

Before the
COPYRIGHT ROYALTY JUDGES
Washington, D.C.

In the Matter of)
)
)

Digital Performance Right in Sound)
Recordings and Ephemeral Recordings)
for a New Subscription Service)
_____)

Docket No. 2005-5 CRB DTNSRA

WRITTEN REBUTTAL STATEMENT AND
REBUTTAL TESTIMONY OF
SIRIUS SATELLITE RADIO INC. AND
XM SATELLITE RADIO INC.

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TABLE OF CONTENTS

Tab 1:

- A. Introductory Memorandum of XM Satellite Radio
- B. Introductory Memorandum of Sirius Satellite Radio
- C. Amended Rate Proposal
- D. Index of Witness Testimony
- E. Index of Witness Exhibits
- F. Certificate of Service

Tab 2: Witness Testimony and Exhibits Jointly Submitted by Sirius Satellite Radio Inc. and XM Satellite Radio Inc.

- A. Rebuttal Testimony of Dr. Tasneem Chipty

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Counsel for XM Satellite Radio Inc

Counsel for Sirius Satellite Radio Inc

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

In the Matter of)
)
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DIGITAL PERFORMANCE RIGHT IN)
SOUND RECORDINGS AND)
EPHEMERAL RECORDINGS FOR A)
NEW SUBSCRIPTION SERVICE)
_____)

Docket No. 2005-5 CRB DTNSRA

**Introductory Memorandum to the
Written Rebuttal Statement of XM Satellite Radio Inc.**

XM Satellite Radio Inc. ("XM") submits this written rebuttal statement pursuant to Rule 351.11 of the Copyright Royalty Board, 37 C.F.R. § 351.11.

Amended Rate Claim

By amendment of its prior rate request, XM requests that the Copyright Royalty Judges promulgate a combined rate for the Section 114(f) sound recording license and for the Section 112(e) ephemeral recordings license of \$ 0.00424 per subscriber, per month, multiplied by the average number of monthly United States subscribers who receive the audio service offered with their television service.

Summary of Testimony

XM submits, jointly with Sirius Satellite Radio Inc., the Rebuttal Testimony of Dr. Tasneem Chipty, Ph.D. ("Chipty WRT") in support of its position that the rate proposal of SoundExchange, Inc. should be rejected, and a rate consistent with the analysis of Dr. Chipty should be adopted in this proceeding.

With regard to the direct testimony of SoundExchange's expert witness Dr.

Michael Pelcovits ("Dr. Pelcovits"), Dr. Chipty explains:

- Under the willing buyer/willing seller standard that governs this proceeding, a willing buyer would never agree to pay a single input provider as much as -- or more than -- its total revenue.
- Dr. Pelcovits fails to properly adjust his webcasting royalty benchmark for important differences between the services and the rights sellers.
- Current pricing information and offerings for both interactive and so-called "non-interactive" webcasting services show the data used by Dr. Pelcovits for his interactivity analysis are outdated and demonstrate that the webcasting market is far too unstable to use as a benchmark.
- Although Dr. Chipty concludes that information is not available to quantify all Rate adjustments to the webcasting benchmark that would be necessary to make it useful for this proceeding, she computes that (i) correcting a computation error in Dr. Pelcovits's regression analysis, (ii) substituting updated pricing and listener information, and (iii) using a sounder interactivity adjustment would reduce the result of the calculations of Dr. Pelcovits by over 90%, even without other critical adjustments. This demonstrates the lack of usefulness of the webcasting benchmark employed by Dr. Pelcovits.

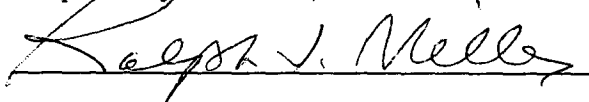
Dr. Chipty concludes that she continues to recommend a fee based on the musical works benchmarks she presented in her direct testimony. She amends her per-subscriber rate calculation based on new information from Dr. Pelcovits about the average revenue to Music Choice for its residential cable music service. Using the updated Music Choice revenue estimates, Dr. Chipty arrives at an amended rate calculation of \$0.00424 per subscriber, per month.

Conclusion

For these reasons, based on the evidence in the record and the rebuttal testimony of Dr. Chipty, XM requests that the Copyright Royalty Judges promulgate in this proceeding a combined rate for the Section 114(f) sound recording performance license and for the Section 112(e) ephemeral recordings license¹ of \$0.00424 per subscriber, per month, multiplied by the average number of monthly United States subscribers who receive the audio service offered with their television service.

July 24, 2007

Respectfully submitted,



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Counsel of XM Satellite Radio Inc.

¹ As noted in footnote 1 of the Introductory Memorandum to the Written Direct Statement of XM Satellite Radio Inc., determining the rates and terms for any ephemeral recording statutory license is within the scope of this proceeding, but XM does not imply in its original or its amended rate proposal that a §112(e) ephemeral recordings license is required or that such a license has any economic value independent of the value of the performances themselves.

**Before the
COPYRIGHT ROYALTY JUDGES
LIBRARY OF CONGRESS
Washington, D.C.**

In the Matter of)

Digital Performance Right in Sound)
Recordings and Ephemeral Recordings)
_____)

Docket No. 2005-5 CRB DTRA

**INTRODUCTORY MEMORANDUM
TO THE WRITTEN REBUTTAL
STATEMENT OF SIRIUS SATELLITE RADIO INC.**

Sirius Satellite Radio Inc. (“Sirius”) submits this introductory memorandum of its written rebuttal statement and amended rate proposal for the convenience of the Copyright Royalty Judges. The rebuttal case of Sirius Satellite Radio Inc. (“Sirius”) and XM Satellite Radio Inc. (“XM”) (collectively “the Services”) will demonstrate that SoundExchange’s rate proposal is based on a flawed economic model.

Sirius joins with XM Satellite Radio Inc. in presenting the rebuttal testimony of **Dr. Tasneem Chipty**, and incorporates by reference herein the “Summary of Testimony” presented in the Introductory Memorandum to the Written Rebuttal Statement of XM Satellite Radio Inc. (filed July 24, 2007).

In addition to Dr. Chipty, Sirius also will present **Douglas A. Kaplan**, Sirius’ Senior Vice President for Business Affairs and Business Development, Entertainment and Sports, who was not able to appear for live testimony during the direct phase of the case. Sirius and SoundExchange instead submitted designated deposition testimony with the Court’s approval. Mr. Kaplan will be presented at the rebuttal hearing, at the Court’s request, to answer questions from the Court as to his Written Direct Testimony and designated deposition testimony.

Sirius amends its earlier fee proposal of \$0.001235 per subscriber per month and proposes a fee based on Dr. Chipty's analysis equal to \$0.00424 per subscriber per month for the performance and ephemeral recording rights at issue in this proceeding. The remainder of the terms in Sirius' original fee proposal remains in place.

Respectfully submitted,



Thomas W. Kirby (D.C. Bar No. 915231)
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Counsel for Sirius Satellite Radio Inc.

July 24, 2007

Rates and Terms

PART 26 -- RATES AND TERMS FOR SUBSCRIPTION TRANSMISSIONS AND THE REPRODUCTION OF EPHEMERAL RECORDINGS BY NEW BUNDLED SUBSCRIPTION SERVICES

Sec.

26_.1 General.

26_.2 Definitions.

26_.3 Royalty fees for public performance of sound recordings and the making of ephemeral recordings.

26_.4 Administrative provisions.

26_.5 Confidential information and statements of account.

26_.6 Notice and Recordkeeping.

§ 26_.1 General.

(a) Scope. This part 26_ establishes rates and terms of royalty payments for the public performance of sound recordings and the reproduction of multiple ephemeral recordings by new digital audio services offered by a television programming services in accordance with the provisions of 17 U.S.C. §§ 112(e) and 114 for the period from the inception of Licensee's service, through December 31, 2012.

(b) Relationship to voluntary agreements. Notwithstanding the royalty rates and terms established in this part, the rates and terms of any license agreements entered into by Copyright Owners and Licensees shall apply in lieu of the rates and terms of this part to transmissions within the scope of such agreements.

§ 26_.2 Definitions.

For purposes of this part, the following definitions shall apply:

(a) "Copyright Owner" is a sound recording copyright owner who is entitled to receive royalty payments under 17 U.S.C. § 112(e) or 114(g).

(b) A "Designated Agent" is any agent designated by the Librarian of Congress for the receipt and distribution of royalty payments made pursuant to this part.

(c) "Licensee" means an owner or operator of a digital audio service that is offered by a television service provider, and includes the Licensee's parent, subsidiaries and divisions.

(d) "Term" means the period commencing November 1, 2005, and continuing through December 31, 2012.

§ 26_.3 Royalty fees for public performances of sound recordings and the making of ephemeral recordings.

(a) Royalty. Commencing with the first calendar quarter following the setting of the rate and continuing through December 31, 2012, the quarterly royalty fee to be paid by a Licensee for the public performance of sound recordings pursuant to 17 U.S.C. § 114(d)(2) and the making of any number of ephemeral phonorecords to facilitate such performances pursuant to 17 U.S.C. § 112(e) shall be calculated as 0.424 cents (\$0.00424) per month per subscriber times the average number of monthly United States subscribers of the television service who receive Licensee's audio service.

(b) Payments. Payments made by a Licensee shall be due 60 days after the close of each calendar quarter for which the payment is being made.

(c) Late Fee. If a Licensee fails to make any payment under this part when due and following ten days after receipt of written notice from a Designated Agent, the Licensee shall pay a late fee on any overdue amount of 0.50% per month, or the highest lawful rate, whichever is lower, from the date of receipt of written notice until the date full payment is received by a Designated Agent.

(d) Weekends and Holidays. In the event the deadline for any payment due under this part falls on a day which is not a business day, payment shall be due on the next business day.

(e) Revenue Adjustment. Beginning in January 2009, the Attributable Monthly Subscriber Revenue shall be adjusted annually according to the Bureau of Labor Statistics Producer Price Index for Cable Networks, in comparison to January 2008.

(f) Past Payment. Payments for the license period prior to the first calendar quarter following the setting of the rate shall be made along with the first payment following the setting of the rate.

§ 26_.4 Administrative provisions.

(a) Audit.

(i) A Designated Agent may audit compliance by the Licensee with the royalty payment provisions of these regulations. If there is more than one Designated Agent, all Designated Agents shall mutually retain a single auditor to perform a single audit on a Licensee.

(ii) An audit pursuant to this section may be conducted no more than once every three (3) years, and no more than once in any given year. An audit of any year in the Term may be conducted only once. Audits shall be conducted during regular business hours, at a mutually agreeable time; provided that an audit shall commence no later than 90 days following a written request for audit.

(iii) Audits shall be performed by an independent auditor according to generally accepted auditing standards.

(iv) If as a result of the audit the parties agree or, in the absence of such agreement there is a final determination, that a Licensee has underpaid royalties by 10 or more percent, within 60 days of such determination the Licensee shall pay the amount of the underpayment with interest at the rate provided in 28 U.S.C. § 1961, plus reasonable out-of-pocket costs incurred by the auditor.

(v) If as a result of the audit the auditor determines that a Licensee has overpaid royalties, the Licensee may credit against future royalty payments the amount of such overpayment plus interest accrued at the rate provided in 28 U.S.C. § 1961, and shall pay the Licensee's reasonable out-of-pocket costs incurred from the audit.

§ 26_.5 Confidential information and statements of account.

(a) For purposes of this part, confidential information shall include statements of account and any information pertaining to the statements of account designated as confidential by the Licensee filing the statement. Confidential information shall also include any information so designated in a confidentiality agreement which has been duly executed between a Licensee and an interested party, or between one or more interested parties; *Provided* that all such information shall be made available, for the verification proceedings provided for in §§2__.4 of this part.

(b) Licensee shall submit quarterly statements of account on a form provided by the agent designated to collect such forms and the quarterly royalty payments.

(c) A statement of account shall include only such information as is necessary to compute the accompanying royalty payment. Additional information beyond that which is sufficient to verify the calculation of the royalty fees shall not be required or included on the statement of account.

(d) Access to the confidential information pertaining to the royalty payments shall be limited to:

(i) Those employees, agents, consultants and independent contractors of the designated agent, subject to an appropriate confidentiality agreement, who are engaged in the collection and distribution of royalty payments hereunder and activities directly related hereto, who are not also employees or officers of a sound recording copyright owner or performing artist, and who, for the purpose of performing such duties during the ordinary course of employment, require access to the records; and

(ii) An independent and qualified auditor who is not an employee or officer of a sound recording copyright owner or performing artist, but is authorized to act on behalf of the interested copyright owners with respect to the verification of the royalty payments.

(e) The designated agent or any person identified in paragraph (d) of this section shall implement procedures to safeguard all confidential financial and business information, including, but not limited to royalty payments, submitted as part of the statements of account, using a reasonable standard of care, but no less than the same degree of security used to protect confidential financial and business information or similarly sensitive information belonging to the designated agent or such person.

(f) Books and records relating to the payment of the license fees shall be kept in accordance with generally accepted accounting principles for a period of three years. These records shall include, but are not limited to, the statements of account, records documenting an interested party's share of the royalty fees, and the records pertaining to the administration of the collection process and the further distribution of the royalty fees to those interested parties entitled to receive such fees.

§ 26.6 Notice and Recordkeeping.

(a) General. This Exhibit prescribes rules under which Licensees shall serve copyright owners with notice of use of their sound recordings, what the content of that notice should be, and under which records of such use shall be kept and made available.

(b) Definition. A "*Report of Use of Sound Recordings Under Statutory License*" (sometimes referred to as a "*Report of Use*") is the sole report of use required to be provided by a Licensee under this Agreement.

(c) Service. Reports of Use shall be served upon SoundExchange. Licensees shall have no obligation to provide Reports of Use for any period prior to January 1, 2006. Licensees shall serve Reports of Use on SoundExchange by no later than the ninetieth day after the close of each month. Reports of Use shall be served, by certified or registered mail, or by other means provided in SoundExchange's "File and Reports of Use Delivery Specifications" filed in the Copyright Office in Docket No. RM 2002-1B or agreed upon by a Licensee and SoundExchange.

(d) Content.

(1) A "Report of Use of Sound Recordings under Statutory License" shall be identified as such by prominent caption or heading, and shall include a Licensee's intended or actual playlist for each channel and each day of the reported month, except that no reporting requirement shall apply to channels reasonably classified as news, talk or sports. Subject to paragraph (d)(2) of this Exhibit, each intended or actual playlist shall include a consecutive listing of every recording scheduled to be or actually transmitted, as the case may be, and shall contain the following information in the following order:

(A) The name of the service or entity;

(B) The channel;

- (C) The sound recording title;
- (D) The featured recording artist, group, or orchestra;
- (E) The retail album title;
- (F) The marketing label of the commercially released and available album or other product on which the sound recording is found;
- (G) The catalog number for albums or other products commercially released;
- (H) The International Standard Recording Code (ISRC) embedded in the sound recording, where available and feasible, for albums or other products commercially released after 1998;
- (I) Where available, the copyright owner information provided in the copyright notice on the retail album or other product (e.g., following the symbol © (the letter P in a circle) or, in the case of compilation albums created for commercial purposes, in the copyright notice for the individual sound recording, for commercially released albums or other products;
- (J) The date of transmission;
- (K) The time of transmission; and
- (L) The release year of the retail album or other product (as opposed to an the individual sound recording), as provided in the copyright notice on the retail album or other product (e.g., following the symbol © (the letter C in a circle), if present, or otherwise following the symbol © (the letter P in a circle)), for commercially released albums or other products.

(2) Notwithstanding paragraph (d)(1) of this Exhibit –

(A) In the case of programming provided to a Licensee by a third party programmer –

(i) if such programming is provided to the Licensee under a contract entered into before the Execution Date and not thereafter amended or renewed, then the Licensee shall have no obligation to provide Reports of Use with respect to that programming; and

(ii) the Licensee shall use commercially reasonable efforts to include in any new contract for programming, or any amendment or renewal of such a contract, a requirement that the provider of programming provide the Licensee the information required by

paragraph (d)(1) of this Exhibit, or in the case of programming consisting of simultaneous retransmission of an over-the-air terrestrial AM or FM radio broadcast by a broadcaster that also transmits such programming over the Internet, such information as may from time to time be required by Copyright Office regulations relating to the broadcaster's transmissions over the Internet, and the Licensee shall provide SoundExchange Reports of Use containing the information provided by the third party programmer.

In any case in which a Licensee does not provide Reports of Use for programming provided to a Licensee by a third party programmer, the Licensee shall report to SoundExchange the relevant channel and the reason it is unable to provide such Reports of Use.

(B) Licensees only shall be required to provide the information identified in paragraph (d)(1)(C) through (I) and (L) of this Exhibit to the extent that such information can be provided using commercially reasonable efforts.

(C) Licensees shall not be required to provide information with respect to an incidental performance that both: (i) makes no more than incidental use of sound recordings including, but not limited to, brief musical transitions in and out of commercials or program segments, brief performances during news, talk and sports programming, brief background performances during disk jockey announcements, brief performances during commercials of sixty seconds or less in duration, or brief performances during sporting or other public events, and (ii) other than ambient music that is background at a public event, does not contain an entire sound recording and does not feature a particular sound recording of more than thirty seconds (as in the case of a sound recording used as a theme song).

(e) Signature. Reports of Use shall include a signed statement by the appropriate officer or representative of the Licensee attesting, under penalty of perjury, that the information contained in the Report is believed to be accurate and is maintained by the Service in its ordinary course of business. The signature shall be accompanied by the printed or typewritten name and title of the person signing the Report, and by the date of signature.

(f) Other Media. If a Licensee makes digital audio transmissions of sound recordings in any medium other than through its SDARS, reports containing the elements set forth in paragraph (d) of this Exhibit shall be deemed to satisfy the Licensee's obligations to identify the sound recordings used in such transmissions (in contrast to any obligations the Licensee may have under applicable regulations to provide information concerning matters other than the identity of such sound recordings).

(g) Format. Reports of Use shall be provided in accordance with SoundExchange's "File and Reports of Use Delivery Specifications" filed in the Copyright Office in Docket No. RM 2002-1B.

(h) Confidentiality.

1.1 (1) Definition. "Confidential Information" means information submitted by a Licensee to SoundExchange in a Report of Use that is uniquely specific to Licensee, including without limitation, the number of performances made by the Licensee and the identification of particular sound recordings as having been performed by the Licensee, but not any information that at the time of delivery to Sound Exchange is generally known to the public or subsequently becomes generally known to the public through no fault of SoundExchange, including without limitation, information identifying sound recordings themselves.

1.2 (2) Use of Confidential Information. SoundExchange shall not use any Confidential Information for any purpose other than royalty collection and distribution, determining and enforcing compliance with statutory license requirements and the requirements of this Agreement, and activities directly related to the foregoing; provided that SoundExchange may report Confidential Information to its members in a form in which information pertaining to both Licensees is aggregated with information pertaining to other statutory licensees such that Confidential Information pertaining to Licensees, either individually or collectively, cannot readily be identified.

1.3 (3) Disclosure of Confidential Information. Access to Confidential Information shall be limited to those employees, agents, attorneys, consultants and independent contractors of SoundExchange, subject to an appropriate confidentiality agreement, who are not also employees or officers of a Copyright Owner or Performer, and who, for the purpose of performing such duties during the ordinary course of their work, require access to Confidential Information. SoundExchange also may disclose Confidential Information to a successor or assignee permitted by this Agreement.

(i) Documentation. Licensees shall, for a period of at least three years from the date of service of the Report of Use, keep and retain a copy of the Report of Use.

(j) Regulation. If the Copyright Royalty Board, the Librarian of Congress, or other judicial body, or administrative or regulatory agency adopts regulations for Notice and Recordkeeping or Reports of Use, applicable to Licensees or other services under the § 114(d) statutory license, that are considered by a Licensee to be in the aggregate more favorable than those set forth in this section, Licensee shall inform SoundExchange within 90 days thereafter if Licensee determines to provide Reports of Use pursuant to such other regulations.

Index of Joint Witness Testimony for Sirius Satellite Radio Inc and XM Satellite Radio Inc:

TAB	WITNESS	TITLE
A	Dr. Tasneem Chipty	Vice President, CRA International

Index of Joint Witness Exhibits for Sirius Satellite Radio Inc and XM Satellite Radio:

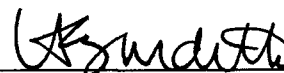
Exhibit List for Dr. Tasneem Chipty

Exhibit No.	Description
1	Table 1: Changes in Webcasting Services that Form the Basis for Dr. Pelcovits' Interactivity Adjustment
2	Table 2: Dr. Pelcovits' Table 6.2 Updated to Reflect Current Information Comparison of the Subscription Price of Internet Radio vs. On-Demand Service
3	Table 3: Summary of Regression Results For the Purpose of Illustrating Sensitivity of his Proposal to Underlying Assumptions
4	Table 4: Revised Pelcovits Rate Calculation For the Purpose of Illustrating Sensitivity of his Proposal to Underlying Assumptions

CERTIFICATE OF SERVICE

I, Leslie Burdette, hereby certify that a copy of the foregoing **Public Version of the Written Rebuttal Statement and Testimony of XM Satellite Radio Inc. and Sirius Satellite Radio** has been served on this 27th day of July 2007.

<p>David A. Handzo Thomas J. Perrelli Michael B. DeSanctis Jared O. Freedman JENNER & BLOCK LLP 601 Thirteenth Street, NW Washington, DC 20005 dhandzo@jenner.com tperrelli@jenner.com mdesanctis@jenner.com jfreedman@jenner.com</p> <p><i>Counsel for SoundExchange</i></p>	<p>Bruce G. Joseph Karyn K. Ablin WILEY REIN LLP 1776 K Street, NW Washington, DC 20006 bjoseph@wileyrein.com kablin@wileyrein.com</p> <p><i>Counsel for Sirius Satellite Radio, Inc.</i></p>
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Leslie Burdette

Before the
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WITNESS REBUTTAL TESTIMONY AND EXHIBITS
JOINTLY SUBMITTED BY SIRIUS SATELLITE RADIO
INC. AND XM SATELLITE RADIO INC.

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Counsel for XM Satellite Radio Inc

Counsel for Sirius Satellite Radio Inc

use of musical works over satellite television; the recently negotiated rate between BMI and Music Choice, for use of musical works over cable television; and the rate stemming from the methodology used to set the original rate between the Recording Industry Association of America and Music Choice, for the use of sound recording performance rights over cable and satellite television. As I explained both in my written and oral testimony, all three of these benchmarks represent rates for similarly situated listeners, services, and rights, and all three emanate from a willing buyer-willing seller negotiation – the statutory standard that I understand governs this proceeding. Consideration of these benchmarks results in a range of reasonable royalty rates from 5.30 to 5.83 percent of revenues.³

3. I also concluded that the nominal revenues associated with the Sirius-DISH and XM-DirecTV contracts, to which a reasonable royalty rate may apply, are likely to be too low, because they conflate the value of these services to ultimate listeners and the promotional value to the Services in attracting subscribers to satellite radio – the Services’ core line of business. I have proposed using Music Choice’s per subscriber per month revenue from cable operators to estimate the revenue the Services would have otherwise received from Multichannel Video Programming Distributors (“MVPDs”), like DISH and DirecTV. Based on publicly available information at the time of my initial report, I estimated that Music Choice earned about 2.33¢ per subscriber per month in 2006.⁴ Assuming that Sirius and XM’s

³ Since my initial report, I have learned that MTV Networks, another service in this proceeding, expects to pay a musical works rate between 5 and 5.5 percent of revenues received for URGE, its digital audio service. This information is consistent with the range of rates that I have proposed. (See “Testimony of Michael Bloom, Vice President and General Manager of Digital Music of MTV Networks,” October 31, 2006, Docket No. 2005-5 CRB DTNSRA, p. 4.)

⁴ Chipty WDT, p. 28.

standalone revenues for their services would have been similar and that the reasonable royalty rate is 5.3 percent, I determined that the Services should pay rights fees of 0.1235¢ per subscriber per month.⁵

4. By contrast, Dr. Pelcovits proposes a rate of 25¢ per subscriber per month⁶ based on his analysis in the most recent webcasting proceeding, CRB 2005-1 (“Webcasting”).⁷ In this report, I evaluate the reasonableness of applying that analysis in the current proceeding. I conclude that there are at least three reasons that Dr. Pelcovits’ associated rate recommendation is seriously flawed. First, Dr. Pelcovits’ proposed rate fails to pass the most basic requirement that a willing buyer would *actually* pay the price. Second, there are significant differences between the benchmark and target rates – differences for which Dr. Pelcovits has not adjusted. Third, even putting these differences aside, Dr. Pelcovits’ analysis from 2005-1 is outdated and unreliable for ratemaking in this proceeding. As I explain below, the marketplace for internet radio services is not yet mature, and as such, the prices and available service offerings have changed significantly since the Webcasting proceeding.

5. Moreover, for the purpose of illustration of these latter two points, I have revised the analyses underlying Dr. Pelcovits’ rate recommendation in two different ways. First, I attempt to extend Dr. Pelcovits’ model to account for differences in interactivity between the services in this proceeding and the so-called “non-

⁵ Chipty WDT, p. 28.

⁶ Pelcovits WDT, p. 11.

⁷ “Testimony of Michael Pelcovits,” October 31, 2005, Docket No. 2005-1 CRB DTRA (hereafter “Pelcovits 2005-1”).

interactive services” he used in his analysis in Webcasting. Second, I use more recent data on (1) prices for interactive and non-interactive internet radio services and (2) the number of hours spent listening to digital audio radio services over the internet. However, I note that even these revised calculations may not be reliable, as they are unlikely to fully reflect all of the differences in interactivity between Dr. Pelcovits’ benchmark services and the Services’ offerings via DISH and DirecTV. In addition, the internet radio offerings appear to change frequently, even month to month; consequently, Dr. Pelcovits’ approach (even updated) is not useful for rate-setting purposes. Nonetheless, for the purpose of illustration, I show that incorporation of these changes, within Dr. Pelcovits’ own framework, results in a significant reduction of his implied rate. Based on my review of this analysis, I conclude that Dr. Pelcovits’ proposed rate is several orders of magnitude too high. I also conclude that the extent and nature of changes in the market for internet services over the past 18 months (since Dr. Pelcovits’ initial submission in 2005-1) cast doubt on the feasibility of using Webcasting as a benchmark for the services in this proceeding.

6. In addition, I have updated my original calculations using more recent information on Music Choice’s revenues. As I have explained, Music Choice is a privately held company and as such, I relied upon 2005 revenue estimates provided by Hoovers, a subsidiary of Dun and Bradstreet. In his deposition testimony, Dr. Pelcovits explains that he has learned that Music Choice’s cable revenues are closer to [[]] per subscriber per month,⁸ rather than the 2.33¢ implied by Hoovers. Using this information, based on a royalty rate of 5.3 percent, I estimate a reasonable royalty

⁸ Pelcovits Deposition, p. 144.

rate of [[]] per subscriber per month, instead of the 0.1235¢ I proposed in my direct testimony.

7. The remainder of this report is organized as follows. Section II explains that Dr. Pelcovits' rate recommendation would never be accepted in a willing buyer-willing seller negotiation. Section III describes the significant differences between the marketplace underlying Dr. Pelcovits' benchmark and the marketplace of interest in this proceeding. Section IV provides an update on information relied upon by Dr. Pelcovits in the previous 2005-1 proceeding, which serves as a basis for Dr. Pelcovits' analyses in this proceeding. For the purpose of illustration only, Section V updates Dr. Pelcovits' rate calculation using an expanded regression model and updated data. Section VI presents my revised rate calculation, based upon new information on Music Choice revenues, and Section VII concludes.

II. Dr. Pelcovits' Rate Recommendation Fails to Satisfy the Willing Buyer-Willing Seller Standard

8. At its very simplest, a rate that satisfies the willing buyer-willing seller standard, which I understand is the statutory standard that governs this proceeding, is one which would be accepted by both the buyer and seller of the right at issue. In other words, the terms of trade must be such that it would be individually rational for each of the transacting parties to accept those terms. As a matter of economics, a buyer would *never* accept a rate that would result in payments to an input provider that exceeded total revenues from the enterprise.

9. Here, Dr. Pelcovits has proposed a rate of 25¢ per subscriber per month. Based on data from Hoover's, I estimated that a Music Choice-like service (such as Sirius on DISH or XM on DirecTV) is able to generate about 2.33¢ per subscriber per

month. Based on Dr. Pelcovits' own testimony, a Music Choice-like service is able to generate about [[]] per subscriber per month. It is hard to imagine any circumstance under which a willing buyer would be agree to pay a price for an input that is anywhere from [[]] to 970 percent *higher* than the buyer's revenues. Even if the buyer had the ability to pass costs on to ultimate consumers, it is highly unlikely that any service in this proceeding could more than triple its price in response to this royalty.⁹ Indeed, a willing buyer would never agree to pay an individual input provider even close to 100 percent of revenues, let alone a rate as high as Dr. Pelcovits' proposed rate. Such an outcome would not be individually rational, nor would it be sustainable in the marketplace. Thus, Dr. Pelcovits' rate fails on its face to satisfy the willing buyer-willing seller standard.

III. Dr. Pelcovits' Analysis Fails to Adjust for Relevant Differences Between His Webcasting Benchmark and the Services in this Proceeding

10. In principle, it is possible to use Dr. Pelcovits' Webcasters' benchmark rate as a starting point to derive an appropriate rate for the services at issue in this proceeding. However, a benchmark is useful only if available data permit reasonable and reliable adjustments to be made when they are necessary. There are, in fact, at least two significant differences between webcasting services and the services in this proceeding that require adjustments to the Pelcovits Webcasting benchmark. In the discussion below, I describe these differences as well as the deficiencies in Dr Pelcovits' attempted adjustments.

⁹ In fact, the Services here cannot raise prices, because their carriage contracts are in place through [[]].

a. Significant Difference in Interactivity

11. The services in this proceeding offer the listener absolutely no interactivity. However, many of the services that are defined by Congress to be “non-interactive” webcasting services are, from the point of view of listeners, interactive in a number of important dimensions. For example, services like WebTunes Gold, WebTunes Platinum, Musicmatch Radio Gold – all of which are classified as non-interactive services and are included as such in Dr. Pelcovits’ analysis of the value of interactivity – allow listeners to customize their playlists. Musicmatch Radio Gold also allows the listener to pause or skip tracks,¹⁰ and the two WebTunes services also permit some free song downloads.¹¹ Dr. Pelcovits acknowledges that the so-called non-interactive services that form the basis of his “interactivity adjustment” in the 2005-1 proceeding offer certain types of listener interactivity, namely “the ability to alter the stream on the channel, either by selecting songs, stopping the stream and restarting it at the same point, or otherwise influencing what is played, songs by a particular artist or album.”¹² However, Dr. Pelcovits does not adjust his benchmark for these differences, and he himself admits that his time-spent-listening adjustment “probably” does not make the necessary adjustment.¹³

¹⁰ “Guide to Internet Music Services,” <http://www.giantpath.com/TMIU/musicmatch.html>.

¹¹ http://ra-hbbls.zip2.com/bellsouth/s/s.dll?spage=cg/yis/enh/web.htm&is=ins&_lid=1631&_lnm=YIS+WebTunes&ck=.

¹² Pelcovits Deposition, p. 102.

¹³ Pelcovits Trial Testimony, p. 71. Later in this report, I provide a measure of an updated, but still inadequate, adjustment.

b. Lack of Comparability of Sellers

12. A second significant difference between Dr. Pelcovits' benchmark and the target rate in this proceeding stems from the asymmetric interests of the record labels themselves. All else equal, the negotiated price emanating from a willing buyer-willing seller negotiation will be higher the greater the risk (or opportunity cost) the transaction creates with respect to the seller's other lines of business. Conversely, the negotiated price will be lower the greater is the benefit conferred by the transaction on the seller's other lines of business. In this context, the issue is whether and how the benchmark and target transactions affect the record labels' ability to sell CDs.

13. Dr. Pelcovits has testified that, in his opinion, internet radio impairs the record labels' ability to sell CDs. According to his Written Direct Testimony in the 2005-1 proceeding:

- "Radio and recorded music compete for the listener's time, and the less time spent listening to CDs, the fewer CDs will be sold." (p. 48)
- "[E]ven if one were to assume that over-the-air radio overall increased record sales, it is an enormous unsupported leap to claim that webcasting is also promotional." (p. 49)
- "[T]he different experience of webcasting suggests that there are strong reasons to believe that non-interactive webcasting supplants rather than enhances CD purchases." (p. 49)

14. By contrast, the services in this proceeding – like Music Choice on cable television – are likely to promote, rather than displace, CD sales. According to the public testimony of Mr. Damon Williams, Vice President of Programming and Production for Music Choice, there is substantial evidence to suggest that public

performances of sound recording by MVPDs, like DISH and DirecTV, are likely to be promotional.¹⁴ Mr. Williams explained:

- “This promotional effect is acknowledged by the record labels and artists in number of ways. Record labels and artists frequently give us testimonials both orally and in writing.” (p. 3)
- “The record labels also send us commemorative plaques. The plaques are given to various key music programmers and stations around the country by record labels as a ‘thank you’ for helping them achieve milestone record sales and airplay.” (p. 4)
- “The record labels and artists management also send us free promotional copies of every new recording that is released, and actively lobby us to include their records on our service.” (p. 6)
- “We also include on some screen displays a notice that the record being played can be purchased through our website, www.musicchoice.com. Over the past 8 years over 380,000 CDs have been sold through our service for sales totaling over \$4,875,000.” (p. 7)
- “Music Choice has conducted numerous studies showing that our customers frequently look at the artist and album names while listening to the service. One such survey, conducted by Arbitron in 2004, showed that 85% of our customers look at the screen to read the name of the artist while a song is playing, and 84% look to read the name of the song.” (p. 8)
- “A recent study has also specifically confirmed that the Music Choice residential music service sells records for the labels. In that study, conducted for us by Arbitron in 2005, almost 40% of customers surveyed said that they had bought a record specifically because they heard it on Music Choice. ... That study also found that 91% of our customers look at the screen to read the name of the artist performing, and 86% look to see the name of the song.” (p. 8)
- “Notably, the record labels find these promotions so valuable that they grant us, at no charge, the right to play the entire album during the promotion, which we would not normally be allowed to do.” (p. 11)

15. Similar public testimony was offered by Mr. David J. Del Beccaro, CEO of Music Choice, regarding the effect of distributing music on satellite and cable

¹⁴ Public Version of “Testimony of Mr. Damon Williams,” October 26, 2006, Docket No. 2006-1 CRB DSTRA.

television on CD sales.¹⁵ Like Mr. Williams, Mr. Del Beccaro explained that beneficial promotional effect the Music Choice service has on CD sales is proven by the conduct of the record labels:

- The record labels "... provide Music Choice with free copies of every new recording and actively seek to have those recordings played on Music Choice." (p. 16)
- "In additional [sic] to specific written and oral testimonials the labels and artists routinely give us, they also send us plaques noting our role in achieving high sales benchmarks. Of course, the very fact that the labels send us all of their new CDs and lobby to have us put the recordings on our service, speaks volumes about their view of our role in promoting sales." (p. 22)

16. Taken together, both effects – the potential displacement risk associated with internet radio (as described by Dr. Pelcovits) and the promotional value associated with cable and satellite television – imply that webcasters should pay more for the use of sound recording performance rights than should the services at issue in this proceeding for use of these rights over satellite television. Yet, Dr. Pelcovits has offered no adjustment to address this significant difference between his benchmark and the proper rate to be applied in this proceeding.

IV. Dr. Pelcovits' Webcasting Benchmark Is Based on Outdated Information from a Marketplace that is Not Yet Mature.

17. Dr. Pelcovits' rate proposal in this proceeding is based on information that was collected in 2005 for the Webcasting case, some of which relates to the webcasting marketplace in existence in 2004. In particular, he calculates the 0.25¢ per subscriber per month rate for the services in this proceeding as: $\$1.37 \times 0.18$, where $\$1.37$ is his recommended rate for statutory webcasting, calculated as $\$8.29 \times$

¹⁵ Public Version of "Testimony of Mr. David J. Del Beccaro," October 26, 2006, Docket No. 2006-1 CRB DSTR.

0.55 x 0.36 x 0.84. The \$8.29 is the average monthly subscription price of an interactive digital audio transmission service.¹⁶ The 0.55 factor is Dr. Pelcovits' interactivity adjustment, which purports to represent the portion that listeners would be willing to pay for digital audio services absent all interactivity features.¹⁷ The 0.36 factor reflects the 36 percent royalty paid by the interactive digital audio transmission services upon which Dr. Pelcovits' 2005-1 analysis is based.¹⁸ The 0.84 factor purports to adjust for the asymmetric displacement risk interactive digital audio transmission service pose, relative to the pay non-interactive services.¹⁹ The 0.18 factor adjusts for relative time spent listening to the benchmark and target services – using estimates of 8 hours of listening per month to satellite television, based on a survey by Zoomerang, and 45 hours of listening per month to music on the internet.²⁰

18. Many of the components of this calculation do not accurately reflect the internet marketplace today. In particular, Dr. Pelcovits' analysis begins with the average monthly subscription price of \$8.29 associated with the seven interactive services upon whose contracts his royalty rate benchmark is based.²¹ Notably, more than half – four of the seven – services are no longer available.²² Not only does this

¹⁶ Pelcovits 2005-1, p. 36.

¹⁷ Pelcovits 2005-1, p. 40.

¹⁸ Pelcovits 2005-1, p. 38.

¹⁹ Pelcovits 2005-1, p. 54.

²⁰ Pelcovits WDT, p. 11. I understand that these data on satellite television listening were collected by counsel for SoundExchange sometime in 2006.

²¹ Pelcovits 2005-1, p. 36, and Appendix A, Table 2.

²² These four are Musicmatch, MusicNow, MusicNet, and Virgin Digital. Musicmatch subscriptions will be discontinued on August 31, 2007, and subscribers will be migrated to Yahoo! Music. (See "Musicmatch Migration Frequently Asked Questions," <http://help.yahoo.com/1/us/yahoo/music/jukebox/update/update02.html>.) MusicNow subscribers were migrated to Napster, when AOL named Napster its exclusive provider of subscription music in 2007. (See "Napster to replace AOL Music Now as AOL's online music service," *Telecomworldwire*, January 12, 2007.) MusicNet was renamed MediaNet Digital and is now a business-to-

fact cast serious doubt on Dr. Pelcovits' use of \$8.29 as a basis for his rate recommendation, but it also casts doubt on the sustainability of the rates reflected in the underlying benchmark contracts.

19. In addition, a significant number of the services upon which Dr. Pelcovits' adjustment for interactivity is based either are no longer available in the marketplace or have changed their offerings significantly.²³ Forty percent (12 out of 30) of the services on which Dr. Pelcovits' regression analysis was based are no longer available today, and 13 of the remaining 18 have changed their subscription prices, their offerings, or both. (*See* Exhibit 1.) Furthermore, two of the four companies upon which his descriptive analysis of the value of interactivity is based are no longer in existence, and each of the remaining services has changed its offerings. (*See* Exhibit 2.)

20. Finally, Dr. Pelcovits' time-spent-listening adjustment (reflected in the 0.18 factor above) is calculated as the ratio of 8 hours to 45 hours of listening to audio music on satellite television and internet radio, respectively.²⁴ Dr. Pelcovits' estimate for internet radio listening is taken from his testimony given in October 2005. In his deposition, Dr. Pelcovits agreed that he based his estimate of 45 hours per month on "a single public statement by Live365" and defended his estimate, saying that it "was,

business service. (*See* "Leading Digital Music Service Provider Changes Name to MediaNet Digital – Name Change Reflects Business Expansion and New Offerings in Music Videos, Television, and Film," *PR Newswire*, July 12, 2007.) Virgin Digital completely shut down its domestic business and gave Napster the exclusive right to market directly to its existing subscribers. (*See* "Virgin veering out of U.S., *Variety Daily*, January 5, 2007, p. 42.)

²³ The services upon which he based his analysis are shown in Pelcovits Deposition Exhibit 6.

²⁴ Pelcovits WDT, p. 11.

if anything, on the high side.”²⁵ According to the 2007 Bridge Ratings report,²⁶ however, the average time spent listening to internet radio today is approximately 57 hours per month, and the high end of time spent listening is closer to 66 hours per month, suggesting that Dr. Pelcovits’ adjustment factor is at least 46 percent too high.

21. Dr. Pelcovits testified that the information he used to calculate his interactivity and time-spent-listening adjustments, upon which his analysis is based, was collected prior to his October 2005 testimony. His failure to update this information is particularly troublesome because the marketplace upon which his analysis is built is relatively new and, as such, still evolving rapidly. Dr. Pelcovits’ failure to take these changes into account renders his rate recommendation utterly uninformative. Furthermore, the nature and extent of these changes also casts doubt on the reasonableness of using the webcasting marketplace as a benchmark for the services at issue in this proceeding.

V. Revised Calculations Performed to Demonstrate the Instability of Dr. Pelcovits’ Rate Proposal

22. For the purpose of illustration only, I have revised the calculations presented by Dr. Pelcovits to reflect an extension of his interactivity analysis to adjust for additional differences between the non-interactive digital audio transmission services and the services in this proceeding. Dr. Pelcovits’ original interactivity adjustment attempts to adjust for differences between the fully interactive services and what I would describe as partially interactive services. In order to adjust more fully for the relative difference in interactivity between Dr. Pelcovits’ benchmark

²⁵ Pelcovits Deposition, pp. 132-3.

²⁶ Bridge Ratings Industry Update – Internet Radio Perceptions, April 18, 2007.

contracts and the services in this proceeding, I introduce a third category of webcasting services – free services that are, in principle, less interactive than the partially interactive services on which Dr. Pelcovits’ analysis is based. I have employed Dr. Pelcovits’ underlying regression framework to implement this analysis.

23. However, I note at the onset that, while I believe these calculations improve upon Dr. Pelcovits’ analysis, I believe they still fail to adjust for all of the substantive differences between webcasting and the services at issue in this proceeding. In particular, because some of the free webcasting services themselves offer certain interactive features, the revised calculations do not fully reflect the complete lack of interactivity associated with the services in this proceeding. In addition, the revised calculations fail to account for the asymmetric promotion versus substitution effect on CD sales – that I discussed earlier. As such, these calculations fall short of satisfying the criteria of a reasonable benchmark. Accordingly, they are not intended to provide an estimate of a reasonable royalty rate to be levied on the services at issue in this proceeding. Rather, they are intended to explain some of the shortcomings of Dr. Pelcovits’ analysis.

a. Specific Comments on Dr. Pelcovits’ Regression Analysis.

24. Dr. Pelcovits estimates the parameters of a hedonic demand model, using the regression technique of Ordinary Least Squares, to isolate the value of interactivity to consumers of online music services.²⁷ His basic model relates (the natural log of) price to a number of hedonic factors that affect price, including: the number of radio stations offered and a set of indicator variables (for whether the

²⁷ Pelcovits 2005-1, pp. 38-9.

service is interactive, for portability, and for sound quality). His dataset included only services that were available for purchase – that is, he excluded, without offering an explanation, services that were available for free, even though many such webcasting services exist.

25. There are a number of flaws with Dr. Pelcovits' use of his regression model. To begin with, he completely ignores the literature on hedonic regressions, which has long recognized that a demand function for product characteristics (such as the one specified by Dr. Pelcovits) *cannot*, in general, be estimated using Ordinary Least Squares.²⁸ Failure to account for this substantive methodological issue gives rise to the “identification” problem, which is well-known in econometrics to prohibit proper interpretation of the underlying parameters of interest.²⁹ Dr. Pelcovits also ignores the fact that his model generates results that are difficult to reconcile, as a matter of economic theory and common sense. For example, he finds no statistically-significant effect of the number of channels offered on price. However, this result is likely driven by the small sample size – only 30 observations – of Dr. Pelcovits' analysis dataset, rather than the lack of a relationship.

26. Putting aside these substantive econometric issues, Dr. Pelcovits focuses on the coefficient on his “interactivity” indicator variable. He translates his coefficient of 0.60 into an associated interactivity adjustment of 0.63. However, I

²⁸ See Dennis Epple, “Hedonic Prices and Implicit Markets: Estimating Demand and Supply Functions for Differentiated Products,” *Journal of Political Economy*, 1987, Vol 95, No. 1, pp. 59-80, at pp. 66-8. For a detailed discussion of hedonic regression models, see Ivar Ekeland, James Heckman, and Lars Nesheim, “Identification and Estimation of Hedonic Models,” *Journal of Political Economy*, 2004, Vol. 112, No. 1, pp. S60-S109.

²⁹ The identification problem refers to situations in which more than one theory is consistent with the same data, and as such, the theories are observationally equivalent. In these circumstances, the underlying structure (e.g. the demand for product characteristics) is said to be unidentified. See William H. Greene, *Econometric Analysis*, 2nd Edition, New York: Macmillan Publishing, 1993, pp.585-98, at 585.

note as an aside that there is a mathematical error in Dr. Pelcovits' translation. The correctly-translated interactivity adjustment associated with his estimated coefficient is only 0.55, not 0.63.³⁰

b. Expanded Analysis Highlights Fragility of Dr. Pelcovits' Benchmark and Associated Rate Recommendation

27. As I explained earlier, many of the services that are defined by Congress to be "non-interactive" webcasting services are actually interactive in a number of important dimensions from the point of view of listeners. As such, Dr. Pelcovits' benchmark does not adequately adjust for the complete lack of interactivity associated with Sirius on DISH or XM on DirecTV, the services at issue in this proceeding. For the purpose of illustration only, I have expanded Dr. Pelcovits' regression analysis in order to better reflect the relative differences in interactivity between the on-demand services that underlie Dr. Pelcovits' benchmark and the services in this proceeding.

28. In this context, it is noteworthy that Dr. Pelcovits' interactivity adjustment completely ignores the many free webcasting services that are less interactive than the ones upon which he basis his interactivity adjustment. To the extent that these free services are less interactive than the other services considered by Dr. Pelcovits, they provide a useful adjustment of the interactive digital audio transmission services benchmark that underlies Dr. Pelcovits' recommended rate in Webcasting. Thus, I expand Dr. Pelcovits' regression model (as described in Table 6.1 of his report) to

³⁰ Dr. Pelcovits calculates his interactivity adjustment as the ratio of \$1.00 to \$1.60. (See Pelcovits 2005-1, footnote 17.) However, the model from which the 0.60 coefficient is estimated is a logarithmic model, which yields the interpretation that the $\log(\text{interactive price}) = \log(\text{non-interactive price}) + 0.6$. Thus, the ratio of prices is given by the exponent of 0.60, and thus the interactivity adjustment is the reciprocal of that ratio.

include the free webcasting services. These additional observations are taken directly from Dr. Pelcovits' original dataset, which he provided in his backup material but failed to include in his analysis.³¹ To handle the zero prices associated with these additional services, I switch from a logarithmic model to a model based on price levels. I also expand the specification to include commercials, an indicator variable provided by Dr. Pelcovits that equals "1" if the service has commercials.³²

29. Exhibit 3 presents a summary of my regression results, which reflect both the updated data and the expanded specification. For comparison, the first column of the table shows the corresponding results from Dr. Pelcovits' analysis. The variable "Interactivity" is defined to be "1" if the service is fully interactive and "0" otherwise. The new variable "Interactivity 2" is defined to be "1" if the service is partially interactive (i.e., a pay "non-interactive" service) and "0" otherwise. Both variables measure the incremental value of interactivity, relative to free webcasting services. The new model has a better statistical fit (as measured by the higher value of adjusted R-squared), and it produces generally sensible results – that the greater the interactivity of the service, the higher the retail price, as reflected in the relative magnitudes of the coefficients on the two interactivity indicator variables. Furthermore, the results show that, on average, about \$9.30 of an on-demand service's price reflects the value of interactivity. (See Column [7] of Exhibit 3.)

30. Exhibit 4 presents the implied interactivity adjustment and my illustrative revised rate calculations. As before, the first column presents Dr. Pelcovits' calculation of the \$0.25 per subscriber per month that he proposes be levied on the

³¹ Pelcovits Deposition Exhibit 7, SXCRB0004711-4.

³² Pelcovits Deposition Exhibit 7, SXCRB0004711-4.

services at issue in this proceeding. Column 2 presents the results I obtain by simply updating the underlying data to reflect information as of the writing of this report. This adjustment reduces Dr. Pelcovits' rate recommendation by over 10 percent, to \$0.22 per subscriber per month. Columns 3 and 4 are derived from a levels model, not a logarithmic model.³³ Column 4 adjusts for both the underlying data and the relative interactivity between the "non-interactive" services which serve as Dr. Pelcovits' starting point and the services in this proceeding. These adjustments reduce Dr. Pelcovits' interactivity adjustment from 0.55 to 0.05, which in turn reduces his rate recommendation to \$0.017 per subscriber per month.

31. To be clear, these calculations do *not* yield a reasonable royalty to be levied on the services at issue in this proceeding. Not only do data limitations render adjusting for all of the significant differences between the benchmark and target transactions impossible, but, in my opinion, the webcasting marketplace is not yet mature and, as such, is too unstable for the purposes of constructing a rate recommendation that will be applied through the year 2010. Rather, these calculations are intended simply to demonstrate the sensitivity and fragility of Dr. Pelcovits' rate recommendation. Incorporating what I consider sensible changes to his basic approach reduces Dr. Pelcovits' recommended rate by over 90 percent, and even this rate is too high, because it does not reflect an adjustment for the asymmetric displacement (or promotion, in the case of the Services) associated with the webcasters and the services at issue in this proceeding.

³³ The similarity across Columns 2 and 3 suggests that the calculations are not sensitive to the choice of functional form.

c. The Musical Works Rates Remain the Most Reasonable Benchmarks Available for this Proceeding.

32. Based on my review of Dr. Pelcovits' benchmark and the available musical works benchmarks, I continue to believe that the musical works rates described in my initial report are the most reasonable benchmarks available in this proceeding. Dr. Pelcovits' absolute rejection of a musical works benchmark rests on what I view as tenuous reasoning.

33. First, he makes the empirical observation that "[i]n the several markets where the two copyright fees are negotiated freely among the parties, the license fees for the sound recordings are much higher than the license fees charged for the musical work."³⁴ Here, he appears to be referring to fees paid for the two copyright rights by the interactive digital audio transmission services.³⁵ However, as I have explained, there may be good reasons to believe that sound recording performance rights holders have more to lose, relative to owners of musical works, from distribution by the interactive digital audio transmission services.³⁶ As a result, I would expect sound recording performance rights holders to command a higher price in a willing buyer-willing seller transaction that marketplace. It certainly does not follow, however, that the rate for sound recording performance rights should always be higher than the corresponding rate for musical works, in every channel of distribution. Second, Dr.

³⁴ Pelcovits 2005-1, pp. 17-8.

³⁵ Pelcovits 2005-1, p. 18.

³⁶ According to Dr. Pelcovits' own testimony, webcasting services (particularly the interactive webcasting services) pose the risk of CD displacement. (See Pelcovits 2005-1, pp. 48-9.) Further, the opportunity cost associated with this risk is greater to the record labels, relative to the owners of the musical works, as it former who earn substantially more of the proceeds from CD sales.

Pelcovits offers a theoretical justification based on the unsupported premise that “popular recording artists are ‘scarcer’ than musical composers.”³⁷

34. There is no basis in economics or real-world facts to take the extreme position that there should never be parity in the rates for the two rights holders under any circumstances simply because there are isolated situations in which the two command different rates. In fact, it is quite plausible that sound recording performance rights holders should be paid more by the interactive digital audio transmissions services and that they should be paid the *same* as musical works owners by services for distribution on cable or satellite television. In making that determination, one needs to consider whether the sellers of the two rights are similarly situated in terms of the incremental costs (including opportunity costs) associated with the transaction.

35. In my opinion, the sellers of the two copyright rights are likely to be more, rather than less, similarly situated in the context of a willing-buyer willing seller transaction involving the services in this proceeding. This fact, coupled with the practical difficulty of properly adjusting a webcasting benchmark, supports the applicability of the musical works benchmarks that I have proposed.

VI. Alternative Calculations with New Information On Music Choice Revenues.

36. In my earlier testimony, I used publicly available data from Hoovers to estimate Music Choice’s 2006 cable revenues. In his deposition testimony, Dr. Pelcovits explained that he has learned that Music Choice’s cable revenues are closer

³⁷ Pelcovits 2005-1, p. 18.

to [[]] per subscriber per month.³⁸ Using this information, I estimate a reasonable royalty rate of [[]], instead of my prior estimate of 0.1235¢, based on royalty rate of 5.3 percent.

37. Since I gave my testimony, I have become aware of another other source of relevant revenue information, which I have evaluated. This information is available from MTV Networks (“MTVN”), another party in this proceeding. MTVN has a new digital audio service, called URGE, which, like XM and Sirius’s services, is made available for carriage by MVPDs.³⁹ Based on MTV’s document production in this proceeding, it appears that MTV currently has carriage agreements with eight different MVPDs, including Verizon and AT&T. MTV currently receives about [[]] per subscriber per month across its paying customers.⁴⁰ On their face, these data are compatible with the information provided by Dr. Pelcovits. MTVN documents indicate that it also expects to receive about [[]] per subscriber per month over the years 2006 to 2010, which spans the term of the license in this proceeding.⁴¹

38. However, there are two important caveats associated with the MTVN information, which render reliance on this information speculative. First, the MTV forecasts include projected subscribers for its carriage partners. It is unclear to me, based on the available information, whether MTVN has access to the actual forecasts of those companies or whether it is making its best guess about their future

³⁸ Pelcovits Deposition, p. 144.

³⁹ 2005-5 CRB MTVN 000001-4.

⁴⁰ 2005-5 CRB MTVN 000248-9.

⁴¹ 2005-5 CRB MTVN 000248-9.

subscribers. Second, the MTVN carriage contracts for all but one small MVPD (which by itself not provide sufficient information upon which to base a rate proposal) involve the entire bundle of MTV or Viacom program services – including the popular MTVN video programming services and popular channels such as BET and Nickelodeon.⁴² The average revenues of [[]] and [[]] associated with MTVN’s digital audio service reflect, in part, an “internal allocation” of the value of this service by MTVN.⁴³ Absent any information or understanding of this allocation, there is no way for me to independently evaluate the reasonableness of this information for the purposes of estimating attributed revenues for the services at issue in this proceeding, and I do not rely on these data in my analysis.

VII. Conclusions

39. Based on my analysis, including a careful review of Dr. Pelcovits’ rate recommendation, I continue to believe that the benchmarks I have used to arrive at a range of reasonable royalty rates (5.30 percent to 5.83 percent) are still the best available benchmarks. Based on new information on Music Choice revenues, I have updated my attributed revenue estimates for the services – from 2.33¢ per subscriber per month to [[]] per subscriber per month. I now estimate that the Services should pay royalties of [[]] per subscriber per month, based on a reasonable rate of 5.3 percent.⁴⁴ Finally, my review of Dr. Pelcovits’ analysis reveals a number of substantive problems with his benchmark analysis and, therefore, with his associated rate recommendation. My analysis shows that Dr. Pelcovits’ recommended rate

⁴² 2005-5 CRB MTVN 000064-93.

⁴³ 2005-5 CRB MTVN 000063.

⁴⁴ This royalty is calculated as $\text{[[]]} \times 5.3 \text{ percent}$.

would amount to a tax of over 200 percent of revenue, which is so overstated as to be completely uninformative.

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

In the Matter of

**DIGITAL PERFORMANCE RIGHT IN
SOUND RECORDINGS AND
EPHEMERAL RECORDINGS FOR A
NEW SUBSCRIPTION SERVICE**

Docket No. 2005-5 CRB DTNSRA

DECLARATION OF TASNEEM CHIPTY

I, Tasneem Chipty, declare under penalty of perjury that the statements contained in my Rebuttal Testimony in the above-captioned matter are true and correct to the best of my knowledge, information and belief. Executed this 24rd day of July 2007.



Tasneem Chipty

Exhibit 1
Changes in Webcasting Services that Form the Basis for Dr. Pelcovits' Interactivity Adjustment

Row	Music Service	Any Change	Discontinued	Price Changes		Changes in Other Offerings
				Original Prices (Monthly, Avg. Annual*)	Current Prices (Monthly, Avg. Annual*)	
(1)	LAUNCHcast Plus	x				Increased number of stations from 125 to over 150
(2)	Y! Music Unlimited	x		\$6.99, \$4.99	\$8.99, \$5.99	Increased number of stations from 125 to over 150
(3)	Y! Music Portable	x		\$11.99, \$9.99	\$14.99, \$11.99	Increased number of stations from 125 to over 150
(4)	Musicmatch Radio Gold	x	x			
(5)	Musicmatch On Demand	x	x			
(6)	Live365 VIP	x		\$5.95, \$3.95	\$4.95, \$3.95	
(7)	MSN Radio Plus	x				
(8)	Rhapsody Radio	x	x			
(9)	Rhapsody Unlimited	x		\$9.99, \$8.33	\$12.99, \$10.83	
(10)	Rhapsody To Go					
(11)	RadioPass	x		\$4.17, \$4.17	No longer available, \$5.00	
(12)	Napster Membership					
(13)	Napster Membership To Go					
(14)	MusicNow	x	x			
(15)	MusicNet	x	x			
(16)	Radio Free Virgin Royal	x	x			
(17)	Virgin Digital	x	x			
(18)	Soundpass Membership	x	x			
(19)	DI Gold	x	x			
(20)	DI Platinum	x		\$13.95, \$11.95	\$4.95, \$4.95	Increased number of stations from 21 to 39
(21)	BS Webtunes Gold	x				Increased number of stations from 150 to over 400
(22)	BS Webtunes Platinum	x				Increased number of stations from 300 to over 400
(23)	XMI Radio Online	x				Increased number of stations from 77 to 85
(24)	GoRadio.com Membership	x		\$2.25, \$2.25	\$4.95, \$2.25	Now offers on demand songs
(25)	3WK Member Streams					
(26)	Ultimate-80s.com Premium Stream	x	x			
(27)	CrossWalk Plus	x		\$5.95, \$4.16	\$5.95, \$5.95	
(28)	Wolf FM Membership	x	x			
(29)	HowlinOldies.com Membership	x	x			
(30)	Super70s.us Various Stations	x		\$3.99, \$3.25	Free	Increased number of stations from 3 to 8; Added commercials
Total Number of Changes		25	12		9	9

* Average annual price refers to the average monthly price based on an annual contract.

Notes:

- (3) Y! Music with the portable feature is Y! Music Unlimited To Go.
- (4) Musicmatch Radio Gold becomes part of Yahoo! on August 31, 2007; Musicmatch Radio Gold customers can switch to LAUNCHcast.
- (5) Musicmatch On Demand becomes part of Yahoo! on August 31, 2007; Musicmatch On Demand customers can switch to Y! Music Unlimited.
- (14) In 2007, AOL named Napster its exclusive provider of subscription music, migrating MusicNow subscribers to Napster and charging the same fee unless they opted out.
- (15) MusicNet was renamed MediaNet Digital and is now a business-to-business service.
- (18) Signup of Soundpass Membership is no longer available on Radio IO's web site.
- (20) A single offering, "Digitally Imported Premium" is now available instead of the two previous offerings, DI Gold and DI Platinum. The new offering appears to resemble DI Platinum.
- (30) Super70s.us is now part of My Free Net Radio.

Sources: Pelcovits Deposition Exhibits 6-8; and various internet websites.

Exhibit 2

Dr. Pelcovits' Table 6.2 Updated to Reflect Current Information
Comparison of the Subscription Price of Internet Radio vs. On-Demand Service

Row	Music Service	Pelcovits Report					
		Monthly			Current		
		Subscription Price	Avg. Annual Subscription Price*	Monthly Subscription Price	Subscription Price	Subscription Price	Avg. Annual Subscription Price*
(1)	Yahoo!'s LaunchCast Plus	\$3.99	\$2.99	\$3.99	\$2.99	\$2.99	
(2)	Y! Music Unlimited	\$6.99	\$4.99	\$8.99	\$5.99	\$5.99	
(3)	Ratio of (1) to (2)	0.57	0.60	0.44	0.50	0.50	
(1)	MusicMatch Gold	\$4.95	\$2.95	Replaced by Yahoo! LaunchCast	NA	NA	
(2)	MusicMatch On Demand	\$6.99	\$4.99	Replaced by Yahoo! Music Unlimited	NA	NA	
(3)	Ratio of (1) to (2)	0.71	0.59	NA	NA	NA	
(1)	Rhapsody Radio	\$4.99	\$3.33	\$4.99	\$3.33	\$3.33	
(2)	Rhapsody Unlimited	\$9.99	\$8.33	\$12.99	\$10.83	\$10.83	
(3)	Ratio of (1) to (2)	0.50	0.40	0.38	0.31	0.31	
(1)	Radio Free Virgin Royal	\$4.95	NA	Discontinued	Discontinued	NA	
(2)	Virgin Digital	\$7.99	NA	NA	NA	NA	
(3)	Ratio of (1) to (2)	0.62	NA	NA	NA	NA	
Average of Ratios		0.60	0.53	0.41	0.40	0.40	

* Average annual price refers to the average monthly price based on an annual contract.

Sources: Pelcovits 2005-1, Table 6.2, and various internet websites.

Exhibit 3

Exhibit 3
Summary of Regression Results
For the Purpose of Illustrating Sensitivity of his Proposal to Underlying Assumptions

Explanatory Variables	Log-Log Regressions		Levels Regressions				
	Updated Data		Pelcovits Data	Updated Data	Expanded Regression Model	Expanded Regression with Updated Data	Expanded Regression with Updated Data, Excluding Obs with Unknown Sound Quality
	Pelcovits	[2]					
Intercept	1.74 (13.06)	2.34 (7.07)	5.52 (11.51)	5.43 (4.05)	1.25 (1.27)	0.36 (0.27)	0.55 (0.40)
Log(No. Radio Stations)	-0.08 (1.17)	-0.22 (1.59)					
Square of Log(No. of Radio Stations)	0.01 (1.02)	0.02 (1.15)					
No. Radio Stations			0.00 (1.25)	0.00 (0.08)	0.00 (0.82)	0.00 (0.23)	0.00 (0.86)
Square of No. of Radio Stations			0.00 (1.27)	0.00 (0.07)	0.00 (0.83)	0.00 (0.12)	0.00 (0.84)
Interactivity (=1 for on demand services)	0.60 (4.50)	0.48 (2.57)	3.74 (4.92)	3.85 (2.16)	8.09 (6.78)	9.05 (5.46)	9.30 (5.48)
Interactivity 2 (=1 for pay noninteractive service)					4.37 (4.49)	5.62 (3.95)	5.89 (4.01)
Download to Portable Device	0.48 (2.57)	0.55 (2.53)	5.09 (4.52)	5.76 (2.60)	3.79 (3.04)	5.23 (4.01)	5.01 (3.73)
Sound Quality	-0.34 (0.88)	(dropped)	-4.00 (1.75)	(dropped)	-1.67 (1.76)	-0.52 (0.42)	-0.54 (0.42)
Commercials					-0.13 (0.14)	0.20 (0.16)	0.08 (0.07)
Adjusted R2	0.71	0.74	0.79	0.59	0.80	0.86	0.86
Number of Observations	30	17	30	18	49	29	28

Notes:

- The dependent variable is the monthly subscription price. Absolute value of T-statistics are shown in parentheses below coefficient estimate.
- The logarithmic models include only webcasting services with non-zero prices. The levels models include both free and pay webcasting services.
- The "interactivity" indicator variable measures the average price difference between the fully interactive and the omitted services. In Dr. Pelcovits' model, the omitted services are the pay so-called noninteractive services that have certain interactive features. In columns [5] and [6] above, the interactive variable measures the average price difference between fully interactive and the less interactive, free webcasting services.
- "Sound Quality" equals to 1 if the sound quality is low or medium, and 0 otherwise. It is dropped in some models with Updated Data as all remaining services have "HIGH" quality. Sound quality is generally insignificant in the above specifications.
- Live365, one of the free webcasting services in Pelcovits Deposition Exhibit 7, is described to have sound quality that "VARIES." The results in column [6] define Live365 to be a high sound quality service. However, absent additional information, it is more appropriate to treat Live365's sound quality as unknown. Accordingly, column [7] drops the service from the regression.

Sources : Pelcovits Deposition, Exhibits 6-8; and various internet websites.

Exhibit 4

Exhibit 4
Revised Pelcovits Rate Calculation
For the Purpose of Illustrating Sensitivity of his Proposal to Underlying Assumptions

	Logrithmic Model		Levels Model	
	Updated Data		Expanded Regression with Updated Data, Excluding Obs with Unknown Sound Quality	
	Pelcovits [1]	Updated Data [2]	Updated Data [3]	[4]
Components of Rate Calculation				
Average Monthly Subscription Price	\$8.29	\$9.78	\$9.78	\$9.78
Interactivity Adjustment (Fully Interactive to Pay Noninteractive)	0.55	0.62	0.61	
Interactivity Adjustment (Fully Interactive to Free Noninteractive)				0.05
Royalty Rate based on Interactive Digital Audio Transmission Service Contracts	0.36	0.36	0.36	0.36
Adjustment for Differential CD Substitution (Fully Interactive to Pay Noninteractive)	0.84	0.84	0.84	0.84
Time-Spent-Listening Adjustment	0.18	0.12	0.12	0.12
Implied Royalty Per Subscriber Per Month	\$0.25	\$0.22	\$0.22	\$0.017

Sources: Pelcovits 2005-1, Appendix A, Table 2; Pelcovits Deposition Exhibits 6-8; 2007 Bridge Ratings Industry Update; various internet websites.