Written Statement of David J. Frear
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Before the

U.S. House of Representatives Committee on the Judiciary
Subcommittee on Courts, Intellectual Property, and the Internet

Hearing on Music Licensing Under Title 17

June 25, 2014

Chairman Goodlatte, Chairman Coble, Ranking Members Conyers and Nadler, and Members of the Subcommittee:

My name is David J. Frear. I am the Executive Vice President and Chief Financial Officer for Sirius XM Holdings Inc. ("Sirius XM"), a position I have held since 2002. On behalf of Sirius XM, I thank you for the opportunity to offer testimony to the Subcommittee.

Sirius XM, with an estimated 40 million listeners, is one of the largest radio providers in the United States. We employ over 2,100 people at our facilities in New York, Washington, DC, Florida, New Jersey, Texas and California. Since our inception, we have operated pursuant to licenses from ASCAP, BMI, and SESAC for the public performance of musical compositions, and we operate under the Section 112 and 114 statutory licenses with respect to the public performance of sound recordings. We have also fully litigated two rate-setting proceedings before the Copyright Royalty Board.

In 2013 alone, we paid approximately $325 million to record companies, publishers, song writers, and recording artists. We have paid well over $1 billion in sound recording performance royalties since we launched in late 2001.

This experience has provided us with great insight into the issues before the Subcommittee, including what works and what does not work within the music licensing market as currently structured. My testimony, builds on that experience – as well as similar comments Sirius XM recently submitted to the Copyright Office as part of its music licensing inquiry – and centers on four key points:

1. **<u>The Need for Platform Parity</u>**: There is no reason that satellite radio and Internet radio should pay sound recording performance royalties while terrestrial radio continues to enjoy an exemption from that obligation.

2. **<u>The Importance of the 801(b) Rate-Setting Standard</u>**: The 801(b) standard provides the Copyright Royalty Judges with both the ability to examine potentially relevant marketplace transactions and the flexibility to balance the interests of both the copyright owners and licensees. The 801(b) standard has proven far superior to the "willing buyer willing seller" standard championed by the rights-owner community. It should be maintained.

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3. **<u>The Continued Necessity of the Consent Decrees Governing ASCAP and BMI</u>**: The antitrust consent decrees are not outdated "relics" that prevent competition or copyright owners achieving fair market value for their works, but a necessary antidote to the extreme concentration that persists in the market and would, absent the decrees, violate the antitrust laws. In short, they help *ensure* that rates are set fairly.

3. **<u>The Significant Problems with the Proposed RESPECT Act for Pre-1972 Sound Recordings</u>**: The proposed act would further exacerbate the irrational disparity between digital services and terrestrial radio (which would remain exempt from paying performance royalties for *any* recordings), create a new payment obligation on a narrow set of licensees, and bestow a one-sided windfall on owners of recordings created 70 or 80 years ago, without advancing in the least the foundational purpose of copyright law: providing an incentive for the creation of new recordings.

As may be evident, a common-theme pervades my comments. In statement after statement, copyright owners suggest that the current regulatory framework – including the statutory licenses, the 801(b) rate-setting standard and the antitrust consent decrees – artificially interferes with the normal working of a free and competitive market. The unmistakable tenor of the conversation is that copyright owners are being unfairly forced to subsidize licensees with below-market rates. But these sorts of comments conveniently overlook the reality on the ground in the music licensing marketplace.

On the publishing side, for example, we confront two collectives (ASCAP and BMI) that each control distinct repertories approaching 50% of the market, and a third (SESAC) that, while smaller, makes outrageous fee demands under threat of statutory infringement claims while refusing to identify the works it is licensing. On the record-label side, we see three major labels that likewise control distinct repertories ranging from 20% to nearly 40% of the market each – and over 85% collectively. These entities control separate catalogs of works that are not substitutes for one another. They do not compete with one another as that term is typically understood. A "free" market in licensing – if by that term one means giving copyright owners free rein to exploit the market power they enjoy by having amassed massive repertories of works – would be neither fair nor competitive, but be plagued by rates approaching monopoly levels.

By contrast, the regulatory framework that has developed over the years, rather than forestalling competition or preventing copyright owners from achieving fair market value, helps to achieve the opposite result: ensuring that rates paid by entities like Sirius XM are at least somewhat insulated from the incredible market concentration that would otherwise push them to monopoly levels.

My comments below provide additional detail on these points.

I. Platform Parity Is Vital

As the Subcommittee no doubt is aware, music services in the U.S. operate under a patchwork of statutes, rules, and regulations that distinguish audio entertainment services based upon the mechanism or medium of delivery. This framework is the product of historical compromises and trade-offs between interested parties that no longer make sense and, as many

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participants noted in the June 10th hearing before the Subcommittee, it is a framework that no one would readily choose again today.

The current framework exempts traditional "terrestrial" radio from the obligation to pay performance royalties to sound recording owners, while requiring other radio services that offer essentially the same service to make such payments. Further, drawing any distinction based on the claim that some services transmit digitally while others do not is nonsensical: terrestrial radio began broadcasting digital signals over a decade ago and has made use of digital copies of sound recordings to further their broadcasts for 30 years. It is antiquated, inequitable, and simply bad public policy to reward the biggest entities in the radio field with a competitive cost advantage while penalizing innovators whose services increase economic activity and create jobs.

To start, similar services – regardless of the mechanism or medium through which they are delivered – should be treated similarly. Copyright law does not distinguish between AM and FM radio based on technology, and should not distinguish between terrestrial and satellite radio, or terrestrial and Internet radio, either. The playing field – that is to say, the requirement that performance royalties be paid, and the standard under which royalty rates are set – should be leveled for all participants in the radio market. In short, "radio is radio," regardless of whether it is AM/FM radio, HD radio, satellite radio, cable radio or Internet radio. *See, e.g.*, *In re Petition of Pandora Media, Inc.*, No. 12 Civ. 8035 (DLC), at 14 (S.D.N.Y. Mar. 18, 2014) (Opinion & Order) (explaining that the "radio experience has remained constant through the years, regardless of whether radio programming is transmitted by broadcasting, through a cable, from a satellite, or over the internet").[1]

Continuing the distinctions between various forms of radio established in 17 U.S.C. § 114 – whereby AM/FM radio is exempted from any sound recording performance right obligation, while satellite, Internet, and other audio services (including simulcasts of those very same AM/FM broadcasts) are not – is bad and unjustified policy. Chiefly, it has the effect of subsidizing the largest entities in the industry – the $15 billion/year AM/FM radio station market – and is exactly the opposite of what the public would expect: accommodations to *new* entrants to encourage growth and entrepreneurship. Such a policy punishes digital pioneers with massive royalty obligations not borne by their established and entrenched competitor. For example, Sirius XM, despite enjoying a subscriber base of nearly 25 million, went 18 years until it achieved profitability in 2010 – and then only after running up cumulative net operating losses of $8 billion, merging the two predecessor companies, and narrowly surviving two brushes with bankruptcy. At the same time, it paid well over $1 billion in royalty payments to the recording industry, while AM/FM radio stations paid precisely *zero*.

[1] We do not mean to suggest by this that all services should pay the exact same fees, but rather that similar services should have their fees set pursuant to the same rate-setting standard and process. As we discuss below, the 801(b) rate-setting standard provides the Copyright Royalty Judges with the necessary and appropriate latitude to account for variations between particular services or service categories in the rate-setting process.

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That sort of inequity hampers innovation and job creation. While Sirius XM survived, and while most AM/FM stations continue to offer some form of simulcast, one need only survey the graveyard of services that have tried and failed to establish viable standalone digital radio businesses (including major companies like Yahoo! and AOL) to see the depth of the problem. Winners and losers in the audio entertainment field should be selected by the market on the basis of innovation and the entertainment and other value they provide to consumers, not historical anomalies or cost-side inequities created by statute.

II. The Importance of the 801(b) Rate-Setting Standard

Copyright owners have stated that 17 U.S.C. § 801(b) provides an artificial subsidy to services and suggested that the "willing buyer-willing seller" (WBWS) standard be applied to all Section 114 licenses, or that the 801(b) standard be altered, for example by removing the "disruption" factor found at 801(b)(1)(D). They are wrong.

To start, it is important to highlight the continuing importance of the statutory licenses for national services using thousands (or tens of thousands) of sound recordings. Negotiating with each and every copyright owner would be extremely difficult and costly for at least two reasons. First, any service would need to be able to identify and then negotiate with the copyright owners of hundreds of thousands (or even millions) of songs. Second, the service would be forced to confront a record industry that has become incredibly concentrated, with three majors (and the smaller independent labels distributed by the majors) accounting for over 85% of the market. This concentration provides those record companies with tremendous negotiating leverage, as each major is a "must have" that many services cannot do without.

For similar reasons, the 801(b) standard should be retained as written. Copyright owners blithely characterize the 801(b) standard as devoid of marketplace considerations. But the 801(b) standard requires the Judges set rates that are "reasonable," and in prior proceedings the Judges have started their rate-setting analyses under that standard by first identifying a "zone of reasonableness" defined by *market* benchmarks, and only then using the 801(b) policy factors to identify a rate *within* the *marketplace* range.[2] Moreover, as the economists who have testified on behalf of the industry have argued repeatedly to the Judges, the 801(b) factors – such as the goals of ensuring a fair return and fair income for the parties, and recognizing their "relative contributions" – are those that parties to a *marketplace* transaction would themselves consider. The 801(b) standard thus allows the Judges to consider *marketplace* benchmarks and considerations as part of their determinations, but also provides the Judges with the latitude and flexibility to consider the enumerated policy factors (for example, in the *Satellite I* proceeding, the disruption that Sirius XM would suffer at the rates proposed by SoundExchange, as well as Sirius XM's need to spend hundreds of millions of dollars in satellite-related expenditures).

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[2] That approach has been blessed by the D.C. Circuit. *See Recording Indus. Ass'n of America, Inc. v. Librarian of Cong.*, 608 F.3d 861, 865 (D.C. Cir. 2010). *See also* 17 U.S.C. § 114(f)(1)(B) (specifying that "the Copyright Royalty Judges may consider the rates and terms for comparable types of subscription digital audio transmission services and comparable circumstances under voluntary license agreements").

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The WBWS standard, by comparison, has proven to be a failure. In the absence of marketplace benchmarks involving non-interactive services, the Judges have been forced to rely on agreements between record companies and completely different categories of music users (*e.g.*, interactive services) and adjust them for application to non-interactive services – an inexact science at best, and one that causes the Judges to apply all manner of imprecise "interactivity" and other adjustments. In the wake of the *Webcasting II* decision, Congress was compelled to enact two Webcaster Settlement Acts to allow the record industry and various services to negotiate "voluntary" agreements (the so-called "WSA" deals) at rates other than those set by the Judges, which would have bankrupted most services. By the time of the *Webcasting III* proceeding, some 95% of the market was operating under such agreements (*i.e.*, not operating under rates set according to the WBWS standard), and only one commercial service of any size participated in the proceeding. Meanwhile, the three largest providers (Yahoo!, AOL, and Microsoft) all exited the market.[3] In contrast, the decisions pursuant to the 801(b) standard have not resulted in the participants rushing to Congress for legislative relief.

Retention of the 801(b) standard is justified not only because it is fundamentally superior to the WBWS standard, but also as a matter of simple fairness. Congress implemented (and later retained) that standard in recognition that services subject to those standards founded their services at a time when there was no sound recording performance right at all. To change the standard now would fundamentally undercut the reliance interests of those services.

To those who would argue that anything other than a free-market standard amounts to a perversion of their property rights and an unfair subsidy from the recording industry to the digital services, it must be remembered that the statutory license was an integral part of the bargain reflected in the Digital Performance Right Act in 1995. Namely, sound recording record companies were provided with a digital audio transmission right against non-interactive services only on the condition that such services (who were being hit with a new royalty not borne by terrestrial radio) have access to a statutory license[4] -- and, in the case of satellite radio, the 801(b)(1) rate-setting standard. Sound recording owners present their right to public performance royalties as a given, and the statutory license as a burden on that right; but that position fails to recognize that the statutory license was the *price* for receiving the performance

[3] Similar problems plagued the satellite television market. After Congress shifted the Section 119 compulsory license to a "fair market value" standard in the Satellite Home Viewer Act of 1994, the rate increase implemented by the CARP was so drastic that Congress was compelled, in the Satellite Home Viewer Improvement Act of 1999, to slash rates by 45%. *See* Register of Copyrights, Satellite Home Viewer Extension and Reauthorization Act § 110 Report, at 8-11 (Feb. 2006).

[4] This is compared to the interactive services – the providers of the so-called "celestial jukebox" – which Congress feared would substitute for CD sales and which drove the legislation. Sound recording owners, who had never enjoyed a public performance right in the U.S., received a full digital performance right as against on-demand streamers, but not as against non-interactive services that were not viewed as creating the same threat of substitution. Several CARP and CRB proceedings have lent further support to this distinction, as the record industry has failed to present any credible evidence that non-interactive services substitute for record sales.

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