a percentage of revenue rate. In his written direct testimony, Professor Shapiro devoted just one paragraph to attempting to justify his ARPU figure of [[redacted]], citing an unnamed, unspecified Sirius XM financial document. Trial Ex. 8 at 54-55 (Shapiro WDT). Although not cited by Professor Shapiro, Sirius XM's proposed findings of fact now cite to Sirius XM's [[redacted]] *See* Trial Ex. 663 (native file) (tab "consolidated outputs," cell HN79). The [[redacted]] figure is hard coded in the version of the native Excel spreadsheet that was produced. Thus it is not clear how Professor Shapiro concluded that, "[a]s is detailed in this document, ARPU includes all subscription related revenues (including the separate subscriber invoice line item for U.S. Music Royalty Fees), but excludes other revenue sources, such as those earned from the sale of radios." Trial Ex. 8 at 54 (Shapiro WDT). In fact, there is no evidence that Professor Shapiro conducted *any* analysis of this number at all. Trial Ex. 42 at ¶ 150 (Lys WRT). *See also* SE FOF at ¶¶ 1425-1427.

Regardless of its provenance, Professor Shapiro's [[redacted]] ARPU figure is the wrong revenue metric to use in calculating a percentage of revenue rate. Trial Ex. 42 at ¶ 153 (Lys WRT). Under the applicable regulations, the percentage of revenue rate paid by Sirius XM is applied to a specific revenue base – what the regulations define as "Gross Revenues." Trial Ex. 42 at ¶ 154 (Lys WRT); *see* 37 C.F.R. § 382.11. Professor Shapiro agrees that the revenue

number used to calculate a percentage of revenue royalty rate should match Gross Revenues. *See* Trial Ex. 42 at ¶ 154 (Lys WRT) (citing Shapiro deposition); 4/19/17 Tr. 213:17-21 (Shapiro). But instead of following through with this approach, Professor Shapiro uses an ARPU figure that includes revenue that *cannot* be included in "Gross Revenues" – such as revenue from equipment sales, which is excluded under the clear language of 37 C.F.R. § 382.11. *See* Trial Ex. 42 at ¶ 154 (Lys WRT). The correct methodology for calculating gross revenues was articulated in SoundExchange's Proposed Findings of Fact. *See* SE FOF at ¶¶ 274-275, 1431. The correct ARPU number derived from following this methodology is [[redacted]]. *See* Trial Ex. 26 at ¶ 60(Orszag Am. WDT).

Obviously, it matters whether the ARPU number put forward by Mr. Orszag or Professor Shapiro is the right number. Professor Shapiro's $1.032 per-subscriber rate results in a percentage of revenue rate of 8.1% when the ARPU of [[redacted]] from Sirius XM's [[redacted]] is used. But if the average revenue per subscriber from Mr. Orszag's report is used [[redacted]], then Professor Shapiro's 8.1% royalty rate rises to 9.6% (even leaving aside all the errors with his other inputs). Professor Shapiro acknowledged as much at trial. *See* 4/19/17 Tr. 212:11-15 (Shapiro); 4/20/17 Tr. 315:1-3 (Shapiro).[29] Furthermore, if the creator compensation [[redacted]], along with the correct ARPU [[redacted]] per subscriber-month), the rate for Sirius XM would be 24.3% of revenue. Trial Ex. 46 at ¶ 57 (Willig WRT). SE FOF at ¶ 1240.

Response to ¶ 210. Sirius XM acknowledges that when Professor Shapiro's $1.032 per-subscriber rate is divided by Mr. Orszag's [[redacted]] ARPU figure, the rate is 9.6%. That figure,

[29] Professor Lys made a minor adjustment to the [[redacted]] figure derive a figure of [[redacted]]. Trial Ex. 42 at ¶ 159 & n.186 (Lys WRT).

however, merely corrects the denominator; as discussed at length in SE FOF at ¶¶ 1213-1317, the derivation and assumptions behind the $1.032 per-subscriber rate are deeply flawed.

2. Sirius XM's "Refinements to Account for Differences Between Subscription Noninteractive Webcasting Services and Satellite Radio" Are Wholly Inadequate

Response to ¶ 211. As noted in response to paragraph 191 above, it is incorrect to say that "[t]he only potential area of concern" in using the *Web IV* benchmark is that the buyer is not identical to the buyer in the benchmark market. The market on which the Judges relied in *Web IV* simply no longer exists; Professor Shapiro wrongly assumes that the value of a play on Sirius XM is equivalent to the value of a play on Pandora; recent market data show that marketplace actors negotiate over *revenues* for subscription services, not per-play consumption; there are differences in the elasticities of demand in the two markets which dictate by how much rates should exceed marginal costs; and the substitution effect component of Professor Shapiro's approach is completely invalid because it relied on the Lenski survey that is not suited for such a purpose and which is deeply flawed methodologically. These and other factors are addressed below and in SE FOF ¶¶ at 1213-1317.

Response to ¶ 212. This is a summary paragraph that refers at a high level to the concepts of opportunity cost and steering. As such it is a gross oversimplification. For example, obviously missing is any reference to the downstream elasticity of demand for the service, the willingness to pay of the downstream users of the service, and the impact of the revenues they generate on the royalties paid by the service.

In addition, Professor Shapiro has not conceived of opportunity cost in the correct manner. As detailed in SoundExchange's Proposed Findings of Fact, *see* SE FOF at ¶¶ 486-495, the relevant opportunity cost for rate-setting purposes is the "walk-away" opportunity cost – that

is, the revenue that a label would realize elsewhere as a result of the movement of subscribers if it refused to provide a license for its catalog to Sirius XM. Professor Shapiro instead assumes that a label has agreed to license its catalogue and focuses on the opportunity cost of licensing additional plays on the platform, that is, the "per-play" or "marginal" opportunity cost associated with licensing. 5/2/17 Tr. 2021:7-24 (Willig). For the reasons explained in SoundExchange's Proposed Findings of Fact, Professor Shapiro's approach is not useful for rate-setting purposes. SE FOF at ¶¶ 496-525.

Response to ¶ 213. This is an introductory paragraph that merely introduces the general concepts of promotion and substitution and requires no response.

Response to ¶ 214. This paragraph discusses the general concept of promotion and substitution and again represents a gross oversimplification. Sirius XM might have had more of a leg to stand on had it added the phrase "all else equal." Even with such a caveat, however, Sirius XM glosses over important complexities. For example, Professor Shapiro conceded that any promotional impact of plays on Sirius XM would have to be evaluated by comparing the Sirius XM promotional effect to the promotional impact of plays on the services for which Sirius XM substitutes. SE FOF at ¶ 440.

Response to ¶ 215. Regarding Sirius XM's supposed promotional effects, Sirius XM has not presented any reliable evidence that plays on Sirius XM offer any material promotional benefit. These and other arguments regarding alleged promotional effects are addressed in detail in SE FOF at ¶¶ 402-444. Sirius XM's citation to the Lenski survey as support for the assertion that "Sirius XM is *more* promotional of other record label revenue streams than are noninteractive webcasters" is even more curious given that the Lenski survey does not purport to measure promotional effect.

Response to ¶ 216. Professor Shapiro's regressions prove nothing and even Professor Shapiro puts no stock in his results, as we explain at greater length in our Responses to ¶¶ 411-413, *infra*.

Response to ¶ 217. The survey conducted by Mr. Lenski provides no reliable evidence regarding substitution for purposes of assessing opportunity costs. As discussed in detail in SoundExchange's Proposed Findings of Fact and in the testimony of Professor Willig and others, Professor Shapiro's use of the Lenski survey to assess substitution is fatally flawed from an economic perspective. Most glaringly, the Lenski survey asked Sirius XM subscribers how they would reallocate their *listening time* if they no longer had the service, not whether or not they would subscribe to or pay for additional services. Because Mr. Lenski failed to ask respondents about how they would spend their music dollars, his results cannot tell us anything about effects on creator compensation. SE FOF at ¶¶ 1250-1268. Additionally, as Professors Dhar and Simonson testified, the Lenski survey suffered from numerous methodological flaws that render its results wholly unreliable. These methodological flaws are discussed in detail in SoundExchange's Proposed Findings of Fact, SE FOF at ¶¶ 1269-1328.

Response to ¶ 218. As discussed in SoundExchange's Proposed Findings of Fact and in Response to ¶ 217 *supra*, the Lenski survey and the Dhar and Simonson surveys measure different types of information (changes in listening time versus music spend, respectively), and the Lenski survey does not produce information that is reliable or useful in assessing substitutional effects. Consequently, it is not accurate to say that Professors Dhar and Simonson are "in agreement with Mr. Lenski's findings." Both Professor Dhar and Professor Simonson testified at length regarding flaws in the Lenski survey and their shared conclusion that it yielded no useful information. *See, e.g.*, Trial Ex. 40 (Dhar WRT); Trial Ex. 44 (Simonson WRT). In

fact, the paragraph of Professor Simonson's written direct testimony on which Sirius XM relies, explicitly states that his results are far different from Mr. Lenski's. Trial Ex. 44 at ¶ 69 (Simonson WRT) (noting that "average [number of answer options selected] is similar to that obtained in the Lenski Survey, *though the distribution across music sources was quite different*" (emphasis added) (internal citation omitted)).

Response to ¶ 219. SoundExchange agrees that Sirius XM has accurately stated Professor Willig's opportunity cost calculations, although SoundExchange of course disputes the characterization of Professor Willig's analysis as a "monopoly" approach. *See* Response to ¶¶ 361-382, *infra*. Moreover, as SoundExchange pointed out in its proposed findings of fact, the opportunity cost associated with Sirius XM is highly likely to rise over the upcoming rate term as connected cars become widespread and vehicle interfaces with mobile devices improve. *See* SE FOF at ¶¶ 576-582.

Response to ¶ 220. SoundExchange agrees that Sirius XM has the *ability* to steer, *see* 4/20/17 Tr. 451:1-2 (Shapiro); 5/10/17 Tr. 3365:24-3366:7 (Blatter), but that is absolutely distinct from having the financial *incentive* to steer. As explained at length in SoundExchange's Proposed Findings of Fact, there are multiple reasons to think that Sirius XM's incentive to steer is less than that of Pandora – not to mention that the absence of evidence of actual steering necessarily means Sirius XM lacks the incentive to do so. *See* SE FOF at ¶¶ 350-353, 978-988.

A service will not engage in steering unless it has the financial incentive to do so, as well as the technical ability. 4/20/17 Tr. 451:19-452:6 (Shapiro). The cost of steering will affect a service's incentive to steer. 4/20/17 Tr. 452:7-10 (Shapiro). As Professor Shapiro agreed, steering can result in a departure from the optimal mix of music, and subscribers might respond to such a departure by abandoning the service; a service must consider this cost in determining

whether to steer. 4/20/17 Tr. 452:11-453:1 (Shapiro). There is every reason to think that Sirius XM's incentives to steer are lower than those of Pandora, because the cost of steering for Sirius XM is higher than for Pandora. In the case of Sirius XM, lost subscribers are very costly. Professor Lys estimates that a subscriber cancellation, on a yearly basis, removes around $90 from Sirius XM's bottom line. Trial Ex. 26 at ¶ 70 & n.83 (Orszag Am. WDT). In light of the price that Pandora charges for its subscription mid-tier service, $4.99, a subscriber cancellation could not possibly have the same financial impact.

Moreover, while Sirius XM's cost of steering is likely higher than the cost of steering for Pandora's subscription service, the cost differential is likely higher still when Sirius XM's service is compared to Pandora's ad-supported service. Ad-supported services generally produce lower revenue per user than subscription services, and an ad-supported service may suffer only a reduction in listening hours rather than a loss of subscribers if users become dissatisfied with the mix of music. In any event, Professor Shapiro agreed that Pandora is mostly an ad-supported service, and likewise agreed that the financial repercussions of steering by an ad-supported service will operate in different ways compared to the financial repercussions of steering by a subscription service. 4/20/17 Tr. 454:6-455:13 (Shapiro).

Pandora and other noninteractive streaming services also have stronger incentives to steer because they can fine-tune playlists at the individual user-level to minimize subscriber backlash to steering, and thus lower the cost of steering. Trial Ex. 26 at ¶ 71 (Orszag Am. WDT); *see also* Trial Ex. 669 at 16 (Shapiro *Web IV* testimony) ("Pandora's flexibility is directly related to its use of an optimizing algorithm to select playlists. The key point is that Pandora can selectively increase and decrease performances of recorded music in a manner that is highly attuned to the preferences of listeners."). Professor Shapiro agreed that Pandora's optimizing algorithm

contributed to Pandora's incentives to steer. 4/20/17 Tr. 458:4-24 (Shapiro). Sirius XM, in contrast, does not have the ability to implement targeted steering. 4/20/17 Tr. 461:4-5 (Shapiro).

The bottom line (as Professor Shapiro agrees) is that where steering is more costly for a service, that service will have a lower elasticity of demand for the sound recording input. 4/20/17 Tr. 453:22-454:2 (Shapiro). Based on the evidence described above, Sirius XM's steering costs almost certainly are materially higher than Pandora's.[30] While Professor Shapiro does not admit that Sirius XM has a higher cost of steering compared to Pandora, he at least admits that its costs may be different. 4/20/17 Tr. 454:3-5 (Shapiro). That admission alone undermines Professor Shapiro's *Web IV* benchmark.

Response to ¶ 221. *See* Response to ¶ 220.

Response to ¶ 222. *See* Response to ¶ 220.

Response to ¶ 223. Professor Shapiro's thought experiment with respect to the Sirius XM Hits One channel hardly overcomes the lack of empirical evidence that Sirius XM engages in steering behavior, and certainly does not show that its cost of steering is equal to or lower than the costs of steering incurred by Pandora.

Response to ¶ 224. *See* Response to ¶ 223.

Response to ¶ 225. *See* Response to ¶ 223.

Response to ¶ 226. *See* Response to ¶ 220.

Response to ¶ 227. *See* Response to ¶ 220.

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[30] Sirius XM's high cost of steering, of course, explains the lack of evidence that it has in fact engaged in steering. Unlike Pandora, whose relatively low level of steering was explained in *Web IV* on the grounds that it only recently obtained the technical ability to steer, Sirius XM has always had that ability. 4/20/17 Tr. 451:3-18 (Shapiro). The fact that it has not engaged in steering, notwithstanding that it has had the ability to do so from the inception of the service, speaks eloquently to the high cost of steering for Sirius XM and its lack of a financial incentive to do so.

Response to ¶ 228. For the reasons already explained above, Sirius XM's concluding thoughts as to the appropriateness of *Web IV* rates as a benchmark in this proceeding are entirely incorrect.

iii. The Section 801(b)(1) Factors Support An Increase – Not A Decrease – In Rates

Response to ¶ 229. This is a largely accurate restatement of Professor Shapiro's testimony. SoundExchange of course takes issue with the suggestion that the Section 801(b)(1) factors warrant a downward adjustment. As explained in SoundExchange's Proposed Findings of Fact, *see* SE FOF at ¶¶ 1433-1597, SoundExchange's proposed rates satisfy the first three statutory criteria, and no adjustment downward is necessary for the fourth statutory criterion because SoundExchange's proposed rates are not disruptive.

Response to ¶ 230. With respect to the first factor – "maximizing the availability of creative works to the public" – Sirius XM has it exactly backwards: Higher royalty rates incentivize record companies and artists to make more works available to the public. *See* SE FOF at ¶ 1444. Record companies bear significant financial risks and make significant investments to create, produce, market, manufacture, distribute, and license sound recordings to Sirius XM. SE FOF at ¶¶ 1557-1563. Without the substantial investment and creative efforts of record companies, it would not be possible to introduce to the marketplace new recordings and new artists. *See, e.g.*, SE FOF ¶¶ 1446-1461. In order to encourage record companies to make sound recordings available to the public, it is more critical than ever that they are fairly compensated when their recordings are performed on Sirius XM's satellite radio service. *See, e.g.*, SE FOF ¶¶ 1446-1461.

By contrast, a lower royalty rate will not lead Sirius XM to increase the availability of works to the public. In *SDARS II*, the Judges rejected the argument that Sirius XM was entitled

to a downward adjustment under the first statutory factor based on the alleged promotional effect of its satellite radio service. *SDARS II*, 78 FR at 23066-67. And there is no evidence in the record that Sirius XM would play more recordings if the statutory rate were lower. In fact, history bears this out: as the royalty rate has increased over the past ten years, there is no evidence that Sirius XM plays fewer recordings today than it did in the past.

Response to ¶ 231. As to the second factor – affording a fair return to copyright owners and a fair income to copyright users under existing economic conditions – the best Sirius XM can manage is that "Professor Shapiro found no substantial evidence that the *Web IV* rate and the marketplace agreements on which it is based, transformed into a percentage-of-revenue rate for Sirius XM's satellite radio service, failed to meet this objective." This is simply not good enough. The Judges and their predecessors have consistently held that fairness to both parties under this provision is best accomplished by replicating to the greatest extent possible the returns that would exist in workably competitive markets, where producers and distributors are rewarded for their risks and for the value of what they bring to the market. *See, e.g.*, *SDARS II*, 78 FR at 23067 (noting the presumption that a "marketplace-inspired" rate "already reflects a fair income and a fair return"); *SDARS I*, 73 FR at 4095 ("a fair income is more consistent with reasonable market outcomes"); *In re Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 FR 25394, 25409 (1998) (hereinafter "*PSS I*") ("[u]sually this balance is struck in the marketplace through arms-length negotiations").

The current rate is much lower than a market rate and thus does not afford a fair return to copyright owners, especially given today's economic conditions. *See* SE FOF at ¶¶ 1468-1491. The evidence shows that dramatic changes in the music industry have made royalty revenues from Sirius XM even more important than in the past. Physical product sales have experienced

significant decline, which has led to substantial cost cutting throughout the record industry. Initially, physical product sales were partially replaced by download sales, but since 2012 U.S. download sales, too, have been steadily declining. And Sirius XM can well-afford an increase in rates. *See* SE FOF at ¶¶ 1492-1538.

Response to ¶ 232. The third factor seeks to "reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication." 17 U.S.C. § 801(b)(1)(C). This objective, also, is one that "marketplace evidence, standing alone" can address. *Amusement & Music Operators Ass'n v. Copyright Royalty Tribunal*, 676 F.2d 1144, 1157 (7th Cir. 1982). The Judges have characterized their task under the third factor as determining "whether the record presents solid empirical evidence of a difference between the benchmark market, if any, and the target market that would warrant an adjustment in the rate most strongly suggested by the evidence." *SDARS II*, 78 FR at 23068.

In *SDARS II*, the Judges concluded that evidence of the "unique and substantial financial costs that Sirius XM has incurred and anticipates incurring over the license period to maintain and upgrade its distribution system" justified a downward departure from 12- 13% to 11%. *SDARS II*, 78 FR at 23069. As discussed in detail in SoundExchange's proposed findings of fact, however, the record in the current proceeding does not support a similar downward departure. Instead, consideration of the relative contributions of the record companies and Sirius XM reveals that it is the record companies — not Sirius XM — that have taken far more risks, invested far more capital, and spent far more money than the SDARS "in the product made available to the public." SE FOF at ¶¶ 1557-1563.

Overall, the major labels spend *billions* of dollars in finding new artists and helping them reach an audience. Artists themselves of course make enormous contributions in terms of time and opportunity cost. Sirius XM's costs — including its satellite costs — do not justify a downward departure. These costs are a small and ever-decreasing percentage of the company's overall revenues. To the extent Sirius XM pays less in royalties, those savings will be used by Sirius XM to buy back stock and pay dividends, not to make more music available to the public. *See* SE FOF at ¶¶ 1564-1573.

Response to ¶ 233. Sirius XM devotes this paragraph to making the point that Professor Shapiro's proposal – a downward adjustment in the rates – would not be disruptive to Sirius XM. True enough, but meaningless – the same logic would always support a reduction in the rates, down to zero.

The Judges have adopted a specific standard of what constitutes disruption under the fourth objective: a rate change can be disruptive if it "directly produce[s] 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." *SDARS II*, 78 FR at 23069 (quoting *SDARS I*, 73 FR at 4097). To justify a downward departure, the disruption would have to "cause the [service] to cease operating or dramatically change the nature of its product." *SDARS I*, 73 FR at 4097. Sirius XM has made no such showing here. In fact, by any measure, Sirius XM is easily capable of paying SoundExchange's proposed rates. *See* SE FOF at ¶¶ 1575-1583. Accordingly, this factor does not support a downward adjustment in rates.

iv. Sirius XM Has No Valid Response To SoundExchange's Objections To The *Web IV* Benchmark

Response to ¶ 234. This is a partial summary of one aspect of Mr. Orszag's testimony regarding the proposed *Web IV* benchmark. Trial Ex. 43 at ¶¶ 40-59 sets forth the complete version of Mr. Orszag's written rebuttal testimony regarding this proposed benchmark.

Response to ¶ 235. Although not *all* data from *Web IV* is stale, at least half of it is – the Merlin/Pandora agreement – and there is much that is new.

With respect to the Merlin/Pandora agreement, Professor Shapiro himself acknowledged during the trial that "the contractual rates upon which [the Judges] relied in *Web IV*" have "been superseded." 4/20/17 Tr. 344:3-8 (Shapiro).

Moreover, new agreements that did not exist at the time of *Web IV* provide useful and corroborative additional information for the Judges. For example, Professor Shapiro argues that the number of plays per user is the metric that does – or at least should, in his view – drive record label compensation. On that issue it surely is highly relevant that [[redacted]] 4/25/17 Tr. 980:13-18 (Orszag). The new mid-tier agreements entered into in 2016 between [[redacted]], Trial Ex. 43 at ¶ 51 (Orszag WRT), with only one exception discussed in SE FOF at ¶ 1225.

Equally important, whatever the headline rates might be and whether or not they have changed, the current marketplace evidence demonstrates even for those older agreements that [[redacted]]

[redacted] Trial Ex. 43 at ¶ 52 (Orszag WRT).

In short, Sirius XM focuses on whether the headline rates in fully-interactive services agreements have changed since *Web IV*. But that tells only half the story. Which of the "greater-of" metrics in those agreements actually governs the payment is new information since *Web IV*. The movement away from per-play rates in recent agreements is new information since *Web IV*. The corroborating mid-tier agreements with Pandora and iHeart offer important information (*see* SE FOF at ¶¶ 844-884) that is new since *Web IV*. Mr. Orszag was correct to point out that it makes no sense to determine rates based on old information and entirely ignore current marketplace data.

Response to ¶ 236. Sirius XM's discussion of the Merlin/Pandora agreement misses the point. As previously explained, the Merlin/Pandora agreement, whose per-performance rates were used in setting the *Web IV* rates, no longer exists. It was amended in February 2016, Trial Ex. 304, and replaced by a new mid-tier agreement in September 2016, Trial Ex. 243. As SoundExchange noted in its Proposed Findings of Fact, the new agreement concerns not only a mid-tier service but also Pandora's on-demand and ad-supported services. But that does not mean that the old, superseded agreement still represents a valid benchmark, or that the new agreement is not relevant to this proceeding. Moreover, while Pandora's mid-tier service has gained some functionality, its price has not changed. It was $4.99 when the service was Pandora One, and it remains $4.99 as Pandora Plus, "suggesting that consumers' evaluation of that increased functionality, in terms of increased skips, the ability to rewind and some limited caching[,] is not so valuable that it moves it closer to the fully interactive service and that they

can move up the price accordingly." 4/25/17 Tr. 1063:3-1064:5 (Orszag). The Merlin/Pandora agreement is more fully discussed in SE FOF ¶¶ at 1218-1223.

Response to ¶ 237. To begin, as we have demonstrated elsewhere, under the *Web IV* rates, Pandora would have paid [[redacted]] per subscriber per month. SE FOF at ¶¶ 1234-1236. Thus, while the rates in the mid-tier agreements are higher, the increase is hardly dramatic. And as Mr. Orszag pointed out, [[redacted]] Trial Ex. 43 at ¶ 55 (Orszag WRT).

More importantly, Sirius XM ignores the real reason Pandora and iHeart are paying the rates reflected in the mid-tier agreements. Once these services sought functionality beyond that permitted by the statutory license, they had to pay market rates. [[redacted]] 5/16/17 Tr. 3965:15-3966:4 (Harrison).

Sirius XM unwittingly makes this point in the following paragraph. UMG wanted rates that would give Pandora and iHeart incentives to move subscribers up to the premium, fully-interactive tier of service. This is the market mechanism at work. UMG considered its opportunity costs of licensing Pandora's mid-tier service, both from the perspective of the additional royalties it might earn if ad-supported users migrated to the mid-tier subscription service, and from the perspective of the royalties it might lose if the mid-tier services cannibalized the fully-interactive services. UMG negotiated rates accordingly, consistent with marketplace incentives and, importantly, consistent with the theory of ratio equivalency. SE

FOF at ¶¶ 466-467. That the record labels and Pandora (as well as iHeart) found it mutually advantageous to agree to these rates is not a reason to disregard them – it is a reason to embrace them.

Response to ¶ 238. *See* Response to ¶ 237.

Response to ¶ 239. *See* Response to ¶ 237.

Response to ¶ 240. This paragraph simply repeats arguments that have already been addressed. Professor Shapiro's reinvention of Mr. Orszag's benchmarking approach, using unadjusted per-play rates that everyone agrees do not apply to determine the royalties paid by fully-interactive services, simply makes no sense. Benchmarking analysis using agreements between fully-interactive services and record companies does not require using the headline per-play rates in those agreements where those per-play rates are not the governing metric. Even Professor Shapiro could not articulate an economic theory why benchmarking should be performed using rates that have no economic effect (SE FOF at ¶¶ 134-136); marketplace evidence demonstrates the current irrelevance of per-play rates for subscription services (SE FOF at ¶¶ 137-142); and the *Web IV* decision does not support Professor Shapiro's arguments. SE FOF at ¶¶ 143-145.

Response to ¶ 241. Despite Sirius XM's contention that Professor Shapiro did not simply assume that Sirius XM and Pandora would pay the same per-play rates in an unregulated market, that is *exactly* what he did. To be sure, Professor Shapiro considered in a general sense whether Pandora and Sirius XM would pay similar rates. But what he did *not* consider was whether those services would pay similar rates on a per-play basis, on a per-subscriber basis, or on a percentage of revenue basis. Of course, as SoundExchange has pointed out, on a per-subscriber basis Pandora paid [[redacted]] per subscriber under the *Web IV* rates, and on a

percentage of revenue basis Pandora paid approximately [▇▇▇] of its subscription revenue. SE FOF at ¶¶ 1234-1236. One searches the record in vain for any discussion by Professor Shapiro explaining why he chose one metric over another, especially when his ultimate goal was to propose a percentage of revenue rate and not a per-play rate.

Response to ¶ 242. As SoundExchange explained in its Proposed Findings of Fact, there is no reason to think that revenues should be directly tied to performances for subscription (rather than ad-supported) services. *See* SE FOF at ¶¶ 1227-1235. Although Mr. Orszag did not attempt to demonstrate this point empirically, he did not need to – the Judges had already reached this same conclusion in *Web IV*:

> IBS argues that royalty payments for noncommercial webcasters must be proportional to their use of sound recordings. While IBS's argument has a superficial appeal, it suffers from several shortcomings. IBS does not and cannot cite any statutory authority for its argument. . . . Willing buyers and willing sellers may, and often do, agree to rates that are not strictly proportional to usage.

Web IV, 81 FR at 26395-96. In *Web IV*, the Judges also concluded: "In the subscription market where the positive [willingness to pay] and functional convergence engenders strong competition for paying listeners, a willing seller in the subscription market seeks to maximize subscriber revenue and focuses on average revenue per user (ARPU), not revenue per play." *Web IV*, 81 FR at 26351.

There is an obvious logic to Mr. Orszag's opinion. Entertainment options are limited in the vehicle, which is where most Sirius XM subscribers listen to the service. Conversely, survey evidence shows that outside of the car much of the listening is in the background while the subscriber is doing other things and likely not paying much attention to the music. SE FOF at ¶ 1228. Thus, consumers will have a higher willingness to pay for music in the car, and that higher willingness to pay will result in higher royalties.

Finally, Professor Willig supported this proposition from the point of economic theory. *See* Trial Ex. 46 at ¶ 39 (Willig WRT); 5/02/17 Tr. 2009:18-23 (Willig) (explaining that per-play rates "are inappropriate even for benchmark calibration because different plays have different values on different platforms for different audiences, and so basing valuation on per-play rates just doesn't make sense from the point of view of consumer welfare.").

Response to ¶ 243. See Response to ¶ 242.

Response to ¶ 244. Any claim that Sirius XM should be separately compensated for the value of its network is meritless. Sirius XM asks rhetorically why the copyright owners should share in any value created by Sirius XM's investment in its network. Sirius XM, however, is perfectly happy to share in the value created by the investment in the creation of sound recordings by artists and record companies. Sirius XM argues that "[w]ere it not for Sirius XM's massive investments in its satellite delivery system, the content offered by Sirius XM would not be available in the car, and this added value would be lost." But were it not for the copyright owners' massive investment of their time, talents and money in their sound recordings, the satellite system offered by Sirius XM would be useless space debris, and the added value would be lost. This is not a disputed point. David Frear, Sirius XM's CFO, admitted that [[redacted]]. Trial Ex. 43 at ¶ 53 n.65 (Orszag WRT) (internal citation omitted).

As Mr. Orszag pointed out, both the sound recording input and the satellite network input are necessary for the success of Sirius XM's service. In this sense, copyright owners and Sirius

XM are partners, each bringing to the enterprise a necessary input, and each having borne its own substantial cost to create those inputs. Economic theory dictates that they share in the value created as a result. *See* SE FOF at ¶¶ 260-264.

Response to ¶ 245. According to Sirius XM, Professor Shapiro "explained" what it characterizes as a "logical flaw" in Mr. Orszag's argument that royalties should not be based on intensity of use, and instead should be based on the revenues earned by the service. Actually, Professor Shapiro explained nothing. To be sure, he asserted that royalties should be based on intensity of use. But he offered no plausible explanation of this position. And, perhaps more importantly, he never grappled with the uncontested evidence that subscription streaming services virtually never pay on a per-play basis in today's market. *See* SE FOF at ¶¶ 1224-1226. Why, if intensity of use is the critical economic driver of royalties, do the subscription service agreements negotiated since 2014 contain no per-play rates? Why, if intensity of use is the critical economic driver of royalties, does almost no subscription service pay on a per-play basis even if it is a party to an older agreement that contains a per-play metric? Why, for that matter, do the services not charge their subscribers on a per-play basis? The reality is that services do not charge subscribers based on intensity of use, and record companies do not charge subscription services based on intensity of use. That is an uncontested fact, and Professor Shapiro never even attempts to explain how he squares his assertions with the marketplace reality.

Although Sirius XM hyperbolically claims that SoundExchange "is suggesting that Sirius XM's royalty payment should be based not on the number of performances on its own service but on the number of performances on *Pandora*'s service," it is not SoundExchange that is offering *Web IV* rates as a benchmark. SoundExchange believes that Sirius XM's royalty

payments should be based on the fully-interactive services benchmark analysis offered by Mr. Orszag and the opportunity cost analysis performed by Professor Willig. And SoundExchange is not suggesting that royalties should be based on the number of performances at all – SoundExchange maintains that royalties should be paid based on the revenues earned by the service, which in Sirius XM's case are considerable.

Response to ¶ 246. As we have discussed previously, Professor Shapiro's use of "per-play" or "marginal" opportunity cost, as opposed to the walk-away opportunity cost, is entirely misguided. SE FOF at ¶¶ 486-489. Even Professor Farrell agrees that record companies will not license a service at a royalty that does not cover its walk-away opportunity cost. SE FOF at ¶ 490. And walk-away opportunity cost is in no sense based on the number of performances on the target market service. SE FOF at ¶ 494.

Sirius XM takes Mr. Kushner's testimony out of context. It is true that an individual record label's share in the royalty paid by a service is based on its pro rata share of plays on the service. But that only affects how record companies divide up the overall royalty pie among themselves; the size of the pie – which is what is at issue in this case – is almost never based on the number of performances on a subscription service.

Response to ¶ 247. Once again, Sirius XM is confused. It states that the "*Web IV* methodology was entirely driven by per-play rates and was used to derive a per-play rate." But, as explained in SoundExchange's Response to ¶¶ 195-196, *supra*, the language of the *Web IV* decision indicates that the Judges set effective rates. It just so happened that, at the time that decision issued, the per-play rates were the effective rates.

Response to ¶ 248. In short, there is no defensible reason to rely on the *Web IV* rates as a benchmark in this proceeding. Marketplace evidence, economic theory, and the *Web IV* decision itself support using effective rates based on the most up-to-date information available.

IV. SOUNDEXCHANGE'S PROPOSED RATE LEVEL AND STRUCTURE SHOULD BE ADOPTED

Response to ¶ 249. For the last decade, the statutory royalty rate for SDARS has *expressly* been set at a below-market level, and Sirius XM has exploited the percentage-of-revenue rate structure to drive its statutory royalty costs even lower. SoundExchange's proposal for an increase to a fair-market level and a rate structure consistent with marketplace agreements is strongly supported by the record in this proceeding.

As to the rate level, in *SDARS I*, the Judges expressly set a rate below the level they thought was "most strongly indicated by marketplace data" (initially less than half that) because the Judges perceived that (1) requiring Sirius XM to pay a market rate would significantly delay Sirius XM's becoming profitable, and (2) Sirius XM's significant (in absolute terms) satellite costs "distinguish[ed] them from other digital distributors of music." *SDARS I*, 73 FR at 4096-98. In *SDARS II*, the Judges again did the same based on what they perceived at that time as Sirius XM's "unique" distribution costs. *SDARS II*, 78 FR at 23069. As a result of these decisions to set below-market rates, Sirius XM pays royalties at a level much lower than competitive services, SE FOF at ¶¶ 463-485, and artists and record companies have effectively subsidized Sirius XM in an amount that by any measure is over [[redacted]]. SE FOF at ¶¶ 1598-1606. That has had the positive effect on Sirius XM's profitability that the Judges desired: the total statutory royalties Sirius XM paid to SoundExchange over the past nine years ($1.6 billion) are less than Sirius XM's Adjusted EBITDA for 2015 alone ($1.7 billion). SE FOF at ¶ 1575.

However, the conditions that led to the Judges' decisions to set below-market rates in *SDARS I* and *II* have changed dramatically. Sirius XM is now immensely profitable. SE FOF at ¶¶ 1495-1538. It would remain highly profitable during the coming rate period at the rates proposed by SoundExchange. SE FOF at ¶¶ 1539-1552, 1575-1582. In addition, as Sirius XM's subscriber base has grown, its capital expenses (including its costs for satellites) have decreased as a percentage of revenue. Those expenses are now a very small percentage of Sirius XM's overall revenues, a percentage similar to the capital costs incurred by Internet-based services such as Pandora. SE FOF at ¶¶ 1564-1573. In this environment, and as described in detail below, the statutory royalty rate applicable to Sirius XM should substantially increase to a fair-market level of $2.48 per subscriber per month or 23% of Sirius XM's gross revenues.

As to the rate structure, in *SDARS I*, the Judges concluded that a percentage-of-revenue rate structure would be easiest to administer and sufficient for purposes of the statutory license. *SDARS I*, 73 FR at 4088. However, ten years later, that structure has generated near-constant disputes and years of litigation. SE FOF at ¶¶ 1647-1656. It has also incentivized Sirius XM to migrate from "paid" to "unpaid" promotional trials, effectively compelling artists and copyright owners to subsidize a Sirius XM marketing expense. SE FOF at ¶¶ 1626-1627, 1657-1659. Marketplace agreements routinely mitigate such issues by requiring payment of a royalty that is the greater of a percentage rate and a per-subscriber rate. SE FOF at ¶¶ 1644-1645. The Judges should adopt such a rate structure at this time.

Response to ¶ 250. SoundExchange's proposed market-level statutory royalty rate has strong supported in the testimony of Mr. Orszag and Professor Willig. The interactive services agreements relied on by Mr. Orszag provide an excellent benchmark that has been accepted by the Judges in prior cases, including *SDARS I*, *Web II*, and *Web IV*. SE FOF at ¶¶ 100-104.

While the Judges rejected such agreements as a benchmark in *SDARS II*, and expressed hesitation about relying on such agreements in *Web III*, none of the reasons they cited is applicable here. SE FOF at ¶¶ 105-113.

Professor Willig quantified the opportunity cost incurred by record companies in licensing Sirius XM, and established that it is comparable to the fair market value royalty rate determined by Mr. Orszag. SE FOF at ¶¶ 470-485. All economists who testified on this subject agreed that sellers will not willingly license at a rate below their opportunity cost in an unregulated market. SE FOF at ¶¶ 459-462. Accordingly, the opportunity cost calculated by Professor Willig establishes a floor for a marketplace SDARS royalty. SE FOF at ¶¶ 457-469. Sirius XM's claim that Professor Willig derived a monopoly rate has no merit. SE FOF at ¶¶ 538-544.

A. SoundExchange's Proposed Change to the Prevailing Rate Structure Has Strong Support in the Record

Response to ¶ 251. SoundExchange's proposed greater-of rate structure has strong support in the record, both from expert testimony and otherwise. Marketplace agreements for the licensing of sound recordings generally provide a royalty based on both a percentage-of-revenue and payment per-subscriber, and require the licensee to pay under the metric that yields the highest royalties. Trial Ex. 26 at ¶ 27 (Orszag Am. WDT); 5/2/17 Tr. 1968:3-10 (Willig); SE FOF at ¶¶ 1644-1645. There are advantages and disadvantages to each of these metrics alone. Trial Ex. 26 at ¶ 27 (Orszag Am. WDT).

While a percentage-of-revenue metric raises issues concerning the appropriate definition of revenue, and may give rise to future disputes, such a metric has the advantage of being linked to consumers' willingness to pay for a service. Trial Ex. 26 at ¶ 27 (Orszag Am. WDT). Because music content drives consumers' willingness to pay for Sirius XM's SDARS service, Trial Ex. 21 at ¶¶ 71-73 (Boedeker WDT); SE FOF at ¶¶ 169-259, artists and copyright owners

should receive a share of the upside, should Sirius XM's average revenue per user rise over the term of the license. *See* Trial Ex. 26 at ¶ 27 (Orszag Am. WDT); SE FOF at ¶¶ 1666-1667. On the other hand, a per-subscriber rate is more straightforward to apply than a percentage-of-revenue rate, and would reduce the potential for accounting issues of the kinds that have given rise to past disputes. Trial Ex. 26 at ¶ 27 (Orszag Am. WDT); SE FOF at ¶¶ 1647-1656.

A per-subscriber rate also would reflect the value Sirius XM receives from the use of recordings in extended free trials. It routinely offers free trials that materially exceed the length of the free trials offered by the benchmark interactive services. Trial Ex. 26 at ¶ 81 (Orszag Am. WDT). Sirius XM has even entered an agreement with at least one OEM for [ ]. SE FOF at ¶ 1634. In the last few years, Sirius XM has [ ], Trial Ex. 26 at ¶ 83 (Orszag Am. WDT), and its forecasts indicate [ ]. Trial Ex. 26 at ¶ 84 (Orszag Am. WDT). [ ] Trial Ex. 26 at ¶ 90 (Orszag Am. WDT). Because Sirius XM easily can achieve a profit-neutral result for itself by offsetting any lost paid-promotion revenue with lower "revenue share" payments to OEMs, the current percentage-of-revenue rate structure gives Sirius XM an ability and incentive to reduce its royalty obligation by making greater use of unpaid trials relative to paid trials. Trial Ex. 26 at ¶ 90 (Orszag Am. WDT); SE FOF at ¶¶ 1657-1665.

Marketplace agreements generally provide a royalty based on both a percent of revenue and payment per subscriber, and require the licensee to pay under the metric that yields the highest royalties. Expert testimony and abundant other evidence establishes that to achieve a fair

return for artists and copyright owners, *see* 17 U.S.C. § 801(b)(1)(B), the Judges should adopt such a rate structure under the statutory license as well.

Response to ¶ 252. There is no basis for Sirius XM's professed fear of a decline in its revenue per subscriber. From 2008 to 2015, Sirius XM was able steadily to increase the subscription prices and fees it charges subscribers, leading to growth in its publicly-reported ARPU from $10.82 to $12.53, a 15.8% increase. Trial Ex. 25 at ¶ 66 (Lys Corr. WDT). When the U.S. Music Royalty Fee is included, Sirius XM's pricing on its Select subscription package increased by 41% over the past decade, from $12.95 in 2006 to $18.12 as of April 2016. Trial Ex. 25 at ¶ 71 (Lys Corr. WDT). Moreover, Sirius XM's pricing increases have had little effect on demand for its services. Trial Ex. 25 at ¶ 72 (Lys Corr. WDT). Based on the foregoing, Dr. Lys concluded that Sirius XM "has been facing a relatively inelastic demand, enabling it to increase prices to consumers without negatively impacting its chum rate." Trial Ex. 25 at ¶ 74 (Lys Corr. WDT).

Because Sirius XM has a demonstrated habit of taking improper deductions from Gross Revenues, SE FOF at ¶¶ 1649-1653, 1673-1687, 1699-1700, [ ] SE FOF at ¶¶ 1657-1665, but considerable flexibility to raise prices, a greater-of rate structure simply helps equalize the asymmetry built into a statutory rate structure where Sirius XM is free to use all copyrighted sound recordings at its discretion, but artists and copyright owners have no control over the pricing of their works.

Response to ¶ 253. At the time of *SDARS II*, difficulties with the standalone percentage-of-revenue rate structure were beginning to emerge. *E.g.*, *SDARS II*, 78 FR at 23072 n.45 ("[t]he Judges stress . . . that the exclusion [for non-music programming] is available only to the extent

. . . offered for a separate charge"). However, SoundExchange was prepared to see whether a percentage-of-revenue rate structure might still prove to be as easy to administer, and have such low transaction costs, as the Judges predicted in *SDARS I*. 73 FR at 4088. Instead of a greater-of rate structure, SoundExchange elected to try to mitigate the emerging disputes by proposing a percentage rate applicable to a royalty base that required less complicated allocations than the current definition of gross revenues. *SDARS II*, 78 FR at 23071-72. The Judges declined that proposal, but the underlying issues proved very real.

As the Judges know, SoundExchange and Sirius XM have spent most of the last rate period in litigation over precisely the issues that were emerging during *SDARS II*. Underpayment Decision, No. 2006-1 CRB DSTRA, at 3 ("because Sirius XM did not offer the channels included for subscribers to the Premier package for a separate charge, it could not reasonably exclude revenue attributable to the Premier subscription price differential from Gross Revenues"). Additional improper deductions from Gross Revenues by Sirius XM during the *SDARS II* rate period have come to light during this proceeding. At trial, Mr. Barry admitted that throughout the *SDARS II* rate period, Sirius XM has been improperly deducting from its gross revenues credit card fees related to equipment sales, 5/17/17 Tr. 4393:24-4394:14 (Barry), and probably all its bad debt expense across all its lines of business. 5/17/17 Tr. 4395:1-21 (Barry). Even though Sirius XM had been aware of these issues for some time as of Mr. Barry's testimony, it still had not paid the late royalties to SoundExchange. 5/17/17 Tr. 4396:14-4397:2 (Barry).

Sirius XM acknowledges that ambiguities in the rate regulations can give rise to "very costly disputes" that "serve neither the interests of the music industry nor Sirius XM's interests." 5/17/17 Tr. 4386:12-20 (Barry). It also agrees that adopting a per-subscriber royalty would

"minimize disputes arising from ambiguities in the definition of gross revenues." 5/17/17 Tr. 4387:8-11 (Barry). At this time, with the benefit of five more years' experience with a standalone percentage rate, the Judges should adopt a greater-of structure. *See* SE FOF at ¶¶ 1644-1656.

Response to ¶ 254. For the reasons given in the paragraphs above, SoundExchange's proposal to change the governing rate structure from a percentage-of-revenue rate to a greater-of formulation with both a percentage-of-revenue rate and a per-subscriber rate should be adopted.

B. Mr. Orszag's Benchmarking Approach Is A Reliable Method For Setting Rates For Sirius XM In A Manner Consistent With The 801(b)(1) Factors

Response to ¶ 255. This is an accurate recapitulation of some of Mr. Orszag's testimony regarding the interactive services benchmark in this case. The interactive services benchmark was used in a number of prior proceedings, and not only by Dr. Ordover in *SDARS II* as Sirius XM implies. The interactive services benchmark was also used in *SDARS I* (where Dr. Ordover was the testifying expert, *see* 73 FR at 4093-4094), *Web II* (where Dr. Pelcovits was the testifying expert, *see In re Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 72 FR 24084, 24092, 24094 (2007) (hereinafter "*Web II*")), *Web III* (where Dr. Pelcovits was the testifying expert, *see In re Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 76 FR 13026,13035 (2011) (hereinafter "*Web III*")), and *Web IV* (where Dr. Rubinfeld was the testifying expert, *see* 81 FR 26353, 26404). The Judges found that the interactive services benchmark provided useful information in each of these four cases.

Response to ¶ 256. Sirius XM correctly notes that Mr. Orszag offered two methods for accounting for differences in interactivity and other functional differences between the target market and the benchmark market. Mr. Orszag's first approach is consistent with the ratio equivalency theory accepted by the Judges in *Web IV*. Just as the record companies receive the

same percentage of revenue from both fully interactive and mid-tier services in the unregulated marketplace — despite the different functionality offered by the two types of services and the different consumer subscription prices — so too it makes sense to apply a similar percentage of revenue royalty rate to Sirius XM's service, after adjusting for Sirius XM's non-music content. To make his non-music content adjustment, Mr. Orszag relied on extensive record evidence showing that, very conservatively, 50% of Sirius XM's subscription revenues were attributable to music content. *See* SE FOF at ¶¶ 168-169.

Response to ¶ 257. Sirius XM accurately if incompletely describes the calculations in Mr. Orszag's Approach Two. The point of this approach was to avoid having to make an adjustment for non-music content (since noninteractive streaming services generally do not offer non-music content) and to address Sirius XM's misguided argument that Mr. Orszag should have adjusted his Approach One calculations for the alleged value of Sirius XM's satellite network. Such an adjustment, even if appropriate for Approach One (and it is not) would not be necessary for Approach Two because the noninteractive services transmit content over the internet. Sirius XM implies that the noninteractive services used by Mr. Orszag in his Approach Two analysis were not really noninteractive, but in fact each was a service that used the statutory license and therefore received the same legal rights to perform sound recordings that Sirius XM receives under its statutory license.[31]

Response to ¶ 258. This is a largely accurate recapitulation of Mr. Orszag's testimony.

[31] The largest of these services is Pandora. Although Pandora's current mid-tier offering, called Pandora Plus, is a non-statutory service, the Plus service was not launched until just before Mr. Orszag filed his written direct testimony. *See* Trial Ex. 32 at ¶ 22 (Harrison WDT) [[redacted]]

Response to ¶ 259. Nothing that was said or established during the proceeding undermined the viability or Mr. Orszag's benchmarking approach; rather, the proceeding confirmed that Mr. Orszag's benchmarking proposal is far preferable to Sirius XM's rate-setting methods both in terms of comparability to the target market and consistency with the *SDARS II* and *Web IV* decisions and the 801(b)(1) factors.

i. Mr. Orszag's Approach Has Been Repeatedly Accepted By The Judges, Most Recently In *Web IV,* And The Concerns Expressed By The Judges In *SDARS II* No Longer Apply

Response to ¶ 260. Mr. Orszag's first approach is indeed very similar to an approach offered by Dr. Ordover in *SDARS II*, but Sirius XM is entirely wrong when it describes the Judges' analysis of that approach in *SDARS II*, as we discuss below.

Response to ¶ 261. Sirius XM offers an incomplete and slanted description of the *SDARS II* decision. The *SDARS II* Judges offered three distinct reasons for their conclusions concerning the interactive services benchmark. As explained in SoundExchange's Proposed Findings of Fact, *see* SE FOF at ¶¶ 105-108, those reasons were as follows: First, the Judges stated that "the rights licensed by interactive subscription services are not the same as those by non-interactive services." Second, the Judges stated that material differences existed between Sirius XM and the buyers in the proposed benchmark market because the "interactive subscription service market . . . is in a constant state of flux." *SDARS II*, 78 FR 23065. Finally, the Judges held that the proposed benchmark did not incorporate license agreements between interactive services and independent labels. *SDARS II*, 78 FR 23065-66.

None of these problems with the interactive services benchmark still pertains today. As explained at length in SoundExchange's Proposed Findings of Fact, the interactive subscription services are "converging" with Sirius XM both in terms of functionality and interactivity — that

is, subscription services are more frequently being used with "lean-back functionality" and in connected cars. *See* SE FOF at ¶¶ 106, 153-161. As to the second basis offered for rejecting the interactive services benchmark in *SDARS II*, the subscription interactive services are now well-established and have massive bargaining power. *See* SE FOF at ¶¶ 107, 286-303. [ ]. *See* SE FOF at ¶¶ 108, 124-129.

As to the alleged "yawning gap," as SoundExchange demonstrated during the trial, the effective per-subscriber royalty found to be most strongly supported by the evidence in *SDARS I*, adjusted to today's dollars, equals $1.67. SE FOF at ¶¶ 1407-1422. Mr. Orszag's benchmark analysis results in SoundExchange's proposal of a per-subscriber rate in 2018 of $2.48 — roughly a 50% increase. Sirius XM's rate proposal, calculated as an effective per subscriber rate, represents as much as a 50% decrease.[32] Given the substantial changes in the marketplace since *SDARS I* was decided ten years ago, including Sirius XM's transition from two companies that were losing money to a single company that is massively profitable, as well as the growth of streaming and the concomitant increase in the record companies' opportunity costs of licensing Sirius XM, it is Sirius XM's rate proposal analysis that should give pause.

Response to ¶ 262. As Sirius XM admits, in *SDARS II* the Judges found Dr. Ordover's second approach "somewhat more pertinent," but were concerned about differences between Sirius XM and the buyers in the benchmark market. *SDARS II*, 78 FR 23065. What Sirius XM omits, however, is that the concern expressed by the Judges about the buyers in the benchmark

[32] Sirius XM proposes rates ranging from 8.1% of revenue to 11% of revenue. Using Mr. Orszag's royalty ARPU of [ ], *see* SE FOF at ¶¶ 268, 274-275, Sirius XM's percentage of revenue rates translate to effective per-subscriber rates of [ ] per subscriber — at the low end a reduction of almost 50%.

market at the time of *SDARS II* was that those buyers were in a "state of flux." *SDARS II*, 78 FR 23065. With the likes of Apple, Spotify, Pandora and iHeart now dominating the market for fully interactive services, that concern no longer applies. *See* SE FOF at ¶¶ 107, 286-303.

Response to ¶ 263. In the testimony that Sirius XM cites, Mr. Orszag stated that he was "aware that Professor Ordover had used such a method in *SDARS II* and Professor Rubinfeld used as a benchmark the interactive services market in *Web IV*. But how they implemented it, I do not recall." 4/26/17 1226:22-25 (Orszag). That answer is hardly "curiously evasive"; rather, it is a direct answer with the level of specificity one would expect from a witness during an oral examination.

Response to ¶ 264. Quite to the contrary of Sirius XM's claim, Mr. Orszag directly addressed each of the concerns expressed by the *SDARS II* Judges. He looked into the convergence of fully interactive services and noninteractive services, Trial Ex. 26 at ¶ 39 (Orszag Am. WDT), addressing the Judges' concerns about the potential differences in rights. Mr. Orszag carefully examined the agreements between indies and fully interactive services, thus addressing the Judges' concerns in *SDARS II* that Dr. Ordover had not done so. Trial Ex. 26 at ¶¶ 101-105 (Orszag Am. WDT). And Mr. Orszag presented evidence that the buyers in the market for fully interactive services were no longer weak supplicants for sound recording licenses who were in a state of flux, but instead are critically important business partners for record labels. Trial Ex. 26 at ¶ 79 (Orszag Am. WDT).

On a more fundamental level, Sirius XM's myopic focus on the *SDARS II* decision ignores the fact that the Judges accepted the interactive services benchmark in *SDARS I*, *Web II*, and *Web IV*. Sirius XM tries to spin the *SDARS II* decision as a blanket rejection of the interactive services benchmark, at least as applied to Sirius XM. Nothing could be further from

the truth. Indeed, in *SDARS I* the Judges grounded their rate determination on the interactive services benchmark and accepted Dr. Ordover's analysis in that case. And if Mr. Orszag "slavishly" followed anything, it was the Judges' analysis in *Web IV*. Mr. Orszag devoted one section of his written direct testimony to a discussion of that decision and an explanation of why his analysis is consistent with it. *See* Trial Ex. 26 at ¶¶ 34-42 (Orszag Am. WDT).

Response to ¶ 265. The trial record does not "demonstrate[] the continued correctness of the Judges' prior evaluations of the Ordover/Orszag benchmark analysis as *not* offering a sound basis for rate-setting for Sirius XM." As we noted above, the Judges *accepted* what Sirius XM characterizes as the "Ordover/Orszag" benchmark analysis in *SDARS I*. As also noted above, the Judges had specific concerns in *SDARS II* that Sirius XM ignores but Mr. Orszag addressed. Nor are the rates Mr. Orszag proposes "dramatically inflated," as Sirius XM argues; his analysis is entirely consistent with the Judges' use of the interactive services benchmark in *Web IV*.

ii. The Interactive Services Market Is Effectively Competitive

1. A Market With Must-Haves Can Be Effectively Competitive

Response to ¶ 266. SoundExchange agrees that the major record companies are must-haves for interactive services, as well as mid-tier services, SE FOF at ¶ 515, and Sirius XM. SE FOF at ¶¶ 514-525. Although the major record companies are must-haves for interactive services, the market for interactive services is effectively competitive because the interactive services have an increased (and increasing) ability to steer (among other reasons). SE FOF at ¶¶ 378-384.

To begin, Sirius XM implies — without ever coming out and saying so — that any market in which certain record labels are "must-haves" is — *ipso facto* — not workably competitive. That is not correct, and not what the Judges held in *Web IV*. The Judges found that

the market for fully interactive services was not effectively competitive because of the confluence of *two* facts: first, the majors are must-haves; and second, the services lack the ability to steer because consumers control the choice of music for an on-demand service. As SoundExchange explains more fully in its Response to ¶ 365, *infra*, the mere fact that a label is a must-have does not preclude workable competition where the service has the ability to steer. *See also* SE FOF at ¶¶ 505-513. SoundExchange's evidence in this case demonstrates that the ability of fully interactive services to engage in steering has grown as the importance and prevalence of play-listing has grown.

The major record companies are not immune from steering. Indeed, the major record companies do not specialize in specific genres, but rather offer repertoire across a wide range of genres, which makes it easier to steer against them. SE FOF at ¶ 508. Interactive services have functionality that enables them to implement this steering, and to a much greater extent than ever before. SE FOF at ¶¶ 378-384. For example, playlists curated by the interactive services now reach a much larger number of users. SE FOF at ¶¶ 378-384. Whereas service curated playlists on Spotify accounted for less than [**__**] percent of plays in 2014,[33] they accounted for as much as [**__**] percent of plays in 2016. SE FOF at ¶ 379. Interactive services also offer music discovery features that allow them to steer towards or away from a particular record company's repertoire. *See, e.g.*, SE FOF at ¶ 447.

These playlists and music discovery features have an outsized impact on revenues, because when users who hear sound recordings on playlists or through music discovery playlists add those tracks to their own playlists, they then listen to them repeatedly. *See, e.g.*, SE FOF at

[33] The [**__**] percent is over-inclusive because it includes all playlists other than user-generated playlists. SE FOF at ¶ 379.

¶¶ 381-382. As Mr. Harrison testified, [ ]. SE FOF at ¶ 380. Because interactive services also have incentive to steer, *see, e.g.*, SE FOF at ¶ 383, and are therefore able to make credible threats that they will direct users towards or away from repertoire, *see, e.g.*, SE FOF at ¶¶ 380, 383, the market for interactive services has become effectively competitive. *Cf.* SE FOF at ¶¶ 328, 505-507.

The interactive services increased and increasing ability to steer provides an independent basis for finding that the interactive services market is effectively competitive. So does analysis indicating that the interactive services now possess considerable leverage over the record labels. As discussed below, this leverage has grown because many of the largest interactive services are now operated by well-diversified and financially stable companies, and because record companies are increasingly dependent on revenue generated by subscription interactive services. The result, confirmed by market indicators, is that the record companies are constrained in negotiations, and compelled to make compromises, including on financial terms. *See* Response to ¶ 272; SE FOF at ¶¶ 280-340.

Response to ¶ 267. *See infra* Response to ¶ 272.

Response to ¶ 268. *See infra* Response to ¶ 272.

Response to ¶ 269. *See infra* Response to ¶ 272.

Response to ¶ 270. *See infra* Response to ¶ 272.

Response to ¶ 271. *See infra* Response to ¶ 272.

Response to ¶ 272. The Participants in this proceeding agree that each major record company is a must-have for the interactive services. However, Sirius XM's assertion that UMG [

[redacted] is at best careless and at worst entirely disingenuous. Aaron Harrison from UMG said exactly the opposite at the trial in this case. Sirius XM bases its misleading statements on the documents it quotes in ¶¶ 267-271, which were authored nearly five years ago. These documents, submitted in connection with the 2012 merger of UMG and EMI, are stale evidence with little or no probative value. Sirius XM reaches back in time for this evidence because it lacks timely support for its assertion that must-have record companies [redacted].

Knowingly conflating statements made nearly five years ago with present belief, Sirius XM elides overwhelming evidence that the marketplace for sound recordings has changed in ways that impose significant constraints on the bargaining power of must-have record companies, and ignores contradictory testimony from the UMG witness who appeared at trial.

For example, in the almost five years since UMG made the quoted representation, interactive services have been launched by Apple, Google, Amazon, Pandora, iHeart, Tidal, and other services. SE FOF at ¶ 309. During the same period, revenue from interactive services has grown from 8 percent of record label revenue to 40 percent of record label revenue. SE FOF at ¶ 287. As explained at length in SoundExchange's proposed findings, the bargaining power of even must-have record companies is now constrained by the considerable leverage that interactive services possess. Market indicators — including the entry of new interactive services, the growth of interactive services, and the margins of must have record companies — confirm that must-have record companies [redacted], which now comprise their principal source of revenue and which the record companies therefore need to compete against downstream competitors that generate less revenue. *See, e.g.*, SE FOF at ¶¶ 280-340.

Sirius XM needs to cite evidence that is nearly five years old because current evidence fails to support its contention. For example, in this proceeding UMG's Vice President of Digital Business & Legal Affairs, Aaron Harrison, explained that interactive services like [ ] have substantial bargaining power and leverage that they exercise in negotiations and that result in complex negotiations requiring UMG to compromise on terms, including financial terms. SE FOF at ¶¶ 291, 300-302; *see also* SE FOF at ¶¶ 324-327 (citing testimony in which Mr. Harrison explained that [ ]).

Response to ¶ 273. Although the Participants agree that the major record companies are must-haves for the interactive services, the record clearly demonstrates that even must-have record companies [ ]. *See* Response to ¶ 272.

Response to ¶ 274. Sirius XM relies on Professor Shapiro's assertion that a market with must-have suppliers cannot be effectively competitive. SXM FOF at ¶ 274. But Sirius XM does not bother to explain why this is the case, and never confronts the fact that, at trial, Professor Shapiro stood by and was unable to distinguish his own *Web IV* testimony, in which he expressly admitted that a market with must-haves can be workably competitive if the services in that market have substantial ability to steer. SE FOF at ¶¶ 506-508.

Sirius XM also failed to engage with Professor Willig's testimony on this point. As Professor Willig explained, "even if a label is a must-have, there's still lots of room for . . . effective competition expressed in the actuality of steering or in the anticipation of it, leading to more favorable terms in the agreement, more favorable from the point of view of the distributor,

reflecting the potentiality for steering in the absence of an agreement not to steer." 5/2/17 Tr. 1996:16-23 (Willig).

In sum, the evidence developed in this proceeding supports a finding that that interactive services market is effectively competitive.

2. Interactive Services Are Not Price-Takers

Response to ¶ 275. Substantial evidence establishes that the interactive services are not price-takers. SE FOF at ¶¶ 323-334. To the contrary, interactive services like [ ] have elicited financial concessions that push percentage of revenue rates [ ]. SE FOF at ¶¶ 300-302, 325-326. These rate concessions matter: [ ] SE FOF at ¶ 327 — amounts to a more than 8% reduction in revenues. And when [ ]. SE FOF at ¶ 325. [ ]. SE FOF at ¶ 325.

Ignoring this evidence, Sirius XM focuses narrowly on whether record labels cut prices in exchange for a greater share of plays. This focus is misplaced. As an initial matter, Sirius XM incorrectly posits a complete absence of tit-for-tat price competition in the interactive services market. Unrebutted evidence at trial indicates that in recent agreements concerning interactive and mid-tier deals, [ ]. SE FOF at ¶¶ 861-869. This is not surprising, as interactive services have an increased and increasing ability to steer, SE FOF at ¶¶ 378-384, and even Professor Shapiro acknowledges that services capable of making credible threats to steer might agree to an

anti-steering provision in exchange for some concessions. SE FOF at ¶ 328. Indeed, as Professor Shapiro also acknowledges, cost-savings from exchanging rate breaks for no-steering provisions can be passed through to consumers. SE FOF at ¶ 328.

In any event, Sirius XM's insistence that tit-for-tat price competition is a necessary rather than sufficient condition for workably competitive markets finds no support in the record. As Professor Blackburn has explained, rates in the interactive services market are bilaterally negotiated. Interactive services are able to negotiate on rates because of the considerable leverage that they possess, whether by virtue of their size, market power, and stability, SE FOF at ¶¶ 297-303, 326, the extent to which record companies now rely on the revenue that interactive services generate, SE FOF at ¶¶ 286-296, or the downstream competition that they confront. SE FOF at ¶¶ 316-322. Sirius XM ignores the extent to which these dynamics allow interactive services to secure price concessions, which can be passed through to consumers.[34] [ ] illustrates that such competition is not a necessary element of workably competitive markets.

Sirius XM also ignores substantial record evidence indicating that [ ]. SE FOF at ¶¶ 335-340. [ ]. 4/20/17 Tr. 272:1-8 (Shapiro). [

[34] As Mr. Harrison explained at trial, [ ]. SE FOF at ¶ 332.

[redacted] confirms that rates obtained by the majors are consistent with the operation of an effectively competitive market and underscores the error of adopting Sirius XM's pinhole focus on tit-for-tat price competition. SE FOF at ¶ 340.

Response to ¶ 276. Sirius XM's selective quotation of Mr. Harrison's trial testimony is misleading. In the portion of Mr. Harrison's response that Sirius XM omitted from its findings, Mr. Harrison indicated that UMG [redacted]. 5/16/17 Tr. 3939:16-17 (Harrison). In the very same response, he further testified that:

> [[redacted]
> 5/16/17 Tr. 3939:18-3940:18 (Harrison).

Sirius XM likewise omits portions of Mr. Harrison's response to other cited testimony. For example, asked whether Sirius XM engages in price competition with other labels when negotiating with interactive services, Mr. Harrison indicated that [redacted]

[redacted]]. 5/16/17 Tr. 4034:17-23 (Harrison); *see also* 5/16/17 Tr. 4029:-21 (Harrison) (emphasizing that UMG [redacted]).

And as Mr. Harrison elaborated in response to Judge Strickler, [redacted].[35] 5/16/17 Tr. 4035:8-4036:4 (Harrison).

Response to ¶ 277. At trial, Mr. Walker confirmed that Sony [redacted], further illustrating that Sirius XM's misguided focus on direct tit-for-tat price competition provides an incomplete view of competitive dynamics in the market for interactive services. 5/15/17 Tr. 3836:12-14 (Walker).

Response to ¶ 278. At trial, Mr. Orszag described the price competition evident in negotiation over [redacted]. *See, e.g.*, 4/26/17 Tr. 1108:5-1112:6, 1116:21-1118:3 (Orszag). There is also other substantial record evidence to support Mr. Orszag's conclusion that the market for interactive services has grown more competitive over the past few years, including the continued growth of service-curated playlisting, *see supra* Response to ¶ 266, the entry of services operated by technology companies with considerable

[35] Regarding changes in the competitiveness of the interactive services market since *Web IV*, Sirius XM again elects to selectively quote and mischaracterize Mr. Harrison's testimony. SXM FOF at ¶ 276. At trial, Mr. Harrison testified that his experience in negotiating licensing agreements with interactive services has involved [redacted]. 5/16/17 Tr. 4026:3-7 (Harrison). Throughout his written and oral testimony, Mr. Harrison describes [redacted], [redacted]. *See, e.g.*, SE FOF at ¶¶ 300-303. As a result, Mr. Harrison testified that he [redacted]. 5/16/17 Tr. 4025:21-4026:7 (Harrison). And as indicated at trial, Mr. Harrison has since the time of *Web IV* seen [redacted], 5/16/17 Tr. 4027:8-10 (Harrison), [redacted]. 5/16/17 Tr. 4025:21-24 (Harrison).

bargaining leverage, SE FOF at ¶¶ 297-303, and the increased importance of revenues attributable to fully interactive services, SE FOF at ¶¶ 286-296, which has given companies like Spotify even more power in negotiations. SE FOF at ¶ 294.

Response to ¶ 279. *See infra* Response to ¶ 280.

Response to ¶ 280. Based on substantial evidence not presented in *Web IV*, and discussed at length in SoundExchange's Proposed Findings of Fact, the record demonstrates that the market for interactive services has been and remains effectively competitive. SE FOF at ¶¶ 280-340. The additional evidence of effective competition that Mr. Orszag discusses, *see supra* Response to ¶ 278, corroborates that record companies remain unable to obtain supra-competitive licensing fees. SE FOF at ¶ 290; *see also* SE FOF at ¶¶ 313-315.

Response to ¶ 281. *See supra* Response to ¶ 280.

3. Sirius XM Mischaracterizes The Contractual Evidence It Relies On

Response to ¶ 282. With respect to *marketing* or *promotional* opportunities, the major record companies and interactive services commonly negotiate most favored nation or non-discrimination provisions.[36] *Web IV*, 81 FR at 26373. However, these provisions are not anti-steering provisions as the Participants use that term in *this* proceeding. That is because the

[36] These provisions preclude the interactive services from steering towards or away from the record companies with respect to marketing or promotional opportunities. However, because the Participants in this proceeding reserve use of the term steering for circumstances in which a service is intentionally shifting plays or programming opportunities, we avoid using the term "anti-steering" when referring to provisions that concern a guaranteed amount of marketing or promotion on- or off-service.

provisions [[redacted]]. *See infra* Response to ¶¶ 283-285.

As discussed below, Sirius XM often conflates provisions that concern share of *marketing* opportunities and provisions that concern share of *programming* opportunities. *See infra* Response to ¶¶ 283-285. Moreover, Professor Shapiro did this at trial, initially intimating that [[redacted]] before acknowledging under questioning from Judge Strickler that [[redacted]]. SE FOF at ¶ 358; *see also* 5/4/17 Tr. 2524:9-2526:3 (Shapiro). These distinctions matter. And Sirius XM consistently fails to draw them. Indeed, Sirius XM provides little reliable evidence to support its assertion that [[redacted]].[37] *See infra* Response to ¶¶ 283-285.

Sirius XM also makes too much of previous analysis regarding how anti-steering provisions might affect effective competition in a *hypothetical* market for non-interactive services. *Web IV*, 81 FR at 26374. When analyzing the potential effect of anti-steering provisions in *Web IV*, the Judges did not have any marketplace evidence to rely on. *Web IV*, 81 FR at 26374. This has changed. After *Web IV*, [[redacted]]. SE FOF at ¶¶ 861-869. These [[redacted]] have been the subject of substantial testimony in this proceeding. [[redacted]

[37] As discussed below, and in SoundExchange's Proposed Findings of Fact, anti-steering provisions advance and reflect effective competition to the extent that securing them has a downward effect on rates. *See* SE FOF at ¶¶ 861-869. To the extent that Sirius XM means to rely on anti-steering provisions negotiated between record companies and interactive services — but not subject to testimony at trial — Sirius XM's reliance is misplaced because there is insufficient evidence to assess whether the relevant provisions reflect rate concessions and thus advance effective competition.

[redacted]]. SE FOF at ¶¶ 844-847, 861-869; *see also* 5/26/17 Tr. 1152:15-1153:18 (Orszag) (describing possibility that [redacted] were not available when Judges analyzed anti-steering provisions in *Web IV*).

This unrebutted testimony demonstrates that [redacted] an effectively competitive market, namely, one in which the threat of steering induces record companies to accept lower rates. SE FOF at ¶ 868. And, importantly, anti-steering provisions accomplish this while preserving downstream competition. SE FOF at ¶ 869. In other words, anti-steering provisions reduce prices without creating a cost incentive for music services to deviate from the optimal mix of plays and, in doing so, diminish the listening experience. SE FOF at ¶ 869. Professor Willig explained: "[T]he potentiality for steering is influencing, perhaps in a very strong way, the level of a uniform royalty rate in the presence of a no-steering provision, which means it's highly pro-competitive because it's adjusting prices in accordance with what steering would do, but without distorting consumer welfare at the same time." SE FOF at ¶ 869 (quoting 5/2/17 Tr. 2001:19-2002:1 (Willig)). Put simply, market evidence unavailable at the time of the *Web IV* decision demonstrates decisively that anti-steering provisions can be pro-competitive.

Response to ¶ 283. Sirius XM purports to provide examples of anti-steering and MFN provisions that thwart price competition in the market for interactive services. There is no reason to believe that at least two of these provisions bear on programming or price competition.[38]

Sirius XM first lists a [ ] pulled from Sony's licensing agreement with Spotify. The provision states, in relevant part:

> [ ].

Trial Ex. 125-30H at SoundX_000065236 (emphasis added). At trial, Sirius XM never asked Mr. Walker to interpret the first sentence of this provision. The reason is obvious. Earlier, Mr. Walker had testified that [ ]. 5/16/17 Tr. 3846:13-22 (Walker). In light of that testimony, there is no reason to believe that the [ ].[39]

Sirius XM also cites a provision from WMG's deal with Tidal. However, [

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[38] Moreover, Sirius XM supplies no evidentiary basis to support a conclusion that these three provisions are representative of terms that appear in other licensing agreements. For that reason, the examples provided do not support any finding about the number and nature of analogous provisions.

[39] [ ]. Trial Ex. 125 at 22 (SoundX_000065236); 5/15/17 Tr. 3849:3-18 (Walker).

[redacted]. Trial. Ex. 127-32I at (SoundX_000026742-43). There is no basis in the record to conclude that [redacted].

Response to ¶ 284. Sirius XM misrepresents Mr. Harrison's testimony and the agreement it concerns. As Mr. Harrison explained, the contractual term at issue requires that [redacted]. 5/16/17 Tr. 4004:14-19 (Harrison). This, of course, has nothing to do with price competition. Rather, the provision [redacted] that Sirius XM insists are irrelevant in assessing workable competition.

Response to ¶ 285. Regarding Sony's agreement with Rhapsody, Sirius XM's assertions are inaccurate. Mr. Walker was clear at trial: [redacted]. 5/16/17 Tr. 3844:22-3845:2 (Walker). In other words, it has nothing to do with the price competition. Instead it concerns [redacted], that is, the non-price competition that Sirius XM insists is irrelevant in assessing workable competition.

Regarding the terms of Sony's licensing agreement with Spotify, Sirius XM's findings are similarly misleading. When Sirius XM asked about the relevant term at trial, it [redacted]. *See supra* Response to ¶ 284 & n.5. As discussed above, [redacted]. *See supra* Response to ¶ 284. Put simply, the cited provision [redacted]

[redacted]].

Response to ¶ 286. Professor Shapiro's opinion that anti-steering provisions exist in the interactive services market and impede price competition finds little support in this record. Professor Shapiro identifies three "examples" of contractual provisions that purportedly prohibit steering and impede price competition. However, the record provides no support for Professor Shapiro's assertion that at least two of the cited provisions in any way affect the relevant services' ability to induce price competition. *See supra* Response to ¶ 283. In any event, Professor Shapiro's assertion that these provisions — and any other supposed anti-steering provisions he means to rely on — impede price competition is conclusory. Professor Shapiro never even considers whether the anti-steering provisions he identifies were bargained for, and whether the give and take of bargaining involved or yielded rate discounts. In other words, Professor Shapiro never bothers to assess whether the anti-steering provisions reflect rather than thwart the price competition he is after. *See* SE FOF at ¶¶ 861-869.

iii. Sirius XM's Analysis Of Non-Price Competition Is A Straw Man

Response to ¶ 287. Sirius XM's analysis of non-price competition is a straw man. As discussed above, substantial evidence not presented in *Web IV* demonstrates that the market for interactive services has been and remains effectively competitive. SE FOF at ¶¶ 280-285. What Mr. Orszag describes — the more prominent role that interactive services play in curating content for users — illustrates that interactive services now have more ability to steer users towards or away from record company content. Trial Ex. 26 at ¶ 74 (Orszag Am. WDT). Put another way, interactive services can now more credibly threaten to advantage or disadvantage particular labels in programming decisions like placement on and location within service-curated

or algorithmically driven playlists. Mr. Orszag makes this clear in a portion of his testimony that Sirius XM ignores. Trial Ex. 26 at ¶ 74 (Orszag Am. WDT). As recent negotiations between [] and the record companies demonstrate, these credible threats can induce price competition.[40] SE FOF at ¶¶ 861-869.

Response to ¶ 288. Sirius XM misreads *Web IV*. In that proceeding, SoundExchange presented figures about the use of playlists in discussing the functional convergence between interactive and non-interactive services. *Web IV*, 81 FR at 26336. In the cited portion of the opinion, there is no discussion about the extent to which increased use of lean-back functionality on fully interactive services can create a credible threat of steering and induce price competition. *Web IV*, 81 FR at 26336. In any event, since the *Web IV* decision, the use of service or third-party playlists on Spotify, for example, has grown significantly. In *Web IV*, the Judges found that [] of plays on Spotify came from service or third party playlists. *Web IV*, 81 FR at 26336. By the time Mr. Harrison submitted written direct testimony in October 2016, that number had increased to [] for *service curated playlists alone*. SE FOF at ¶ 379.

Response to ¶ 289. *See supra* Response to ¶ 287.

Response to ¶ 290. *See supra* Response to ¶ 287.

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[40] Of course, it is also possible that music services view their current rates as fair market rates and, accordingly, leverage their ability to steer to secure non-price concessions from the record companies. *See, e.g.*, SE FOF at ¶ 300 ([]); SE FOF at ¶ 302 ([]); SE FOF at ¶ 303 ([]). In fact, Sirius XM furnishes no evidence that interactive services have offered and the record companies rejected a contractually guaranteed volume of plays in exchange for rate discounts. Indeed, Sirius XM focuses entirely on whether the record companies have proposed such arrangements, without bothering to address whether the services have made such proposals. *See, e.g.*¸ Response to ¶¶ 276-277.

iv. Dr. Blackburn's Empirical Analysis Of Evidence Not Presented In *Web IV* Confirms That The Interactive Services Market Is Effectively Competitive

Response to ¶ 291. Professor Shapiro concludes on the basis of incomplete analysis that the market for interactive services is not effectively competitive. As Professor Blackburn explained, assessing the competitive dynamics of a bilateral negotiation requires assessing relative bargaining power. Professor Shapiro does not do this. Instead, he focuses entirely on the ostensible bargaining power of the record companies, ignoring entirely the bargaining power of the interactive services. SE FOF at ¶ 281. Because Professor Shapiro does not consider relative bargaining power, his analysis of effective competition is not reliable. SE FOF at ¶¶ 281-282.

Response to ¶ 292. Sirius XM presents a stylized and incomplete recitation of Dr. Blackburn's testimony. Dr. Blackburn presents substantial evidence that the interactive services have significant leverage in their negotiations with record companies because record companies rely heavily on revenue generated from interactive services, because the record companies' profitability turns in significant part on whether subscription interactive services prevail against downstream competitors that generate less revenue, because the record companies rely on companies operating interactive services in physical and other digital distribution channels, and because the record companies are smaller and much less diversified than many of the entities operating interactive services. SE FOF at ¶¶ 286-296, 316-322.

Response to ¶ 293. Dr. Blackburn presents substantial evidence that interactive services have and exercise their considerable leverage in negotiations with the record companies. This evidence includes testimony concerning specific price and non-price concessions elicited by

interactive services during negotiations with record companies, as well as evidence of the holdout power that services like Spotify now possess. SE FOF at ¶¶ 294, 300-303.

Response to ¶ 294. Relying on Table One to Mr. Orszag's amended written direct testimony, Sirius XM asserts that there is no relationship between service size and the royalties paid. But looking at royalties paid is a red herring, as parties cannot know how a service will perform ex-ante.

[[redacted]]. *See, e.g.*, SE FOF at ¶¶ 327, 883; 4/26/17 1152:15-1153:11 (Orszag). Size is one of many factors that affect the rates and terms in an agreement. Unrebutted testimony provided by Mr. Harrison establishes that [[redacted]]. SE FOF at ¶¶ 297-303. Mr. Harrison's testimony further establishes that [[redacted]]. *See, e.g.*, SE FOF at ¶¶ 325, 327.

Response to ¶ 295. Unable to marshal any contemporaneous evidence that contradicts Dr. Blackburn's testimony, Sirius XM again reaches back to July 2012 for statements that UMG made in filings concerning its merger with EMI. As previously discussed, this stale evidence is not probative of the existing market for interactive services, which has changed considerably over the past five years. *See* Response to ¶¶ 272-273. And it is contradicted by testimony given in this proceeding by UMG's Senior Vice President of Digital Business & Legal Affairs, Aaron Harrison, whose written and oral testimony establishes that even must-have record companies

like UMG [[redacted]]. *See* Response to ¶¶ 272-273.

Response to ¶ 296. Dr. Blackburn's careful analysis of marketplace evidence establishes that indicia of supra-competitive pricing are absent and the rates negotiated between record companies and interactive services are workably competitive rates.

Response to ¶ 297. Sirius XM intentionally omits a critical portion of Dr. Blackburn's testimony. Dr. Blackburn testified that it would be improper to conclude that rates reflect fair market value based on growth *alone*. 5/1/17 Tr. 1778:10-13 (Blackburn). As Dr. Blackburn explained time and again, assessing whether rates represent fair market value requires a holistic analysis that includes evaluation of factors including suppression of output for recorded music, supra-competitive profits inuring to the record companies, and a lack of downstream alternatives for consumers. *See, e.g.*, SE FOF at ¶ 305.

Response to ¶ 298. Dr. Blackburn evaluated revenues and costs aggregated across different distribution channels because calculating an operating margin requires assessing revenues and costs, and most of the costs associated with distribution of recorded music cannot be allocated to a particular distribution channel. 5/1/17 Tr. 1738:3-9 (Blackburn). As Dr. Blackburn explained, there is no reason to think that the operating margins attributable to interactive streaming would be materially different had he instead opted to allocate costs on a revenue basis, as firms commonly do. 5/1/17 Tr. 1738:3-1739:8 (Blackburn). Nor does Sirius XM supply sufficient evidentiary support of a conclusion that piracy meaningfully impacts this analysis, particularly given that piracy also constrains the prices that record companies can charge in the upstream market. SE FOF at ¶ 321.

Response to ¶ 299. In *Web IV*, the Judges observed that SoundExchange noted "persuasively" that downstream competition would in theory depress the upstream price. 81 FR at 26343. As the Judges pointed out, economists for the Services in *Web IV* concurred with that point as a matter of theory. 81 FR at 26343. In this case, unlike in *Web IV*, there is marketplace evidence to suggest that what is true in theory has occurred in practice. For example, Mr. Harrison testified that [ ]. 5/16/17 Tr. 3981:14-18 (Harrison); SE FOF at ¶ 320. Mr. Kushner confirmed that Atlantic views every type of streaming service as competing to some extent with every other such use of music, views none as more promotional than any other, and is focused on growing lines of business that generate the highest revenue per user. SE FOF at ¶ 318; *see also* SE FOF at ¶ 319.

Response to ¶ 300. Sirius XM's analysis of non-price competition is a straw man. *See supra* Response to ¶ 287. Dr. Blackburn points to the more prominent role that interactive services play in curating content for users in part to illustrate that interactive services now have more ability to steer users towards or away from record company content. Trial Ex. 39 at ¶¶ 38-40 (Blackburn WRT). Dr. Blackburn makes this clear in portions of his testimony that Sirius XM ignores. As recent negotiations between [ ] and the record companies demonstrate, these credible threats can induce price competition.[41] SE FOF at ¶¶ 861-869.

[41] It is true that, after deals are consummated, the ability of interactive services to steer *also* induces non-price competition. *See* SE FOF at ¶ 383. This, of course, has no effect on the interactive services' ability to leverage credible steering threats to negotiate rate discounts when deals are up for renegotiation. That interactive services *already* use their ability to steer to [ ], simply underscores that the threat of steering will be sufficiently credible to influence renegotiations. *See* SE FOF at ¶ 383.

Response to ¶ 301. Substantial evidence not presented in *Web IV* supports Dr. Blackburn's conclusion that the market for interactive services has been and remains effectively competitive. *See* SE FOF at ¶¶ 280-340.

v. If The Judges Determine That The Interactive Services Market Is Not Effectively Competitive, Mr. Orszag's Proposed Competition Adjustments Produce Appropriate Royalty Rates

Response to ¶ 302. Should the Judges determine that a competition adjustment is needed, Mr. Orszag has identified three potential competition adjustments, each sufficient to redress the alleged lack of competition in the market for interactive services.

Based on rate discounts in Sirius XM's direct licenses, Mr. Orszag first proposed an adjustment of [[redacted]], which reflects the maximum amount of the rate discount that *could be* (but likely is not) attributable to steering. SE FOF at ¶¶ 343-348.

Mr. Orszag next proposed a 12% adjustment based on the steering adjustment in *Web IV*. 81 FR at 26325, 26404-405. This adjustment was applied to the market for subscription noninteractive services, which is comprised of services that have greater incentive to steer than does Sirius XM. SE FOF at ¶¶ 349-353.

Finally, Mr. Orszag analyzed recently executed direct licenses for subscription mid-tier services offered by Pandora and by iHeart, and proposed a [[redacted]] competition adjustment based on Pandora's willingness to [[redacted]]. SE FOF at ¶¶ 354-360.

Sirius XM attacks the first two proposed adjustments. As discussed below, its attacks have no merit. *See* Responses to ¶¶ 303-304.

Response to ¶ 303. Mr. Orszag's proposed competition adjustments comport with the methodological approach that the Judges adopted in *Web IV*. There, the Judges found that the

market for interactive services was not effectively competitive. Nevertheless, the Judges determined that rates in the interactive services market provided an effective benchmark, so long as those rates were adjusted to ensure that they reflected effective competition. *Web IV*, 81 FR at 26343, 26404.

To make this adjustment, the Judges in *Web IV* looked to direct licenses in the target market: the market for noninteractive services. The Judges determined that those licenses provided evidence from which to calculate the likely effects of steering on rates in the market for interactive services, and then used that evidence to adjust the rates recommended by SoundExchange's interactive services benchmark. *Web IV*, 81 FR at 26343, 26404.

In other words, the Judges have already rejected the argument Sirius XM now makes: that rates in SoundExchange's interactive services benchmark cannot properly be adjusted using evidence of steering derived from direct licenses in the target market. *Web IV*, 81 FR at 26343, 26404. Notwithstanding Sirius XM's claim that "these discount factors do not speak to the downward adjustment that would be necessary to translate monopoly rates [meaning, presumably, the interactive services market rates] into workably competitive rates," the Judges in *Web IV* did exactly that — the Judges used these discount factors to translate the interactive market rates into workably competitive rates. Contrary to Professor Shapiro's unsupported claim that "[i]t's not what was done in *Web IV*," in reality this is *exactly* how the Judges used the 12% adjustment in *Web IV*. 5/4/17 Tr. 2517:24 (Shapiro). The Judges applied the discount observed in the target market to the rates in the benchmark market. Sirius XM's effort to re-write history (and the Judges' *Web IV* decision) should be rejected.

Response to ¶ 304. As discussed above, it is Sirius XM that misunderstands how the Judges calculated and then applied their 12% effective competition adjustment in *Web IV*. *See*

supra Response to ¶ 303. Sirius XM's primary complaint is that the Judges applied the 12% effective competition adjustment to minimum per-play rates rather than effective rates in *Web IV*. This is a red herring. The per-play rates *were* effective rates in *Web IV*. *See* 81 FR at 26325. And for all of the reasons discussed in SoundExchange's Proposed Findings of Fact describing Mr. Orszag's interactive benchmark analysis, SE FOF at ¶¶ 130-145, using effective rates is the correct methodological approach. *See also* Response to ¶ 195, *supra*.

Sirius XM's real objection to the adjustments offered by Mr. Orszag is simply that Sirius XM believes the resulting rates are too high. Sirius XM starts from the proposition that rates should come out where Sirius XM wants them to, and the competition adjustment should be calculated to achieve that result, instead of determining (as the Judges did in *Web IV*) an appropriate adjustment and accepting the result that follows. That Professor Shapiro's arguments in this regard are circular and result-driven becomes quite clear when one reads the colloquy between Professor Shapiro and Judge Strickler.[42] 4/20/17 Tr. 388:17-389:16 (Shapiro). The best argument Professor Shapiro could manage was "12 percent is not nearly enough if you're using that arithmetic." 4/20/17 Tr. 386:2-3 (Shapiro).

[42] Professor Shapiro's approach to calculating rates in this case confirms this circularity. Professor Shapiro embraced the 12% effective competition adjustment when implementing a version of Mr. Orszag's approach that begins with minimum per-play rather than percentage of revenue rates. *See, e.g.*, SX FOF at ¶ 325. And at trial, he testified that the Judges could eliminate the complementary oligopoly effect on interactive rates by "follow[ing] the same steps that [the Judges] did in *Web IV*, including with the 12 percent adjustment . . . for steering." 4/20/17 Tr. 359:15-360:6 (Shapiro). This makes plain that Sirius XM's real argument is with Mr. Orszag's use of percentage of revenue and per-subscriber rates, rather than headline per-play rates, and not with the 12% adjustment. SoundExchange thoroughly discredited the argument that per-performance rates are preferable to percentage-of-revenue and per-subscriber rates. *See* SE FOF at ¶¶ 130-145.

vi. Mr. Orszag Correctly Relied On The *Web IV* Decision

Response to ¶ 305. Sirius XM is correct that Mr. Orszag uses the same benchmarking methodology as that endorsed by the Judges in the *Web IV* decision.

Response to ¶ 306. For the reasons discussed below, the record demonstrates that Mr. Orszag adhered faithfully to the benchmarking approach that the Judges approved in *Web IV*.

1. Mr. Orszag's Analysis Follows The Judges' Conception And Application Of "Ratio Equivalency" In *Web IV*

Response to ¶ 307. Sirius XM correctly restates portions of Dr. Rubinfeld's *Web IV* benchmarking analysis, but omits that Dr. Rubinfeld adjusted his per-play rates to account for any non-rate compensation. *Web IV*, 81 FR at 26338.

Response to ¶ 308. Sirius XM misreads the *Web IV* decision by implying that "a 1:1 'opportunity cost' for record companies" with respect to noninteractive and interactive subscription services is a requirement for using the interactive services benchmark. That is wrong. In fact, the only requirements are those listed in the *Web IV* decision, *see* 81 FR at 26353, as explained in Sirius XM's own Paragraph 309. Although one of those requirements — that there be "sufficiently high cross-elasticity of demand as between interactive and noninteractive services" — is related to the 1:1 requirement, they are not identical. That is, a 1:1 relationship need not be shown in order for there to be a sufficiently high cross-elasticity of demand — rather, a 1:1 relationship can be assumed when the other three conditions listed above are satisfied. That is how the Judges used the concept in *Web IV*. *See* 81 FR at 26353.

Response to ¶ 309. Sirius XM correctly restates the three requirements for the interactive services benchmark to apply.

Notably absent from the *Web IV* decision is any statement that there is a fourth requirement — that the benchmarking methodology employ headline per-play rates as opposed

to effective rates. Sirius XM does its best to imply such a requirement, but none exists. Moreover, the *Web IV* decision is not the first time the concept of ratio equivalency has been applied in a proceeding before the Judges. As noted previously, the decisions in *Web II*, *Web III* and *SDARS I* each relied in whole or in part on the interactive services benchmark. Although the phrase "ratio equivalency" had not yet been coined, that theory supported the interactive services benchmarking analysis in each of those earlier cases, and in none of those cases was anything other than effective rates used in the analysis.

Mr. Orszag carefully considered each of the three requirements listed in ¶ 309, and in his written testimony demonstrated why each requirement was satisfied in this case. *See* Trial Ex. 26 at ¶¶ 34-42 (Orszag Am. WDT).

Response to ¶ 310. Sirius XM claims that Mr. Orszag's attempted application of the concept of ratio equivalency from *Web IV* is unmoored from sound economics and is not grounded in the Judges' reasoning. Presumably, what Sirius XM means is that Mr. Orszag used effective rates. But even Professor Shapiro does not argue that this approach is "unmoored from sound economics." Indeed, when asked at trial, Professor Shapiro could not conjure up any economic basis for using anything other than effective rates. 4/20/17 Tr. 390:8-10, 390:18-19 (Shapiro). As for not being grounded in the Judges' reasoning, SoundExchange disagrees because in *Web IV* the per-play rates were the effective rates. *See* 81 FR at 26325 (noting that none of the percentage of revenue prongs in the benchmark agreements had been triggered, and that the "parties to those agreements viewed the per-play rate as the rate term that would most likely apply for the length of the agreement."); *see also* 81 FR at 26326 ("Dr. Rubinfeld indicated that his 'ratio-equivalency' per-play methodology resulted in a per-play royalty payment that approximated 55% of service revenue.").

2. Ratio Equivalency Applies As Between Sirius XM And Subscription Interactive Services

Response to ¶ 311. SoundExchange agrees that the Judges in *Web IV* stated that ratio equivalency applies when "functional convergence and downstream competition for potential listeners indicate a sufficiently high cross-elasticity of demand . . . provided the noninteractive subscription rate is reduced to reflect the absence of the added value of interactivity." 81 FR at 26353. The Judges did not say that this requires a showing that "one more dollar spent on a subscription to Sirius XM corresponds to one dollar less spent on interactive subscription services," which is how Professor Shapiro spins the decision. Trial Ex. 9 at 14 (Shapiro Corr. WRT). This twists the Judges' words. Sirius XM quotes the relevant passage of *Web IV* more accurately in ¶ 308, where it notes that the Judges referred to a one-to-one "opportunity cost" such that a dollar spent on Sirius XM is a lost opportunity for royalties from a dollar to be spent on a subscription to an interactive service. 81 FR at 26344-45. Given the disparity between the royalties paid by Sirius XM and interactive services, at the present time a dollar spent on Sirius XM generates $.11 in royalties (*i.e.*, 11% of Sirius XM's subscription revenues), whereas a dollar spent on a fully interactive subscription generates more than $.50 in royalties. In other words, it takes $5 spent on Sirius XM to equal the royalties earned by the copyright owners from $1 spent on a fully interactive service. Consequently, the opportunity cost of licensing Sirius XM far exceeds the one-to-one opportunity cost ratio referred to by the Judges.

What the Judges required was "functional convergence and downstream competition." As we discuss below, that requirement is satisfied.

Response to ¶ 312. Sirius XM's discussion of the evidence, and its claim that no empirical analysis was attempted, entirely ignores the surveys performed by Professor Dhar and

Professor Simonson, which show that Sirius XM diverts a substantial number of subscribers away from fully interactive services. *See* SE FOF at ¶¶ 585, 641.

Response to ¶ 313. Sirius XM cites only a selection of the evidence on which Mr. Orszag and SoundExchange's other witnesses relied to show significant competition between the target and benchmark markets. Tellingly, Sirius XM does not mention its own admissions, which include the following:

- Sirius XM, in a lawsuit it filed against one of its former programmers who left Sirius XM for a programming job at Spotify, stated that "Spotify aims to, and in fact does, compete directly with Sirius XM by offering and providing music and music entertainment services including curated music playlists . . . ," and Spotify is "one of Sirius XM's key direct competitors." Trial Ex. 26 at ¶ 39 (citing Trial Exs. 282 & 283).
- Sirius XM's SEC filings state: "Nearly all automakers have deployed or are planning to deploy integrated multimedia systems in dashboards. . . . These systems enhance the attractiveness of Internet-based competitors by making such applications more prominent, easier to access, and safer to use in the car." Trial Ex. 356 at 6 (Sirius XM 2015 10-K).
- Sirius XM's own witness, Professor Farrell, testified that "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. 605:2-4 (Farrell).
- Sirius XM's CEO, James Meyer, testified that automobile companies are deploying software in the vehicle that makes pairing with smart phones and their

interactive services "seamless," and acknowledged to Judge Strickler that he is concerned about future competition from interactive services. SE FOF at ¶ 157.

- Professor Shapiro admits that the amount of in-car listening to fully interactive services will increase during the coming rate term. 4/20/17 238:4-5 (Shapiro).

Given the evidence of downstream competition to which Sirius XM admits (not to mention the findings of the Dhar and Simonson surveys), it is hard to imagine that anything further could be necessary. But in addition to all this, Mr. Orszag persuasively demonstrated that the fully interactive services are converging with Sirius XM in terms of functionality, because the interactive services are increasingly offering, and consumers are increasingly taking advantage of, lean-back listening and seamless mobility. *See, e.g.*, SE FOF at ¶¶ 378-384.

Sirius XM cannot and does not contest that this is happening — instead, it argues that functional convergence does not conclusively prove downstream competition. Yet the functional convergence of subscription services that charge similar subscription prices strongly suggests downstream competition. Which, presumably, is why the Judges in the *Web IV* decision mentioned functional convergence as one of their proxies for proof of cross-elasticity. That evidence of functional convergence exists in this case in abundance. *See* Trial Ex. 26 at ¶ 39 (Orszag Am. WDT).

Response to ¶ 314. *See supra* Response to ¶ 313.

Response to ¶ 315. *See supra* Response to ¶ 313.

Response to ¶ 316. *See supra* Response to ¶ 313.

Response to ¶ 317. *See supra* Response to ¶ 313.

Response to ¶ 318. Sirius XM relies on Figure 4 in Professor Shapiro's written direct testimony, which suggests that terrestrial radio comprises 66% of in-car listening, while Sirius

XM comprises 16% and other forms of subscription and ad-supported streaming comprise only 6% of in-car listening. Trial Ex. 8, Figure Four (Shapiro WDT). Sirius XM claims that any competition it faces from subscription interactive services is insignificant.

There are a variety of problems with this argument. First, there is substantial evidence cited above, *see, e.g.*, Response to ¶¶ 20, 22-23, 313, of significant competition between Sirius XM and subscription streaming services. Second, Sirius XM cherry-picks data that is contradicted by other evidence of record showing substantial and ever-increasing streaming use in vehicles. *See* Response to ¶¶ 20-22, above. The fact that subscription streaming in the car is not even greater than the data indicate shows only that Sirius XM is competing successfully for the dollars that subscribers might otherwise spend on subscriptions to fully interactive services. That is, Sirius XM has managed somewhat to limit the use of fully interactive services in the car, which simply shows that the opportunity cost of licensing Sirius XM is quite high.

The fact that, if Sirius XM were not available, some of its subscribers would divert to terrestrial radio instead of purchasing subscriptions to fully interactive services is not relevant: the critical point is that a substantial percentage of consumers would switch to subscription streaming services if Sirius XM were unavailable, as shown by the Dhar and Simonson surveys and multiple documents demonstrating that streaming services compete with Sirius XM. *See, e.g.*, Response to ¶¶ 20-22, 313, *supra*. Thus, even if one out of five current Sirius XM subscribers purchased a subscription to a fully interactive service, the copyright owners would be better off given the disparity in royalties. That Sirius XM subscribers would switch to subscription streaming services if Sirius XM were not available makes perfect sense, because Sirius XM subscribers have demonstrated a high willingness to pay for a commercial-free

product and obviously find AM/FM radio unsatisfying. *See* SE FOF at ¶¶ 1358-1359, Response to ¶¶ 20-22, *supra*.

There are other problems with Professor Shapiro's claim. *See* SE FOF at ¶¶ 1351-1359. We summarize them briefly here: First, Professor Shapiro does not dispute that in-car listening to interactive services is going to rise during the coming years due to improvements in connected car technology. 4/20/17 Tr. 238:4-5 (Shapiro). Second, the Share of Ear survey is not in evidence, and the methodology it used is unreliable. *See* SE FOF at ¶ 1354. Third, as noted above, other materials actually in evidence indicate that streaming is a much higher percentage — 23% — of in-car listening, exceeding the share devoted to satellite radio. *See* Trial Ex. 122 at 72 (SoundX_000033362). Fourth, the correct question to ask in assessing substitution is not how consumers allocate their listening time, but how they would allocate their expenditures on music consumption were Sirius XM to become unavailable. *See* SE FOF at ¶¶ 635-645, 1245-1317. Fifth, other record evidence shows that, aside from the amount of time consumers spend listening to streaming services in the car, a greater number of consumers use streaming services in the car than use Sirius XM in the car. Trial Ex. 123 at 2 (SoundX_000034822) (22% of respondents listening to Sirius XM in the car; 18% to Pandora; 7% to Spotify, and 5% to other streaming audio services); Trial Ex. 294 (SoundX_0000488981) (indicating that more respondents have used online radio in the car (26%) than satellite radio (22%)).

Response to ¶ 319. In sum, it is Sirius XM that has failed to rebut the evidence of sufficiently high cross-elasticity of demand between its service and interactive subscription services, not SoundExchange that has failed to show such rivalry in the marketplace.

3. Sirius XM's Insistence On Using Minimum Per-Play Rates Rather Than Effective Rates Is Misplaced

Response to ¶ 320. *See infra* Response to ¶ 321.

Response to ¶ 321. SoundExchange agrees with Sirius XM that in this case the outcome of the benchmarking analysis will be different depending on whether effective or headline rates are used. *See* SE FOF at ¶ 132. But SoundExchange disagrees with Sirius XM's argument that using headline rates in calculating that ratio is the correct approach.

Sirius XM criticizes Mr. Orszag's use of effective rates on the basis that the *Web IV* Judges used headline rates, not effective rates. As we have said many times, and will repeat once more, the *Web IV* decision itself says otherwise — the per-play rates used for the interactive services benchmark *were* the effective rates in that case. *See Web IV*, 81 FR at 26325 (explaining that because "none of the percentage-of-revenue prongs in the greater-of agreements in the record has been triggered," the per-play rates "apply for the length of the agreement."). *See also supra* Response to ¶¶ 195-196.

Moreover, there is nothing in the Judges' discussion of the ratio equivalency theory in *Web IV* to suggest that it was tied to the use of minimum per-play rates. To the contrary, the Judges tied ratio equivalency to the opportunity cost of the record companies and their economic incentive to earn similar marginal margins across different platforms. 81 FR at 26344. That rationale necessarily relates ratio equivalency to effective rates, because it is the effective rates that determine opportunity costs and margins.

Sirius XM also ignores, as we pointed out previously, that the concept of ratio equivalency has long been employed by the Judges in prior cases in which interactive services agreements were offered as benchmarks (*e.g.*, *Web II, Web III, SDARS I*), even if the phrase

"ratio equivalency" is a recent development. In none of those cases was there any suggestion that headline per-play rates must be used even if they were not the effective rates.

Finally, and again at the risk of undue repetition, marketplace evidence does not support Professor Shapiro's approach, and Professor Shapiro was unable to offer any economic theory for using anything other than effective rates (as he himself did in his *Web IV* testimony). SE FOF at ¶¶ 134-142.

Response to ¶ 322. What is noteworthy about Sirius XM's description of Professor Shapiro's re-calculation of the interactive services benchmark is that *Professor Shapiro agrees with Mr. Orszag with respect to every step in the methodology save one — Professor Shapiro opposes the use of effective rates.* Apart from that single point of contention, it appears that Professor Shapiro is in complete agreement with Mr. Orszag's Approach Two methodology. The two economists agree on the denominator for the adjustment ratio equation (the $9.99 interactive service subscription price). The two economists agree on the numerator for the adjustment ratio equation (the $4.91 average noninteractive subscription price). They agree on the resulting adjustment ratio (.49). And they agree that the 12% competition adjustment applied in *Web IV* may be used to make an adjustment for the alleged lack of competition in the interactive services market, if such an adjustment is necessary.

In short, despite Sirius XM's arguments that the Judges in *SDARS II* rejected the so-called "Ordover/Orszag" methodology, it turns out that Professor Shapiro substantially agrees with the second of the two approaches employed by Mr. Orszag.

Response to ¶ 323. *See supra* Response to ¶ 321.

Response to ¶ 324. *See supra* Response to ¶ 321.

Response to ¶ 325. The average number of plays per subscriber that Professor Shapiro uses to convert his per-play rate into a per-subscriber rate is suspect. Professor Shapiro's conclusion that on average Sirius XM subscribers listen to 469 plays per month rests on a survey that is not in evidence, and is contrary to Professor Willig's calculations that yielded a higher number. *See* SE FOF at ¶¶ 1238-1239.

Professor Shapiro also used an incorrect ARPU number when he converted his effective per-subscriber rate into a percentage of revenue rate. *See* SE FOF at ¶ 1240. *See also* Response to ¶¶ 201-210, *supra*.

Response to ¶ 326. *See supra* Response to ¶ 321.

Response to ¶ 327. *See supra* Response to ¶ 321. In addition, SoundExchange notes that Professor Shapiro's claim that Mr. Orszag's calculations yield a rate that is 2.4 times higher than the *Web IV* rate is correct only if one focuses exclusively on per-play rates. As discussed previously, the *Web IV* rates result in an effective per-subscriber rate for Pandora of [ ]. SE FOF at ¶¶ 1234-1236. Viewed from this perspective, it is Professor Shapiro's proposed rates that are dramatically out of line. Based on Mr. Orszag's analysis, SoundExchange proposes a per-subscriber rate for 2018 ($2.48) that is modestly above the effective *Web IV* per-subscriber rate, while Professor Shapiro proposes that Sirius XM pay approximately half of what Pandora would have paid for its Pandora One service under the *Web IV* rates.

The same holds true for percentage of revenue rates. Professor Shapiro calculates that Sirius XM should pay 8.3% to 9.9% of revenue using his *Web IV* methodology, where [ ] would have paid approximately [ ] of revenue under *Web IV* rates. SE FOF at ¶ 1236.

Considering that Sirius XM's subscribers have demonstrated a higher willingness to pay compared to Pandora subscribers, this makes no sense.

4. Sirius XM's Additional Criticisms Of Mr. Orszag's Benchmarking Approach Are Meritless

Response to ¶ 328. SoundExchange has already addressed Sirius XM's argument that Mr. Orszag should have assigned some independent value to Sirius XM's delivery platform. Sirius XM is wrong for the reasons stated in SE FOF at ¶¶ 260-264.

Response to ¶ 329. No response.

Response to ¶ 330. It is in no way anomalous that the copyright owners would share in any increased consumer value that results from the fact that Sirius XM's satellite network makes music easily available in the car. Sirius XM could not realize that increased value — or any value at all — without music. *See SDARS II*, 78 FR at 23065 (finding that "the success of Sirius XM is dependent upon its access to music"). Even Sirius XM does not suggest otherwise. The suppliers of necessary inputs therefore share in the value created by the joint offering. And, in this case, SoundExchange proposes only that the copyright owners receive 23% of that value, leaving Sirius XM with the lion's share of the value of the joint product.

Response to ¶ 331. Mr. Orszag's assumption that at least 50% of the value of Sirius XM is attributable to music is well-founded. Numerous pieces of evidence support this conclusion. *First*, Mr. Boedeker conducted a survey to measure the value of music versus non-music to Sirius XM subscribers. Mr. Boedeker's survey included six different measures, *all* of which produced the same result: "that the subscribers value music content *significantly more* than the non-music content." 5/8/17 Tr. 2963:18-24 (Boedeker) (emphasis added) ("each one of [these measures] and all of them together even more so" support this conclusion with a high degree of scientific certainty); *see also* Trial Ex. 21 at ¶ 14 (Boedeker WDT). The degree of subscribers'

expressed preference for music over non-music was also remarkably consistent. Respondents to Mr. Boedeker's survey attributed 70-80% of the value of Sirius XM programming to music content. Trial Ex. 21 at ¶¶ 14, 71-74 (Boedeker WDT); 5/8/17 Tr. 2942:19-2945:18 (Boedeker). These results show overwhelmingly that Mr. Orszag's assumption that 50% of Sirius XM's value is attributable to music is conservative.

Second, this conclusion is bolstered by the results of Professor Simonson's survey. In answer to two open-ended questions in which respondents were asked why they subscribed to Sirius XM, significantly more respondents mentioned music than mentioned non-music. Trial Ex. 44, App. D, App. F (Table 10) (Simonson WRT) (showing that 378 respondents mentioned music in response to Questions 220/225, whereas only 261 respondents mentioned news, talk, and other non-music channels); *see also* SE FOF at ¶ 253 (noting that respondents were allowed to include multiple answers and were not asked specifically about music, non-music, or any other feature of Sirius XM). *Third*, in the previous *SDARS* proceeding, Sirius XM itself took the position that music accounts for more than 55% of Sirius XM's content value. *SDARS II*, 78 FR at 23064-65 (Sirius XM's expert Roger Noll attributed 55% of value to music content). In fact, both parties and the Judges agreed on this issue. *See SDARS II*, 78 FR at 23063, 23088 (noting SoundExchange's expert Dr. Ordover conservatively assumed that music accounts for at least 50%); *SDARS II*, 78 FR at 23065, 23089 (Judges finding that "the success of Sirius XM is dependent upon its access to music" and citing the testimony of Sirius XM witnesses for that proposition). Sirius XM has provided no evidence or argument to support a different position from the one it took just five years ago. *Fourth*, Sirius XM's internal business documents confirm that the Service's music content is more valuable to subscribers than its non-music content. *See, e.g.*, Trial Ex. 129 at 18-19 (SXM_DIR_00023555-56); Trial Ex. 130 at 5

(SXM_DIR_00024240), 27 (SXM_DIR_00024262); Trial Ex. 132 at 13 (SXM_DIR_00023902). *Fifth*, Sirius XM's pricing structure also reflects the Service's understanding that its customers value music at least as much as non-music. Trial Ex. 26 at ¶ 49 (Orszag Am. WDT) & n.40 (discussing Sirius XM monthly pricing of $10.99 for News, Sports & Talk versus $12.52 for Mostly Music).

By contrast, Sirius XM offers no evidence whatsoever that Mr. Orszag's assumption of 50% is too low. Sirius XM simply ignores the overabundance of evidence that conforms with Mr. Boedeker's conclusions, and urges the Judges to find facts contrary to Sirius XM's own admissions in *SDARS II*. There is no basis to do so.

Response to ¶ 332. With regard to the *only* value-of-music evidence that Sirius XM attempts to address in its findings — Mr. Boedeker's survey — the Service's criticisms are half-hearted at best. Sirius XM simply repeats critiques of the survey set forth in Professor Hauser's written testimony, which were soundly discredited at trial. Here, Sirius XM reprises its argument that Mr. Boedeker's survey is flawed in that it did not attempt to measure other (non-content) features of satellite radio. But as Mr. Boedeker explained at trial, these other aspects of satellite radio "don't add additional categories at that high level." 5/8/17 Tr. 2960:4-5 (Boedeker). In other words, the music programming and non-music programming that Mr. Boedeker's survey measures account for the complete universe of content that is played on Sirius XM. Things like sound quality, song title displays, and choice of programming can better be described as "features and levels of those features . . . that either type of music [or non-music] programming may or may not have." 5/8/17 Tr. 2960:6-11 (Boedeker). This distinction is important in light of the Judge's finding in *SDARS II* that Sirius XM has *no* marketplace value independent of the content it plays. *SDARS II*, 78 FR at 23065 ("The value of Sirius XM's

satellite radio service is the bundling of music and non-music content with its delivery platform, and Sirius XM has failed to present convincing evidence that its delivery platform and non-music content, alone, present a viable business.”).

Consistent with principles articulated in *SDARS II*, Mr. Boedeker’s survey assesses the relative value of the two types of programming available on Sirius XM: music and non-music. Significantly, at trial, Professor Hauser conceded that Mr. Boedeker’s survey design and methodology is appropriate for this purpose. 5/9/17 Tr. 3112:17-3113:9 (Hauser) (“if his goal is purely to parse music versus non-music, then I don’t have a problem” with not listing other features); 5/9/17 Tr. 3113:24-3114:3 (Hauser) (JUDGE BARNETT: “But wasn’t Mr. Boedeker’s aim simply to find the relative valuation of music and non-music without regard to the other features?” THE WITNESS: “Then he would be fine.”).

Response to ¶ 333. Mr. Boedeker is an experienced expert, who properly followed the accepted scientific standards of his field in designing, implementing and analyzing his survey. Trial Ex. 21 at ¶¶ 1-6, 16 (Boedeker WDT); SE FOF at ¶ 176.

Despite Sirius XM’s unsupported assertion that this survey “violates multiple fundamental principles of survey design,” its few, weak criticisms are unfounded and certainly do not call the reliability of Mr. Boedeker’s survey into question. As discussed in SE FOF at ¶¶ 249-250, Mr. Boedeker excluded quasi-filters (“Don’t Know/Unsure” options) from only two survey questions: Questions 7 and 9. These questions ask, respectively, “Were you involved in your household’s decision to subscribe to Sirius XM satellite radio?” (Yes / No), and “Are you involved in your household’s decision about whether to remain a subscriber to Sirius XM satellite radio?” (Yes / No). Mr. Boedeker’s decision not to include qualifiers for these two questions was both purposeful and well-reasoned. As he testified at trial, both are factual

questions for which binary answer choices are entirely appropriate, 5/8/17 Tr. 2962:16-2963:7 (Boedeker), and, neither Question 7 nor Question 9 is a key substantive question about the relative value of music or non-music.

Sirius XM does not point to *any* other "principle of survey design" to which it claims Mr. Boedeker should have hewed.[43] In fact, the *only* other "error" that Sirius XM now identifies is a quibble with the definitions of "music programming" and "non-music programming," which it says "led respondents to attribute value of non-music programming to music." But Sirius XM offers no evidentiary basis whatsoever for this claim. The Service has offered *no* evidence about the *quantity* of non-music content on music channels; nor has it offered any evidence that the incidental use of non-music content on music channels is *more* prevalent than the use of music on non-music channels (*e.g.*, songs played during talk radio, sports games, etc.).[44] In fact, none of Sirius XM's experts took issue with this aspect of Mr. Boedeker's survey in either their written or oral testimony. The unsupported assertion that Sirius XM makes for the first time here — that Mr. Boedeker's definitions constitute a "gross" methodological error — is unsupported by the evidence and in tension with the opinions of its own experts.[45]

Response to ¶ 334. As explained in Mr. Boedeker's testimony and in SE FOF at ¶¶ 235-239, what Sirius XM calls an "inconsisten[cy]" is nothing of the sort. There is nothing contradictory about choosing to continue subscribing to service at one's current rate if no

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[43] Sirius XM appears to have abandoned Professor Hauser's argument that select questions in Mr. Boedeker's survey which did not include rotated answer choices should have. This argument was utterly discredited at trial, as discussed in SE FOF at ¶¶ 243-49.

[44] Even with regard to the existence of non-music content on music channels, Sirius XM's evidence is minimal: the Service cites only to general testimony from Mr. Blatter and one statement made by a Sirius XM lawyer during cross-examination.

[45] Because Mr. Boedeker's definition of "music" does not include non-music sound recordings covered by the statutory license (*e.g.*, covered comedy recordings), his survey may actually lead respondents to *undervalue* covered content and *overvalue* non-music content that is not covered by the statutory license.

discount is available, but wanting to take advantage of a discount when such an option is presented. 5/8/17 Tr. 2947:18-2948:19 (Boedeker).

Only 2% of survey respondents provided responses that can fairly be described as inconsistent. SE FOF at ¶¶ 238-239 (only 20 respondents out of approximately 1,100 provided responses that are actually internally inconsistent). As Mr. Boedeker explained, these numbers are within a reasonable margin of error; removing these 20 responses would not lead to statistically different results; and these responses provide no basis for questioning the reliability of Mr. Boedeker's results overall. SE FOF at ¶¶ 238-239; 5/8/17 Tr. 2957:14-2959:16 (Boedeker).

Response to ¶ 335. Adopting Sirius XM's "logic" that Mr. Orszag's decision to offer two different approaches to his benchmark calculations represents a "tacit" admission that one of them is flawed, it likewise follows that Sirius XM's decision to offer three different benchmark approaches represents a tacit admission that each of them is flawed. But of course this is silly — economists, like lawyers, frequently offer multiple approaches to solving any problem. Mr. Orszag was clear that he regards the 50% value of music conclusion as quite conservative, Trial Ex. 26 at ¶ 48 (Orszag Am. WDT); Tr. 4/25/17 988:3-989:25 (Orszag), and that Approach One is his preferred approach.

Response to ¶ 336. Sirius XM claims that Mr. Orszag's two ratemaking approaches are "infect[ed]" with a "failure to properly account for the different intensity of use of sound recordings as between the target market subscribers (Sirius XM) and the benchmark market subscribers (subscription interactive services)." As explained earlier, *see supra* Response to ¶¶ 242-245, Mr. Orszag made no adjustment for greater intensity of use on the subscription interactive services because there is no reason to think that royalties should be directly tied to

performances for subscription (rather than ad-supported) services. Economic theory, marketplace evidence, and prior decisions by the Judges all support that conclusion. *See* SE FOF at ¶¶ 1224-1235. There is simply no logical basis to conclude that, in a workably competitive market, subscription services that use sound recordings less intensively would necessarily pay less for those sound recordings than services that use those recordings more intensively. All plays are not created equal.

Response to ¶ 337. Remarkably, Professor Shapiro claims (as Sirius XM summarizes his testimony) that "in a workably competitive market, one would expect services to negotiate a lower fee for inputs that are less intensively used. . . ." What is remarkable about this statement is that there is *no* marketplace evidence to support it. Subscription services almost never pay on a per-play basis, as Mr. Orszag has testified, and this is true whether the subscription service at issue is a fully interactive service or a mid-tier service with an undoubted ability to steer (such as Pandora Plus). Likewise, this lesson from the marketplace holds true for both agreements with majors and agreements with indies. SE FOF ¶¶ 1224-1226. There is no support for Professor Shapiro's claims beyond his own say-so.

Further, if Professor Shapiro were correct, then one would expect services to offer lower fees to their subscribers who use music less intensively. Indeed, according to Professor Shapiro's theory, because Sirius XM uses music less intensively than nonsubscription streaming services, Sirius XM ought to charge its subscribers less than what noninteractive streaming services charge. Of course, it does nothing of the sort.

Response to ¶ 338. *See supra* Response to ¶ 336.

Response to ¶ 339. For all of the reasons just discussed, Mr. Orszag's interactive services benchmark analysis offers a reliable basis to determine rates in this case.

C. Sirius XM's Responses To SoundExchange's Free Trials Proposals Are Based On Conjecture And Flawed Economics

Response to ¶ 340. SoundExhange's proposal for free trials is directly based on the benchmark interactive services agreements and is eminently reasonable. SoundExchange proposes as follows: For unpaid trials — that is, trials where Sirius XM does not receive compensation from a third party, such as an OEM, in return for offering the trial — Sirius XM pays no royalties for the first 30 days of the trial; a reduced rate calculated by Mr. Orszag, based on trial subscribers lower willingness to pay, for months two and three of the trial; and thereafter the full paying subscriber rate. *See* SoundExchange Amended Proposed Rates and Terms, Appendix A at §§ 382.20 (definition of subscriber), 382.21(a)(1)(i) (filed June 14, 2017). For paid trials — that is, trials where Sirius XM does receive compensation from a third party, such as an OEM — Sirius XM is to pay the full per-subscriber rate for the duration of the trial. *See* SoundExchange Amended Proposed Rates and Terms, Appendix A at § 832.21(a)(1)(i)(B) (filed June 14, 2017). Contrary to Sirius XM's assertions, this approach is consistent with the best available benchmarks and would ensure that copyright holders and artists are fairly compensated for the immense value they provide when Sirius XM licenses music for free trials.

Response to ¶ 341. Sirius XM's attempts to attack SoundExchange's proposal fail. Sirius XM first offers expert testimony from Professor Shapiro, but, as discussed in further detail below, Professor Shapiro fails to adequately model the costs and benefits associated with free trials for record companies, and his testimony must be disregarded. Sirius XM also offers testimony from its CFO, Mr. Frear, attempting to show that a longer free trial period is necessary given Sirius XM's business model. But Mr. Frear's testimony is conjecture and points only to deliberate choices made by Sirius XM about how to structure its free trial program — the costs of which should not be passed on to copyright holders and artists.

Response to ¶ 342. As discussed above, SoundExchange's amended rate proposal does distinguish between paid and unpaid trials. Unpaid trials would be compensated in accordance with Mr. Orszag's proposed approach. Sirius XM would not pay royalties for the first month of a trial, then would pay two months of reduced rates, and thereafter would pay the full per-subscriber rates. *See* SoundExchange Amended Proposed Rates and Terms, Appendix A at § 382.20 (definition of subscriber, 382.21(a)(1)(i) (filed June 14, 2017). Paid trials are treated in the same manner as regular paid subscribers. *See* SoundExchange Amended Proposed Rates and Terms, Appendix A at § 382.21(a)(1)(i)(B) (filed June 14, 2017).

Response to ¶ 343. Contrary to Sirius XM's assertions, there are good reasons for treating paid trial subscribers in the same manner as regular paying subscribers. Currently, for paid trials, SoundExchange only receives compensation for a percentage of the payments that Sirius XM receives from OEMs. SE FOF at ¶ 1610. Those payments are a small fraction of the overall value that Sirius XM derives from paid trials. SE FOF at ¶ 1632. A paid trial is valuable to Sirius XM not only because of the money paid to it by the OEM, but also because the trial subscriber could turn into a full paying subscriber, resulting in future revenue. SE FOF at ¶ 1630. It is only fair that SoundExchange be compensated commensurate with the full value of a paid trial. SE FOF at ¶ 1632.

Response to ¶ 344. Sirius XM mischaracterizes Mr. Orszag's testimony regarding free trials. Mr. Orszag does not assert that free trials are a "gift." *See* Trial Ex. 26 ¶ 92 (Orszag Am. WDT). Rather, offering free trials results in costs and benefits to Sirius XM and to record companies and artists. For each month of a free trial, record companies incur opportunity costs — that is, foregone income that record companies and artists would have earned were customers subscribing to paid services. Record companies also receive benefits from free trials — namely,

the possibility that the free trial subscriber may eventually become a paying subscriber, resulting in royalty payments. The point at which a record company would stop licensing free trials in the free market is the point at which the marginal costs of the free trials begin to outweigh their benefits. A similar cost/benefit structure also exists for Sirius XM. *See* SE FOF at ¶ 1616.

Response to ¶ 345. SoundExchange agrees that a comparison of cost/benefit ratios could, in theory, be an appropriate way of determining the point at which Sirius XM should begin paying royalties on free trials. SE FOF at ¶ 1617. The problem, as discussed in SoundExchange's Proposed Findings of Fact, is that Professor Shapiro did not properly model the costs and benefits to record companies of licensing Sirius XM for free trials. *See* SE FOF at ¶¶ 1617-1620. In his testimony, Professor Shapiro assumed that the major record companies were not "must haves" for Sirius XM. SE FOF at ¶ 1619. That was wrong. As explained in SoundExchange's Proposed Findings of Fact, the major record companies *are* must-haves for Sirius XM. SE FOF at ¶ 1620. Substantially all subscribers would leave Sirius XM if the major record companies did not license their music to Sirius XM. SE FOF at ¶ 1619. As a result, Professor Shapiro's calculation of record companies' opportunity cost in licensing to Sirius XM for free trials is inaccurate, and yields a number that is too low. SE FOF at ¶ 1619. Accordingly, Professor Shapiro's comparison of the cost/benefit ratios of Sirius XM and record companies is incorrect and unreliable.

Response to ¶ 346. Most of the costs that Sirius XM references as part of its free trial program are the result of Sirius XM's own business decisions. For example, Sirius XM points to revenue share payments that Sirius XM makes to OEMs as a cost justifying a longer period for which it should not have to pay royalties on free trials. This makes little sense. Sirius XM has chosen to offer revenue share payments to OEMs. It is under no obligation to do so. In fact,

Sirius XM often [ ]. If Sirius XM so desired, it likely could reduce those payments by [ ]. Indeed, Sirius XM has [ ]. SE FOF at ¶ 1627.

Response to ¶ 347. Sirius XM also references its [ ] net conversion rate as justification for why it should not have to pay royalties on free trials less than three months long. This is a non sequitur. Every free trial, including the free trials offered by the benchmark interactive services, has [ ]. *See* Trial Ex. 322 (SXM_DIR_00117349). That is not a ground to excuse Sirius XM from paying royalties on its free trials; every free trial has value to Sirius XM because every free trial customer has the potential to convert to a full paying customer, even if each individual trial subscriber does not convert. SE FOF at ¶ 1630. In any event, SoundExchange's rate proposal accounts for Sirius XM's conversion rate by reducing the rates that Sirius XM is obligated to pay for months 2 and 3 of unpaid trials. *See* SoundExchange Amended Proposed Rates and Terms, Appendix A at § 382.21(a)(1)(i)(A) (filed June 14, 2017); SE FOF at ¶¶ 1634-1637.

Sirius XM also contends that the interactive services benchmark is inappropriate for free trials because offering free trials to interactive services customers is "largely costless." Sirius XM has offered no legitimate basis from this assertion, aside from the testimony of Mr. Frear, who does not appear to have worked in the interactive services business and certainly has no first-hand knowledge of how much it costs interactive services to offer free trials. *See* Trial Ex. 12 at ¶ 1 (Frear WRT) (outlining Mr. Frear's background and qualifications). Moreover, the cost he cites — the cost of having radios installed in cars — is a cost of Sirius XM's business in

general, not a cost of its free trials. Many of those radios will generate years of subscriber revenue; it would not be appropriate to assign their costs only to the first few months of their use.

Response to ¶ 348. That Sirius XM receives email addresses for only some of its free trial subscribers is irrelevant because it is the result of Sirius XM's own choices about how to structure its free trial program. Sirius XM certainly could request that OEMs provide it with email addresses of consumers who buy cars with Sirius XM receivers, and there is no reason in the record why that would be impracticable. In any event, Sirius XM will [ ], thereby reducing the need for email addresses. *See* SE FOF at ¶ 1624.

Response to ¶ 349. That Sirius XM has field representatives or other marketing costs is irrelevant because it is the result of Sirius XM's own choices about how to market its service and is not directly related to the structure its free trial program. And Sirius XM made no effort to compare its marketing costs to the marketing costs incurred by interactive services. To the extent Sirius XM invests money in making car purchasers and car dealers aware of its service, those efforts directly go to increasing Sirius XM's trial conversion rates — which first and foremost benefits Sirius XM. Sirius XM's efforts to market its service certainly do not justify forcing record companies and artists to foot the bill.

Response to ¶ 350. See response to ¶ 349.

Response to ¶ 351. Sirius XM's argument is belied by its own documents. Sirius XM emphasizes Mr. Frear's testimony that Sirius XM is "not incented to do long unpaid trials because . . . we're not making any money." 5/17/17 Tr. 4453:13-15 (Frear). True, most of Sirius XM's free trials last [ ]. Sirius

XM offers numerous trials [[redacted]]. Trial Ex. 322 (SXM_DIR_00117349). Sirius XM has even entered an agreement with at least one OEM for [[redacted]] SE FOF at ¶ 1634. Certainly, it would be inappropriate for Sirius XM to be allowed to compensate artists and record companies at a reduced rate for [[redacted]] worth of music. Sirius XM also has offered no actual evidence that it needs three months of not paying royalties in order to maintain its conversion rates. Sirius XM has not produced any kind of study showing how conversion rates would change if Sirius XM reduced the length of its trials. Even if conversion rates would go down if Sirius XM reduced trial length, Sirius XM could alleviate the problem simply by offering the same trials it offers now but paying royalties on the trials to SoundExchange. *See* SE FOF at ¶ 1625.

Response to ¶ 352. As discussed above, Mr. Frear's testimony does not show that Sirius XM's rate proposal is inappropriate. Even if it is true that it would be "very difficult" to implement an effective direct mail and telemarketing approach in 30 days, as Mr. Frear claims without any supporting documentation, Sirius XM could still offer trials of whatever length it desires under SoundExchange's proposal. SE FOF at ¶ 1625. It would simply have to compensate copyright owners and artists for the value of the music licensed in those trials.

Response to ¶ 353. It is true that Sirius XM does not offer a persistently free tier of service directly analogous to those offered by some interactive services, but that is irrelevant. An ad-supported version of an interactive service is *not* a substitute for a free trial of the fully interactive version of that service. Subscribers to, say, Spotify's fully interactive service generally may listen to whatever songs they want without interruption. Subscribers to ad-supported Spotify must listen to advertisements and, in some instances, [[redacted]]. *See* SE FOF at ¶ 467. Thus, a subscriber to

basic Spotify is not equivalent to a Sirius XM trial subscriber, who can access all of Sirius XM's service without any limits.

Response to ¶ 354. SoundExchange's proposal to rely on the benchmark interactive services in determining appropriate free trial rates is far from "cavalier." As SoundExchange has exhaustively demonstrated, the benchmark interactive services are the closest available analogy to Sirius XM's service, and, with one lone exception, each of the interactive services agreements [[redacted]]. SE FOF at ¶ 1615. Sirius XM has failed to offer any compelling reason why this benchmark should not apply in the free trial context. Each of the supposed differences between Sirius XM and the benchmark interactive services is the result of a choice freely made by Sirius XM about how to structure its free trial program and market its service. Even if Sirius XM's investments in its free trial program did bear on its cost/benefit structure, Sirius XM has offered no credible analysis of how that cost/benefit structure compares to that of record companies. As discussed previously, Professor Shapiro's erroneous assumption that the major record companies are not "must haves" for Sirius XM precluded him from accurately measuring record companies' cost/benefit ratio for trials. *See* SE FOF at ¶¶ 1618-1620.

Response to ¶ 355. Sirius XM's assertion that the current treatment of free trials under the rate regulations should not change because it has "worked well" is myopic. Certainly, the current arrangement has worked well for Sirius XM because it has been able to give away as much music as it wants for as long as it wants — even up to [four years] — without having to pay artists and record companies. SE FOF at ¶ 1634; *see* SE FOF Section X.B.2.ii (detailing Sirius XM's financial performance under the current regulations). But that is not the measure of whether the regulations should change. The goal of this proceeding is to determine a reasonable

rate based on the § 801(b) objectives, one of which is to "afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions." 17 U.S.C. § 801(b)(1)(B). The fact that Sirius XM has been able to generate large amounts of revenue by offering free trials is irrelevant if, as SoundExchange has demonstrated, copyright owners are systemically undercompensated for the music Sirius XM uses as part of those trials. Rather, the regulations should require fair compensation for copyright owners and artists whenever Sirius XM uses music.

Response to ¶ 356. See response to ¶¶ 340-355.

D. Professor Willig's Opportunity Cost Analysis Establishes An Appropriate Floor For The Rates To Be Set In This Case

Response to ¶ 357. SoundExchange generally agrees with Sirius XM's description of Professor Willig's analytical approach in ¶¶ 357-360.

To recap, Professor Willig calculated that the walk-away opportunity cost of licensing Sirius XM equals $2.55 per subscriber per month, and opined that this opportunity cost establishes a floor for the royalties that Sirius XM should pay during the upcoming rate period. SE FOF at ¶¶ 457-458. Professor Willig's opportunity cost analysis relied on the results of a survey conducted by Yale Professor Ravi Dhar to supply information about how Sirius XM subscribers would choose to acquire music if they left Sirius XM due to a price increase. SE FOF at ¶ 470. Professor Dhar's survey was corroborated by results of a survey conducted by Stanford Professor Itamar Simonson, who modeled his survey off of the Lenski survey submitted by Sirius XM. SE FOF at ¶¶ 475, 635-657. Professor Willig multiplied the percentage rate of substitution for each of the alternative modes of distribution by the per-subscriber compensation paid to the record companies by each distribution mode. SE FOF at ¶¶ 470-485. The sum of the

lost compensation from each alternative distribution mode resulted in Professor Willig's $2.55 opportunity cost. SE FOF at ¶ 470.

The testifying economists on both sides agree that opportunity costs represent a floor for reasonable rates, and that sellers of differentiated products (which indisputably includes sound recording copyright owners) would bargain for rates somewhat above opportunity cost. SE FOF at ¶¶ 461-462; 533. Professor Willig therefore applied the principles of Ramsey public interest pricing and the Nash bargaining solution as a guide to estimate the appropriate increase above opportunity cost. SE FOF at ¶¶ 695-832. Professor Willig also discussed the Efficient Component Pricing Rule (ECPR). Although Professor Willig did not use ECPR principles to estimate a rate, he pointed out that ECPR principles confirm that rates should not be set below opportunity cost. SE FOF at ¶¶ 833-836.

Response to ¶ 358. *See* Response to ¶ 357.

Response to ¶ 359. *See* Response to ¶ 357.

Response to ¶ 360. *See* Response to ¶ 357.

i. Professor Willig's Opportunity Cost Analysis Is Consistent With The Outcomes In A Market That Is Effectively Competitive

Response to ¶ 361. Sirius XM states that Professor Willig concluded that record companies would refuse to license Sirius XM unless each received, on average, a royalty equal to $2.55 per subscriber. This is not precisely correct. Professor Willig's $2.55 opportunity cost figure represents the minimum amount that Sirius XM should pay on an industry-wide basis, and each copyright owner would receive its pro rata share of that amount. SE FOF at ¶ 496.

Response to ¶ 362. It is wrong to say that Professor Willig's opportunity cost analysis is flawed because he assumed a market that contained only a single monopoly seller or a cartel. In fact, Professor Willig analyzed the market based on the premise that there are many sellers, and

certain of those sellers are "must-haves" for Sirius XM. SE FOF at ¶ 498. This does not mean that Professor Willig is proposing rates equivalent to those that might prevail in a market with a single seller possessing monopoly power, or a group of sellers who exercise complementary oligopoly power. SE FOF at ¶¶ 505-513.

Professor Willig's approach of treating some of the record labels as "must-haves" has the important virtue of being consistent with marketplace reality. The evidentiary record in this case strongly supports that proposition, and neither Professor Farrell nor Professor Shapiro seriously contest it. SE FOF at ¶¶ 514-525. Instead, Sirius XM's experts simply ignore reality and argue that a market that includes must-have sellers cannot be effectively competitive. Neither Professor Shapiro nor Professor Farrell ever really explains why this is so, and as we explain below in Response to ¶ 365, Sirius XM's experts are wrong.

Response to ¶ 363. One of the many places Sirius XM's analysis goes off the rails is its refusal to acknowledge what its testifying economists conceded: If a seller is a must-have, then its individual opportunity cost equals its pro rata share of the industry-wide opportunity cost. SE FOF at ¶¶ 501-504. In other words, Professor Willig's opportunity cost analysis results in a calculated cost of $2.55 per subscriber not because he is assuming a single monopoly seller or a cartel, but rather because that is the correct result for a market characterized by many sellers where one or more of them are must-haves. SE FOF at ¶¶ 501-504. This conclusion is not disputed by Professor Shapiro or Professor Farrell, but it begs the question of whether a market in which certain sellers are must-haves can be effectively competitive. The answer is "yes," as the Judges previously have held, as Professor Shapiro conceded in his *Web IV* testimony, and as Professor Willig explained in this case. We discuss this point at greater length in our Response to ¶ 365.

Response to ¶ 364. This paragraph offers two citations to Professor Willig's trial testimony. With respect to the first citation, Sirius XM manages to get Professor Willig's testimony exactly backwards. Professor Willig was quite clear, in response to the question by Judge Strickler that immediately preceded the cited testimony, that the definition of a "must-have" is that "the loss of one label is tantamount to a loss of all of the labels." 5/02/17 Tr. 2137:21:25 (Willig). Read in light of Judge Strickler's question and Professor Willig's answer, it is plain that Professor Willig opined in the cited testimony that his opportunity cost calculation measures what a *single* record label would earn elsewhere, even if it is the *only* label that declines to license, assuming that label is a must-have.

With respect to the second citation, Sirius XM is correct that Professor Willig's opportunity cost calculation is not effected by the potential for steering in the target market, because Professor Willig was calculating the walk-away opportunity cost, not the marginal or per-play opportunity cost. In our Response to ¶ 366 we explain why this distinction — which Sirius XM persistently and perhaps intentionally ignores — renders steering in the target market irrelevant to the opportunity cost calculation.

Response to ¶ 365. It is simply not correct that Professor Willig's opportunity cost analysis departed from workable competition.

Professor Willig testified that he viewed the target market as one in which certain labels are must-haves. Professors Shapiro and Farrell unequivocally conceded that a must-have label's opportunity cost equals its pro rata share of the industry-wide opportunity cost. SE FOF at ¶ 503. Consequently, Professor Willig's approach to calculating opportunity cost is correct unless it is the case that a market that includes one or more must-have sellers cannot possibly be effectively competitive. On this point, Sirius XM simply repeats the *ipse dixit* of its testifying

economists that Professor Willig ignores effective competition. He does not. Professor Willig explained convincingly why a market that includes must-have sellers may nevertheless be effectively competitive. SE FOF at ¶¶ 505-513.

First, it is worth bearing in mind that the issue at hand is opportunity cost, not the ultimate rate. The economists agree that opportunity cost is a floor, and the amount by which the royalty rate would *exceed* that floor in a workably competitive market will depend in significant part on the level of competition faced by the seller. The existence of effective competition, or lack thereof, comes into play when determining how much *above* opportunity cost to set the rate. *See* SE FOF at ¶¶ 461, 495, 533-534. But even where a market is deemed not effectively competitive, or where a seller has acted in an anti-competitive fashion, the remedy is never to compel a sale *below* opportunity cost. Indeed, that is the point of Professor Willig's testimony about the Efficient Component Pricing Rule. ECPR principles exist to remedy anti-competitive behavior — they might even be considered punitive in some cases — and yet ECPR principles permit a seller to recover its opportunity cost. SE FOF at ¶¶ 833-836.

Viewed in this light, Professor Willig persuasively explained why a market that includes must-have sellers may nevertheless be effectively competitive. As Professor Willig put it, "even if a label is a must-have, there's still lots of room for there to be effective competition expressed in the actuality of steering or in the anticipation of it . . . ." 5/02/17 Tr. 1996:16-23 (Willig). There is no reason why the economic incentives to discount prices in return for volume increases applies with any less force to must-have sellers, and neither Professor Shapiro nor Professor Farrell offers any. If the buyer can steer, must-have labels have just as much incentive to avoid losing market share to their competitors as do non-must-have labels.

Professor Willig's testimony in this regard is consistent with the conclusions of the Judges in the *Web IV* decision. Despite the invitation to do so, the Judges expressly declined to find that effective competition required a hypothetical market in which the majors were deprived of whatever market power exists due to the size of their repertories.

> It is important to emphasize the limited nature of this sort of effective competition. Price competition through steering does not diminish the stand-alone monopoly value of any one sound recording. Further, effective competition through steering does not diminish the firm-specific monopoly value of each Major's repertoire taken as a whole. Although Dr. Katz urged the Judges to reduce the statutory rate to eliminate that market power as well . . . the Judges decline to do so.

Web IV, 81 FR at 26368.

> In whatever ways in which the reality of steering and the concomitant threat of steering-induced price competition develop, it is clear to the Judges that, as Dr. Shapiro explained, steering is the mechanism by which the complementary oligopoly power of the Majors is offset, allowing the Majors to realize only their considerable (non-complementary) oligopoly power generated by their repertoires and their organizational acumen.

Web IV, 81 FR at 26383 n.185.

> Here, the range of steering adjustments from direct noninteractive licenses has been introduced in evidence, steering experiments have confirmed the reasonableness of such an endeavor[,] and expert testimony has explained how steering is a mechanism by which to offset the complementary oligopoly power of the Majors (while not reducing their firm-specific and copyright-specific market power).

Web IV, 81 FR at 26343.

Finally, Professor Shapiro appears to be a recent convert to the idea that a market cannot be effectively competitive if any seller is a must-have. He testified to the contrary during the *Web IV* proceedings:

> Q: So what I'm showing you is your deposition from Web IV. Do you see that, Professor Shapiro?
>
> A: I do.
>
> Q. Okay. Let me ask you to turn to page 60. And do you see starting at line 10?
>
> A. I do.
>
> Q. And you were asked: "*So in what situation could Universal be a must-have and the market still be workably competitive?" And your answer was: "It is possible that could happen if the services have substantial ability to steer, although by definition of must-have, could not survive without music entirely.*"

4/24/17 Tr. 539:19-540:8 (Shapiro) (emphasis added). Professor Shapiro stated that he stood by that testimony, although he tried without success to explain it away. SE FOF ¶ 507.

Response to ¶ 366. Sirius XM attempts to confuse the opportunity cost analysis by refusing to distinguish between "walk-away" opportunity cost and "marginal" or "per-play" opportunity cost. The two are quite different. As the name implies, walk-away opportunity cost is the opportunity cost of choosing to license a service in the first place. SE FOF at ¶¶ 486-488. Marginal or per-play opportunity cost is the cost associated with increasing or decreasing the number of plays on a service, assuming the decision to license was made in the first place. SE FOF at ¶ 492. Professor Farrell recognizes this distinction, and concedes that record labels would not agree to license at less than their walk-away opportunity cost. SE FOF at ¶ 490. Steering in the target market is not relevant to the calculation of walk-away opportunity cost, because that form of opportunity cost is based solely on compensation from the *alternative* modes of distribution, not compensation in the target market. SE FOF at ¶ 494.

Response to ¶ 367. Sirius XM's economists both modeled opportunity costs making incorrect or unsupported assumptions, as we describe in our Responses to ¶ 368 and ¶ 369. In

Response to ¶ 367, SoundExchange simply notes that Sirius XM's economists never made any attempt to actually calculate an opportunity cost. SE FOF at ¶ 565; 4/24/17 Tr. 676:25-677:6 (Farrell) (". . . this is not a model that I even intend, let alone hold out to produce a number that I'm proposing."). Indeed, the survey commissioned by Sirius XM and designed by Joe Lenski was never intended to obtain the kind of information that would be necessary to calculate opportunity costs. *See* SE FOF at ¶¶ 562-563 (Sirius XM agrees that the Lenski survey "was never intended as an input to a 'ground up' opportunity cost calculation."). SXM FOF at ¶ 401. Sirius XM's obvious desire to avoid any opportunity cost calculation based on actual marketplace data speaks volumes.

Response to ¶ 368. Professor Farrell's contention that the marginal or per-play opportunity cost incurred by the record companies may be less than their walk-away opportunity cost is utterly irrelevant in light of his agreement that record labels would not willingly agree to license for less than their walk-away opportunity cost. SE FOF at ¶ 490.

Response to ¶ 369. Professor Farrell's modeling of walk-away opportunity cost provides no useful information, inasmuch as he simply makes unsupported assumptions about what percentage of subscribers would leave Sirius XM if a given label's sound recordings were not available. SE FOF at ¶ 560. Obviously, one could calculate any opportunity cost one wanted simply by changing the assumptions about the impact on subscriber levels. Professor Farrell has no basis in fact for the particular assumptions he made in this regard, rendering his model quite useless. Moreover, Professor Farrell modeled walk-away opportunity cost based on a hypothetical market in which no label is a must-have. But he candidly admits that he has no idea whether in reality any record label is a must-have (SE FOF at ¶ 560), and for the reasons

discussed above in SoundExchange's Response to ¶ 367, Professor Farrell is wrong to suggest that a market that includes must-haves cannot be effectively competitive.

Response to ¶ 370. Professor Shapiro's modeling suffers from the same flaws as the modeling performed by Professor Farrell. Professor Shapiro has made no effort to calculate actual opportunity costs. SE FOF at ¶ 565. He simply performs mathematical calculations using made-up numbers and unsupported assumptions. Three of his four models involve per-play or marginal opportunity cost, instead of the opportunity cost that is actually relevant here — walk-away opportunity cost. Professor Shapiro, like Professor Farrell, assumes a hypothetical market in which no record label is a must-have, despite substantial evidence to the contrary and his own professed uncertainty on the question of whether the majors are, in reality, must-haves for Sirius XM. SE FOF at ¶ 567. He contends that a market cannot be effectively competitive if some of the sellers are must-haves, but one searches the record in vain for any explanation of why this should be so.

Response to ¶ 371. *See* Response to ¶ 370.

Response to ¶ 372. *See* Response to ¶ 370.

Response to ¶ 373. Sirius XM's claim that Professor Willig did not respond to the critiques of Professors Farrell and Shapiro is downright frivolous. Professor Shapiro's opening testimony was presented on April 19, 20, and 24, 2017. Professor Farrell testified on April 24, 2017. Professor Willig followed and responded at length to both on May 2, 2017. Indeed, Sirius XM's counsel repeatedly (and unsuccessfully) objected that in responding to Sirius XM's economists, Professor Willig strayed beyond his written testimony. *E.g.* 5/2/17 Tr. 1985:5-11 (Larson) ("MR. LARSON: I think the criticism is made that his opportunity cost calculation fails to incorporate a notion of steering or effective competition. But what I see happening here is a

discussion of effective competition and how it undergirds his entire model that's not found in the written direct or rebuttal testimony.").[46] While Sirius XM's counsel *attempted* to prevent Professor Willig from responding to the Sirius XM economists, they did not succeed, and Professor Willig provided the Judges with a thorough rebuttal.

Response to ¶ 374. Again, Sirius XM argues that Professor Shapiro's assumption that no record label is a must-have — which runs counter to the evidence in this case — "properly account[s] for workable competition" without ever explaining why steering induced competition would not affect the pricing decisions of Majors in the same way it would affect the pricing decisions of smaller labels. Indeed, in the *Web IV* decision, the Judges used an agreement between iHeart and WMG as one of their principle benchmarks to set rates for ad-supported services, on the theory that the iHeart/WMG agreement reflected the impact of steering. *Web IV*, 81 FR at 26383 ("Further, and as discussed in connection with the Pandora/Merlin Agreement, the steering aspects of the iHeart/Warner Agreement also satisfy a statutory 'test' omitted from Dr. Rubinfeld's four-part approach: The 'effective competition' test."). WMG, of course, is a major and was viewed by the Judges as a must-have for noninteractive services, *Web IV*, 81 FR at 26373, but its agreement with iHeart nevertheless was found by the Judges to reflect effective competition. Professor Shapiro's unsupported conclusion that a market that includes must-have record labels necessarily will lack price competition is belied by the *Web IV* record.

ii. Professor Willig's Opportunity Cost Analysis Accepts The Markets For Alternative Modes Of Distribution As They Are, Without

[46] In response to Mr. Larson's objection, SoundExchange counsel pointed out: "It responds very directly to the very direct attacks that both Professors Farrell and Shapiro leveled, not only on Professor Willig's opportunity cost analysis but also on his Nash bargaining model, which we'll get to in a little bit." 5/2/17 Tr. 1985:18-23 (Handzo). Judge Barnett overruled this and similar objections. 5/2/17 Tr. 1986:24 (Judge Barnett).

Adjusting Compensation For Any Of Those Modes Of Distribution Up Or Down

Response to ¶ 375. SoundExchange agrees with Sirius XM's description of Professor Willig's opportunity cost calculation and its components, and disagrees that Sirius XM has identified any "fundamental problem."

Response to ¶ 376. Sirius XM is correct that Professor Willig calculated opportunity costs without any adjustment to "perfect" the creator compensation paid by alternative modes of distribution. As Professor Willig explained, there is a "fork in the road" with respect to the opportunity cost analysis. One fork would lead to acceptance of all of the alternative markets as they are, without adjustment. The other fork in the road logically would lead to the adjustment of the rates for *every* alternative service (including terrestrial radio) that does not pay rates established through an unregulated, effectively competitive market process. 5/02/17 Tr. 2040:2-19 (Willig).

Professor Willig pointed out that the first approach — which he adopted for his analysis — has two important virtues. First, it comports with reality. Any attempt to adjust downward the creator compensation received from fully interactive services on the theory that the market for such services is not effectively competitive would deprive the copyright owners of their true, real-world opportunity cost. Second, any attempt to adjust all markets in which rates are not set through an effectively competitive market process — notably including terrestrial radio — is fraught with complexity and essentially would involve the Judges in multiple rate setting proceedings for multiple markets. The better approach, Professor Willig advised, is to accept markets as they are and not attempt to extend the regulatory authority of the Judges to markets that Congress either chose to regulate directly (*i.e.*, the terrestrial radio market, where Congress

legislated a royalty-free license) or chose not to regulate at all (*i.e.*, the market for fully interactive services). SE FOF at ¶¶ 539-544.

Response to ¶ 377. For the reasons described above, giving the copyright owners a rate that at least covers their real world, actual opportunity cost is hardly inconsistent with the goals of this proceeding. Indeed, a rate that did not at least cover the copyright owners' actual costs would not be consistent with the objective of Section 801(b)(1)(B) to provide the copyright owners with a "fair return." It would also be inconsistent with Section 801(b)(1)(D), because setting a rate below the record companies' opportunity costs would give Sirius XM an unfair competitive advantage vis-à-vis its competitors and thus would have a disruptive impact on the industries involved and generally prevailing industry practices. SE FOF at ¶ 491.

Nevertheless, were the Judges to decide that it is appropriate to adjust the portion of Professor Willig's opportunity cost analysis that is based on creator compensation in the fully interactive services market, such an adjustment is relatively simple. Professor Willig calculated that the lost creator compensation in the market for fully interactive services equals $1.78. Reducing that figure by 12 percent (the steering adjustment applied to the fully interactive services market in *Web IV*) produces a figure of $1.57, and Professor Willig's overall opportunity cost is reduced by the same amount to $2.34. SE FOF at ¶ 474.

Response to ¶ 378. *See supra* Response to ¶ 377.

iii. Professor Willig Does Not Assume Tacit Collusion Or A Group Boycott

Response to ¶ 379. As Professor Willig testified, even if the Majors are not must-haves, uniformity of rates in the marketplace suggests that all labels would respond to price offers in the same way, making an industry-wide approach appropriate. Individual labels would bargain with an understanding that a royalty which is not acceptable to that label likely is also not acceptable

to other labels. Where royalty rates are uniform, "each label's view of the adequacy of that uniform royalty rate is the same." 5/02/17 Tr. 2026:12-16 (Willig). As a result, the decision-making is unilateral but parallel across the record labels, making industry-wide analysis of opportunity costs appropriate. 5/02/17 Tr. 2027:22-23 (Willig).

Response to ¶ 380. Sirius XM seems to suggest that Professor Willig's unilateral alignment reasoning is incorrect because the interests of the record companies are not in fact aligned. That is wrong. To the contrary, the economists on both sides agree that royalty rates tend to be relatively uniform in the marketplace across different labels. 5/02/17 Tr. 2026:10-11 (Willig); 4/24/17 Tr. 541:22-542-12 (Shapiro). Certainly, it is correct that each label's pro rata share of a per-subscriber or percentage of revenue rate will be different, but as Professor Willig demonstrated during the trial, this makes no difference. 5/02/17 Tr. 2029:23-2034:8 (Willig). What matters is that a label likely will understand that a given royalty rate offer (of which it will receive its pro rata share) will likely be unacceptable to other labels if it is unacceptable to that label. Moreover, considering uniform rates is appropriate if the regulatory task is to set a uniform rate. 5/02/17 Tr. 2026:7-9 (Willig).

Sirius XM argues that this uniform approach to licensing decisions amounts to a group boycott or cartel arrangement. But a rate that simply equates to an industry-wide opportunity cost does not represent the behavior of a cartel, as Professor Shapiro had to concede. Professor Willig explained: "[T]here's a range that runs from what a true cartel monopoly would be attempting to extract, and it might have a shot at it; the other end of that range is the opportunity cost." 5/04/17 Tr. 2615:5-9 (Willig). "And that opportunity cost is the bottom end of the range because without exercising or attempting to exercise any monopolization over the entire service that the agreement enables to be in business . . . the opportunity cost is the fallback for even the

must-have label. And so more a competitive non-monopoly, non-cartel circumstance would create that opportunity cost as the bottom end of the range." 5/04/17 Tr. 2615:12-20 (Willig). A cartel "would be aiming to extract all of the available extra value to the entire service that its contribution to the agreement helps to bring about." 5/04/17 Tr. 2614:16-2615:2. (Willig). Professor Shapiro agreed with this analysis and conceded that record labels engaged in a group boycott would seek compensation in excess of industry-wide opportunity cost. 5/04/17 Tr. 2592:12-15 (Shapiro).

Response to ¶ 381. No real or tacit collusion is required for record companies to understand that they likely will respond to a royalty offer in the same way. They all are aware of their analogous reaction to that same offer and their expectations about what is going to happen inform what they decide to do unilaterally in reaction to the proposed royalty. 5/04/17 Tr. 2617:6-25 (Willig).

Response to ¶ 382. As Professor Willig explained, there is no need for a public notice of the rates being negotiated in order for record labels to understand that what is unacceptable to one is likely unacceptable to another. Empirically, we know that rates tend to be relatively consistent, albeit not identical. And it is entirely plausible that record companies are aware of that fact from their experience in the industry. 5/04/17 Tr. 2624:7-2625:2 (Willig).

iv. Professor Dhar's Survey Was Properly Designed To Provide Data To Calculate Opportunity Cost And Its Results Are Confirmed By The Results Of The Simonson Survey

Response to ¶ 383. This is a summary paragraph; detailed arguments and responses are discussed below in the Responses to ¶¶ 384-408. SoundExchange disputes that the Dhar survey over-emphasized paid subscriptions, is not representative of the Sirius XM user base, or is

otherwise flawed, for the reasons set forth below and in SoundExchange's Proposed Findings of Fact at ¶¶ 584-666.

Response to ¶ 384. SoundExchange disputes that the Dhar and Simonson surveys are flawed because they did not provide an explicit response option for listening to an existing paid streaming subscription. This paragraph addresses the issue in summary fashion; Sirius XM's more detailed argument is addressed below in ¶ 401 and in SE FOF at ¶¶ 611-22, 658-61. In addition, Sirius XM mischaracterizes Professor Willig's testimony, citing Trial Ex. 46 ¶¶ 46-49 (Willig WRT). In his rebuttal testimony, Professor Willig criticized the Lenski survey because, by focusing on listening time rather than consumption/purchasing (see Trial. Ex. 46 ¶¶ 46-53 (Willig WRT)), it failed to measure the extent to which respondents would subscribe to new services. "Creators 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 (since its creator compensation is not linked to usage.)" Trial. Ex. 46 at ¶ 48 (Willig WRT). Contrary to Sirius XM's assertion, Professor Willig did not state that data on listening, including increased listening to existing paid subscription services, was needed to calculate opportunity costs or otherwise to allow for a reliable survey. Sirius XM's more detailed mischaracterization of Professor Willig's testimony in SXM FOF at ¶ 400 is addressed in more detail below in the SoundExchange Response to ¶ 400.

Moreover, to the extent that "[i]ncreased consumption of an *ad-supported* interactive service would provide some incremental compensation" to SoundExchange, "since compensation from an ad-supported interactive service is linked to usage," Trial. Ex. 46 at ¶ 48 (Willig WRT) (emphasis added), the fact that Professor Willig did *not* include any such increased consumption in his calculations for respondents who said they would purchase a

streaming subscription means that, if anything, his opportunity cost calculation is understated. Indeed, the same is true for any increased listening to ad-supported services (interactive or non-interactive), increased purchasing of CDs/downloads, or increased watching or listening to music videos — since the Dhar survey terminated if a respondent indicated he or she would subscribe to a (paid subscription) streaming service, none of that incremental listening on top of a (paid) streaming subscription was included in Professor Willig's calculation, making it conservative.

Sirius XM thus has it exactly backwards. In order to calculate creator compensation/opportunity cost, the economists required a survey that determines the degree to which people who quit Sirius XM or no longer had access to Sirius XM would, or would not, subscribe to or acquire new services; it is undisputed that the Lenski survey, unlike the Dhar and Simonson surveys, does not measure such acquisition. *See* SE FOF at ¶¶ 661, 1296.

In addition, Professor Willig noted that *in the context of the Lenski survey, which focuses on listening,* because the survey does not distinguish between increased listening to an existing paid interactive service, increased listening to an ad-supported interactive service, and purchasing a new subscription to a paid-interactive service, the Lenski survey not only is incapable of providing a basis to calculate the absolute level of opportunity costs, but is also incapable of providing a basis to even compare the opportunity costs for Sirius XM with Pandora. Trial Ex. 46 at ¶¶ 47-48 (Willig WRT).

Sirius XM's argument that the Dhar and Simonson surveys needed to provide an *explicit* response option for increased listening to an existing subscription is addressed below in the Response to ¶ 401 and incorporated herein.

1. Professor Dhar's Survey Was Properly Designed

Response to ¶ 385. Contrary to Sirius XM's argument that the Dhar Survey somehow led respondents to choose paid streaming subscriptions, Dhar Question 210 properly asked respondents who would cancel their Sirius XM subscription at various price points whether *or not* they would subscribe to a new paid streaming service. 5/8/17 Tr. 2734:8-11 (Dhar) ("And so one of the things the economists wanted out of my survey was to understand if you cancel your subscription, would you go to any of these other paid services or not.") The question whether or not they would do so was not in the least bit leading or confusing since "No, I would not subscribe to a paid music service in place of **Sirius XM**" was one of only three options (in addition to "Don't know/unsure") and was rotated so that half the respondents saw "No, I would not" first. *See* SE FOF at ¶ 607; Trial Ex. 22, App. D. at 69 (Dhar Corr. WDT). The underlining of "not" is in the survey as seen by the respondents. Trial Ex. 22, App. D at 69 (Dhar Corr. WDT). Moreover, the question itself likewise avoids leading respondents by providing both affirmative and negative phrasing: "would you *or would you not* subscribe to a paid music service …" (emphasis added). Trial Ex. 22, App. D at 69 (Dhar Corr. WDT).

If respondents stated they would subscribe to a streaming service, the Dhar survey ended, and the choices of those respondents were taken into account in Professor Willig's CCC/opportunity cost calculation. Trial Ex. 28 ¶¶ 40-43 (Willig WDT); Trial Ex. 22, App. D at 69 (Dhar Corr. WDT). Those who said they would not subscribe to a paid music service in place of Sirius XM were then asked two levels of questions as to what they would do "instead of paying for a subscription to Sirius XM." Trial Ex. 22 at App. D. p.69 (Dhar Corr. WDT) (emphasis in original). Professor Willig's calculation of CCC is thus conservative: since those who said they would subscribe to a new streaming service were not asked any further questions, the survey would not capture respondents who, for example, would purchase new CDs or

downloads *in addition to purchasing a streaming service*. Even though such purchases would result in additional compensation for music creators, they were not included in Professor Willig's calculations because the Dhar survey did not ask about additional purchases if a respondent said he or she would subscribe to a new paid streaming service.

Sirius XM's argument that the Dhar definitions of Satellite Radio, On-Demand, and Not-On-Demand somehow improperly put respondents in the frame of mind of paid subscriptions is addressed in the Response to ¶ 386 below and incorporated herein.

Response to ¶ 386. Sirius XM's argument that the Dhar survey definitions of Satellite Radio, On-Demand, and Not-On-Demand somehow improperly put respondents in the frame of mind of paid subscriptions, rather than free music options, is without merit. The definitions and examples were provided because not everyone will understand the terms "on-demand" and "not-on-demand." 5/8/17 Tr. 2733:8-21 (Dhar). Moreover, the definitions section of the survey which Sirius XM criticizes describes "on-demand" and "not-on-demand" *without any reference at all to paid subscriptions*,[47] Trial Ex. 22, App. D. at 66 (Dhar Corr. WDT), so there is no basis for Professor Hauser's claim that the definitions steer respondents to paid services. And it is frivolous to suggest that the Dhar survey would need to also define "free over-the-air AM/FM," or other "free music options." Sirius XM does not claim, and could not credibly claim, those terms are at all ambiguous. Moreover, in his "Modified Dhar Survey" in which he changed other aspects of Professor Dhar's survey, Professor Hauser did not modify or eliminate the definitions or their order in the survey. Trial Ex. 11, App. I at 7 (Hauser WRT).

[47] The actual switching question (Q210) does, of course, describe the price of paid subscriptions because cost is important to consumers and omitting cost information was a major flaw of the Lenski survey. SE FOF at ¶¶ 1288-93. This paragraph of Sirius XM's proposed findings is addressed to a different issue — an allegation that the definitions section of Professor Dhar's survey somehow "cued" respondents towards paid services. As noted above, the definitions do not even mention the word paid.

Sirius XM's citation to Professor Simonson's discussion of order effects — as supposed support for Sirius XM's criticism of the Dhar survey definitions — is misplaced and misleading. Professor Simonson explained that an order effect occurred in the Lenski survey because Mr. Lenski added a closed-ended question that limited the response options right before another related question. Trial Ex. 44 at ¶¶ 36-40 (Simonson WRT). That is, the Lenski survey required respondents to list what *one* source Sirius XM mostly replaced, prior to asking what they would switch to if Sirius XM no longer existed. SE FOF at ¶¶ 1276-87. In contrast, the definitions in the Dhar survey are just that — *definitions* — they do not even ask respondents to make a choice, let alone a single choice. Professor Simonson's discussion of order effects thus provides no support for Professor Hauser's criticisms of the definitions in the Dhar survey.

Finally, the fact that Professor Simonson's survey, which did not have a separate definitions section preceding the switching question (because it was modeled on the Lenski survey), *see* Trial Ex. 44 at App. D, reached very similar results to the Dhar survey[48] belies the argument that the definitions somehow biased the results.

Response to ¶ 387. Professor Hauser criticizes Dhar question 210 for failing to provide free choices, beyond the option of "No, I would <u>not</u> subscribe to a paid music service in place of Sirius XM." This criticism is without merit. As Sirius XM expands on this assertion in ¶ 388, we address it in the Response to ¶ 388 below, incorporated by reference herein.

Response to ¶ 388. There is no merit to Professor Hauser's criticism that Dhar question 210 should have spelled out various free or other choices, beyond the option of "No, I would <u>not</u> subscribe to a paid music service in place of Sirius XM." (In its proposed findings, Sirius XM

[48] See SE FOF at ¶¶ 639-43.

eliminated the underlining of "not" in Dhar Question 210; but in Professor Dhar's survey, the respondents saw the word "not" underlined. Trial Ex. 22, App. D at 69, App. E at 130 (Dhar Corr. WDT)).

There are multiple safeguards Professor Dhar included to ensure this question was not leading. First, the question asks "would you or would you not subscribe to a paid music service in place of **Sirius XM**," rather than asking only "would you." Second, the option "No, I would not subscribe to a paid music service in place of **Sirius XM**" was rotated, so that half the respondents saw the "No, I would not . . ." option first. 5/8/17 Tr. 2744:3-23 (Dhar); SE FOF at ¶ 607; Trial Ex. 22, App. D at. 68-69 (Dhar Corr. WDT). That phrasing and answer rotation by itself demonstrates that the question is not leading.

Professor Hauser's argument that respondents would not have in mind existing subscriptions they have is also flatly contradicted by the explicit and clear instruction Professor Dhar included in question 210: "Keeping in mind all other music services you subscribe to, would you or would you not subscribe to a paid music service in place of **Sirius XM**?" Thus, contrary to Professor Hauser's assertion, Trial Ex. 11 at 69 (Hauser WRT), Professor Dhar did ***explicitly*** remind respondents to consider subscriptions they already have. Sirius XM cannot have it both ways — *i.e.*, assert that Professor Dhar needed to put existing subscriptions "top of mind" and at the same time criticize a survey instruction that does precisely that. Nor could the survey any more clearly state that respondents answering the switching question should "only include a new subscription, and [] not include a music service that you currently subscribe to," *thus twice reminding respondents to keep in mind their existing subscriptions when they decide*

whether or not they would choose a new subscription to replace Sirius XM. Trial Ex. 22 at 69 (Dhar Corr. WDT). Professor Hauser never criticizes those aspects of the question.[49]

Moreover, Professor Dhar, who unlike Professor Hauser is an experienced consumer psychologist, explained that the framing of the question mirrors marketplace reality: Faced with cancellation of their paid Sirius XM subscription, consumers would first consider whether or not to purchase a substitute subscription. 5/8/17 Tr. 2750:25-2752:16 (Dhar); SE FOF ¶ 625. If they decided not to purchase a new subscription (as 49% of survey respondents stated, *see* Trial Ex. 288, Figure 10A (Hauser summary of Dhar survey switching responses)), consumers would then consider other options. Professor Dhar's survey mirrors this process, covering alternatives to purchasing a new subscription in the next set of questions. Trial Ex. 22 at 69 (Dhar Corr. WDT)); 5/8/17 Tr. 2751:9-12 (Dhar). Professor Dhar's approach is also consistent with the *unrebutted* expert testimony that consumers typically have a mental budget for entertainment and thus consider other subscriptions when one of their existing subscriptions is canceled. SE FOF ¶ 645 (citing Simonson testimony); Trial Ex. 44 at ¶ 75 (Simonson WRT) (citing C. Heath and J. Sole (1996), "Mental Budgeting and Consumer Decisions," *Journal of Consumer Research, 23,* 40-52; R. Thaler (1985), "Mental Accounting and Consumer Choice," *Marketing Science,* 4(3), 199-214); 5/11/17 Tr. 3456:14-3457:10 (Simonson).

Finally, and critically important, Professor Simonson's survey provided seven options, in addition to "None of the above," in a *single* switching question, rather than in stages. The fact

[49] In response to questions Judge Strickler raised concerning this phrasing, Professor Dhar, a trained consumer psychologist with decades of survey experience, found the instruction completely clear, 5/8/17 Tr. 2907:11-2908:23 (Dhar); and this aspect of the survey question was not even criticized by Professor Hauser despite his many other attacks on the Dhar survey. In fact, Professor Hauser believes it is important to provide cues to aid in the recall of other options, which is exactly what is accomplished by Professor Dhar twice reminding the respondents of their existing subscriptions.

that his survey showed the same extent of switching to on-demand services, and even higher switching to not-on-demand services than Professor Dhar's survey, fully puts to rest any assertion that presenting the options in stages biased Professor Dhar's results.

Response to ¶ 389. In ¶ 389, Sirius XM proposes findings of fact that are duplicative of those in ¶ 388. To avoid repetition, SoundExchange incorporates its Response to ¶ 388, *supra*.

Response to ¶ 390. Portions of ¶ 390 are duplicative of the findings of fact that Sirius XM proposes in ¶ 388. To avoid repetition, SoundExchange incorporates its Response to ¶ 388. In addition, Sirius XM argues that returning to AM/FM is "by far the most common source" former Sirius XM subscribers would turn to, apparently suggesting that the Dhar survey should have explicitly listed AM/FM as a response option in the first stage of the switching question. This argument is without merit for multiple reasons:

- The Simonson survey did include additional AM/FM listening as a response option in the first stage, and the results as to the percentage of respondents who would subscribe to an interactive or non-interactive streaming service were similar or even higher than in Professor Dhar's survey. *These results demonstrate that explicitly providing AM/FM as an answer choice in the first stage of the question does not make respondents any less likely to choose paid streaming services*. *See* SE FOF at ¶¶ 626, 631, 640-44.
- The Lenski survey is not reliable and is biased because, among many other reasons, it primed respondents to think about AM/FM radio immediately before asking the switching question. *See* SE FOF at ¶¶ 1279-84.
- Sirius XM notes in ¶ 390 that in the Lenski survey "among all time spent listening to Sirius XM, 40.8% of those listening hours would go to AM/FM radio." Notwithstanding all of the Lenski survey flaws, including the inability to equate listening time with

acquisition and subscription data needed to calculate opportunity cost, even in the Dhar survey *49%* of those who would cancel their Sirius XM subscription stated they would *not* subscribe to a paid substitute service, and 44% of those who would cancel their Sirius XM subscription stated they would use *free music* as a substitute, showing that respondents were not at all hesitant to decline the option of switching to paid services. Trial. Ex. 288, Figure 10A (Hauser summary of Dhar survey switching results).

Response to ¶ 391. Sirius XM's claim that Professor Hauser's "Modified Dhar" survey demonstrated "[t]he biasing effect of hiding these other options" ignores *unrebutted* trial evidence of the flawed phrasing of the Hauser survey. SE FOF at ¶¶ 614-22. At trial, Professor Dhar testified specifically about the fundamental flaws and misleading nature of the very section of Professor Hauser's "Modified Dhar" survey on which Sirius XM's ¶ 391 is premised. Despite testifying after Professor Dhar at trial, Professor Hauser never defended the flawed phrasing in response to Professor Dhar's testimony. SE FOF at ¶ 619.

First, even though Professor Hauser purportedly conducted nine days of pretesting, he never tested Professor Dhar's switching question as originally phrased in the Dhar survey. 5/9/17 Tr. 3123:14-20, 3125:3-10 (Hauser).

Second, *not a single one* of the Sirius XM subscribers in Professor Hauser's pretest of his own revised draft survey questions stated that they wanted or needed to add response options for switching to an existing subscription. Trial Ex. 11, App. H at 2 (Hauser WRT) (top of page summarizing comments on the *Sirius XM* part of the survey); 5/9/17 Tr. 3124:8-19 (Hauser). As for the *on-demand* section of the survey (not the Sirius XM part), Professor Hauser acknowledged there may have been only one on-demand subscriber who made such a comment. 5/9/17 Tr. 3124:20-3125:2 (Hauser). SE FOF at ¶ 614. In short, based on a *non-existent concern*

in pretesting of a draft question that did not list "existing subscription" as a response option for switching from Sirius XM, Professor Hauser trumped up a reason to abandon Professor Dhar's unambiguous switching question (which did remind respondents to keep in mind their existing subscriptions), in favor of a hopelessly vague and poorly worded response option that nullifies any conclusions from Professor Hauser's survey.

Thus, as explained at trial and in SoundExchange's Proposed Findings of Fact, in Professor Hauser's "Modified Dhar" survey, Professor Hauser added the following response option to Question 210: "I would listen to Apple Music, Spotify, Amazon Music, Google Play or another On-Demand music streaming service that I already pay to subscribe to." Trial Ex. 11, App. I at 10 (Hauser WRT) (response option #2). As Professor Dhar explained, the clause "that I already pay to subscribe to" is *misplaced*. Because of the misplaced clause, option #2 in Question 210 could readily be understood by a respondent to include four **new services** the respondent does not already subscribe to (Apple Music, Spotify, Amazon Music, and Google Play), and one existing service option ("another On-Demand music streaming service that I already pay to subscribe to"). 5/8/17 Tr. 2814:15-2816:15 (Dhar); SE FOF at ¶¶ 614-617.

As Professor Dhar explained, in testimony that was unrebutted at trial, had Professor Hauser really wanted to test whether adding an explicit "existing subscription" option would make any difference in the survey results, he could have phrased option #2 correctly in Question 210, *i.e.*, "I would listen to an [O]n-[D]emand music streaming [service] *that I already subscribe to, such as* Apple Music, Spotify, Amazon." 5/8/17 Tr. 2816:8-15 (Dhar) (emphasis added). SE FOF at ¶ 615.

Sirius XM is thus wrong to claim that respondents who selected option #2 in response to Question 210 in Professor Hauser's survey chose *existing* services. *See* SXM FOF at ¶ 391.

Instead, respondents who selected option #2 could clearly have intended to choose a "new" service option (*i.e.*, interpreting the options of the most popular services listed in the answer — Apple Music, Spotify, Amazon Music, and Google Play — as new subscriptions). The misleading phrasing of this answer choice demonstrates that Sirius XM's and Professor Hauser's *entire conclusion is invalid* — *i.e.*, that the Hauser "Modified Dhar" survey supposedly shows more people would subscribe to an existing service had they been given the explicit option. Respondents who do *not* have Apple Music, Spotify, Amazon Music, or Google Play, and decided they would want one of those services if Sirius XM were canceled, and selected answer option #2, *would be mistakenly categorized by Professor Hauser as wanting to subscribe to an existing service they already have* — all because of the basic mistake of misplacing the clause "that I already pay to subscribe to."

Sirius XM inexplicably declines to address in its proposed findings this fundamental issue from the trial. There was no evidence at trial rebutting the existence of this major flaw in Professor Hauser's survey.

Response to ¶ 392. Sirius XM, again ignoring key trial evidence or planning to present new explanations not provided at trial on reply, persists in touting the results from Professor Hauser's invalid survey, claiming that only 15% of respondents in Hauser's Modified Dhar Survey said they would switch to a new paid on-demand subscription. As explained at length above in Response to ¶ 391 and at trial, this is because of the number of respondents who instead chose Hauser option #2, which Sirius XM and Professor Hauser erroneously describe as an option to switch to an existing on-demand service. The unrebutted testimony at trial is that the "existing" service option does not actually say that at all because of the misplaced modifier, and the actual data (which Professor Hauser's consultants verified) show that *in fact* a significant

number of respondents in the Hauser "Modified Dhar" survey who purportedly chose an "existing" subscription service in fact *had no such thing* — because they were obviously confused by the flawed survey design. *See* SE FOF at ¶¶ 614-19. Correcting this error increases the percentage of respondents who would choose a new On-Demand service in Professor Hauser's survey from 15% to 19%, 5/8/17 Tr. 2822:1-2823:10 (Dhar), a significant increase that does not even take into account that Professor Hauser's survey is unreliable because it eliminated anyone who had taken a music survey in the six months prior to the survey (and hence eliminated respondents who may have a greater interest in music). *See* SE FOF at ¶¶ 808-12.

Response to ¶ 393. Sirius XM's assertions regarding the percentage of people who would listen to AM/FM if they no longer have their Sirius XM subscription are addressed above, including in the Response to ¶ 390. In addition, where a survey allows respondents to choose as many options as they please, as the Hauser Modified Dhar survey does, it should hardly be surprising that a high percentage of people would *in part* listen to AM/FM radio if they no longer have Sirius XM — but that does not mean they would listen *exclusively* to AM/FM radio. *See* Trial Ex. 11, App. I at 10 (Hauser WRT) ("Please select all that apply.") To the extent Sirius XM suggests otherwise, it has mischaracterized the survey results.

Moreover, Professor Hauser does not criticize Professor Simonson for the way he included the AM/FM option in his survey. Like Professor Hauser, Professor Simonson allowed respondents to choose as many options as they wanted to replace Sirius XM (*see* Trial Ex. 44, App. D at 5 (Simonson WRT) (Q 240)). Fifty-nine percent of respondents said they would listen to AM/FM more than they currently do, Trial Ex. 44 at ¶ 69 (Simonson WRT), a result Sirius XM has not challenged, further demonstrating the reliability of the Simonson survey.

Response to ¶ 394. Sirius XM, citing Professor Dhar's trial testimony, states that Professor Dhar concedes that if his survey had in the first question explicitly offered the choice of free music or AM/FM, the number of people choosing free music would be higher. But Sirius XM cut off the simple explanation Professor Dhar gave for this: that the number would be higher if the survey was a "check all that applied" methodology. 5/8/17 Tr. 2920:25-2921:2 (Dhar). As discussed above, if respondents would listen to AM/FM, or purchase new CD's, *in addition to* subscribing to a streaming service, the Dhar Survey did not measure that. It is in that context — context omitted by Sirius XM — that Professor Dhar explained that increased listening to AM/FM was not what the economists were looking at.

As explained above and in Professor Willig's testimony, the economists used the survey data to determine the extent to which respondents who no longer had Sirius XM would purchase *new* subscriptions or acquire other music for which creators would receive a royalty. Trial Ex. 28 ¶ 40 (Willig WDT). The Dhar survey quite clearly asked whether "or not" respondents would subscribe to a new streaming service, and if a respondent would choose only free services such as AM/FM, in lieu of a subscription to a streaming service, the option "No, I would <u>not</u> subscribe to a paid music service in place of Sirius XM was plainly and clearly provided (and presented first to half the respondents). *See* Response to ¶ 388 *supra*; *see also* 5/8/17 Tr. 2755:20-25 ("Q: somebody says, okay, I've lost my Sirius XM; the only thing I'm going to do is listen to AM/FM radio now. How would they answer 210? A. So the way they would answer 210 is no, I would not subscribe to a paid service.")

Thus, SXM FOF at ¶ 394 shows only that the Dhar survey does not provide data on the extent to which respondents who would purchase a streaming service would, in addition, listen to AM/FM; but that data is not relevant to the CCC/opportunity cost calculation. As Professor

Willig explained, and as discussed at length in SoundExchange's Proposed Findings of Fact, it is changes in acquisition of alternative forms of music that provide creator compensation which are relevant to opportunity cost, *not* simply listening time. And anyone who would choose *only* to listen to AM/FM or other free music or existing subscriptions, and not purchase a new subscription upon losing Sirius XM, was given the clear "no" option in Professor Dhar's survey.

2. Professor Dhar's Survey Population Was Appropriate And Representative, As Confirmed By The Simonson Survey

Response to ¶ 395. Professor Dhar's response to the argument that the Dhar Survey is not representative of the Sirius XM population is addressed in SE FOF at ¶¶ 629-31 and will not be fully repeated here. This section focuses primarily on additional Sirius XM assertions in SXM FOF at ¶ 395. First, Sirius XM's argument that Professor Dhar provided no defense in his written testimony for using the Select Group is easily dispensed with; it was not until Professor Hauser filed his written rebuttal testimony that there was any criticism of this approach for Professor Dhar to respond to.

Second, Sirius XM disingenuously criticizes Professor Dhar for relying for the first time at trial on Sirius XM's produced data as to the specific percentage of Sirius Select subscribers in the Sirius XM subscriber base. *See* SXM FOF at ¶ 395 n.42. But this data was not produced by Sirius XM until after Professor Dhar submitted his written direct testimony, so he could not have relied on it at the time his direct testimony was submitted in October 2016. *See* Trial. Ex. 265 (Sirius XM Responses to Interrogatories Dated Nov. 22, 2016); 5/8/17 Tr. 2827:3-2829:25 (Dhar) (discussing Trial. Exs. 146-148, 265, referred to in the interrogatory responses). In the meantime, for purposes of his written testimony, Professor Dhar relied on his understanding that [[redacted]]. 5/8/17 Tr. 2827:3-2829:25 (Dhar); Trial Ex. 22 at ¶ 46 n.33 (Dhar Corr. WDT). This understanding

Professor Dhar already had was simply confirmed in greater detail by the later-produced Sirius XM documents (Trial Exs. 146-48, 265); at trial Sirius XM did not contest Professor Dhar's interpretation of those documents and conclusions regarding the percentage of Sirius XM subscribers who subscribe to the Select package.

Third, it was entirely rational for Professor Dhar, as a survey expert and consumer psychologist, to design his survey to avoid confusion and undue complexity by not listing all the different types of packages and instead focusing on the main package that, [ ]. Trial Ex. 146 (native file) (tab "Subscribers by Package," Heading "Selfpay"); 5/8/17 Tr. 2736:24-2738:13, 2827:1-2830:11 (Dhar). While Sirius XM points to other packages such as Mostly Music, in its own proposed findings, Sirius XM acknowledges that that package represents only 6% of its subscriber base. SXM FOF at ¶ 4. Even the second most popular package, [ ]. Trial Ex. 146 (native file) (tab "Subscribers by Package," Heading "Selfpay"). It is important to note that the Dhar survey had a willingness-to-pay section which included the "list price" and common features of the service (a key section omitted in the Lenski survey); that is why it would have been confusing to list a dozen or more package names with different list prices — each with a small subscriber base. Professor Dhar, as the only expert qualified as a consumer psychologist, explained that consumers often do not know the particular name of a product variation they use (*e.g.*, Tide vs. Tide Basic detergent), and listing multiple packages would have unnecessarily confused respondents. 5/8/17 Tr. 2737:4-2738:12 (Dhar).

Fourth, and relatedly, the fact that some respondents may have mistaken the name of their package is not relevant. All of the respondents were subscribers to Sirius XM (in order to

qualify for the survey) and thus by definition know what they listen to and like about their service (and how much they are willing to pay for what they are getting), regardless whether they know the right *name* of the package.

Fifth, the fact that subscribers who did not identify themselves as Select subscribers were not included in the survey does not in any way affect the validity of the survey. Sirius XM boasts 31 million subscribers. With a sample size of 509 paid Sirius XM Select Subscribers, Trial Ex. 22, Table 1 (Dhar Corr. WDT), the survey necessarily "excluded" millions of subscribers. The relevant point, however, is that the sample size of 509 that Professor Dhar used was robust — Professor Hauser did not in any way challenge the sample size as inadequate. Indeed, unlike Professor Hauser, Professor Dhar calculated precision intervals around the results of his robust 500-person survey population. *See, e.g.*, Trial Ex. 22, Table 9 (Dhar Corr. WDT).

The number of people not included in the survey is thus a red herring. The representativeness of the survey population in terms of various Sirius XM packages is addressed above. And, once again, the Simonson survey results belie Professor Hauser's criticism. Professor Simonson (who did not have a willingness-to-pay section, as his survey was modeled off of Mr. Lenski's, and thus did not have the concerns about survey confusion if multiple packages were included) included subscribers to any package, and his results were similar to those of Professor Dhar. SE FOF at ¶¶ 639-43.

Importantly, in contrast to Professor Hauser's candid acknowledgment that he does not actually know whether the Dhar survey population is representative of the full Sirius XM subscriber base, 5/9/17 Tr. 3130:1-11 (Hauser), the Simonson survey results showing a similar level of streaming subscription substitution constitutes hard evidence demonstrating the

representativeness of the Dhar survey population. Professor Hauser had no evidence to the contrary.

Response to ¶ 396. Sirius XM's argument concerning the Select package is discussed above. In ¶ 396, it is unclear whether Sirius XM also attempts, for the first time, to claim that the Dhar survey is not representative because the "switching" questions are directed to persons who stated they would cancel their Sirius XM service at a given price. That argument fails as a threshold matter because Sirius XM never made it in its testimony. But in any event the argument makes no sense and is without merit, as the whole point of the economic *substitution* analysis is to determine what customers would acquire if they did *not* have Sirius XM. Asking respondents who are *keeping* their Sirius XM subscription what additional services they might acquire is not a "substitution" analysis at all.

Moreover, to the extent this aspect of Sirius XM's argument about the Dhar survey representativeness is based on the survey's use of a hypothetical price increase as the predicate for the switching question, it should be noted that Sirius XM's own CEO emphasized and re-emphasized that most people who leave Sirius XM do so because they do not want to pay. 5/15/17 Tr. 3725:23-3726:1 (Meyer) ("I can tell you the vast majority leave us for one simple reason: I don't want to pay, I don't want to pay, I don't want to pay, I don't want to pay. Okay?"). That is the scenario presented in the Dhar survey.

And, yet again, the similar Simonson survey results (which mimicked the Lenski survey by asking respondents to assume they no longer have their Sirius XM subscription, without specifying a reason) confirm that the two variations of the question (quitting Sirius XM because of price vs. assuming Sirius XM is no longer available) do not change the results.

Sirius XM's discussion of the All Access package is just a continuation of the "Select" package issue already addressed above. Given that the Dhar Survey did not include subscribers to *either* the All Access package (which has a higher list price and a few more channels than Select), or the Mostly Music package (which has a lower list price and a few less channels), Trial Ex. 643, and that Mostly Music and All Access each represent only a small fraction of the Sirius XM subscriber base (as discussed in Response to ¶ 395 above), it is not surprising that the Dhar survey focus on the Select package [[redacted]] produced similar results to the Simonson survey (which covered any subscriber).[50]

Response to ¶ 397. Professor Dhar explained that the Sirius XM packages and names are "confusingly similar." 5/8/17 Tr. 2854:24 (Dhar). [[redacted]]. 5/8/17 Tr. 2859:16-20 (Dhar). As long as respondents know what they like about Sirius XM (and by definition they are *all* subscribers — that key point is not disputed), they can readily answer questions about their willingness to pay and what alternative services they would subscribe to if they canceled their Sirius XM subscription. Professor Dhar gave the example of cable t.v. packages — "I don't know all the channels that I don't have, but I do know the channels that I use." 5/8/17 Tr. 2850:25-2851:2 (Dhar). Each respondent is a Sirius XM subscriber who would know what channels they listen to and what they like about Sirius XM, whether or not they know the name of the package.

[50] All of the same points apply to Sirius XM's discussion of the slight differences between packages that apply to legacy Sirius radios vs. XM radios — Professor Dhar explained that it would be far too complex to add multiple package variations, survey respondents do in fact know what they listen to regardless of package name, and the survey proved to be representative for the reasons discussed above.

Moreover, if some All Access customers were included in the survey because they *thought* their package was called Select, according to Sirius XM's own logic in ¶ 396, that would serve only to make the survey population *more* inclusive. The flip side — that some Select customers may have been excluded because they thought their package had a different name — is irrelevant because the survey indisputably had a robust sample size of 509 paid Sirius XM subscribers. *See* Response to ¶ 395, *supra*.

Response to ¶ 398. In sum, it was entirely appropriate for Professor Willig to rely on the Dhar survey given that Select customers represent [[redacted]] of the subscriber base, that Professor Dhar explained it would have been confusing to respondents to list 12 or more varieties of packages, that no other package has anything remotely close to the subscribership levels of Select, and that the Simonson survey, which included subscribers to any Sirius XM package, reached similar results.

3. The Dhar And Simonson Surveys Provided Clear And Sufficient Questions, Instructions, And Response Options

Response to ¶ 399. The fact that Professor Willig explained that the Simonson survey results corroborate the Dhar Survey results, and that Professor Willig also relied on the Simonson survey results, hardly constitutes an "acknowledge[ment]," implicit or otherwise, that the Dhar survey is flawed. Professor Willig said no such thing.

Response to ¶ 400. Sirius XM grossly mischaracterizes Professor Willig's testimony when it claims that Professor Willig "specifically criticized Mr. Lenski's survey for its failure to offer survey respondents the opportunity to select as an option replacing Sirius XM listening with *increased listening to a subscription service that they already subscribe to,* describing this failure as a 'critical shortcoming.'" SXM FOF at ¶ 400 (citing Willig WRT ¶ 48) (emphasis in SXM FOF). Sirius XM misstates Professor Willig's testimony in an attempt to suggest that

Professor Dhar's and Professor Simonson's surveys are flawed. As Sirius XM well knows, however, that is not the "critical shortcoming" Professor Willig identified. Sirius XM blatantly misquoted Professor Willig's testimony.

Professor Willig clearly explained that the shortcoming in the Lenski survey exists 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* (since its creator compensation is not linked to usage)." Trial. Ex. 46 at ¶ 48 (Willig WRT). In other words, Professor Willig contrasted a proper survey that focuses on new paid subscriptions from an improper survey that focuses on increased listening time for an existing subscription. Sirius XM omits the entire context of Professor's Willig's discussion of this issue, which is that the Lenski focus on listening time is the *wrong* measure. Trial Ex. 46 at ¶¶ 46-49 (Willig WRT). The point of Professor Willig's testimony is that increased listening time is the wrong focus, not that the survey needs to *include* that measure.

Thus, Professor Willig explained that Mr. Lenski's lumping together, and failing to distinguish, new subscriptions from increased use was a critical flaw. Professor Willig plainly did not say that to calculate opportunity cost it was necessary to quantify increased listening to an existing subscription.

Sirius XM should know better, but it nevertheless doubles down on its misrepresentation of Professor Willig's testimony: "This is the case, *according to Professor Willig*, since a survey that does not offer respondents the option of listening more to an existing subscription 'cannot provide the information needed to assess the relevant effect, namely, the impact on creator compensation.'" SXM FOF at ¶ 400 (citing Willig WRT ¶ 46) (emphasis added). This is not even close to what Professor Willig said.

Professor Willig did not say that in order to determine creator compensation, a survey needs to include the option of listening more to an existing subscription. He said the opposite. Here is the full version of the *same* sentence from Professor Willig's testimony that Sirius XM selectively chops up: "Because it focuses exclusively on how respondents would otherwise spend their listening time, the Lenski Survey cannot provide the information needed to assess the relevant effect, namely, the impact on creator compensation." Trial Ex. 46 at ¶ 46 (Willig WRT); Trial Ex. 46 at ¶ 48 (Willig WRT) ("Creators 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 (since its creator compensation is not linked to usage")). Sirius XM's misrepresentation of Professor Willig's testimony is indefensible.

Sirius XM thus has it exactly backwards: in order for Professor Willig to calculate creator compensation/opportunity cost, the surveys needed to determine the degree to which people who quit Sirius XM or no longer had access to Sirius XM would, or would not, subscribe to new streaming services; the Lenski survey, unlike the Dhar and Simonson surveys, failed to do so. Moreover, to the extent that "[i]ncreased consumption of an *ad-supported* interactive service would provide some incremental compensation" to SoundExchange, "since compensation from an ad-supported interactive service is linked to usage," Trial. Ex. 46 at ¶ 48 (Willig WRT) (emphasis added), the fact that Professor Willig did *not* include any such increased consumption in his calculations for respondents who said they would purchase a streaming subscription means that, if anything, his opportunity-cost calculation is *understated*.

Response to ¶ 401. Beyond its mischaracterization of Professor Willig's testimony, Sirius XM's assertion that the Dhar and Simonson surveys are not reliable because they do not

have an explicit response option of more use of an existing subscription is without merit. As explained above, Professor Dhar's survey quite explicitly in the switching question tells respondents to "keep[] in mind all other music services you subscribe to" when answering whether they would or would not subscribe to a paid music service in place of Sirius XM. And for extra emphasis and redundancy to this already clear instruction, the Dhar survey in the very next sentence of the same question reminds respondents, "This would only include a new subscription and would not include a music service that you currently subscribe to." *See* ¶¶ 384, 388 *supra*; Trial Ex. 22 at 69 (Dhar Corr. WDT); 5/8/17 Tr. 2907:7-10 (Dhar). So there is no ambiguity about how clear the Dhar survey is on this score, the full Question 210 is reproduced here:

> *SEQUENCE AS OTHER "YES- NO" QUESTIONS IN THE SURVEY. ANCHOR OPTION 4}*
>
> {INSERT link to definitions provided in Q200. It should say, "Click here if you want to review the music services definitions."
>
> (QUESTION 210)
>
> You mentioned that you would cancel your subscription to **Sirius XM** if you were charged **[INSERT SWITCH PRICE]** per month. Keeping in mind all other music services you subscribe to, would you or would you not subscribe to a paid music service in place of **Sirius XM**? This would only include a new subscription, and would not include a music service that you currently subscribe to. **Please select one answer**.
>
> 1: Yes, I would subscribe to an **On-Demand** music streaming service like Apple Music or Spotify at **$9.99** per month →(**SKIP TO Q220**)
> 2: Yes, I would subscribe to a **Not-On-Demand** music streaming service like Pandora One at **$4.99** per month →(**SKIP TO Q220**)
> 3: No, I would <u>not</u> subscribe to a paid music service in place of **Sirius XM** →(**SKIP TO Q210.1**):
> 4: Don't know/unsure → (**SKIP TO Q220**)

Trial. Ex. 22 at 69 (Dhar Corr. WDT) (emphasis in original).

In addition to the fact that the Dhar survey does instruct respondents to keep in mind existing subscriptions, and rotates the option "No, I would not subscribe to a paid music service in place of Sirius XM" so that half the respondents see "no" first, Professor Dhar explained that in the marketplace this is exactly how consumers would approach the issue — with the loss of a paid subscription service (Sirius XM), they would first consider and decide whether or not they would pay for a substitute subscription. *See* ¶ 388, *supra.*

Professor Simonson's survey, and his responses to Sirius XM's critique, are described in detail in SE FOF at ¶¶ 635-87. Professor Simonson explained, among other things, that he already provided respondents with seven answer options, in addition to "None of the above," and he had to avoid an excessive cognitive load associated with having too long a list of response options. 5/11/17 Tr. 3485:17-3486:4 (Simonson). The "None of the above" would be the obvious and clear choice for anyone who would use their existing subscription and none of the other six options listed. 5/11/17 Tr. 3485:17-3486:2 (Simonson). Adding both an existing subscription to an interactive service and an existing subscription to a non-interactive service would result in *nine* different response options in addition to "None of the above." It should be noted that the Lenski survey, on which the Simonson survey is based, has only five response options in addition to listening to less audio overall and "other." Trial Ex. 7, App. B at B-4 (Lenski WDT). Even Professor Hauser acknowledged the core principle that providing too many response options can lead to respondent fatigue. Trial Ex. 11 at ¶ 63 (Hauser WRT).

Professor Simonson also noted that it would likely be rare for a Sirius XM subscriber who already has a streaming subscription to rely solely on that existing subscription were Sirius XM service to become unavailable; by definition this subset of consumers was not satisfied with

having *only* a streaming subscription for use in the car, since they also subscribed to Sirius XM even though they already had a streaming subscription. *See* 5/11/17 Tr. 3489:1-19 (Simonson).

Response to ¶ 402. Sirius XM simply continues its criticism from ¶ 401; SoundExchange incorporates by reference its Response to ¶ 401. In addition to the fact that the Dhar survey does remind respondents about existing subscriptions (unlike the Lenski survey Professor Dhar criticized, in the excerpts quoted by Sirius XM), the Dhar survey was designed to determine whether **or not** respondents would purchase a new paid subscription and thus *did* provide complete response options to that yes or no question, and respondents were reminded to keep in mind their existing subscriptions.

The Simonson survey, as noted above, already had more response options than the Lenski survey on which it was based, including an unambiguous "None of the above" option, and Professor Simonson explained the importance of avoiding too many response options.

Response to ¶ 403. As Professor Simonson explained at trial, there is nothing at all inconsistent about the fact that some respondents who have a Pandora subscription and a Sirius XM subscription would purchase a second Pandora subscription *if they lost their Sirius XM service*. Professor Simonson gave the obvious example of spouses who share a car: The family could well decide to purchase a Pandora subscription for the spouse who did not have one once Sirius XM became no longer available. 5/11/17 Tr. 3512:21-3514:4. Professor Simonson explained that Pandora service does not allow two simultaneous users, 5/11/17 Tr. 3512:6-3513:3 (Simonson), even leaving aside the obvious point that two members of a family may have distinct tastes in music and thus want their own individual subscriptions and customized programming.

Response to ¶ 404. Nor is it unreasonable that some respondents with both a paid Sirius XM subscription and Pandora subscription, upon losing their *Pandora* subscription, would get a second Sirius XM subscription. Professor Simonson gave the example of a family (in the example, his own), with more than one vehicle. 5/11/17 3516:17-3517:4. That is, in the scenario outlined by Sirius XM and Professor Hauser, it is perfectly reasonable that when one family member who uses Pandora in the car is told Pandora service no longer exists, the family might purchase another Sirius XM subscription for a vehicle that does not already have one. (It should also be noted that Professor Willig does not even use the data from the Simonson survey on Pandora substitution.)

Response to ¶ 405. There is no merit to Sirius XM's claims that Professor Simonson's explanations (cited in the Responses to ¶¶ 403-04 above) are not plausible. It is perfectly plausible, and consistent with common sense, that a household would have more than one family member who listens to music in a vehicle, and/or more than one vehicle. Indeed, the Simonson survey asks both if the respondent is a "primary user" of the subscription and if the respondent made the decision to subscribe or had a major or minor role in the decision — questions that on their face contemplate a household.

Moreover, when Mr. Lenski described his survey (on which the Simonson survey is based), he stated, "We know that there are people that subscribe or pay for a subscription, but then there are often additional people in their household or otherwise that have access and listen to Sirius XM even if they aren't the paid subscriber to the survey." 5/4/17 Tr. 2678:1-6 (Lenski); *see also* 5/4/17 Tr. 2641:4-10 (Lenski).

Sirius XM's assertion that Professor Simonson's explanation is implausible because respondents had to be primary users of their subscription, is a *non sequitur*. The fact that, for

example, a head of household who is a primary user of one subscription, has in mind what new services the household might need when the subscription becomes unavailable, is perfectly reasonable and plausible. And while Sirius XM points to Professor Simonson's statement that he cannot actually read minds, it is of course true (and irrelevant) that no survey expert in any case can read the minds of the respondents to know with certainty why a respondent chose a particular answer.

Response to ¶ 406. The purported inconsistency identified by Sirius XM in ¶ 406 is not inconsistent, and perfectly plausible, for the same reason as identified above — *i.e.*, multiple family members. In this variation, when the Sirius XM subscription becomes no longer available, one family member would choose free Pandora even though another already has a paid Pandora subscription. This is rational for the same reason as identified above — different family members can have different music tastes and want their own customizable service, and it is an undisputed fact that two people are not permitted to listen to the same subscription at the same time. 5/11/17 Tr. 5/11/17 Tr. 3512:6-3515:4. That would be a significant problem if, for example, a family member in the car tried to use a Pandora subscription while another family member was already using that subscription at home or at work. The only difference between this scenario and the one discussed above in Response to ¶ 403 is that here the household chose a free Pandora service for one of its sources rather than two paid subscriptions.

Response to ¶ 407. Sirius XM claims that the only survey that made all the distinctions that Professor Willig claims are critical is Professor Hauser's. This is absurd. In addition to having misrepresented Professor Willig's testimony through incomplete and misleading quotations, *see* Response to ¶ 400 *supra*, Sirius XM simply ignores the fatal, undisputed flaws in the Hauser survey. As explained in detail in the SE FOF at ¶¶ 614-22 and above in Response to

¶ 391, Professor Hauser did *not* ask respondents if they would switch to an existing subscription. Because of an obviously misplaced modifier, as explained by Professor Dhar — a glaring error that Professor Hauser did not even attempt to rebut, even though he testified after Professor Dhar — the Hauser survey did not have an option for pre-existing subscriptions. The percentages in the Hauser survey are therefore meaningless, because of the misphrased response options (not to mention that Professor Hauser eliminated from the survey anyone who had taken a music survey in the past six months, and thus potentially a core group of respondents with a keen interest in music). SE FOF at ¶ 808.

Response to ¶ 408. Professor Farrell's recasting of Professor Willig's calculations using the Hauser survey is invalid since the Hauser survey entirely misstated the switching question, *see* SE FOF at ¶¶ 614-22, and since Professor Hauser conceded unequivocally that the economists should not rely on his survey, *see* SE FOF at ¶ 619 (citing Hauser testimony).[51]

Moreover, Professor Willig has already explained at length why the Lenski survey cannot be used to establish opportunity cost (because it focuses on listening time rather than acquisition/purchase, in addition to the methodological failings of the Lenski survey). *See* SE FOF at ¶ 563. Even Sirius XM admits it is not possible to build up an actual opportunity cost from the Lenski survey. SXM FOF at ¶ 401.

In addition, in *Web IV* the Judges rejected a consumer survey in part because it failed to provide prices for the substitute services. The Judges' description of the rejected survey could just as well describe the Lenski survey in this proceeding. The Judges found that the rejected Butler survey in *Web IV*, among other things, "did not test whether the responding listeners had

[51] This is not the first time a survey submitted by Professor Hauser was fundamentally flawed. *See* SE FOF at ¶ 242. The CRB has never relied on a survey submitted by Professor Hauser despite his multiple attempts.

any knowledge of the prices of the potential substitute services she provided to them when asking her second question. Given that the Judges are attempting to set rates in this proceeding, a survey that asks 'listeners' to rank substitute services without providing price information fails to provide any meaningful information as to how those 'listeners' will act as 'consumers' of streaming services." *Web IV*, 81 FR at 26327.[52]

v. The Promotional Impact Of Sirius XM Was Examined By Professor Ford And Found To Be Immaterial

Response to ¶ 409. No response.

Response to ¶ 410. Professor Willig did not attempt to examine promotional effects because that was the job of SoundExchange expert Professor George Ford. Sirius XM simply ignores Professor Ford's extensive testimony and seemingly suggests that Professor Willig's opportunity cost analysis is flawed because it was Professor Ford rather than Professor Willig who served as SoundExchange's expert on promotion. The argument is frivolous. Professor Ford examined this subject extensively and found no reason to believe that Sirius XM is promotional in any respect. *See* SE FOF at ¶¶ 406-444. Thus, no adjustment to the proposed royalty rates or the opportunity cost analysis was necessary.

Further, although Sirius XM claims that the purported failure to consider promotional effects of Sirius XM results in a royalty for Sirius XM that is too high, Sirius XM has never offered any useful proof that any such promotional effect exists. To begin, Sirius XM would first have to show that its service, standing alone, promotes sales in other markets. And then, as Professor Shapiro expressly agreed, it would also have to show that any promotional impact of

[52] The Judges also criticized the Butler survey for failing to calculate confidence intervals. The Dhar and Simonson surveys here do so, while the Hauser survey does not. 5/9/17 Tr. 3137:21-3139:1 (Hauser).

plays on Sirius XM is greater than the promotional impact of plays on the services for which Sirius XM substitutes. SE FOF at ¶ 440. Sirius XM has done neither.

Sirius XM's evidence that the Sirius XM service is promotional (apart from Professor Shapiro's regressions, which we address in Responses to ¶ 411 and ¶ 412 below) consists only of the kind of evidence the Judges have consistently rejected. Sirius XM's fact witness, Mr. Blatter, presents only a smattering of self-selected anecdotes reflecting nothing more than the expression of courtesies by both record labels and services, almost identical to the evidence he presented (and the Judges rejected) in *SDARS II*. *SDARS II*, 78 FR at 23066. As to the experts, once again Professor Farrell is all theory and no facts; he made no effort to examine promotion. *See* Trial Ex. 10 at ¶¶ 55-58 (Farrell WRT). Professor Shapiro likewise disclaims any attempt to actually calculate a promotional effect. 4/24/17 Tr. 559:2-5 (Shapiro).

Moreover, no one has attempted to assay whether Sirius XM — even if it were promotional to some degree — is more promotional than the services for which it substitutes; that is, whether there is any net positive promotional effect. Absent such evidence, Sirius XM supplies no reason to discount Professor Willig's opportunity cost analysis.

Response to ¶ 411. Lacking anything better, Sirius XM tries to resurrect Professor Shapiro's regression analysis. In his written rebuttal testimony, Professor Shapiro claimed that he had revised regressions run by Professor Willig and proved a promotional effect for Sirius XM. In the end, it turned out that Professor Shapiro proved nothing beyond the obvious conclusion that Professor Willig was right and Professor Shapiro was wrong. Certainly, Professor Shapiro's regression analysis does not prove that Sirius XM promotes sales in other markets. Even Professor Shapiro correctly, if rather belatedly, disavowed his own results.

Professor Willig conducted a regression analysis that looked at all streaming services together and concluded that streaming, in the aggregate, has cannibalized download sales. Professor Willig explained that one could not analyze each category of streaming service separately due to issues of multi-collinearity and the absence of instrumental variables necessary to separate out interactions between the services. SE FOF at ¶ 549. Thinking he knew better, Professor Shapiro ran a separate regression for each of Sirius XM, noninteractive services, and fully interactive services. In so doing, Professor Shapiro only proved Professor Willig right. As we show in Response to ¶ 413 below, the results of Professor Shapiro's regression were not just wildly improbable — they were literally impossible.

Response to ¶ 412. Sirius XM claims that Professor Shapiro's regressions show that Sirius XM promotes the sale of subscriptions to fully interactive services. We discuss in Response to ¶ 413 below the flaws in those regressions. It will suffice here to say that Professor Shapiro conceded that his results concerning the alleged promotional effect of Sirius XM on interactive service subscriptions are no more reliable than his results concerning the promotional effect of Sirius XM on download sales (which is to say, not reliable at all, as we discuss in the following paragraph). 4/24/17 Tr. 558:23-559:1 (Shapiro) ("All the things I said about the other [$5.45 download] figure apply to this one equally.").

Response to ¶ 413. Surprisingly, Sirius XM still touts Professor Shapiro's conclusion that Sirius XM promotes download sales in the amount of $5.45 per subscriber per month. This is impossible, because that figure equates to *$2 billion* in download sales per year *purchased by Sirius XM subscribers alone*, even though the *total* domestic U.S. download sales amounted to only *$1.8 billion* in 2016. SE FOF at ¶ 551. With supreme understatement, Sirius XM acknowledges that Professor Shapiro "expressed some skepticism about the precision of these

results" at trial. Actually, what Professor Shapiro said was (1) "I don't really put weight on these high level regressions," (2) "I just don't — I don't think it's reliable," (3) "I don't put any weight on that number," and (4) "it's squirrely." SE FOF at ¶ 552. The notion that Professor Shapiro's regression proves anything — other than that Professor Willig was right — is laughable.

Response to ¶ 414. *See* Response to ¶ 410.

Response to ¶ 415. *See* Response to ¶ 411.

vi. Professor Willig Correctly Applied Ramsey Pricing Principles And The Nash Bargaining Solution

Response to ¶ 416. This is a summary paragraph and SoundExchange will respond to specific claims and arguments in the paragraphs that follow.

Response to ¶ 417. Professor Farrell's argument that Professor Willig calculated a "weighted average royalty benchmark" simply confirms the fact that Professor Farrell knows almost nothing about the recording industry, and made no effort to educate himself.[53] It should be perfectly obvious to anyone who knows the music business that Professor Willig did not regard terrestrial radio as a benchmark, because terrestrial radio stations by law are exempt from paying royalties. Similarly, music video services such as YouTube pay extremely low royalties because of the impact of the safe-harbor provisions of the Digital Millennium Copyright Act, again making such services wholly inappropriate for any benchmarking analysis. Trial Ex. 32 at ¶ 15 (Harrison WDT).

The foregoing should lay to rest Sirius XM's professed concern that Professor Willig was attempting a double mark-up. There is no mark-up for the zero royalty rate applicable to

[53] Professor Farrell's lack of prior experience in the recording industry, and his non-existent efforts to educate himself about the facts in this case, are detailed in SoundExchange's Motion in Limine to Exclude the Written Rebuttal Testimony of Joseph Farrell, filed April 6, 2017.

terrestrial radio, no mark-up for the artificially low YouTube rates, and very low if any for other services such as ad-supported noninteractive streaming which are part of the opportunity cost calculations. Again, Sirius XM simply mischaracterizes the purpose and effect of Professor Willig's analysis.

Finally, with respect to Professor Farrell's "Lake Wobegon effect," Sirius XM once again stubbornly clings to an argument that was explicitly abandoned at trial by the very expert who first proposed it. Professor Farrell admitted at trial that his "Lake Wobegon" theory has no application in a market that includes services such as terrestrial radio that by statute pay no royalties. SE FOF at ¶ 694.

1. Ramsey Pricing Principles Strongly Indicate An Upward Departure From Opportunity Cost

Response to ¶ 418. No response.

Response to ¶ 419. *See* Response to ¶¶ 361-378.

Response to ¶ 420. Sirius XM is correct that Professor Willig did not use Ramsey pricing principles to propose a particular royalty rate. Since Professor Willig was quite clear on this point from the beginning, it is not apparent why Sirius XM regards this as a "gotcha." Professor Willig's conclusion, based on his review of Ramsey pricing and its application to this case, is that public interest pricing principles are consistent with the objectives of § 801(b)(1) and suggest an upward departure from opportunity cost. SE FOF at ¶ 832.

Response to ¶ 421. Professor Willig did not perform a formal financial analysis of the impact of a higher royalty rate on the creation or availability of sound recordings. But he discussed at length why Ramsey pricing furthers the goals embodied in Section 801(b)(1). After pointing out that the creation of sound recordings involves substantial effort and cost, and that

sound recordings are consumed in many different markets distinguished by varying degrees of willingness to pay, 5/02/17 Tr. 1980:1-1981:1 (Willig), Professor Willig then explained:

> So Ramsey pricing chooses or informs the choice of the pricing for the different uses of the common assets in a way that is consonant with the public interest. So what does that mean? In terms of economics, that means choosing those prices to maximize consumer welfare, because consumers care about each of these prices. And some can be high, some can be low. Consumers care about all of them.
>
> So the aim is to maximize the sum total of consumer welfare across all of these uses, subject to the constraint that those prices had better bring in enough revenues to cover the costs of supply.
>
> So both sides of the market are being attended to by the definition of Ramsey pricing. It's the kind of balancing that the 801(b) objectives point to. And Ramsey pricing by definition does that. It says the price has got to be high enough to be financially sustainable on the supply side, but balanced across uses in a way that maximizes consumer welfare.

5/02/17 Tr. 1981:2-22 (Willig).

Response to ¶ 422. Sirius XM addresses in this paragraph the *distribution* of existing sound recordings, but discounts the *creation* of new sound recordings. It was the latter that was the focus of Professor Willig's testimony and Ramsey pricing analysis. Simply distributing existing sound recordings to listeners, without paying the royalties necessary to fund the creation of new sound recordings, hardly advances the objectives of Section 801(b)(1). And that was precisely Professor Willig's point: "The substitution of streaming distribution of music for paid downloading has significantly reduced total creator compensation, even as it has not reduced the total volume distributed." Trial Ex. 28 at ¶ 21 (Willig WDT). Sirius XM's argument that the Judges should focus principally on the distribution of sound recordings, and not consider as part of the Section 801(b)(1) objectives funding the creation of new sound recordings, makes sense

only if one believes that consumers do not care whether or not their favorite artist ever releases new sound recordings, and are indifferent to whether any new and exciting artists emerge on the music scene. As Professor Willig put it, § 801(b)(1) is intended to advance consumer welfare, and one important aim "is the creation of incentives for the record companies and the artists to create desirable sound recordings." 5/02/17 Tr. 1961:9-11 (Willig).

Response to ¶ 423. There is no "massive" markup above opportunity cost in the market for fully interactive services. Sirius XM cites Professor Farrell for this proposition, but Professor Farrell characteristically offers no evidence on the point; it is simply his assumption. In fact, the "massive" mark-up over opportunity cost does not exist.

As Aaron Harrison testified, the record companies regard fully interactive services as potentially substitutional for sales of digital downloads. In the download market, UMG receives [[redacted]] percent of sales revenue from Apple and other download services. [[redacted]]. SE FOF at ¶ 464. Given the opportunity cost of potential lost download sales, there is no reason to think that the record companies are receiving high mark-ups over opportunity cost as Professor Farrell seems to believe.

Moreover, it is worth repeating that while fully interactive services are indeed the main driver of Professor Willig's $2.55 opportunity cost, that is only because certain other alternative modes of distribution (terrestrial radio, music videos and cable/satellite music channels) pay zero or very low royalties. SE FOF at ¶ 474. If any adjustment were necessary for the component of opportunity cost represented by fully interactive services (and SoundExchange believes no such

adjustment is necessary), adjustments should also be made for other modes of distribution that do not reflect market-based rates. *See* ¶ 376 *supra*.

2. Professor Willig's Nash Bargaining Solution Does Not Treat Record Labels As Monopolists

Response to ¶ 424. Although Professor Farrell insists that Professor Willig's Nash bargaining solution treated sellers as monopolists, Professor Willig offered a simple and compelling answer that neither of Sirius XM's economists ever attempted to refute. The Nash bargaining solution offers a way to model the outcome of a bilateral negotiation. In Professor Willig's application of Nash, he assumed that the seller and the buyer would split 50/50 the surplus created by their bargain. This is hardly a monopoly outcome. A monopolist might command 90 percent or 95 percent of the surplus. A 50/50 split treats the buyer and seller as having equal bargaining power, rather than conferring monopoly power on the seller or monopsony power on the buyer. SE FOF at ¶¶ 710-712.

Response to ¶ 425. Untethered as usual from any facts, Professor Farrell's Nash-in-Nash model makes assumptions-upon-assumptions, some of them quite critical to the output of the model, and some of them chosen only because they made the model "tractable" and not because they bear any relation to reality. Professor Farrell's model adds nothing to the determination of appropriate royalty rates in this case. SE FOF at ¶¶ 713-724.

Response to ¶ 426. Professor Willig's opportunity cost calculation represents the costs that record labels incur as a result of licensing Sirius XM, and accurately reflects the workings of a competitive market, albeit one in which certain record companies are "must-haves."

V. SOUNDEXCHANGE'S PROPOSED REGULATORY LANGUAGE, RATHER THAN SIRIUS XM'S, SHOULD BE ADOPTED

A. The Judges Should Complete The Revision Project They Started In *Web IV* By Restructuring And Harmonizing The PSS And SDARS Regulations

Response to ¶ 427. While SoundExchange appreciates Mr. Barry's asserted goal of reducing ambiguity and the potential for disputes in the current SDARS regulations, Sirius XM's specific proposals fall well short of that goal. Instead, Sirius XM cherry-picks a few bits of the regulatory language adopted by the Judges in *Web IV* while arguing stridently against continuation of the revision project the Judges started in *Web IV*. In doing so, it seeks to preserve regulatory language similar to language the Judges found problematic and fixed in *Web IV*, while simultaneously imposing on SoundExchange the burden of administering unnecessarily complex and inconsistent regulations. SE FOF at ¶¶ 2162, 2168-2171.

That proposal runs counter to two principles previously articulated by the Judges. First, the Judges have concluded that in setting terms, their "mandate . . . is to adopt terms that are practical and efficient." *SDARS II*, 78 FR at 23073; *see also Web III Remand*, 79 FR at 23124 (noting economic and administrative efficiency as reasons for having a single collective); *Web II*, 72 FR at 24102 (Judges "should consider matters of feasibility and administrative efficiency"); *SDARS I*, 73 FR at 4098-99. Second, the Judges have emphasized the importance of consistency of terms across statutory licenses. In adopting terms "the Judges seek, where possible, consistency across licenses to promote efficiency and minimize costs in administering the licenses." *SDARS II*, 78 FR at 23073-74; *see also SDARS I*, 73 FR at 4098-99 ("[W]e seek to maintain consistency across the licenses set forth in Sections 112 and 114. Consistency promotes efficiency thereby reducing the overall costs associated with the administration of the licenses."). Although terms across the statutory licenses may vary, the "burden is upon the

parties to demonstrate the need for and the benefits of variance." *SDARS I*, 73 FR at 4099. The Judges should employ those principles here and harmonize the PSS and SDARS regulations with each other and the *Web IV* regulations unless there are good reasons not to do so for any particular provision.

Response to ¶ 428. In Section XIV.A of its Findings of Fact, SoundExchange explained why it adopted as a starting point the restructured and revised regulations adopted by the Judges in *Web IV*, and then incorporated various provisions specific to SDARS and PSS. It also explained that the SDARS and PSS regulations should be integrated and harmonized to further the Judges' goals of promoting efficiency and minimizing the costs of administering the licenses. *See* SE FOF at ¶¶ 2168-2173.

Sirius XM is for the most part effectively opposing the Judges' rewrite of the regulations in *Web IV* by using the current SDARS regulations as the starting point for its proposal. Its argument in its Findings of Fact in support of using the current regulations as a starting point boils down to an assertion that the Judges should adhere to the status quo. SXM FOF at ¶ 428 ("For more than ten years, Sirius XM has operated under and adjusted its practices to the existing regulations."). This approach utterly fails to recognize – let alone grapple with – the fact that the Judges in *Web IV* expressed a preference for the "plain language" format of the regulations they adopted in that proceeding. *Web IV*, 81 FR at 26316 n.1. This approach also is contrary to the Judges' expressed preference to maintain consistency across licenses where possible. *SDARS II*, 78 FR at 23073-74; *SDARS I*, 73 FR at 4098-99.

Response to ¶ 429. Aligning the SDARS regulations with the webcasting regulations the Judges adopted in *Web IV* will tend to *decrease* the total number of overall disputes. First, the specific objective of the Judges' *Web IV* rewrite was to use a "plain language" format, thereby

eliminating the kinds of ambiguity and convoluted language to which Sirius XM now clings. *Web IV*, 81 FR at 26316 n.1. Moreover, with the SDARS, PSS and webcasting regulations substantially aligned, interpretations of provisions would be informed by the experience of all statutory licensees, and the Judges would only need to opine on any particular issue that may arise once.

Response to ¶ 430. In its Proposed Findings of Fact and Conclusions of Law, SoundExchange presented *a number* of rationales for restructuring the SDARS and PSS regulations along the lines of the *Web IV* regulations. *See generally* SE FOF at Section XIV.A. SoundExchange explained that consistency in the regulations promotes accuracy and efficient administration. SE FOF at ¶¶ 2168-2173. In addition, SoundExchange detailed desirable improvements in the *Web IV* regulations, including employing "plain language," reducing repetition, and "cleaning up" the regulations, *see* SE FOF at ¶ 2175, as well as substantive changes such as expanding the required attestation in Section 380.3(a)(8) and adding the certification requirement in Section 380.3(b), *see* SE FOF at ¶¶ 2176-78. These improvements far outweigh Sirius XM's chief argument in favor of *its* proposal: maintaining the status quo.

Although Sirius XM may be the only SDARS, there are significant operational advantages for SoundExchange in having provisions that are relatively consistent across rate categories. Minor differences in the regulations, even nonsubstantive ones, require extra work by SoundExchange staff, because even in the case of provisions that are similar across services (*e.g.*, those relating to statements of account, confidentiality, and audits), SoundExchange may need to proceed differently depending on the type of service involved. Even a difference as nonsubstantive as having definitions at the beginning of the subparts of Part 382 and at the end of Subpart A of Part 380 means that SoundExchange staff will spend unnecessary time flipping

through the regulations trying to find where the definitions relevant to a particular issue are located. Trial Ex. 48 at 3 (Bender WRT).

Sirius XM's characterization of the disputes that have arisen between the parties is inaccurate. For example, it refers to the parties' dispute concerning the treatment of the Premier package as "a legitimate and reasonable dispute over certain ambiguous *SDARS I* regulations." SXM FOF at ¶ 430. However, the Judges found that "the plain language of the regulation disallows this revenue exclusion." Underpayment Decision, No. 2006-1 CRB DSTRA, at 17; *id*. at 21 ("inconsistent with the plain meaning of the subsection (vi)(B) exclusion and with the purpose of the 'separate charge' requirement"). The Judges also noted that Sirius XM's approach "was economically inaccurate and imprecise, thus failing to satisfy the reasonableness standard." Underpayment Decision, No. 2006-1 CRB DSTRA, at 22. Sirius XM may not like Mr. Bender's perception of Sirius XM's willingness to pay what it owes, but Sirius XM's aggressive use of exclusions that even it concedes are inappropriate is well-documented in the record. *E.g*., SE FOF at ¶¶ 1674-1676, 1679-1683, 1686-1687, 1699-1700. In view of that experience, perhaps no amount of clarifying the regulations would be enough to avoid all possible disputes with Sirius XM, but generally seeking to mirror the *Web IV* revisions would be a good start.

Sirius XM's characterization of the disputes that have arisen between the parties is also misleading. It is telling that the examples Sirius XM provides both relate to the definition of gross revenues. There have been extensive disputes between the parties concerning that subject. *See generally* SE FOF at Section XII.B. However, the definition of gross revenues is one aspect of the SDARS regulations that would not be touched by conforming the regulations to those adopted in *Web IV*, because of the different rate structures for the different types of services.

Sirius XM has not pointed to any provision of the *Web IV* regulations that would actually apply to it that is likely to give rise to disputes.

B. The Exclusions From Gross Revenues For Separate Data Services And Non-Music Programming Should Not Be Revised As Proposed By Sirius XM

Response to ¶ 431. Paragraphs (3)(vi)(A) and (B) of the definition of gross revenues in 37 C.F.R.§ 382.11 are straightforward provisions allowing the exclusion from gross revenues of revenue recognized by Sirius XM from data services and non-music channels offered by Sirius XM for a separate charge. Sirius has proposed to transform those provisions into dramatically different rules for allocating revenue from its programming packages.

Sirius XM's practice of taking certain additional exclusions from gross revenues that are not allowed by the clear and straightforward language of current paragraphs (3)(vi)(A) and (B) eventually caused SoundExchange to sue Sirius XM in the U.S. District Court for the District of Columbia for additional royalty payments based on the improper exclusions (sometimes referred to as the "underpayments case"). After referral by the court, the underpayments case is pending before the Judges under Docket No. 2006-1 CRB DSTRA (2007-2012).

However, Sirius XM's characterization of the underpayments case attempts to obscure one of the two major issues in that case, as well as Sirius XM's economically-inappropriate proposal to reverse the result in that case. Sirius XM has offered consumers at least two distinct subscription packages – a basic package currently called Select and a premium package currently called Premier. In the underpayments case, Sirius XM took the position that the incremental channels included in the Premier package, but not included in the Select package, were a distinct service offered for a separate charge and bundled with Select. Underpayment Decision, No. 2006-1 CRB DSTRA, at 16. The Judges rejected that position based on the clear language of current paragraph (3)(vi)(B) and sound economic theory, finding that "the revenue exclusion

described in subsection (vi)(B) did *not* permit Sirius XM to exclude from the Gross Revenues royalty base the price difference, *i.e.*, the Upcharge, between the Premier package and the Basic package." Underpayment Decision, No. 2006-1 CRB DSTRA, at 17.

Response to ¶ 432. In an effort to reverse the Judges' decision in the underpayments case, Sirius XM has proposed changes to the definition of gross revenues that would allow it to do precisely what the Judges found to be improper there. SE FOF at ¶ 1702. It is not necessary to make this change to avoid future disputes. The Judges' decision in the underpayments case has now made clear (if interpretation of the straightforward language of paragraph (3)(vi)(B) was ever seriously in doubt) that the deductions Sirius XM has been making are improper, so there should be no future disputes if Sirius XM will simply pay in accordance with the rules. There is no basis for making this significant change in a definition that the Judges have found multiple times to "unambiguously relate the fee charged for a service that an SDARS provided to the value of the sound recording performance rights covered by the statutory licenses." *SDARS II*, 78 FR at 23072; *see also SDARS I*, 73 FR at 4087.

SoundExchange has also proposed changes to the definition of gross revenues relevant to services provided for a separate charge. However, those changes were genuine clarifications of the existing rule that would codify the result of the underpayments case. SE FOF at ¶¶ 1698-1699. In view of the Judges' initial decision in the underpayments case, the clarifications are probably unnecessary. SoundExchange continues to request the clarifications only because the Judges' initial decision in the underpayments case has been withdrawn. SE FOF at ¶ 1700.

i. Sirius XM's Proposal To Undo The Judges' Underpayments Decision Should Not Be Adopted

Response to ¶ 433. The current definition of gross revenues is substantially the same as a definition originally proposed by Sirius XM. *SDARS I*, 73 FR at 4087. The Judges adopted it

over objections from SoundExchange because they concluded that it "clearly delineate[d] the revenues related to the value of the sound recording performance rights at issue." *SDARS I*, 73 FR at 4087. In *SDARS II*, SoundExchange proposed a different approach to defining gross revenues, in part because of questions such as those presented in the underpayments case. *SDARS II*, 78 FR at 23071-72. Sirius XM opposed that proposal, again "arguing that [the existing definition] properly identifies only those revenues that are related to the provision of statutorily licensed sound recordings." *SDARS II*, 78 FR at 23071. The Judges agreed with Sirius XM, reiterating that the definition of gross revenues "unambiguously relate[s] the fee charged for a service that an SDARS provided to the value of the sound recording performance rights covered by the statutory licenses." *SDARS II*, 78 FR at 23072. In this proceeding, Mr. Barry testified that "the Gross Revenues definition was thoughtfully constructed 10 years ago by the CRB." Trial Ex. 13 at ¶ 31 (Barry WRT).

Despite Sirius XM's long fondness for the current definition – largely its authorship – and the Judges' repeated decisions that the current definition properly identifies the revenues that should be included in the royalty base as a policy matter, Sirius XM changed its tune once the Judges confirmed the obvious proposition that the price difference between the Select package and the Premier package is not a "separate charge."

Now Sirius XM proposes completely rewriting paragraphs (3)(vi)(A) and (B) to omit the concept of revenue recognition, define gross revenues with respect to its Select package, and permit exclusion of any charges incremental to its Select package. However, nothing about the scope of the sound recording performance rights covered by the statutory licenses or the nature of Sirius XM's Select and Premier packages has changed since *SDARS II*. All that has happened is that the Judges confirmed that they really meant what they had previously said about the

separate charge requirement in paragraphs (3)(vi)(A) and (B). There are good reasons for that requirement, as detailed most recently in the Judges' decision in the underpayments case. Underpayment Decision, No. 2006-1 CRB DSTRA, at 17-21; SE FOF at ¶ 1699. Sirius XM's losing its argument about deductibility of the difference between the price of the Select and Premier packages is not a sufficient reason to completely reimagine a rule that Sirius XM advocated, and the Judges found, on multiple occasions to properly relate the royalty to the value of the sound recordings used. *See* SE FOF at ¶¶ 1701-1705.

Moreover, eliminating the separate charge requirement would have significant financial consequences if not reflected in the transposition of benchmarks into the hypothetical target market in this proceeding. At a given percentage royalty rate, the difference in the royalty base between the current definition of gross revenues and the one proposed by Sirius XM would lead to a substantial cut in royalty payments. SE FOF at ¶ 1651. That would not necessarily matter if the percentage rate was calculated with reference to the revised definition, since a higher percentage can be applied to a smaller base to generate an equivalent royalty payment. However, in this proceeding, SoundExchange calculated its proposed percentage rate with reference to approximately the current definition of gross revenues. SE FOF at ¶¶ 268, 274-275 (describing use of "royalty-base ARPU" in Mr. Orszag's calculations). Sirius XM did the same for its direct license benchmark, although not its *Web IV* benchmark. Trial Ex. 4 at ¶ 10 (White WDT) (definition of gross revenues in Sirius XM direct licenses is "similar to that found at 37 C.P.R. 382.11"); Trial Ex. 8 at 35-37 (Shapiro WDT) (incorporating royalty rates from direct licenses into proposed benchmark); SE FOF at ¶ 1240 (explaining that Professor Shapiro used the wrong ARPU in translating his *Web IV* benchmark into a percentage rate). It would be mathematically wrong to calculate a percentage rate with reference to one royalty base and then

apply that percentage to a dramatically smaller one. SE FOF at ¶ 274. Thus, if Sirius XM's proposed revision of the definition of gross revenues were adopted, it would be necessary to make offsetting adjustments to the percentage rate calculations.

Response to ¶ 434. Mr. Barry's explanation of Sirius XM's proposal confirms that the purpose of the proposal is to permit exactly the kind of deduction the Judges found to be improper in the underpayments case. For the reasons identified by the Judges why the separate charge requirement is important, they should not abandon it here. Underpayment Decision, No. 2006-1 CRB DSTRA, at 18-21; SE FOF at ¶¶ 1702-1705.

Response to ¶ 435. To avoid repetition, SoundExchange incorporates its Responses to ¶¶ 433-434 *supra*.

Response to ¶ 436. A critical reason the Judges rejected Sirius XM's treatment of incremental channels in the underpayments case is that it is "economically indeterminate." Underpayment Decision, No. 2006-1 CRB DSTRA, at 19-20. That is, if anything, even more of an issue where discounting is involved. In Mr. Barry's example, Sirius XM's All Access package (which typically retails for $19.99) is offered at $14.99, which is less than the $15.99 standard price of Select. It would be rational for any consumer with a willingness to pay $14.99 or more for Select to take the more expansive All Access package at the price the consumer would have been willing to pay for Select. However, Sirius XM's proposal would allow it to deduct $3.00 of the package price from gross revenues, even if the incremental elements of All Access are of little or no interest to the consumer. In such a case, as Professor Lys "cogently explained" in the underpayments case, Sirius XM's approach inappropriately assigns most of the discount to the incremental products. Underpayment Decision, No. 2006-1 CRB DSTRA, at 19.

Response to ¶ 437. Changing the numbers in an example does not make Sirius XM's proposed approach any more reasonable. To avoid repetition, SoundExchange incorporates its Responses to ¶¶ 433-434 *supra*.

Response to ¶ 438. Sirius XM's argument that its approach is simple and mechanical does not address the fundamental problem that it is economically inappropriate. Underpayment Decision, No. 2006-1 CRB DSTRA, at 19-20. To avoid repetition, SoundExchange incorporates its Responses to ¶¶ 433-434 *supra*.

Response to ¶ 439. Sirius XM is free to offer any subscription packages or other "bundles" it wishes, as it always has. 5/17/17 Tr. 4338:8-10 (Barry). It just has to pay a reasonable royalty like it has always been required to, and should not be permitted to take exclusions from gross revenues in a way that the Judges have found to be economically inappropriate. Underpayment Decision, No. 2006-1 CRB DSTRA, at 18-21. Sirius XM has for ten years argued, and the Judges have agreed, that the straightforward and clear language of paragraphs (3)(vi)(A) and (B) "unambiguously relate[s] the fee to the value of the sound recording performance rights at issue." *SDARS II*, 78 FR at 23072 n.45 (quoting *SDARS I*, 73 FR at 4088). It cannot be that Sirius XM's radically different new proposal does as well. Underpayment Decision, No. 2006-1 CRB DSTRA, at 21.

As for any possible double payment, in his written rebuttal testimony, Mr. Barry complained that Sirius XM would have to double pay for Internet webcasting in its All Access package. Trial Ex. 13 at ¶ 15 (Barry WRT). However, exclusion of webcasting revenue is expressly addressed in paragraph (3)(vi)(D) of the definition of gross revenues. It does not need to be addressed again by paragraph (3)(vi)(B).

Response to ¶ 440. To avoid repetition, SoundExchange incorporates its Response to ¶ 438 *supra*.

Response to ¶ 441. Sirius XM's argument that any consumer who chooses All Access at $19.99 must value the incremental elements at $4.00 or more is plainly wrong and inconsistent with the Judges' underpayment decision. For example, a consumer with a willingness to pay $17.99 for Select might well decide that it is worth an extra $2.00 to subscribe to All Access at $19.99. The subscriber's taking All Access under those conditions increases Sirius XM's revenue by $4.00, which is the point of its offering the bundle. However, $4.00 is not necessarily the price the consumer would be willing to pay for the incremental elements on a standalone basis. That price is indeterminate, but might be $2.00 rather than $4.00 or more. Underpayment Decision, No. 2006-1 CRB DSTRA, at 19-20.

Response to ¶ 442. There is no reason to delete the reference to "[r]evenues recognized" in the preamble of paragraph (3)(vi), and some risk in doing so. At trial, Mr. Barry acknowledged his intention that revenue would need to be recognized to be excluded. 5/17/17 Tr. 4401:21-4402:5 (Barry). Deleting the reference to revenue recognition would create the implication that is not the case.

ii. SoundExchange's Proposed Clarification Should Be Adopted

Response to ¶ 443. SoundExchange has been very clear that the purpose of its proposed changes to paragraphs (3)(vi)(A) and (B) is to confirm again that revenue from non-music offerings offered for a separate charge is excludable only when those offerings are provided on a standalone basis. SE FOF at ¶¶ 1698-1699. This proposal and usage are fully consistent with the Judges' underpayments decision. Underpayment Decision, No. 2006-1 CRB DSTRA, at 16 ("Sirius XM offered the Basic package as a stand-alone product"; "Sirius XM did not offer the

additional channels included in the Premier package as a separate, standalone product"). SoundExchange continues to make this proposal only because Sirius XM has previously refused to acknowledge the plain meaning of the current language, and the Judges withdrew their initial decision in the underpayments case. SE FOF at ¶ 1700.

Response to ¶ 444. The rationale for SoundExchange's proposed clarification is to be found in the Judges' underpayments decision. Sirius XM deducted millions of dollars in revenues from the royalty base by employing an economically-inappropriate allocation methodology that was contrary to the plain language of the Judges Regulations. Underpayment Decision, No. 2006-1 CRB DSTRA, at 16-22; Response to ¶¶ 431-441 *supra*. In the absence of a final ruling in the underpayments case establishing what "separate charge" means, the Judges should clarify their intentions in the regulations to be determined in this proceeding.

Response to ¶ 445. Mr. Bender was clear that his intention is that the clarified language would work just like the current language as explicated by the Judges in the underpayments case. 5/10/17 Tr. 3184:5-19, 3238:24-3239:7, 3241:6-14 (Bender).

Response to ¶ 446. To avoid repetition, SoundExchange incorporates its Responses to ¶¶ 443-445 *supra*.

Response to ¶ 447. To avoid repetition, SoundExchange incorporates its Responses to ¶¶ 443-445 *supra*.

Response to ¶ 448. To avoid repetition, SoundExchange incorporates its Responses to ¶¶ 443-445 *supra*.

Response to ¶ 449. To avoid repetition, SoundExchange incorporates its Responses to ¶¶ 443-445 *supra*.

Response to ¶ 450. While Sirius XM is of course correct that the purpose of this proceeding is to determine the regulations for the next five years, that does not make Sirius XM's proposed allocation methodology any more appropriate. Sirius XM has for ten years argued, and the Judges have agreed, that the current, straightforward and clear language of paragraphs (3)(vi)(A) and (B) "unambiguously relate[s] the fee to the value of the sound recording performance rights at issue." *SDARS II*, 78 FR at 23072 n.45 (quoting *SDARS I*, 73 FR at 4088). It follows that Sirius XM's radically different new proposal does not do so. Instead, it would produce economically-inappropriate results, and so should be rejected for the reasons identified by the Judges in their underpayments decision. Underpayment Decision, No. 2006-1 CRB DSTRA, at 18-21; SE FOF at ¶¶ 1702-1705; Responses to ¶¶ 431-442 *supra*.

C. The Judges Should Reject Sirius XM's Proposal to Drastically Reduce The Late Fee It Owes On Improperly Withheld Royalties

Response to ¶ 451. The current regulations already include a provision providing a late for nonpayment (including underpayment) of statutory royalties. SE FOF ¶¶ 2209-2210, 2212 (citing 37 C.F.R. § 382.13(d)). This provision imposes a fee of 1.5% per month on late payments, including underpayments. SE FOF ¶¶ 2212-2214; 5/17/17 Tr. 4364:13-23 (Barry) (Q: "What is the current interest rate that applies to Sirius XM's underpayments to SoundExchange?" A (by Sirius XM's Comptroller): "1.5 percent a month"). In *Web IV*, the Judges inserted a cross reference to the late fee provision into the audit provision, presumably reflecting that they, like Sirius XM's Controller, understood the late fee provision to apply even when late payments are discovered in an audit. SoundExchange has simply proposed copying the *Web IV* provision. Trial Ex. 48 at 2-3 (Bender WRT).

SoundExchange refers to Section XIV.C of its Proposed Findings of Fact, which further describes the arguments against Sirius XM's proposal, details the unrebutted evidence in favor of

SoundExchange's position, and describes SoundExchange's proposed regulations regarding audit-related terms. With regard to overpayments, SoundExchange refers to Section XIV.C.2 of its Proposed Findings of Fact. SE FOF ¶¶ 2249-2257.

i. A 1.5% Per Month Late Fee Applies And Should Continue to Apply to Late Payments, Including Underpayments Discovered in Audits

Response to ¶ 452. First, as explained in Response ¶ 451, there is no doubt that under current 37 C.F.R. § 382.13(d), the late fee prescribed by the Judges is 1.5% per month, and that late fee applies whether a payment is only a little late or very late, and whether the licensee has previously paid part of what it owes or nothing at all. At trial, Mr. Barry readily acknowledged that an underpayment is a late payment of the unpaid balance, and the late fee applies to such an underpayment under the Judges' regulations just like it would under a typical commercial contract late fee provision. There is no basis for the notion that Sirius XM's partial payment of some of the statutory royalties it owes somehow cuts off accrual of late fees as to the unpaid balance, leaving the Judges to decide now, for the first time, what late fee should apply to such late payments. SE FOF ¶¶ 2212-2214. For that reason, it is not SoundExchange that has proposed some radical and inequitable concept by copying a cross reference from the *Web IV* regulations. It is Sirius XM that has radically proposed to eliminate any incentive for it to pay the statutory royalties it owes on a timely basis.

As to Sirius XM's specific example, SoundExchange disputes its accuracy and relevance. Sirius XM appears to suggest that SoundExchange's process of conducting audits – not the Sirius XM's own payment delays – prejudices its ability to pay what it owes on a timely basis. This claim is contradicted by the evidence. Although audits can be complicated and time-consuming, it is not in SoundExchange's interest to drag them out. By contrast, licensees frequently delay and resist SoundExchange's efforts to verify the royalty payments made by licensees. Trial Ex.

48 at 14 (Bender WRT); *see* SE FOF ¶ 2231 (noting Sirius XM controller's concession that Sirius XM would never delay an audit in order to collect late fees and has "no facts" to support allegations of delay by SoundExchange).

Sirius XM's shrill cries that the existing late fee amount is "confiscatory," "inequitable in the extreme," "remarkable," and "unreasonable" are belied by its conduct. Even setting aside the numerous agreements to which Sirius XM is a party to a late fee of that amount or higher, SE FOF ¶¶ 2233-2241, Sirius XM has demonstrated a complete lack of urgency with regard to correcting its underpayment of statutory royalties to SoundExchange. Although Mr. Barry testified that Sirius XM improperly withheld royalties during the *SDARS II* period [[redacted] excluding certain categories of revenue from its royalty base, misallocating bundled revenue, and deducting expenses other than bad debt from the royalty base], it has been in no hurry to pay what it owes. SE FOF at ¶¶ 1653, 2222-2224; Trial Ex. 48 at 13-14 (Bender WRT) (Sirius XM's hypothetical "good faith" reporting errors present a false premise). To date, it has failed to pay SoundExchange for these improper withholdings, despite Mr. Barry's admission that it is obligated to do so. SE FOF at ¶¶ 2222-2224.

If Sirius XM truly was worried about the rate at which late fees accrue, or wanted to cut off their accrual, there is, as Mr. Bender explained, an obvious means of doing so:

> Licensees have a tool at their disposal to minimize the financial impact of the length of the audit process – payment. Even setting aside the potential to avoid aggressive royalty calculations in the first instance, it is pretty common for our auditors to discover certain underpayments relatively early in the process that are not disputed by the licensee. . . . However, licensees under audit do not typically send us a check as soon as such errors are discovered. Instead, they tend to wait until the end of the audit and seek to discuss an overall settlement. If a licensee wants to minimize its late fee exposure, it should pay as soon as a calculation error is discovered.

Trial Ex. 48 at 14-15 (Bender WRT); *see also* SE FOF ¶ 2230. Mr. Barry would find time to cut a check for the statutory royalties that Sirius XM indisputably owes if the quantum of accruing late fees really weighed as heavily on him as he professes in this litigation.

Response to ¶ 453. SoundExchange disputes the contention that the 1.5% per month late fee from 37 C.F.R. § 382.13(d) was wrongly applied in the cited example. SoundExchange repeats its Response to ¶ 452 *supra*, as well as Section XIV.C of its Proposed Findings of Fact.

Response to ¶ 454. Sirius contends that the 1.5% per month late fee applicable under § 382.13(d) might "serve[] a very different purpose" than some "typical interest payment." SXM FOF at ¶ 454. However, the purpose served is that of § 382.13(d), which is relevant to late payments of statutory royalties that are discovered in an audit. *See* SE FOF ¶¶ 2220-2229 (1.5% fee is meant "to provide a strong incentive to prompt payment" and applies to underpayment and late payment alike); *see also* SE FOF ¶ 2239 (Mr. Barry's testimony that [[redacted]] indicates that standard 1.5% per month late fee is effective in deterring underpayments).

The statutory license, and its late fee, were never conceived as a commercial loan program with a "typical interest payment." As Sirius XM says, the point of the late fee was to ensure that licensees pay the statutory royalties they owe to artists and record companies on a timely basis "*so that royalties can be collected and distributed on time*." SXM FOF ¶ 454 (emphasis in original). The imperative to distribute statutory royalties on time applies to all statutory royalties, not just whatever part of them Sirius XM chooses to send to SoundExchange in the first instance. The Judges should not indulge its proposal to turn the statutory license into a commercial loan program with a "typical interest payment."

Response to ¶ 455. Again, SoundExchange disputes the distinction between underpayment and late payment and refers to Section XIV.C of its Proposed Findings of Facts.

Sirius XM's reference to "good-faith deductions" assumes two false premises: First, as Mr. Barry testified, there is no "good faith" limitation in Sirius XM's interest rate proposal. This means that the extremely low rate the Service puts forward would apply even to intentional, bad faith deductions. SE FOF ¶ 2221 (citing 5/17/17 Tr. 4384:19-4385:1 (Barry)); *see also* SE FOF ¶¶ 2223-2224 (discussing underpayment disclosed in Mr. Barry's testimony, which he acknowledges involves no legitimate dispute). Second, Sirius XM's pending underpayments are not minor mistakes. *See generally* SE FOF § XII.B.1; Response ¶ 431.

Sirius XM also fails to offer any support for its contrived distinction between shorter and longer periods of delinquency. Sirius XM cites no example of a contract – including any of its own agreements – that make such a distinction. *See* SE FOF ¶¶ 2233-2241 (discussing 1.5% late fee provisions in Sirius XM's agreements and other music industry contracts). Nor does Sirius XM explain why such a distinction would work in its favor. While there is no good excuse for any late payment, arguably the withholding of payments over a long period would justify a higher penalty than applies to "payments that are a month or two late."

Response to ¶ 456. First, the basis for Mr. Bender's testimony is described in Trial Ex. 29 (Bender WDT), as well as in his oral testimony. This includes his knowledge and experience personally overseeing the collection, processing, and distribution of statutory license royalties as SoundExchange's Chief Operating Officer.

Second, Sirius XM's focus on Mr. Bender, and what evidence he personally relied on, is a red herring. As described in Section XIV.C.1 of its Proposed Findings of Fact, SoundExchange provided substantial evidence that its proposal of 1.5% per month is reasonable,

consistent with the goal of deterrence, consistent with both *Web IV* and the current regulations, and typical in commercial contracts (including music industry contracts and contracts to which Sirius XM is a party). Whether this evidence came in through Mr. Bender or other witnesses is of no consequence.

By contrast, Sirius XM has presented no evidentiary support whatsoever – not even a single contract – to justify the drastic late fee rate reduction that it urges. 5/17/17 Tr. 4383:24-4384:2 (Barry) ("Q. Your written testimony does not cite one single contract that incorporates an interest rate as low as 1 percent a year? A: That's correct."); *see also* SE FOF ¶ 2226. Far from defending a reasoned approach, Sirius XM admits that a higher rate than what it proposed would be no less appropriate. SE FOF ¶ 2219; Sirius XM FOF ¶ 465. And Sirius XM's suggestion that the Judges should adopt a rate that "Sirius XM typically pays on its debt instruments," Sirius XM FOF ¶ 465, is at odds with the rationale that Sirius XM itself cites for the statutory late fee. Response ¶ 454.

Response to ¶ 457. As described in Section XIV.C.1 of its Proposed Findings of Fact, *SoundExchange* provided substantial evidence that its proposal of 1.5% per month is reasonable, consistent with the goal of deterrence, consistent with both *Web IV* and the current regulations, and typical in commercial contracts (including music industry contracts and contracts to which Sirius XM is a party). To the extent that Sirius XM claims there is some meaningful evidentiary difference between SoundExchange's business documents ("evidence of its own") and other types of evidence, that is a distinction for which it provides no legal support.

For its part, Sirius XM provides false dichotomies: It provides no reason why different interest rates are needed for advertising revenue versus royalty payments, or larger or smaller contracts. In fact, these contracts (and the existing late fee rate under the Judges' regulations for

SDARS and webcasters) are consistent with the industry standard, evident in numerous cited agreements. SE FOF ¶¶ 2233-2248 (discussing Sirius XM agreements as well as agreements between other services and labels). In the face of this evidence, Sirius XM asks the Judges to believe that it would "as a practical business matter" not to hold its business partners to the terms of their written contracts and instead accept a lower amount or waive late fees. [ ] 5/17/17 Tr. 4425:7-4426:2 (Barry). And perhaps Sirius XM's business partners have not underpaid Sirius XM by the extent to which Sirius XM has underpaid SoundExchange. SE FOF ¶ 1651.

SoundExchange objects to Sirius XM's suggestion that beyond those agreements that it cites, none of the other "thousands of content agreement" to which Sirius XM is a party "contain[] a similar provision" regarding a 1.5% per month interest rate. [ ] 5/17/17 Tr. 4424:23-4425:6 (Barry) [ ] This is a far cry from providing evidence that additional examples do not exist.

Notably, Sirius XM did not present *any* agreement with an interest rate as low as the one that the Service proposes here, nor did it elicit testimony from Mr. Barry or any other witness that even one such agreement exists. SE FOF ¶¶ 2217-2218; Trial Ex. 48 at 16 (Bender WRT) (testifying that he has never heard of a music industry agreement with late fees of less than 1% per year).

Response to ¶ 458. As discussed in Section XIV.C.1 of SoundExchange's Proposed Findings of Fact, Sirius XM's attempt to separate "late payments" from "underpayments" is a distinction without a difference. *See, e.g.*, SE FOF ¶ 2213. The numerous agreements that

SoundExchange cites reflect the industry's standard 1.5% penalties for late payments, including underpayments. SE FOF ¶¶ 2217, 2233-2248. Mr. Barry's self-serving lay opinion about the legal meaning of these terms is not evidence.

Response to ¶ 459. SoundExchange refers to Section XIV.C.1 of SoundExchange's Proposed Findings of Fact; it also incorporates its Response ¶¶ 452 and 454 *supra*. Because the current SDARS audit provision is silent on the subject of late fees, the general SDARS late fees provision applies.

It is not SoundExchange that embarked on this case with a goal of changing SDARS late fees. SoundExchange was absolutely clear in its direct case that it approached the regulatory drafting aspect of this case with a philosophy that the PSS and SDARS regulations should generally track the *Web IV* regulations. Trial Ex. 29 at 33-34 (Bender WDT). It addressed late fees relative to audits only because it largely copied the Judges' *Web IV* audit provisions. For that reason, Sirius XM's suggestion that SoundExchange would not have needed to propose a clarification of late fees relative to audits if § 382.13(d) already applied to "underpayments" is irrelevant. In *Web IV*, the Judges explained that their revisions to the analogous webcasting regulations were driven by a desire to state the regulations in "plain language." 81 FR at 26316 n.1. Evidently they thought adding a cross reference to the late fees provision in the audit provision furthered that goal. SoundExchange simply copied the *Web IV* regulations.

Response to ¶ 460. Sirius XM is wrong that the Judges' addition of a cross-reference to the generally-applicable late fee provision in *Web IV* means that this provision did not previously apply to underpayments discovered in audits. As the Judges explained, their revisions to the webcasting regulations were driven by the desire to reduce repetition in the regulations and to state the regulations in "plain language." 81 FR at 26316 n.1. Sirius XM provides no evidence

that the Judges intended this clarification to be read as a substantive change. *See* Trial Ex. 48 at 12 (Bender WRT) (noting that clarification of *Web IV* regulations affirmed that the 1.5% per month late fee in § 380.4(e) applied and continues to apply to underpayments discovered in the course of an audit).

Response to ¶ 461. SoundExchange disputes the relevance of the Judges' initial decision regarding interest in *Web IV*. The relevant touchstone is final regulation, not the parties' arguments or an intermediate decision that the Judges ultimately altered. With regard to the advisability of making an analogous change to the SDARS regulations, SoundExchange refers to Sections XIV.A and XIV.C.1 of its Proposed Findings of Fact.

Response to ¶ 462. SoundExchange disputes the relevance of the procedural history and the Judges' rehearing decision in *Web IV*. Regardless of this history, the final regulation speaks for itself. As the Judges have repeatedly found, consistency in the regulations across rate categories promotes accuracy and efficient administration and the Judges should conform the SDARS regulations with the *Web IV* regulations, unless there are valid reasons not to do so. SE FOF ¶¶ 2160-2167. Sirius XM's speculation that the Judges did not thoroughly consider arguments it makes here, which challenge the fairness of the generally-applicable 1.5% per month rate, is not a valid reason to diverge from *Web IV*. If anything, the series of opinions leading up to the final determination in *Web IV* suggest that the Judges' ultimate conclusion was carefully deliberated, even if the grounds for this clarification were not elaborated. Sirius XM offers no evidentiary basis to believe otherwise.

ii. Sirius XM's Late Fee Proposal Should Be Rejected

Response to ¶ 463. SoundExchange disputes the characterization its proposal as "exorbitant" and Sirius XM's proposal as "more reasonable." *See* SE FOF at § XIV.C. These

characterizations reflect nothing more than Sirius XM's desire to continue withholding payments it agrees it owes while accruing late fees at a lower rate.

Response to ¶ 464. Section XIV.C.1 of SoundExchange's Proposed Findings of Fact detail numerous arguments against Sirius XM's proposed late fee of approximately 1% per year, as well as substantial evidence supporting these arguments – most of which Sirius XM fails to acknowledge at all. SE FOF ¶¶ 2209-2248.

With regard to the only two arguments that it does address, Sirius XM is wrong. It essentially asks the Judges to take Mr. Barry's word that the perverse incentives it proposes would never affect its behavior. Putting aside that such a position requires an assumption that Sirius XM will behave *irrationally*, the record is replete with evidence that undermines Mr. Barry's claim. *See, e.g.*, SE FOF ¶ 2222 (describing Sirius XM's long history of taking aggressive deductions from its royalty payments); SE FOF ¶¶ 2223-2224 (Sirius XM has not repaid SoundExchange for royalties that Mr. Barry admitted at trial were improperly withheld for the entirety of the *SDARS II* period, despite the fact that it knew about them); SE FOF ¶ 2228 ("borrowing" money from royalty payments would be entirely rational because proposed rate is much lower than interest rate applicable to Sirius XM's other debt). As Mr. Barry acknowledged, there is nothing that would prevent Sirius XM from paying SoundExchange late in order to take advantage of the exceptionally low rate of interest rate that Sirius XM's proposes. SE FOF ¶ 2227.

While the administrative difficulties that Sirius XM dismisses are obviously of less consequence than getting Sirius XM to pay what it owes on a timely basis, the Judges have always favored terms that are simple, easy to administer and consistent. *SDARS II*, 78 FR at 23073-74 (the Judges' "mandate . . . is to adopt terms that are practical and efficient"; "the

Judges seek, where possible, consistency across licenses to promote efficiency and minimize costs in administering the licenses"); *Web III Remand*, 79 FR at 23124 (noting economic and administrative efficiency as reasons for having a single collective); *SDARS I*, 73 FR at 4098-99 ("[W]e seek to maintain consistency across the licenses set forth in Sections 112 and 114. Consistency promotes efficiency thereby reducing the overall costs associated with the administration of the licenses."); *Web II*, 72 FR at 24102 (Judges "should consider matters of feasibility and administrative efficiency"). Sirius XM has provided no good reason to depart from those principles here.

Response to ¶ 465. In the end, even Sirius XM cannot in good faith stand behind its low-ball proposal. *See* SE FOF ¶ 2219 (citing Barry testimony, in which he conceded that he could not defend its proposal and agreed that 1% and 5% would be equally acceptable). Apparently recognizing that it cannot plausibly defend a rate of less than 1% per year, *see* SE FOF ¶ 2216, Sirius XM now attempts to bargain. However, this is not a negotiation, it is a litigation, in which the Judges must base their decision on evidence. Sirius XM's bargaining is not evidence.

As discussed above and in Section XIV.C.1 of its Proposed Findings of Fact, SoundExchange disputes Sirius XM's characterization of SoundExchange's proposed rate – which is in line with the current regulations, the position adopted by the Judges in *Web IV*, and the standard industry practice of Sirius XM and other companies. *See, e.g.*, SE FOF ¶¶ 2212-2214, 2232-2248.

D. Artists And Copyright Owners Whose Works Are Used Under The Statutory License Should Not Be Penalized When Other Copyright Owners Enter Into Direct Licenses To Exploit Regulatory Differences

Response to ¶ 466. SoundExchange is pleased that Sirius XM decided to drop its former proposal to calculate the direct license and pre-'72 exclusions based on satellite plays. Such a methodology clearly would have been inferior to the current methodology for calculating the exclusions, which is based on performances on the Internet "reference channels" (sometimes referred to as the "webcasting proxy"). SoundExchange agrees that in the absence of actual satellite listenership data, the webcasting proxy is the best currently available approach for calculating the exclusions. SE FOF at ¶¶ 1735-1744. (However, as described in Section XII.C.i of SoundExchange's Findings of Fact, an even better approach involving actual satellite listenership data is likely to become available during the coming rate period.)

Response to ¶ 467. SoundExchange proposes that until such time as actual satellite listenership data can be used to calculate the direct license exclusion, the direct license share should be capped based on plays on the satellite service. *See* SoundExchange Amended Proposed Rates and Terms, App. A § 382.21(d)(1)(iii) (filed June 14, 2017); SE FOF at ¶ 1745. This is a purely transitional proposal, intended to protect artists and copyright owners whose works remain subject to the statutory license from having their royalty payments unfairly reduced if a disproportionate share of labels decide to exploit differences between the statutory license system and the direct licenses Sirius XM offers to claim a larger share of the overall royalty pool than they would receive under the statutory system. SE FOF at ¶¶ 1745-1752. A measure like this will not be necessary once it becomes possible to use actual satellite listenership data to calculate the exclusions. SE FOF at ¶ 1754.

Sirius XM's example is optimistic. Since 2013, royalties paid by Sirius XM under its direct licenses have accounted for only [] of its total SDARS royalties. SE FOF at ¶ 921. During the 12 months ending November 2016, directly-licensed Internet reference channel performances were only [] of total Internet reference channel performances. SE FOF at ¶ 930. Since January 2015, the percentage of performances that are directly licensed has been on average [] than the percentage of plays that are directly licensed (*e.g.*, [] of performances v. [] of plays, meaning that the performance percentage is []). SE FOF at ¶¶ 928-929.

Looking at the real numbers, it is apparent that SoundExchange's proposed cap is not an "effort to make Sirius XM's direct licensing efforts uneconomical." SXM FOF at ¶ 467. As Sirius XM itself acknowledges, [ ]. SXM FOF at ¶ 470; *see also* SE FOF at ¶¶ 928-929, 1751. So long as "the pool of Sirius XM direct licensors is split almost evenly between labels who 'over-index' . . . and those who 'under-index,'" Sirius XM FOF at ¶ 470, the cap will never be reached. [ ] SE FOF at ¶¶ 928-929, 1753.

The point of SoundExchange's proposal is simply that Sirius XM has strong incentives to exploit the differences between the play-based methodology SoundExchange is required to use for distributions and the webcasting proxy used to calculate the exclusions by pitching direct licenses to labels that over-index, SE FOF at ¶¶ 1749-1750, and labels that over-index have

strong incentives to join Sirius XM in exploiting those differences. SE FOF at ¶ 1748. They are surely entitled to enter into such agreements if they wish. But when labels that over-index sign direct licenses, the increased exclusion that Sirius XM can take decreases the pool of royalties available to artists and copyright owners whose works are used under the statutory licenses. Trial Ex. 25 at ¶ 301 (Lys Corr. WDT). The extra payment to the over-indexing direct licensor is [ ] 4/27/17 Tr. 1557:24-1558:3 (Lys). That means that if direct licensors as a group were to net over-index, all artists and copyright owners in the statutory system would receive lower royalty payments than they would if all repertoire was in the statutory system.

The Judges are the guardians of the statutory license system. They should not design a statutory license system that has strong incentives not to participate, and it would not be fair to punish those who remain in the statutory system if enough owners of popular repertoire defect.

Response to ¶ 468. There is no dispute that in the absence of actual satellite listenership data, the webcasting proxy is the best available approach for calculating the exclusions. SE FOF at ¶¶ 1735-1744.

However, it is important to keep in mind the broader context of Sirius XM's direct licensing efforts. [

[redacted]]

In that environment, it is important to base the direct license exclusion on a measure of listenership, as the Judges concluded in *SDARS II*, and both SoundExchange and Sirius XM agree should happen in this proceeding, lest direct licenses by owners of less popular repertoire disproportionately reduce the royalty pool to be distributed among artists and copyright owners who remain in the statutory system. However, recognizing that the owners of the most popular repertoire have the greatest incentives to sign direct licenses under the current system, it is also important that a disproportionate share of direct licenses by such labels not unfairly reduce royalty payments for recordings of average popularity that remain in the statutory system.

Response to ¶ 469. SoundExchange's proposed cap on the direct license exclusion is not aimed at crippling direct licensing, and would not have the effect of crippling direct licensing. To avoid repetition, SoundExchange incorporates its Response to ¶ 467 *supra*.

Response to ¶ 470. As explained in SoundExchange's Response to ¶ 467 above, Sirius XM's Findings of Fact ¶ 470 shows that [[redacted]]. That is why the alarmist concerns in Sirius XM's Findings of Fact ¶¶ 467 and 469 are misplaced. However, so long as there is a mismatch between the methodology used to calculate the exclusions from Sirius XM's royalty payments and the methodology used for SoundExchange distributions, there is an opportunity for arbitrage that could significantly disadvantage artists and record companies that remain in the statutory system. The Judges should limit the potential for such arbitrage.

Response to ¶ 471. The issue is that when Sirius XM pays an over-indexing direct licensor more royalties than it would earn under the statutory license, that money has to come from somewhere – and it doesn't come from Sirius XM. If the direct licensors net over-index, the money comes from the royalty income of all the artists and copyright owners who remain in the statutory system. SE FOF at ¶¶ 1748-1750. That is not fair to the artists and copyright owners who remain in the system.

A simple elaboration on Sirius XM's illustration shows how this works. In Sirius XM's example, 12% of performances but only 10% of plays are directly licensed. Suppose there are 100 plays that generate 1000 performances, and that the pre-exclusion royalty payment associated with those plays is $1000. If there were no direct licenses and all that usage was covered by the statutory license, Sirius XM would pay SoundExchange the $1000. SoundExchange would then distribute the $1000 among the 100 plays, generating statutory royalty distributions of $10 per play before deduction of SoundExchange's administrative fee. 37 C.F.R. § 382.13(f)(1).

With Sirius XM's hypothetical direct licenses, Sirius XM would deduct $120 from its SoundExchange payment (12% of $1000) and divide that among itself and the over-indexing direct licensors (who would do better than they would under the statutory system even at a lower direct license royalty rate). 37 C.F.R. § 382.12(d); SE FOF at ¶¶ 1748-1750. SoundExchange would receive $880 ($1000 - $120) and distribute it among the 90 statutory plays (90% of 100), yielding a statutory distribution of $9.70 per play ($880 / 90). 37 C.F.R. § 382.13(f)(1).

In either scenario, all the artists and record companies in the statutory system would have their recordings used by Sirius XM in the same way and to the same extent, and Sirius XM would generate the same revenue from the use of the recordings (corresponding to the $1000

royalty). The "value of the sound recording performance rights at issue," *SDARS I*, 73 FR at 4087, is from the perspective of the artists and record companies in the statutory system, the same in either scenario. All that is different is that some labels have signed direct licenses. When that happens, Sirius XM and the direct licensors remove from the statutory royalty pool and divide among themselves $20 more than the direct licensors would have received under the statutory system (corresponding to the 2% over-indexing). That leaves everyone remaining in the statutory system, no matter how popular their repertoire, receiving 30¢ less per play.

If there is going to be a statutory license, it is not reasonable or fair to diminish the compensation provided to artists and record companies whose works are used under it because of the direct licenses signed by others. Ultimately, the solution to that problem is to use actual satellite usage data for both calculating the exclusions and for SoundExchange distributions. SE FOF at ¶ 1754. In the interim, artists and record companies should not be punished for remaining in the statutory license system.

E. The Direct License And Pre-'72 Exclusions Should Be Calculated Using Actual Satellite Listenership Data If Available

Response to ¶ 472. Since the Copyright Office originally set forth notice and recordkeeping requirements for non-PSS services in 2004, all such services (including SDARS) have been required to report listenership data to SoundExchange on essentially the same basis as currently provided in 37 C.F.R. § 370.4(d)(2)(vii). *In re Notice and Recordkeeping for Use of Sound Recordings under Statutory License*, 69 FR 11515, 11530 (2004); Trial Ex. 29 at 27 (Bender WDT).

SoundExchange acknowledges Sirius XM's assertion that it cannot currently provide the required information due to the one-way nature of its satellite network. Trial Ex. 29 at 7-8 (Bender WDT). Accordingly, there have been no disputes concerning Sirius XM's non-reporting

of such data even as the Judges declined a similar request from Sirius XM to eliminate the requirement in *SDARS II*. *SDARS II*, 78 FR at 23074 n.50. However, if Sirius XM were able to provide actual listenership data (as webcasters do), that would be very important to making fairer royalty distributions to artists and copyright owners, because there is a huge variation in the popularity of Sirius XM channels. Currently, plays on Sirius XM cannot be weighted for listenership when SoundExchange makes royalty distributions, even though plays on its most popular channels potentially reach approximately [ ] times as many subscribers as plays on the least popular channels. SE FOF at ¶¶ 1737-1738. Fortunately, Sirius XM is on the cusp of being able to provide actual satellite listenership data generated from 360L radios. SE FOF at ¶¶ 1723-1730.

The Judges have repeatedly expressed their preference that statutory royalty payments "relate . . . to the value of the sound recording performance rights that give rise to the royalty obligation." *E.g.*, *SDARS II*, 78 FR at 23073. If the Judges continue to wish that result (as they should), now is not the time to do away with the longstanding, generally-applicable and important requirement that statutory licensees provide listenership data for use in distributing statutory royalties.

Response to ¶ 473. Mr. Barry's [ ]. SE FOF at ¶¶ 1728-1730. [ ]. 5/15/17 Tr. 3741:6-8 (Meyer); 5/15/17 Tr. 3783:25-3784:2 (Meyer); 5/15/17 Tr. 3792:2-5 (Meyer). [ ]. 5/15/17 Tr. 3792:18-20 (Meyer). [

[redacted]]. 5/15/17 Tr. 3792:6-9 (Meyer). [redacted]]. 5/15/17 Tr. 3741:17-23 (Meyer). [redacted]]. SE FOF at ¶¶ 1731-1732.

Sirius XM's strident opposition to using actual satellite usage data for both calculating the direct license and pre-'72 exclusions and making SoundExchange distributions is puzzling, because it agreed that the best way to calculate the exclusions would be on the basis of actual satellite listenership. 5/17/17 Tr. 4414:21-25 (Barry); *see also* Trial Ex. 13 at ¶ 43 (Barry WRT) ("Sirius XM does not disagree with the spirit of SoundExchange's proposal"). In fact, Mr. Barry agreed that actual listenership data is the "gold standard" of data. 5/17/17 Tr. 4415:1-2 (Barry). Perhaps Sirius XM would actually like to maintain the potential for arbitrage between the exclusion and distribution methodologies that has fueled its direct licensing program. *See* SE FOF at ¶¶ 1079-1123. Whatever the motivations for its opposition, SoundExchange believes that the Judges should incorporate into the regulations at this time a path to migration to actual satellite usage data whenever it becomes available.

Response to ¶ 474. It would be premature to try to specify with mathematical precision what would constitute a good enough sample of listenership data, because [redacted]]. 5/15/17 Tr. 3785:1-3; 3789:11-14 (Meyer). However, [redacted]]. 5/15/17 Tr. 3789:15-3790:22 (Meyer). If it starts to do so, the parties certainly could if necessary consult statisticians for opinions about what sample size of the available data would be reasonable. *See* 5/10/17 Tr. 3187:6-15 (Bender). However, if Sirius XM were actually collecting listenership data and relying on that data for its own business purposes to make

personalized recommendations to users and to inform its programming decisions, it seems likely that data would be sufficient to calculate the exclusion percentage.

F. SoundExchange's Other Proposed Changes To The Definition Of Gross Revenues Should Be Adopted

Response to ¶ 475. SoundExchange addressed at length in its Findings of Fact the need for its proposed clarification that items of excluded revenue identified in paragraph (3) of the definition of gross revenues should be subtracted from the pool of gross revenues established by paragraphs (1) and (2) of the definition only to the extent that the relevant revenue is included in that pool in the first place. SE FOF at ¶¶ 1669-1684. Recapitulating briefly, the current list of exclusions confusingly combines (A) items that are excluded from gross revenues only in the sense that paragraph (3) confirms that they are not included in gross revenues to begin with (by virtue of paragraphs (1) and (2)), along with (B) items that are excluded in the sense that they might be included in the pool established by paragraphs (1) and (2), and if so, can be subtracted from that pool. Relying on this jumble of non-inclusions and subtractions, Sirius XM has improperly *subtracted* from gross revenues various categories of revenue and expense not associated with amounts that were ever included in gross revenues, including [[redacted]] , and credit card fees pertaining to unrelated revenue (SE FOF at ¶¶ 1683). The parties seem to be in agreement on the proper treatment of these items, but in at least some cases [[redacted]],

and it still had not paid the late royalties to SoundExchange. SE FOF at ¶¶ 1676-1677, 1681-1684; 5/17/17 Tr. 4396:14-4397:2 (Barry).

SoundExchange's proposal would not include in gross revenues any revenue that is not included in gross revenues by operation of paragraphs (1) and (2). Such revenue does not need to be *subtracted* from gross revenues, because it is not included in gross revenues in the first place. SE FOF at ¶¶ 1669-1671.

Response to ¶ 476. As described above in Response to ¶ 475, Sirius XM has provided an incomplete list of the cases in which it has inappropriately subtracted from gross revenues amounts that were never in the pool of gross revenues identified in paragraphs (1) and (2). More fundamentally, the Judges should adopt a clear definition of gross revenues that does not allow Sirius XM to subtract from gross revenues a long list of items that were never included in gross revenues and [[redacted]]. SE FOF at ¶¶ 1676, 1681. Sirius XM's suggestion that the parties should instead fight over these issues years later "in an audit" is not a reasonable alternative to the Judges' adopting a regulation that is clear about the proper treatment of these items. When artists and copyright owners are forced to make their works available to Sirius XM, everyone should be able to understand what Sirius XM's payment obligation is, and it should be expected to pay the right amount on a timely basis. Artists and copyright owners should not be expected to spend years chasing after Sirius XM trying to collect money that it agrees was improperly withheld but still has not paid. 5/17/17 Tr. 4396:14-4397:2 (Barry).

Response to ¶ 477. The statutory license gives Sirius XM complete discretion over how it structures and prices its offerings, and SoundExchange does not question that result in this proceeding. However, that principle should not imply that Sirius XM also has complete

discretion to decide what amounts it includes in gross revenues based on what it decides to call particular amounts that it collects from subscribers. The general principle established by paragraph (1)(i) of the definition of gross revenues (which SoundExchange does not propose changing) is that revenue recognized by Sirius XM from U.S. subscribers is supposed to be part of the royalty base. Setting aside taxes (which are not subscription revenue, SE FOF at ¶ 1679), current paragraph (3)(iv) (which SoundExchange proposes renumbering paragraph (3)(v)) provides an exception to that general rule that permits subtraction of certain types of miscellaneous fee revenue that might otherwise be included by paragraph (1)(i). SE FOF at ¶ 1685; SE COL at ¶ 31. When a general statement of policy is qualified by an exception, the exception should be understood narrowly "to preserve the primary operation of the provision." *Commissioner v. Clark*, 489 U.S. 726, 739 (1989).

SoundExchange's proposal is simply that Sirius XM should not be permitted to subtract miscellaneous subscriber fee revenue from its overall subscriber fee revenue unless the miscellaneous subscriber fee revenue is clearly unrelated "to the value of the sound recording performance rights at issue in this proceeding." *SDARS I*, 73 FR at 4087; SE FOF at ¶¶ 1690-1692, 1696-1697. SoundExchange proposes specifying that these fees can be excluded only when they are reasonably related to the Licensee's expenses to which they pertain, because miscellaneous fee revenue that is simply an additional source of profit from providing an SDARS, and not reasonably related to costs having nothing to do with the use of sound recordings, should not be excluded from the royalty base. Trial Ex. 29 at 21 (Bender WDT). Were that not the case, Sirius XM could call any arbitrary portion of a subscriber's payments a special fee and exclude that from the royalty base. That would be neither reasonable nor fair.

Response to ¶ 478. Sirius XM points out a further problem with its administration of the current definition of gross revenues, which is that while current paragraph (3)(iv) (which SoundExchange proposes renumbering paragraph (3)(v)) permits subtraction of certain types of miscellaneous fee revenue otherwise included by paragraph (1)(i), it has subtracted from gross revenues various miscellaneous expenses, such as the amounts it pays a vendor for processing paper invoices. SXM FOF at ¶ 478. SoundExchange agrees that if Sirius XM charged its subscribers a special fee to receive paper invoices, that invoice fee revenue could be subtracted from the overall pool of subscriber revenue (if otherwise included therein and reasonably related to Sirius XM's costs of processing paper invoices). However, paragraph (3)(iv) clearly is not styled as one providing for the subtraction of expenses from gross revenues. *See* Response ¶ 479 *infra*. Permitting subtraction of arbitrary expenses from gross revenues would turn what was conceived as a percentage-of-revenue rate structure into some kind of hybrid percentage-of-profits structure. Sirius XM's deduction of invoice expenses is improper. SE FOF at ¶¶ 1685-1687.

As to activation fee and termination fee revenue, SoundExchange agrees that such revenue could potentially be subtracted from subscriber revenue (again if otherwise included therein and reasonably related to Sirius XM's associated costs). SE FOF at ¶¶ 1690-1692. However, it is reasonable to expect Sirius XM to have some justification for subtracting such fee revenue from overall subscriber fee revenue. The absence of any justification for the amount of the fee would demonstrate that the fees are simply an additional source of profit from providing an SDARS. In such a case, the miscellaneous fee revenue could not be shown to be unrelated "to the value of the sound recording performance rights at issue in this proceeding," *SDARS I*, 73 FR at 4087, and should not be subtracted from subscriber revenue. SE FOF at ¶¶ 1690-1692.

Response to ¶ 479. In ¶ 479, Sirius XM continues to address subtraction from gross revenues of expenses rather than revenue. Current paragraph (3)(iv) (which SoundExchange proposes renumbering paragraph (3)(v)) does not permit subtraction of expenses from gross revenues. SoundExchange's addition of the phrase "charged to subscribers" merely serves to clarify that the paragraph is talking about fee revenue, not fee expense. SE FOF at ¶¶ 1690-1692.

Paragraph (3)(iv) appears within the definition of "Gross Revenues." It is part of a long list of items that, with one exception, are on their face forms of revenue: equipment revenue (paragraph (3)(i)), royalty revenue (paragraph (3)(ii)), record sales revenue (paragraph (3)(iii)), and "[r]evenues recognized by Licensee for the provision of" various services. The one exception on this list is the exclusion of "[b]ad debt expense." However, there, the Judges clearly called for the exclusion of an expense, demonstrating that the Judges knew how to specify the deduction of expenses when they wanted to do so.

Tellingly, when Sirius XM proposed a new exclusion of the late fees it collects from subscribers, it included it in paragraph (3)(iv). Sirius XM Second Amended Proposed Rates and Terms at 4 (filed June 14, 2017); Sirius XM FOF at ¶ 480. While SoundExchange does not agree with the new exclusion, SoundExchange agrees that paragraph (3)(iv) would be the right place for it, because paragraph (3)(iv) is (with the exception of taxes) a list of revenue items, while it is current paragraph (3)(v) that identifies an expense item. It would have been very strange for Sirius XM to include late fee revenue in paragraph (3)(iv) if that paragraph was supposed to identify a list of expenses, and not revenue.

The history of the Judges' consideration of the definition of gross revenues makes clear that they have always viewed it as a "revenue-based metric" and a "definition of revenue."

SDARS I, 73 FR at 4087. The Judges' goal in adopting it was to "delineate the revenues related to the value of the sound recording performance rights at issue in this proceeding." *SDARS I*, 73 FR at 4087. In *SDARS II*, the Judges again explained that their object was to "relate the fee charged for a service that an SDARS provided to the value of the sound recording performance rights." *SDARS II*, 78 FR at 23072.

Sirius XM's revenues correspond to "the fee charged for a service that an SDARS provided." The arbitrary set of expenses that Sirius XM has subtracted from gross revenues – including invoice processing expenses, [[redacted]], Sirius XM FOF at ¶ 478; SE FOF at ¶ 1686 – are not "the fee charged for a service that an SDARS provided." *SDARS II*, 78 FR at 23072. Sirius XM's interpretation of current paragraph (3)(iv) as identifying a mix of revenue and expense items and establishing some kind of hybrid percentage-of profits metric is wrong. The Judges should clarify that the paragraph refers to revenue in the form of "fees charged to subscribers."

Response to ¶ 480. Sirius XM strangely accuses SoundExchange of "wrongly omit[ting] late fees as an excludable charge." That accusation is strange, because the Judges' definition of gross revenues – which was originally written substantially by Sirius XM – has never included an exclusion of late fee revenue. 37 C.F.R. § 382.11; *SDARS I*, 73 FR at 4087, 4102. At the hearing, Mr. Barry agreed that late fee revenue is not an exclusion currently permitted under the regulations. 5/17/17 Tr. 4390:23-4391:2 (Barry).

Instead, it is Sirius XM that proposed a *new* exclusion of late fee revenue with its rebuttal case. Sirius XM First Amended Proposed Rates and Terms at 3 (filed February 17, 2017). It would be unfair for the Judges to add a significant new exclusion from gross revenues based on this last minute proposal. SE FOF at ¶ 1694. On the merits, late fees are payment for access to

programming, paid late. SE FOF at ¶ 1695. The Judges should not grant Sirius XM's proposed new exclusion of late fee revenue.

G. Other Disputed Issues Related To The Audit Regulations

i. § 382.11 Definition Of "Qualified Auditor"

Response to ¶ 481. SoundExchange and Sirius XM agree that the definition of "Qualified Auditor" should include an independence requirement. *See* SoundExchange Amended Proposed Rates and Terms, App. A at § 382.7 (filed June 14, 2017) ("*Qualified Auditor* means an independent Certified Public Accountant"); Sirius XM Second Amended Proposed Rates and Terms at § 382.11 (filed June 14, 2017) ("*Qualified Auditor* is a Certified Public Accountant who is independent of the Licensee and the Collective."). This is just an editorial change. Currently, auditor independence is required by 37 C.F.R. § 382.15(c) ("[a]ny such audit shall be conducted by an independent and Qualified Auditor"). Consistent with the *Web IV* regulations, both parties propose including the word "independent" in the definition. Also consistent with the *Web IV* regulations, SoundExchange proposes removing the word "independent" from the operative provision once it moves to the definition. Sirius XM is so keen on auditor independence that it would like the word "independent" to appear redundantly in both the definition of Qualified Auditor and in 37 C.F.R. § 382.15(c).

Sirius XM proposes a further change to the definition of the term "Qualified Auditor" that is unnecessary and conceptually problematic. Specifically, it wishes to incorporate the definition of independence from the AICPA Code of Professional Conduct. SXM FOF at ¶ 481. As Sirius XM's Controller conceded at the hearing, this proposed change is unnecessary. Mr. Barry testified that the regulations as written already require an auditor to be independent and already require an auditor to be a CPA. 5/17/17 Tr. 4418:3-8 (Barry). He further testified that

CPAs must abide by the AICPA Code of Professional Conduct – a fact that he knew because he himself is a CPA. 5/17/17 Tr. 4418:9-11, 19-21 (Barry). And he testified that the AICPA Code of Professional Conduct requires CPAs to be objective, impartial, intellectually honest, and free of conflicts of interest. 5/17/17 Tr. 4418:12-18 (Barry). When asked whether Sirius XM's proposed change to the definition of "Qualified Auditor" actually added any new requirements to the regulations, Mr. Barry acknowledged that it did not. 5/17/17 4418:22-4419:2 (Barry).

One might conclude from the foregoing that there is no harm in adopting Sirius XM's proposal. But SoundExchange explained in its Findings of Fact that the proposed change is in fact conceptually problematic. *See* SE FOF at ¶¶ 2284-2287. Briefly, (1) some aspects of the AICPA rule that Sirius XM seeks to incorporate are obviously irrelevant here; and (2) the proposal would selectively incorporate bits and pieces of state law into federal regulations, creating a potential for future conflict if state regulation of CPAs changes. Given that Sirius XM's proposed change does not add anything to the existing requirements (as admitted by Sirius XM's Controller), there is no reason for the Judges to incorporate selected portions of state law into the regulations. 5/17/17 Tr. 4418:22-4419:2 (Barry); Trial Ex. 48 at 24-25 (Bender WRT). The Judges should adopt SoundExchange's proposal regarding the definition of "Qualified Auditor."

Sirius XM makes a separate point about the nature of royalty verification that is irrelevant to its specific proposal. However, for the sake of completeness, the Judges should understand that a verification of statutory royalty payments as contemplated by the various regulations such as 37 C.F.R. § 382.15 ("Verification of royalty payments") is not technically what a CPA considers to be an "audit" when using that word as a term of art. As a matter of accounting practice, an audit is a very specific kind of engagement in which a CPA is asked to obtain

assurance that a company's "financial statements as a whole are free from material misstatement" and express a professional opinion that "the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework." Trial Ex. 48 at 23 n.10 (Bender WRT) (quoting AICPA Codification of Statements on Auditing Standards (AU-C) § 200.12(a)). Such an audit is something that Sirius XM obtains so that public securities markets and others can have confidence that its financial statements fairly represent the company's overall financial condition. Trial Ex. 357 at F-2 (report of KPMG explaining the purpose, methodology and conclusions of its audit of Sirius XM).

A true "audit" of that nature is a very different thing from determining whether a statutory licensee has calculated its statutory royalty payments in accordance with the applicable regulations. Trial Ex. 48 at 23 n.10 (Bender WRT). However, the latter kind of royalty verification, colloquially referred to as an audit, "serve[s] a critical function in the context of a statutory license where a copyright owner cannot easily terminate access to its works." *SDARS I*, 73 FR at 4101. Sirius XM's observation that SoundExchange's auditors do what the Judges' regulations contemplate – verify Sirius XM's statutory royalty payments rather than opine on its overall financial statements – is neither surprising nor sinister.

ii. § 382.15(c) Requirement That Audits Be "Binding On All Parties"

Response to ¶ 482. Because SoundExchange has based its proposed regulations on the Judges' *Web IV* regulations, SoundExchange's proposed regulations do not include the language Sirius XM has proposed striking. SoundExchange Amended Proposed Rates and Terms, App. A at § 382.6 (filed June 14, 2017). Rather than cherry-picking just a few *Web IV* changes that Sirius XM likes, the Judges should adopt this change for SDARS and PSS along with other

changes they made as part of their *Web IV* rewrite of the regulations, unless there are good reasons not to do so as to any particular provision. SE FOF at ¶¶ 2161-2193.

Response to ¶ 483. To avoid repetition, SoundExchange incorporates its Response to ¶ 482 *supra*.

Response to ¶ 484. To avoid repetition, SoundExchange incorporates its Response to ¶ 482 *supra*.

iii. SoundExchange's Proposed 5% Threshold For Audit Cost Fee-Shifting Should Be Adopted

Response to ¶ 485. SoundExchange demonstrated in its Findings of Fact that both the SDARS and PSS should be required to pay audit costs in the event an audit reveals an underpayment in excess of 5%. *See* SE FOF at ¶¶ 2258-2272. It is simply not true that, as Sirius XM states, "SoundExchange's only justification for the change to 5%" is that a 5% underpayment "dwarfs" the audit cost. SXM FOF at ¶ 485. Rather, in its Findings of Fact, SoundExchange sets out the following rationale for shifting audit fees in the case of a 5% underpayment: (1) it is important to select a fee-shifting threshold at point where an underpayment "becomes unreasonable enough to penalize the licensee," SE FOF at ¶ 2259 (quoting Trial Ex. 13 at ¶ 42 (Barry WRT)); (2) a 10% threshold is too high given the amount of payments (and underpayments) involved, SE FOF at ¶¶ 2260-2261; (3) the audit fees are modest compared to the amount of underpayments involved, SE FOF at ¶ 2262; and (4) a 5% fee-shifting threshold is justified by marketplace agreements – including many entered into by Sirius XM. SE FOF at ¶¶ 2263-2272. As Mr. Bender explained, there can be no excuse for underpaying statutory royalties by [[redacted]] (roughly 10% of Sirius XM's royalty payments over an audit period based on current payments) or even [[redacted]] (5%). The Judges should

not signal that a [[redacted]] underpayment should be expected in the ordinary course or is in any way acceptable. Trial Ex. 29 at 39 (Bender WDT).

Response to ¶ 486. SoundExchange provided ample evidence to support the fee-shifting threshold of 5%. As SoundExchange detailed in its Findings of Fact, a 5% fee-shifting threshold is justified by marketplace agreements, including many entered into by Sirius XM. SE FOF at ¶¶ 2263-2272. For example, SoundExchange provided evidence that Sirius XM's contracts with content providers ([[redacted]]) and automobile manufacturers ([[redacted]] and others) contain 5% fee-shifting thresholds. SE FOF at ¶¶ 2264-2267. Mr. Barry testified that the 5% threshold was a standard term in Sirius XM contracts. 5/17/17 Tr. 4379:24-4380:7 (Barry). In addition, at least a dozen agreements between major labels and music services confirm that this 5% threshold is standard throughout the industry. SE FOF at ¶¶ 2268-2272 (citing agreements between the majors and [[redacted]]. It is not the case, as Sirius XM claims, that SoundExchange presented no evidence regarding "fee-shift thresholds in agreements between music suppliers and digital music services generally." SXM FOF at ¶ 486.

iv. Treatment Of Underpayments In Audits

Response to ¶ 487. Overpayments discovered in audits should be handled in all respects as the Judges determined in *Web IV*. *See* SE FOF at ¶¶ 2249-2257. While Sirius XM likes the change the Judges made in *Web IV* to 37 C.F.R. § 380.6(d), indicating that the auditor should be sensitive to overpayments, it does not like the Judges' treatment in 37 C.F.R. § 380.6(g) of a hypothetical net overpayment by the licensee. Instead, it believes the licensee should receive a credit, with interest. SXM FOF at ¶ 487. The Judges should reject this proposed departure from

the *Web IV* approach, as it is premised on an imaginary issue and raises substantial administrability and fairness concerns.

First, the change is not necessary. As part of the audit settlement process, SoundExchange credits any overpayments that it discovers towards underpayments. And as Mr. Bender testified, overpayment by a licensee is rare. SE FOF at ¶ 2251. SoundExchange has never encountered a situation where a licensee's total overpayments *exceed* its total underpayments – the situation contemplated by Sirius XM's proposal. Indeed, both Mr. Bender and Mr. Barry testified that no SoundExchange audit of Sirius XM has ever uncovered a net overpayment by Sirius XM. SE FOF at ¶ 2250. The report of SoundExchange's most recent audit of Sirius XM quantifies SDARS underpayments of [[redacted]]. Trial Ex. 101 at 1.

Second, putting aside the fact that Sirius XM's proposal is addressed to a non-issue, the proposal is problematic conceptually. Unlike Sirius XM, which can use its cash flow for general corporate purposes (including paying refunds if it wishes), the royalties that SoundExchange receives are designated for distribution to the artists and copyright owners whose recordings were used in a particular month (as indicated by the licensee's reports of use). SE FOF at ¶ 2252. SoundExchange works hard to distribute royalties quickly, and pays out over 90% of the royalties it receives within 45 days after receiving them. In other words, within a short time after SoundExchange receives a licensee's payment, the vast majority of that money is gone. SE FOF at ¶ 2253. SoundExchange's power to claw back royalties that have already been distributed to artists is limited, and doing so is administratively difficult when possible. SE FOF at ¶ 2254.

Response to ¶ 488. Sirius XM suggests that SoundExchange could solve the problem of its inability to claw back royalties by "crediting" a licensee, allowing it to reduce its payment in the next reporting period by the amount of the credit. SXM FOF at ¶ 488. This proposal raises

substantial fairness concerns. Consider a situation in which on June 1, 2018, Artist *A* received higher royalties than she otherwise would had Sirius XM not overpaid. Sirius XM's overpayment is then discovered on December 1, 2019. If Artist *A* did not earn any royalties in that later time period, then SoundExchange's "credit" to SoundExchange would effectively be coming out of the pockets of all the artists who *did* earn royalties in the later time period. In other words, Artist *A*'s overpayment would be "solved" by underpaying everyone else. SE FOF at ¶ 2255.

Sirius XM argues that because Sirius XM pays royalties on a percentage-of-revenues basis, its payments are not tied to particular usage, so correcting a hypothetical overpayment would not require SoundExchange to claw back any previous distributions to artists and copyright owners. SXM FOF at ¶ 488. This is incorrect. Although *Sirius XM* does not pay royalties to SoundExchange that are calculated on the basis of particular usage (such as the per-performance metric used in a webcasting context), *SoundExchange* distributes the royalties it receives from Sirius XM to specific artists and copyright owners based on the plays reported by Sirius XM on its reports of use. 37 C.F.R. § 382.13(f)(1); Trial Ex. 29 at 8 (Bender WDT). As explained above, if Sirius XM were permitted to reduce its royalty payments in one period based on overpayments in a previous period, the artists and copyright owners otherwise entitled to payment in the later period would be prejudiced.

Given the administrative and fairness concerns detailed above, it is unsurprising that the Judges rejected a similar gambit in *Web IV*, observing that "[t]he burden of accurate reporting and payment is on the Licensee." *Web IV*, 81 FR at 26402; *see* SE FOF at ¶ 2256.

v. The Judges Cannot And Should Not Adopt Sirius XM's Proposed "Finality" Provision

Response to ¶ 489. Sirius XM proposes a new Section 382.15(i) that purports to make the licensee's payments "final" on a specified date. The purported reason for this is alleged delays in SoundExchange's completion of audits. However, SoundExchange has no desire to draw out any audit process. To the contrary, it is in SoundExchange's interest to minimize the time spent by the auditor and to obtain results for artists and copyright owners as quickly as practicable. Trial Ex. 48 at 14 (Bender WRT).

There are many reasons that audits may take longer than anyone would like. SoundExchange often encounters licensee resistance at every phase of an audit, from objections to its choice of an auditor, to difficulties scheduling field work, to licensees' refusal to grant access to necessary information in the field, to licensees' failures or delays in providing follow-up information. When the auditor finds possible issues, it frequently takes multiple rounds of inquiry, response and evaluation for the auditor to understand the issues and the licensee's position concerning them. In addition, audits of Sirius XM are very complicated due to the range of its offerings, the complex royalty calculations it has employed, and the pending litigation between the parties. Trial Ex. 48 at 13-14 (Bender WRT).

Outside this litigation, Sirius XM has shown no inclination toward speed in resolving audits. SoundExchange's last audit of Sirius XM was completed just over a year ago. Trial Ex. 101 at 1. The issues are well defined, and in many cases Sirius XM has indicated that it will pay royalties. *E.g.*, SE FOF at ¶¶ 1674-1682. However, even in such cases Sirius XM still has not paid the amounts it acknowledges it owes pursuant to the audit completed last year. SE FOF at ¶¶ 2222-2224.

Response to ¶ 490. Sirius XM's proposed new Section 382.15(i) would make Sirius XM's payments during any audited period final on the *earlier* date of (i) the date two years after an audit report is delivered or (ii) the expiration of any applicable statute of limitations, absent a legal action being filed before that time by SoundExchange. Sirius XM FOF at ¶ 490. In its Findings of Fact, Sirius XM stated that this proposal "reflects a slight variation on its original proposal to account for concerns raised by SoundExchange regarding the interplay of this provision with applicable statutes of limitations." SXM FOF at ¶ 490.

Sirius XM's original proposal would have made an audit final two years after delivery of the auditor's report, without regard to the statute of limitations. *See* Sirius XM Proposed Rates and Terms at 7 (filed Oct. 19, 2016). SoundExchange explained in its Findings of Fact that the Judges cannot and should not adopt this proposal, which would have overridden the Copyright Act's three-year statute of limitations, 17 U.S.C. § 507(b). *See* SE FOF at ¶¶ 2273-2275.

Sirius XM's new proposal to add an explicit reference to the statute of limitations in no way obviates SoundExchange's concerns. By providing that the audit results become final on the *earlier* of two years from the auditor's report or the statute of limitations, Sirius XM's proposed regulation would still cut off statutes of limitations that are longer than two years, like that of the Copyright Act found in 17 U.S.C. § 507(b). For the reasons set out in SoundExchange's Findings of Fact and Conclusions of Law, the Judges cannot and should not adopt this proposal. *See* SE FOF at ¶¶ 2273-2275.

H. Sirius XM's Other Proposed Changes To The SDARS Terms

i. Definition Of "GAAP"

Response to ¶ 491. Sirius XM's proposal concerning which version of GAAP applies is a solution in search of a problem. SE FOF at ¶¶ 1707-1708. None of the SoundExchange staff

involved in handling licensee audits and disputes recalls any instance in which the resolution of a question concerning the amount of a disputed royalty payment (with Sirius XM or any other licensee) depended on the particular GAAP provisions in effect at a certain time. Trial Ex. 48 at 21 (Bender WRT). This is just not an important issue for the Judges to address. SE FOF at ¶ 1708.

Sirius XM has most recently proposed using the GAAP definition in effect "during the month when the performances giving rise to a Licensee's royalty payment obligation were transmitted." Sirius XM's Second Amended Proposed Rates and Terms at § 382.11 (filed June 14, 2017). This is an improvement over Sirius XM's previous proposal, but it still suffers from the same problem as Sirius XM's original proposal that it potentially identifies multiple dates for GAAP determination with respect to a single royalty payment (all the days of a month) rather than just one. *See* SE FOF at ¶ 1711. That is, if GAAP were to change midway through a month, different versions of GAAP would apply to determining a single month's payment.

If the Judges are inclined to specify which version of GAAP applies to a particular payment, SoundExchange is not opposed to either of the following options. First, the version of GAAP to be applied to a particular royalty payment could be the version in effect on the *last day* of the accounting period to which the payment relates. Second, the Judges could adopt the proposal set out by Mr. Bender, which is that the version of GAAP to be used is the one in effect on the date the payment is due. Trial Ex. 48 at 21 (Bender WRT). Either of these approaches would lead to the desirable result that the licensee's liability is both knowable and fixed as of the date the payment is due, and the same definition would apply to the entirety of a particular month. SE FOF at ¶ 1710.

ii. Ephemeral Recordings

Response to ¶ 492. Sirius XM and SoundExchange agree in substance that the Judges should conform the SDARS regulations regarding ephemerals to the language adopted by the Judges in *Web IV*, SE FOF at ¶ 2371; SXM FOF at ¶ 492, and have submitted virtually identical proposed language, *compare* SoundExchange Amended Proposed Rates and Terms, App. A at § 382.21(c) (filed June 14, 2017) *with* Sirius XM Second Amended Proposed Rates and Terms at § 382.12(b) (filed June 14, 2017). The only differences are minor editorial differences, such as ones relating to use of defined terms, which the Judges should implement as appropriate to the final regulations.

iii. Payment Date

Response to ¶ 493. SoundExchange does not oppose this proposal.

iv. Unclaimed Funds

Response to ¶ 494. Undistributable SDARS royalties should continue to be applied to reduce the costs of administering the statutory license. *See* SE FOF at ¶¶ 2194-2208. While that is a departure from the result of *Web IV*, SoundExchange believes that a departure from the *Web IV* language is warranted. The result in *Web IV* seems to have been based on an unnecessary concern about the Judges' authority to adopt regulations that might be inconsistent with state law. And while it was intended "to avoid potential confusion," its result was to replace a clear mandate consistent with the federal purpose of the statutory license with a vague and less certain reference to other applicable law. *Web IV*, 81 FR at 26400; SE FOF at ¶ 2199.

As set out more fully in Section XIV.B of SoundExchange's Findings of Fact, (1) the Judges are clearly empowered to adopt a uniform national rule for disposition of unclaimed statutory royalties, *see* SE COL at ¶¶ 48-53; (2) the Judges have been tasked with setting rates

and terms under the federal statutory license, *see* SE FOF at ¶ 2202; (3) the current SDARS regulations' provision for the disposition of unclaimed funds is fair and consistent with the federal purpose of compensating artists and copyright owners under the statutory license, *see* SE FOF at ¶¶ 2203-2204; and (4) the change made in *Web IV* and proposed here by Sirius XM replaces clear direction with ambiguous language that may be susceptible to differing interpretations, opening up the possibility of unnecessary future disputes with state unclaimed property administrators, *see* SE FOF at ¶¶ 2203, 2205.

Sirius XM tries to justify its proposal by arguing that it "avoid[s] a rule that might preempt state law." SXM FOF at ¶ 494. However, as explained in Section XIV.B of SoundExchange's Findings of Fact, that is not a concern at all, given Congress's clear direction to the Judges, and the Judges' power as a federal agency to preempt state law in carrying out their congressional mandate. *See* SE COL at ¶¶ 48-53 & SE FOF at ¶ 2201.

Sirius XM also alleges that its proposal "attempts to 'ensure the collective works to appropriately reach out to the corresponding artist or label.'" SXM FOF at ¶ 494 (quoting 5/17/17 Tr. 4419:18-24 (Barry)). However, Sirius XM has provided no evidence whatsoever that this change is necessary or that SoundExchange is not fulfilling its statutory mandate appropriately. In fact, SoundExchange takes very seriously the mission the Judges have assigned it of distributing statutory royalties "promptly." 37 C.F.R. §§ 382.4(d)(1), 382.13(f)(1); Trial Ex. 48 at 17-18 (Bender WRT). As Mr. Bender described in detail, SoundExchange's outreach efforts are quite extensive. Trial Ex. 29 at 10-12 (Bender WDT). After more than 15 years of such efforts, SoundExchange is able to pay to artists and copyright owners over 90% of the royalties that SoundExchange receives on a current basis. SE FOF at ¶ 2194. The small fraction that cannot be distributed after three years is applied to SoundExchange's administrative

expenses, as current 37 C.F.R. § 382.8 and § 382.17 provide. This benefits artists and copyright owners by defraying costs they would otherwise have to bear. SE FOF at ¶¶ 2196-2198.

It is quite evident that Sirius XM has no direct interest in the change it has proposed, as Mr. Barry acknowledged at trial. *See* SE FOF at ¶ 2207. The Judges should reject Sirius XM's proposal to adopt the *Web IV* language concerning the disposition of unclaimed funds.

Respectfully submitted,

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July 7, 2017

CERTIFICATE OF SERVICE

I, Jared O. Freedman, do hereby certify that, on July 7, 2017, copies of the foregoing are being filed via eCRB, sent via electronic mail to all parties at the email addresses listed below, and sent in hard copy by first class mail.

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Dated: July 7, 2017

/s/ Jared O. Freedman

_____

Jared O. Freedman

Certificate of Service

I hereby certify that on Friday, July 07, 2017 I provided a true and correct copy of the SoundExchange, Inc. and Copyright Owner and Artist Participants' Replies to Sirius XM Radio Inc.'s Proposed Findings of Fact and Conclusions of Law to the following:

Sirius XM, represented by Bruce Rich served via Electronic Service at bruce.rich@weil.com

Music Choice, represented by Paul M Fakler served via Electronic Service at paul.fakler@arentfox.com

Signed: /s/ Jared O. Freedman