



1410-72-P

LIBRARY OF CONGRESS

Copyright Royalty Board

37 CFR Part 382

[Docket No. 2006-1 CRB DSTRA (2007-2012)]

Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services

AGENCY: Copyright Royalty Board (CRB), Library of Congress.

ACTION: Ruling on regulatory interpretation.

SUMMARY: The Copyright Royalty Judges publish their ruling on regulatory interpretation that was referred to them by the United States District Court for the District Of Columbia. The regulation at issue is about gross revenue exclusions that a satellite digital audio radio service may use when calculating royalty payments owed to SoundExchange, a collective for copyright owners, for digital transmissions of sound recordings pursuant to a statutory license. The Judges find that Sirius XM properly interpreted the regulation to apply to pre-'72 sound recordings and that it improperly excluded certain revenues from its Gross Revenues royalty base.

DATES: [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: *Docket:* For access to the docket to read background documents, go to eCRB, the Copyright Royalty Board's electronic filing and case management system, at <https://app.crb.gov/> and search for docket number 2006-1 CRB DSTRA (2007-2012). For documents not yet uploaded to eCRB (because it is a new system), go to the agency website at <https://www.crb.gov/> or contact the CRB Program Specialist.

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SUPPLEMENTARY INFORMATION:

I. Background

SoundExchange, Inc. (SoundExchange) is the Collective designated by the Copyright Royalty Judges (Judges) to receive, administer, and distribute royalty funds due from entities making digital transmissions of sound recordings under the statutory licenses described at 17 U.S.C. 114.¹ Sirius XM Radio, Inc. (Sirius XM)² is a licensee, transmitting sound recordings digitally over its satellite radio network.³ In 2007, after considering oral and written evidence and arguments of counsel, the Copyright Royalty Judges (Judges) determined that Sirius XM's royalty obligations for its satellite radio business would be determined as a percentage of Gross Revenues. *See Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services (SDARS I)*, Docket No. 2006-1 CRB DSTRA (Determination), 73 FR 4080, 4084 (Jan. 24, 2008). Gross Revenues are defined in the regulations the Judges adopted as part of the Determination and codified as 37 CFR 382.11 (2008).

A. Procedural Setting

¹ The Judges determine rates and terms for the section 112 license (ephemeral recordings to facilitate digital transmissions of sound recordings) concurrently with their determination of rates and terms for the section 114 license. The section 112 license is not at issue here.

² Sirius XM Radio, Inc. is the entity resulting from the merger of Sirius Satellite Radio Inc. and XM Satellite Radio Inc.

³ Section 114 authorizes and describes licenses available to several transmitting and streaming media. The standards the Judges are to apply in setting rates for the various section 114 licenses are detailed in 17 U.S.C. 114 and 801.

In 2013, SoundExchange filed a complaint in the United States District Court for the District of Columbia (District Court) against Sirius XM seeking additional royalty payments for the period 2007-2012. *See SoundExchange, Inc. v. Sirius XM Radio, Inc.* 65 F. Supp. 3d 150 (D.D.C. 2014) (D.C. Action). On January 10, 2017, the Judges issued a Ruling (Initial Ruling) on two questions referred by the District Court under the doctrine of primary jurisdiction. *See id.* at 157. The issues referred by the District Court arose from the CRB's 2008 regulations. The District Court Judge concluded that in the promulgated regulations "the gross revenue exclusions are ambiguous." *Id.* at 155.

After seeking an opinion from the Register of Copyrights (Register) under 17 U.S.C. 802(f)(1)(B) regarding their authority to render the interpretation required by the District Court referral, the Judges proceeded with the analysis that resulted in the Initial Ruling. The Judges transmitted the Initial Ruling to the Register for the legal review required by the Copyright Act. *See* 17 U.S.C. 802(f)(1)(D).

In March 2017, upon further reflection, the Judges withdrew the Initial Ruling from the parties and from the Register's statutorily required review for legal error. *See Order Withdrawing Ruling and Soliciting Briefing on Unresolved Issues* (Mar. 9, 2017) at 2. The Judges solicited briefs from the parties to address specifically the breadth of the District Court referral. The Judges sought memoranda of law from the parties to the District Court controversy to address:

(1) Whether section (V)(C)(1)(b) of the Initial Ruling (at pp. 14-16 therein) constituted an *interpretation* of the 2008 regulations or an *application* of the Judges' interpretation of those regulations;

(2) Whether the District Court referral to the Judges under the doctrine of primary jurisdiction included not only a referral of questions of *interpretation* of the 2008 regulations, but also a referral of questions relating to the *application* of the 2008 regulations;

(3) Whether, regardless of the District Court's intent, the Judges have jurisdiction under the Copyright Act to *apply* their *interpretations* of the regulations to the facts in the record and reach binding conclusions regarding the parties' compliance with the interpreted regulations;

(4) Whether question (3) poses a material question of substantive law under the Copyright Act that the Judges may refer to the Register of Copyrights under 17 U.S.C. 802(f)(1)(A) or a novel material question of substantive law under the Copyright Act that the Judges must refer to the Register of Copyrights under 17 U.S.C. 802(f)(1)(B); and

(5) Whether, under the doctrine of primary jurisdiction, the Judges may recommend to the District Court *applications* of their *interpretations* of

the regulations to the facts in the record before the District Court regarding the parties' compliance with the interpreted regulations.

B. Parties' Analyses

In its briefing, SoundExchange asserted that (1) the language the Judges are reconsidering constituted an allowable interpretation of the CRB regulations; (2) even if the subject portions of the Initial Ruling conducted or required an application of the Judges' interpretation, that application was responsive to the District Court's inquiries in the referral; (3) the Judges have jurisdiction to interpret and apply their regulations; (4) this aspect of the Judges' authority need not be referred to the Register as a material or novel material question of law requiring the Register's input; and (5) the Judges may not make nonbinding recommendations to the District Court regarding application of the CRB regulations. *See* SoundExchange's Brief in Response to the Judges' Order Dated March 9, 2017 (*SoundExchange Initial Brief*) at 1-2. SoundExchange took the position that the Judges' Initial Ruling was appropriately broad in offering interpretation of the subject regulation. In fact, SoundExchange asserted that it would be inappropriate to distinguish between interpretation and application of the regulations in this context. *Id.* at 5-7. SoundExchange asserted that the Judges' conclusions should be binding on the parties, thus its opposition to the Judges making nonbinding recommendations to the District Court. *Id.* at 12-14.

Sirius XM countered that (1) the section about which the Judges inquired constitutes both an interpretation and application of the CRB regulations, that "goes

beyond the limited interpretive guidance appropriate for a primary jurisdiction referral;” (2) the District Court’s referral was limited to a request for regulatory interpretation; (3) the Judges’ continuing jurisdiction to interpret their regulations does not extend to a detailed review of the facts of the parties’ application of the regulation; (4) the question regarding the limits of the Judges’ jurisdiction is a material question the Judges may refer to the Register, but not a novel question that the Judges must refer to the Register; and (5) the Judges are not authorized to make findings or recommendations regarding specific rulings regarding a party’s compliance with the regulations. *See* Sirius XM Radio Inc.’s Memorandum of Law ... on Unresolved Issues (*Sirius XM Initial Brief*) at 1-2. Sirius XM reinforced its position by noting that, in presenting the referred issues for the Judges’ ruling, the parties engaged in limited discovery. Regardless of resolution of the interpretation *vs.* application question,⁴ Sirius XM argued that the limits on discovery left the Judges insufficiently informed to apply their interpretation of the subject regulation in this instance. *See id.* at 6.

C. Judges’ Conclusions

In its Reply Brief, Sirius XM summarized the points at which it perceived agreement between the parties regarding the Initial Ruling. *See* Sirius XM Radio Inc.’s Reply Memorandum of Law ... on Unresolved Issues (*Sirius XM Reply Brief*) at 1-2. The Judges agree with Sirius XM’s statement of the parties’ points of agreement. The Judges disagree with SoundExchange’s argument that it is inappropriate to draw a

⁴ Sirius XM did not agree with SoundExchange that a distinction between interpretation and application would be inappropriate, but did acknowledge that the distinction between those two acts “is not a bright-line rule that separates what the Judges have the authority to do from what they do not.” *Sirius XM Initial Brief* at 7, footnote omitted.

distinction between interpretation and application in this circumstance. The distinction might not always be a bright-line, but it is not a distinction totally without difference in the present circumstance.

After consideration of the arguments of both parties, the Judges conclude: (1) section V(C)(1)(b) of the Initial Ruling applies the Judges' interpretive conclusions to facts the parties presented in their merits presentations; (2) the District Court referral was ambiguous in the task referred to the Judges; (3) regardless of the scope or intended scope of the District Court's referral, in this particular circumstance, the Judges' application of their interpretations of the regulations was inappropriate; (4) the question of interpretation *vs* application in this instance is not a material or novel question of law referable to the Register; and (5) the application of the Judges' interpretations is more appropriately carried out by the District Court, so it is unnecessary for the Judges to recommend proposed findings or conclusions.

1. Application of the Regulatory Interpretation in the Initial Ruling

In the Initial Ruling, the Judges concluded that GAAP standards did not offer guidance for interpreting the subject regulations. The Judges concluded, therefore, that a standard of reasonableness should prevail. To the extent the Judges observed what actions might meet the reasonableness standard, they were appropriately offering interpretation relating to the regulations. Going beyond that guidance, the Judges' ruling was an application of the regulations to the present dispute pending in the District Court.

Application of the Judges' interpretation is better done by the District Court, after a review of the complete factual record.

2. Scope of District Court Referral

The District Court referred this issue of regulatory interpretation to the Judges under the doctrine of primary jurisdiction. The doctrine provides that a court may defer to an administrative agency when, based on its special competency, the agency "is best suited to make the initial decision on the issues in dispute." *See SoundExchange*, 65 F. Supp. 3d at 154 (citations omitted). Whatever the interpretation of the language of the District Court's Memorandum Opinion,⁵ the District Court could not have referred to the Judges resolution of the ultimate issues of fact presented by the SoundExchange litigation. The District Court is the forum in which resolution of the factual dispute lies. That factual dispute requires full discovery. The issues presented to the CRB were not the subject of full discovery nor were the factual issues fully developed, briefed, or argued for the Judges' determination. Notwithstanding language or rhetoric regarding the application of the CRB regulations to the facts of the District Court matter, the narrow question referable to the Judges was one of interpretation.⁶

⁵ In seeking referral to the CRB, Sirius XM argued that the primary disputes involved both interpreting and applying the CRB regulations. *See* 65 F. Supp. 3d at 154. The District Court concluded, and the Register accepted, that "the meaning of the relevant [regulations], and the application of those provisions to the particular fact pattern presented here, is [sic] uncertain." *See* Memorandum Opinion on a Novel Question of Law at 6, citation omitted. The District Court's referral posed two questions: (1) whether Sirius XM's attribution of revenues to pre-'72 recordings and the exclusion of those attributed revenues from the royalty base were permissible and (2) whether Sirius XM's Premier service was excludable from Gross Revenues for purposes of calculating the royalty. *See* 65 F. Supp. 3d at 154-55.

⁶ The District Court "agreed with Sirius XM" that the disputes at issue involve "interpreting and applying" the CRB's regulations. *SoundExchange*, 65 F. Supp. 3d at 154. In framing the issues referred, however, the District Court did not ask the CRB to complete a factual analysis. *See id.* at 154-55 (issues are revenue exclusion for pre-'72 recordings and for Premier package upcharges).

3. Regulatory or Inherent Authority to Apply Interpretation to these Facts

Sirius XM argued to the District Court that the CRB bore or should bear the task of both interpretation and application of the 2008 regulations. *See, e.g., SoundExchange*, 65 F.Supp.3d at 154 (both disputes best suited to CRB resolution as they involve interpreting and applying regulations). In response to the Judges' request for additional briefing after withdrawing the Initial Ruling, Sirius XM argued forcefully the other side of the coin. *See Sirius XM Initial Brief* at 11-14. *SoundExchange*, which initially challenged the Judges' authority to interpret their regulations, argued in their reply papers that the Judges have the authority to both interpret and apply their regulations. *SoundExchange Initial Brief* at 9 (Register's confirmation of continuing jurisdiction to resolve ambiguity equivalent to conclusion of jurisdiction to apply interpretation).

The Judges accept the scope of their "continuing jurisdiction" under 17 U.S.C. 803(c)(4) as described by the Register. The Judges do not agree with *SoundExchange*, however, that the continuing jurisdiction to interpret, or their ability to provide "interpretive guidance," somehow endows them with jurisdiction to resolve factual disputes relating to application of those regulations. As Sirius XM represented, the parties agree that the Judges "lack enforcement jurisdiction and, therefore, can neither order compliance nor fix penalties." *Sirius XM Reply Memorandum ... on Unresolved Issues (Sirius XM Reply)* at 2. Lacking those enforcement and remedial powers necessarily leads to the conclusion that the Judges' jurisdiction does not extend to application and factual dispute resolution regarding application of the regulations.

4. No Material or Novel Question of Substantive Law Remains

The parties agree that the question of the Judges' jurisdiction to apply their regulatory interpretations is not a novel question requiring referral to the Register. *Id.* The Register reviewed and analyzed the question of the Judges' continuing jurisdiction in her April 2015 opinion.

5. The Judges May Not Make Recommendations to the District Court

The parties agree, as do the Judges, that nothing in the doctrine of primary jurisdiction or in the Judges' authority would suggest that the Judges could or should make recommendations to the District Court regarding its determination of the factual questions properly before the Court.

In light of the foregoing conclusions, the Judges hereby reissue the Initial Ruling as an Amended Ruling, the text of which follows.

II. Introduction and Summary of Amended Decision

The issues before the Judges arose in the context of SoundExchange's action against Sirius XM in District Court. SoundExchange sued to recover additional sound recording royalties from Sirius XM for licenses used during the period 2007 to 2012. The alleged underpayment occurred, according to SoundExchange, because Sirius XM improperly excluded two categories of revenue when calculating "Gross Revenues," before it determined the royalties due to SoundExchange. 65 F. Supp. 3d at 153. Because the royalties in *SDARS I* were set as a percentage of Sirius XM's "Gross

Revenues” (rather than on a per-performance basis), exclusions of revenue by Sirius XM had the effect of reducing the royalties paid to SoundExchange. *See* 73 FR at 4084.

Sirius XM controverted the SoundExchange complaint and moved the District Court to stay or dismiss the D.C. Action in favor of a resolution by the Judges. In August 2014, the District Court stayed the D.C. Action and referred this matter to the Judges citing the doctrine of primary jurisdiction.

In the D.C. Action, SoundExchange alleged that Sirius XM had misinterpreted and misapplied the Judges’ 2008 regulations regarding exclusions from Gross Revenues for (1) sound recordings made before 1972 (and therefore exempt from the federal statutory license) and (2) a portion of subscription revenues that Sirius XM allocated to “premier” channels with primarily talk content that use only incidental performances of sound recordings. With regard to these allegations, the District Court referred two questions to the Judges for resolution. 65 F. Supp. 3d at 154-55. Specifically, the District Court described two “open” questions for the Judges: (1) whether Sirius XM improperly applied the Judges’ regulations in calculating the amount of royalties it paid to SoundExchange “such that it owes SoundExchange additional [royalties] for times past” and (2) whether the Judges consider the Sirius XM Premier channels to be “offered for a separate charge” permitting Sirius XM to exclude Premier subscription revenues from Gross Revenues. *Id.* at 156.

In response to the District Court Judge’s Memorandum Opinion (*Referral Opinion*), and on motion of SoundExchange, the Judges reopened the *SDARS I* proceeding. *Order Reopening Proceeding for Limited Purpose* (Dec. 9, 2014). In their

Order, the Judges requested briefing by the participants regarding the existence and scope of the Judges' jurisdiction and authority to entertain the issues raised in the D.C. Action.

On March 9, 2015, after considering the participants' briefs, the Judges referred three legal questions to the Register of Copyrights (Register) pursuant to 17 U.S.C.

802(f)(1)(B):

(1) Do the Judges have jurisdiction under title 17, or authority otherwise, to interpret the regulations adopted in the captioned proceeding?

(2) If the Judges have authority to interpret regulations adopted in the course of a rate determination, is that authority time-limited?

(3) Would the answer regarding the Judges' jurisdiction or authority be different if the terms at issue regulated a current, as opposed to a lapsed, rate period?

The Register opined that the Judges have jurisdiction under 17 U.S.C. section 803(c)(4) to clarify the regulations adopted in *SDARS I*. The Register added that the Judges' jurisdiction is not time-limited and the Judges do not lose their jurisdiction and authority when the issues relate to a lapsed rate period. *Register's Memorandum Opinion on a Novel Question of Law* at 4-5 (Apr. 8, 2015) (*Register's Opinion*).⁷ Based on the

⁷ The Register declined to opine as to whether the Gross Revenues definitional provisions at issue constituted a regulatory "term," as to which, by statute, the Judges may issue a "clarification." According to the Register, the Judges' separate statutory power to "correct any technical ... errors" provides a sufficient basis for the Judges to issue an Order clarifying a prior Determination. *Id.* at n.3.

language of the *Referral Opinion* and the *Register's Opinion*, the Judges hereby address the issues presented to them in the *Referral Opinion*.⁸

To address the revenue-exclusion issues, the Judges have engaged in a thorough review of the *SDARS I* record. Additionally, the Judges ordered the participants to supplement the extant record by engaging in discovery, exchanging expert reports and filing Opening (Initial) and Rebuttal Submissions. *See Case Scheduling Order* (Oct. 6, 2015). The participants appended to their Initial and Rebuttal Submissions discovery and expert materials on which they rely.

As detailed in this Ruling, the Judges conclude that Generally Accepted Accounting Principles (GAAP) apply broadly to the definition of Gross Revenues in 37 CFR 382.11 (2008). GAAP does not, however, address specifically the two revenue exclusions at issue in this referral; consequently, the Judges must look beyond the specific words of the regulation to answer the questions posed by the District Court. For the reasons explicated in this Ruling, the Judges conclude that a reasonableness standard must apply to both inclusions and exclusions from Gross Revenues. Based on the following reasoning, the Judges conclude that Sirius XM employed different methodologies with regard to excluding revenues attributable to pre-1972 sound recordings. A determination of reasonableness of either methodology, or both, will

⁸ The Copyright Act and the Judges' regulations do not prescribe a procedure for administering a District Court referral pursuant to the primary jurisdiction doctrine. Accordingly, the Judges have established the procedures to address this referral pursuant to their inherent jurisdiction and pursuant to their *general* authority under 17 U.S.C. 803(c) "to make any necessary procedural or evidentiary rulings in any proceedings under this chapter."

require closer examination.⁹ Further, because Sirius XM did not offer the channels included for subscribers to the Premier package for a separate charge, it could not reasonably exclude from Gross Revenues revenue attributable to the Premier subscription price differential.

III. Procedural History

On January 9, 2006, the Judges commenced the original *SDARS I* proceeding to determine “reasonable rates and terms of royalty payments for ... transmissions by preexisting satellite digital audio radio services [SDARS]” 17 U.S.C.

114(f)(1)(A).¹⁰ *See Notice Announcing Commencement of Proceeding with Request for Petitions to Participate*, 71 FR 1455 (Jan. 9, 2006). Three parties: SoundExchange, on behalf of the licensors, and two licensees, Sirius and XM (Sirius XM’s pre-merger predecessors) participated in the rate determination hearing. *Id.*¹¹

Following a twenty-six day hearing,¹² and the participants’ submission of *Proposed Findings of Fact (PFF)* and *Conclusions of Law (COL)* and replies thereto, the Judges issued their *Initial Determination* on December 3, 2007. *See SDARS I*, 73 FR at 4080, 4081 (Jan. 24, 2008) (*SDARS I Determination*). Thereafter, SoundExchange filed a Motion for Rehearing. Upon the Judges’ request, Sirius XM responded to the Motion

⁹ Application of the methodologies relating to pre-’72 recordings is a fact determination for the District Court and is not before the Judges.

¹⁰ The proceeding was originally commenced also to establish rates and terms for preexisting subscription services, pursuant to the same statutory section. The participants in that aspect of the hearing settled prior to the hearing. *SDARS I*, 73 FR at 4081.

¹¹ On July 29, 2008, Sirius and XM completed a merger, and the successor-by-merger was named Sirius XM Radio Inc. <http://investor.siriusxm.com/investor-overview/press-releases/press-release-details/2008/SIRIUS-and-XM-Complete-Merger/default.aspx> (last visited January 3, 2017).

¹² The oral testimony comprised 7,700 pages of transcripts, more than 230 exhibits were admitted and the docket contained over 400 pleadings, motions and orders. *Id.*

for Rehearing. *Id.* On January 8, 2008, the Judges issued an Order Denying Motion for Rehearing (*Rehearing Order*).¹³

SoundExchange appealed the Judges' *SDARS I Determination* and the U.S. Court of Appeals for the D.C. Circuit affirmed all aspects of the Judges' *SDARS I Determination* relating to the rates and terms established for the section 114 licensing of sound recordings. *SoundExchange, Inc. v. Librarian of Congress*, 571 F.3d 1220 (D.C. Cir. 2009).¹⁴

IV. The Parties' Dispute

SoundExchange commenced the *D. C. Action* in 2013, seeking additional royalties from Sirius XM for the period 2007-2012. SoundExchange alleged that, in order to reduce its royalty payments during that period Sirius XM improperly

(1) reduced Gross Revenues by an amount it estimated was attributable to pre-1972 sound recordings;¹⁵ [and]

(2) excluded from Gross Revenues the revenue received from the price difference between its standard [Basic] package and its premium [Premier]

¹³ Although the Judges styled their January 8, 2008, Rehearing Order as one “denying” the Motion for Rehearing, the Judges expressly clarified and amended a portion of their Initial Determination in a manner that bears on the present proceeding.

¹⁴ The D.C. Circuit vacated and remanded the Judges' *SDARS I Determination* for reconsideration of an issue unrelated to the section 114 issues presently before the Judges. 571 F.3d at 1225-26.

¹⁵ Pursuant to 17 U.S.C. 301(c), “no sound recording fixed before February 15, 1972, shall be subject to copyright under this title” For ease of expression, commercial actors, jurists and attorneys commonly describe the time before February 15, 1972 as the “pre-'72” period.

package, the latter of which includes additional talk channels, but no additional music channels¹⁶

65 F. Supp. 3d at 153 (citations omitted); *see also Sirius XM's Initial Submission* at 2.¹⁷ SoundExchange contends that the actions by Sirius XM resulted in significant royalty shortfalls.

During the *SDARS I* rate period, the regulations stated “Gross Revenues shall mean revenue recognized by the Licensee in accordance with GAAP from the operation of an SDARS, and shall be comprised of ... [s]ubscription revenue recognized by Licensee directly from residential U.S. subscribers for Licensee’s SDARS” 37 CFR 382.11 (2008) (definition of *Gross Revenues*). The regulations permitted a number of exclusions from Gross Revenues, two of which are relevant to the present dispute, namely, those recognized by Licensee (1) for the provision of “[c]hannels, programming, products and/or other services offered for a separate charge where such channels use only incidental performances of sound recordings” and (2) for the provisions of “[c]hannels, programming, products and/or other services for which performance of sound recordings and/or the making of ephemeral recordings is exempt from any license requirement or is separately licensed, including by a statutory license” 37 CFR 382.11(2008).

SoundExchange asserts that the Sirius XM interpretation of the regulation is contrary to the standards of GAAP.¹⁸ SoundExchange focuses on (1) the term

¹⁶ For ease of reference, Sirius XM’s subscription offering that included its base channels is referred to herein as the Basic package, and the offering that bundled the base channels and the additional channels is referred to herein as the Premier package, (regardless of any previous names used by Sirius XM or its predecessors, unless the context requires reference to the names of predecessor subscription offerings).

¹⁷ Other claims made by SoundExchange in the Complaint are not germane to the issues referred to the Judges.

“recognized” revenue, (2) the methodology employed by Sirius XM to exclude revenues it attributes to pre-’72 sound recordings, and (3) Sirius XM’s exclusion from Gross Revenues of the subscription revenue differential between its Basic package of channels and the Premier package Sirius XM offers for an increased subscription fee.¹⁹ Sirius XM contends the pre-’72 recordings satisfied the requirement in paragraph (3)(vi)(D) of the Gross Revenues definition that, for the revenue exclusion to apply, performances must be “exempt from any license requirement.” According to Sirius XM the exclusion of the “additional charge” (Upcharge) paid for Premier channels satisfied the requirement in paragraph (3)(vi)(B) of the definition that channels be offered for a “separate charge.” *Id.*

V. Issues for the Judges under the Primary Jurisdiction Referral

In invoking the doctrine of primary jurisdiction, the District Court tasked the Judges with interpreting the Gross Revenues regulation and, to the extent appropriate, providing “interpretive guidance.” The District Court concluded that the “gross revenue exclusions are *ambiguous* and do not, on their face, make clear whether Sirius XM’s approaches were permissible under the regulations.” 65 F. Supp. 3d at 155. The District Court instructed the Judges, in interpreting the Gross Revenues regulation, to utilize their “technical and policy expertise.” *Id.* The District Court specifically noted that the “technical and policy expertise” to which it referred were in the domains of “copyright law” and “economics.” *Id.* at 155-56.

¹⁸ GAAP stands for Generally Accepted Accounting Principles.

¹⁹ SoundExchange does not dispute that the channels added to the basic package to comprise the Premium package are stations that make only incidental use of sound recordings. *SoundExchange Initial Submission* ¶¶ 54-59.

Based on its application of the principles of primary jurisdiction, the District Court identified two broad questions for the Judges to answer:

- (1) Were Sirius XM's attribution of revenues to performances of pre-'72 recordings and its exclusion of those attributed revenues from the Gross Revenues royalty base permissible under the *SDARS I* regulations?
- (2) Were the additional talk channels on Sirius XM's Premier service "offered for a separate charge," and therefore excludable from Gross Revenues?

See id. at 154-55. The District Court concluded that the Judges have the statutory authority to answer these questions pursuant to their continuing jurisdiction to "issue an amendment to a written determination to correct any technical ... errors in the determination or to modify the terms, but not the rates, of royalty payments in response to unforeseen circumstances that would frustrate the proper implementation of such determination." *Id.* at 156 (quoting 17 U.S.C. 803(c)(4)). The Register echoed the District Court's assessment of the Judges' task in this referred proceeding, accepting "the district court's conclusion that both the meaning of the relevant regulatory provisions, and the application of those provisions to the particular fact pattern presented here, are uncertain." *Register's Opinion* at 6.

VI. Analysis

To address the issues presented in the *Referral Opinion*, the Judges answer the following specific questions.

(1) Does the Gross Revenues definition require that the revenue exclusions satisfy applicable GAAP?

(2) If so, what GAAP principles, if any, apply to the two exclusions?

A. (3) If no GAAP principles are applicable, what is the standard, if any, that the two exclusions must satisfy?

A. Application of GAAP to Gross Revenues Definition

The parties and their experts disagree regarding the application of the regulatory phrase “recognized in accordance with GAAP.”²⁰ Section 382.11, in paragraph (1) of the definition of “Gross Revenues,” defines “Gross Revenues” as “revenue recognized by the Licensee in accordance with GAAP from the operation of an SDARS.” 37 CFR 382.11, paragraph (1) of the definition of “Gross Revenues.”

SoundExchange argues that GAAP applies in full and equal measure to the regulatory *exclusions* as to the *inclusions* that comprise the definition of “Gross Revenues.” *SoundExchange Memorandum of Law* at 9-10. In support of this point, SoundExchange and its expert, Dr. Thomas Lys, rely on paragraph (3)(vi) of the definition of “Gross Revenues” in § 382.11, which limits the categorical revenue exclusions at issue in this proceeding to “[r]evenues *recognized* by Licensee” *Id.*; see also *SoundExchange Initial Submission*, App. Ex. 1 at A.131, (Deposition of Professor Lys) at 129 (Lys Dep.) SoundExchange notes that “GAAP is the only accounting standard mentioned in the definition of “Gross Revenues” and argues that it would be

²⁰ GAAP is defined in the applicable regulation as “generally accepted accounting principles in effect from time to time in the United States.” 37 CFR 382.11. “GAAP refers to the set of standards, conventions, and rules that define accepted accounting practices.” Lys Report ¶ 26.

“implausible” to suppose that the Judges “actually meant to incorporate *sub silentio* some other accounting standard elsewhere in the definition ... or for that matter, that the Judges meant to divorce portions of the definition from any accounting standard at all”

SoundExchange Memorandum of Law at 10.

Sirius XM does not disagree with these broad points. Rather, it contends that its treatment of revenue from pre-'72 recordings is fully consistent with GAAP, stating:

Sirius XM's exclusion of revenue for its transmissions of pre-1972 sound recordings and its separately charged premium non-music channels during the *Satellite I* period was consistent with the plain language and purpose of the regulations. Sirius XM implemented the regulations in a clear and straightforward manner in line with ... GAAP.

Written Merits Rebuttal Submission of Sirius XM ... (*Sirius Merits Rebuttal*) at 2.

The Judges find and conclude that the applicable regulations require that Sirius XM's inclusions and exclusions of revenue in the Gross Revenues definition *must not be inconsistent with GAAP*. The Judges utilize the double negative intentionally, because an issue exists as to whether GAAP in fact provides rules or guidance regarding the method by which the pre-'72 exclusions may be taken. That is, if GAAP does not address a particular issue, then a party's treatment of that issue cannot be “inconsistent” with GAAP, and, equally so, it would be senseless to consider whether such treatment was “consistent” with GAAP.

Sirius XM makes two arguments regarding the applicability of GAAP to its calculation and exclusions of revenue. First, Sirius XM asserts that *all* its revenues were recognized pursuant to GAAP. With regard to pre-'72 recordings, Sirius XM's financial and accounting expert, John W. Wills states "there is no doubt that *all* of its subscription revenue – including that earned for performing pre-1972 recordings – is 'recognized' consistent with GAAP" since "the subscriber revenue recognized by Sirius XM on its financial statements includes the entirety of its entertainment and information content delivered during the period at issue." Expert Report of John W. Wills, at 7 (May 9, 2016) (Wills Report). Mr. Wills employs the same reasoning to reach the same conclusion regarding the Upcharge revenue. *See* Wills Rebuttal Report at 11.

Based on that 100% recognition argument, Sirius XM contends that it had no obligation, under the regulations or the authority of GAAP, to *separately recognize* the excluded revenue it attributed to pre-'72 recordings or to the Upcharge. *See* Wills Report at 8 ([“T]here is no requirement in GAAP to record revenue separately for pre-1972 recordings (or any other type of content), and no support for the idea that it is not recognized if *not* separately reported.”); Wills Rebuttal Report at 11 (“GAAP is irrelevant ... to the further question of how much of Sirius XM’s recognized subscription revenue is attributable to non-music content offered for a separate charge”).

SoundExchange does not dispute the first point, tacitly acknowledging that all of the subscription revenue – including any revenue that allegedly could be attributable to pre-'72 sound recording performances – was recognized pursuant to GAAP as part of an undifferentiated sum. *See, e.g., SoundExchange Rebuttal Submission* at 10 (“It is ...

irrelevant whether Sirius XM recognized all of its subscription revenue at the most aggregated level”). However, SoundExchange strongly disputes the second point, *viz.*, Sirius XM’s assertion that the latter need not separately comply with GAAP in quantifying an excludable sub-set of that revenue as attributable to the performance of pre-’72 sound recordings. *Id.* (“The regulation actually provides that excludable revenue must be ‘recognized by Licensee’”).

The Judges find that Sirius XM cannot rely on the fact that 100% of its undifferentiated subscription revenue was “recognized” as a sufficient basis to support its assertion that an excluded sub-set of that revenue was independently “recognized” in accordance with GAAP. The repetition of the word “recognized” in the exclusionary language clearly indicates that in *SDARS I* the Judges did not intend to supersede or disregard GAAP *as it might pertain* to the standards applicable to potentially excludable revenue.²¹

The Judges agree with SoundExchange that “[t]he only reasonable reading of the Gross Revenues definition is that [GAAP] flows through its entirety.” *SoundExchange Memorandum of Law* at 10. Accordingly, *if* there are GAAP provisions that required Sirius XM to recognize pre-’72 revenue *separately*, it would have been obliged to follow them.²² Thus, in order for the Judges to decide whether Sirius XM ran afoul of GAAP –

²¹ The regulations also separately reference revenue “recognized” by the Licensee with regard to *included* revenue, without redundantly reiterating there that the “recognition” must satisfy GAAP. 37 CFR 382.11 (paragraph (1)(i) of “Gross Revenues” definition).

²² The record reflects that in the *SDARS I* proceeding the participants did not identify and analyze specific GAAP provisions. Rather, they selected GAAP as a comprehensive default set of standards to be utilized as the regulatory standard to resolve accounting issues.

and therefore the regulations – the Judges must determine whether any GAAP provisions in fact apply to this pre-'72 exclusion.

B. GAAP Principles, if Any, that Apply to Exclusions at Issue

SoundExchange argues at length that Sirius XM failed to abide by GAAP in identifying and quantifying revenues supposedly attributable to the performance of pre-'72 sound recordings, *SoundExchange Initial Submission* ¶¶ 25-38, and to the Upcharge. *Id.* at ¶¶ 60-66. According to SoundExchange, “GAAP sets forth clear rules on how a company should recognize revenue for bundles or packages ... which GAAP sometimes calls “multiple element arrangements” or ‘MEAs.’” *Id.* ¶ 24. The entirety of SoundExchange’s GAAP-based argument is conditioned on the categorization of (i) the pre-'72 recordings; and (ii) the premium nonmusic channels, respectively, as MEAs.

However, SoundExchange’s accounting and economic expert, Professor Lys, expressly declined to opine that the MEA concept is even applicable to the two exclusions.

One question relevant to this lawsuit is whether GAAP’s multiple element arrangement (“MEA”) rules²³ can be used to justify Sirius XM’s exclusions of pre-1972 recordings.... GAAP does not define the term “element” For the purposes of my subsequent analysis, I *treat* Sirius

²³ When referring to the applicable GAAP, the Judges are referring to EITF-0021 and ASC 605-25, which are the GAAP provisions relating to MEAs relied on by Professor Lys. As he explained, GAAP at present is set forth in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). Prior to 2009 (and during the *SDARS I* period), official guidance on the implementation of GAAP was provided by the Emerging Issues Task Force (EITF). Lys Report ¶ 30. Professor Lys notes that there is no difference between EITF-0021 and ASC 605-25 as they relate to the MEA argument he advances in this proceeding. *Id.* 39, n.40. *Accord*, Wills Expert Report at 11 (“ASC 605-25 ... incorporates ... the guidance from EITF 00-21 [on] ‘Revenue Recognition Multiple-Element Arrangements.’”).

XM subscription arrangements *as if* they fall within the scope of GAAP for multiple element arrangements I note, however, that details of Sirius XM’s subscription agreement suggest that the provision of pre-1972 recordings and the incremental premium programming *would not be seen as separate deliverables or elements. Specifically, the Sirius XM subscription agreement does not list specific programming as an obligation of Sirius XM. Furthermore, Sirius XM reserves the right to change, rearrange, add or delete programming.*

Lys Report ¶¶ 34, 36 and n.39 (emphasis added); *see also* EITF-0021([MEA rule] applies “to all deliverables (that is, products, services, or rights to use assets) *within contractually binding arrangements....*”) (emphasis added).

Professor Lys’s candid refusal to answer his own question in the affirmative, *i.e.*, “whether GAAP’s ... MEA rules can be used to justify Sirius XM’s exclusions,” leaves the Judges with no basis to conclude that such an MEA-based approach is mandated in these circumstances. Rather, the Judges agree with Mr. Wills that SoundExchange has misapplied GAAP’s MEA rules to the issues in this proceeding. As Mr. Wills stated, the key point is that “while ASC 605-25 may serve as a mandate as to recognition where an MEA and separate units of accounting exist, *it is not a block or limit on recognition where such conditions do not exist.*” Wills Rebuttal Report at 6 (emphasis added).

Thus, the Judges decline to adopt Dr. Lys’s decision to analyze Sirius XM’s treatment of either pre-’72 recordings or the Premier Upcharges “*as if*” the

product/service delivered by Sirius XM to its customers would constitute an MEA.²⁴

Rather, the Judges conclude that the record fails to identify particular provisions of GAAP that apply to the accounting treatment of the two exclusions at issue.

The Judges reject the application of the MEA approach for an additional reason. Even assuming the MEA approach is not inapplicable for the foregoing reasons, the MEA approach would still be inapplicable because it is only relevant in a context in which several elements are deliverable *over time*. That is, GAAP's "separate unit of accounting" principles do not apply to the allocation of revenue between or among products or services that are provided *simultaneously* to the customer.

As Mr. Wills stated in his report, GAAP is completely irrelevant to the question in this dispute. The issue addressed by [GAAP] is how to deal with multiple deliverables within a package that may occur *at different points in time*, such that revenue for certain items may need to be allocated, and its *recognition deferred, until later periods when the item is actually earned*. In other words, it deals with the *timing* of recognition That simply is not an issue here. Sirius XM delivers all elements of its monthly subscription package – performances of pre-72 recordings and other content alike – during the same monthly period, and all revenue from such a package rightly is recognized as earned on a

²⁴ To be clear, the Judges do not concur with a broader assertion made by Sirius XM (*see Sirius XM Rebuttal Submission* at 4) that the MEA analysis (or any test derived from it) is inapposite merely because that specific accounting principle is "stated nowhere in the Gross Revenues definition." As noted *supra*, the Judges conclude that the regulations regarding Gross Revenues do incorporate GAAP in all of GAAP's particulars, *but only to the extent those GAAP particulars apply*.

monthly basis. It therefore is not the kind of “arrangement with multiple deliverables” addressed by [GAAP], which envisions a mix of delivered and “undelivered” items.

Wills Report at 12-13. Referring to relevant source materials, the Judges note that the language in EITF 00-21 relied upon by both Mr. Wills and Professor Lys states at the outset that the issue it addresses “involve[s] the delivery or performance of multiple products, services, or rights to use assets, and performances [that] may occur *at different points in time or over different periods of time.*” EITF 00-21 at 2, ¶ 1 (emphasis added). Similarly, ASC 605-25, which codifies EITF 00-21, provides that the standard it codifies is for situations in which “deliverables often are provided *at different points in time or over different time periods.*” ASC 605-25 at 1 (emphasis added).

Neither SoundExchange nor its expert, Professor Lys, point to any language within either EITF 00-21 or ASC 605-25 that expressly applies the MEA process to simultaneous deliverables. Professor Lys also relies on SEC Staff Accounting Bulletin No. 13, which he understands to provide that entities “*first* evaluate whether an element is a separate unit of accounting and *then* evaluate whether each unit of accounting has been delivered and therefore whether revenue for that element has been earned.” Lys Rebuttal Report ¶ 28. However, the SEC document, like the other documents upon which Professor Lys relies, does not indicate that the “separate unit of accounting” approach applies to elements that are delivered *simultaneously*.

At any rate, in the present case, the timing of deliverables is irrelevant.

SoundExchange is not concerned with the *timing* of revenue recognition.

SoundExchange does not contest that any Sirius XM revenue properly within the definition of Gross Revenues (and not excluded by that definition) will be subject to royalties at the applicable rate. Therefore, SoundExchange's reliance on the *timing* rationale behind revenue recognition principles is not applicable in the present case.

SoundExchange conducted two audits of Sirius XM relating to the 2007-2012 rate period.²⁵ Importantly, the results of those audits confirm the inapplicability of GAAP in evaluating Sirius XM's application of the two exclusions at issue here. SoundExchange engaged two auditing firms, PricewaterhouseCoopers, d/b/a PwC (PwC) and EisnerAmper LLP (EisnerAmper), to audit Sirius XM's books and records for the *SDARS I* period. Sirius XM asserts that the results of the audits confirm the inapplicability of GAAP in determining the appropriate manner in which to evaluate Sirius XM's application of the two exclusions. Further, according to Sirius XM, neither of the firms concluded that its exclusions violated GAAP or were otherwise improper. *See* Written Merits Opening Submission of Sirius XM ... (*Sirius XM Merits Submission*) at 13-14. Rather, as Sirius XM points out, EisnerAmper concluded that the dispute regarding the two exclusions was a "legal issue." *Id.*

SoundExchange attempts to minimize the importance of the auditing firms' conclusions, arguing that the auditors simply "declined to take sides on how the regulations should be interpreted" because they were told by Sirius XM "that this matter

²⁵ SoundExchange conducted these audits pursuant to its verification rights under 37 CFR 382.15.

is a legal issue.” SoundExchange Written Merits Rebuttal Submission (*SoundExchange Rebuttal Submission*) at 7 n.5.

The Judges find SoundExchange’s point unresponsive of its position. The gravamen of SoundExchange’s argument is that GAAP applies to the propriety of Sirius XM’s two categorical revenue exclusions. That is, SoundExchange asserts that the *legal* interpretation of the Gross Revenues definition must be determined by applying GAAP. Indeed, that it is precisely what SoundExchange’s expert, Professor Lys, purported to do in this proceeding. Thus, SoundExchange argues that if GAAP applies, the proper *legal result* is wholly dependent upon the proper *accounting treatment under GAAP*. In fact, the Judges agree with that line of reasoning, *but only to the extent GAAP actually addresses the issues in dispute*.

SoundExchange offers no explanation for why neither of its auditing firms opined that Sirius XM’s exclusions of revenue for performances of pre-’72 recordings and for the subscription price differential for the Premier package (the Upcharge) were inconsistent with GAAP. If the auditors had so concluded, SoundExchange could have perhaps bootstrapped such a conclusion into its legal argument. The fact that neither auditing firm reached the conclusion proffered by SoundExchange supports the Judges’ conclusion that the revenue exclusion issues in this proceeding are not addressed by GAAP.

For these reasons, the Judges find no record evidence indicating that GAAP provides a particular method for quantifying the two exclusions at issue in this

proceeding.²⁶ Given the absence of any applicable GAAP, the Judges seek to answer the District Court’s inquiries by analyzing the applicable standard to interpret and apply the two revenue exclusions at issue.

C. Determination of Appropriate Standard in Absence of Applicable GAAP

Guidance

Without specifically applicable GAAP principles, the Judges must construe and interpret their regulation using legal principles. The Judges consider both the language and the purposes of the regulations to determine those standards.²⁷ The non-applicability of specific GAAP principles did not and does not afford Sirius XM unfettered discretion regarding its application of the two revenue exclusions at issue.²⁸

²⁶ The Judges recognize that in the *SDARS II Determination*, the judges held that “[r]evenue exclusion is not the proper means of addressing pre-’72 recordings [as] there is *no revenue recognition* for the performance of pre-1972 works.” *SDARS II*, 78 FR at 23073 (emphasis added). The District Court found this statement to be dicta because “the construction and application of the [*SDARS*] I rates were not before the CRB in the [*SDARS*] II proceeding.” 65 F. Supp. 3d at 156. Further, as the *SDARS II Determination* does not contain any record citations that would support this finding, the Judges do not now view it as persuasive authority and decline to follow it.

²⁷ SoundExchange argues that, when construing the revenue exclusion regulations, the Judges should apply the interpretative doctrine of *contra proferentem*. That is, because the revenue exclusions were proposed and initially drafted by Sirius XM, they should be interpreted against Sirius XM. *SoundExchange Memorandum of Law* at 17-18. The Judges agree with Sirius XM, however, that the law on which SoundExchange relies applies to contracts, not regulations. See *Sirius XM Rebuttal Submission* at 10 n.10 (and cases cited therein). Therefore, the doctrine of *contra proferentem* is inapplicable.

More broadly, the Judges note that a review of the *SDARS I* record of proceeding shows that the participants presented fairly cursory arguments regarding treatment of pre-’72 recordings. The *SDARS I* participants did not address directly the issue of how to quantify or estimate the monetary value of a pre-’72 exclusion. Thus, the evidence and arguments proffered by the *SDARS I* participants are of limited value in the present proceeding.

²⁸ Sirius XM itself recognizes that, even though GAAP is inapplicable, it could not exclude revenue in an unconstrained manner.

This is not to say—as SoundExchange misleadingly suggests—that Sirius XM could “slice and dice” its revenue however it saw fit without accounting controls.... While Mr. Wills testified that GAAP does not direct (or limit) how a company subdivides already recognized revenue for internal or regulatory purposes, such attribution is still governed by *principles of managerial and cost accounting* and subject to audit.

Sirius XM’s Rebuttal Submission at 5 n.2 (emphasis added). Unfortunately, Mr. Wills fails to identify any “*principles of managerial and cost accounting*” that Sirius XM *did* apply to these exclusion issues, nor does he even identify any such principles that *should* be applied.

Absent guidance from the participants, the Judges look first to the authority by which they are bound: the Copyright Act. In *SDARS* proceedings under section 114(f)(1)(B), the Copyright Act contains a core requirement that the Judges set terms (and rates) that are “reasonable.” 17 U.S.C. 801(b)(1). The obligation to set reasonable rates and terms imposes upon the Judges a requirement to assure that the rates and terms they codify are neither vague nor ambiguous, but rather are subject to reasonable interpretation. In its referral, the District Court has termed ambiguous the provisions of the regulations at issue here. 65 F. Supp. 3d at 155.

Further, assuming the Judges’ regulations are reasonable or may be reasonably interpreted,²⁹ the Judges’ clarification must likewise be reasonable and aimed at reasonable interpretation going forward. Ultimately, licensors and licensees should be confident of compliance when attempting a reasonable interpretation and application of those regulations. Even though the Judges find no specific GAAP guideline applicable to the interpretation of the regulation at issue, they nonetheless look to the standard established by the overarching concepts within GAAP. GAAP requires that an entity provide a “faithful representation” of the facts in its financial reporting, *i.e.*, a presentation that is “complete” and “free of error ... to the extent possible.” *FASB Statement of Financial Accounting Concepts No. 8* at 27 (Quality Characteristic (QC) 12) (September 2010). This overarching GAAP standard guides the Judges’ regulatory interpretation notwithstanding the absence of any GAAP principle specifically applicable to the regulations at issue.

²⁹ As the parties agreed, they proposed the text of the regulation at issue, which the Judges adopted as reasonable.

Moreover, QC 30 in *FASB Statement of Financial Accounting Concepts No. 8* also requires that financial reporting be “understandable.” That GAAP pronouncement notes that “understandability” embodies “transparency.” *Id.* at 21, 31 (QC 30; Basis for Conclusion (BC) 3.44) (“*transparency*, high quality, internal consistency, true and fair view or fair presentation are *different words to describe information that has the qualitative characteristic[] of ... understandability.*”)(emphasis added).

These GAAP standards are consonant with the Judges’ application of the pre-’72 exclusion in *SDARS II*. There, the Judges concluded that the statutory requirement for reasonable terms is satisfied when those terms are “precise” (*i.e.*, “reasonably accurate”) and “methodologically transparent.” 78 FR at 23073.³⁰ The Judges thus apply the GAAP standards of understandability (embodying transparency), faithfulness, accuracy, and transparency, in shorthand, “reasonableness,” in the circumstances at issue.

1. The Pre-’72 Sound Recordings

(a) Paragraph (3)(vi)(D) Exclusion for “Exempt” Performances

Paragraph (3)(vi)(D) of the definition of Gross Revenues, relating to exclusions, does not *explicitly* identify pre-’72 sound recordings as excludable from Gross Revenues. Rather, Sirius XM deemed such pre-’72 performances excludable pursuant to the broader exclusion for revenues recognized for the provision of “[c]hannels, programming, products and/or other services for which the performance of sound recordings and/or the

³⁰ In *SDARS II* the Judges articulated this standard in connection with exclusion of royalties attributed to performances of pre-’72 sound recordings. The Judges conclude that the *SDARS II* determination is not precedential or binding on the Judges’ interpretation of regulations that preceded that determination. *See* 78 FR 23054 (Apr. 17, 2013). Nonetheless, the Judges accept as instructive the language in *SDARS II* relating to revenues or exclusion of royalties attributed to performances of pre-’72 recordings.

making of Ephemeral Recordings is *exempt from any license requirement . . .*” 37 CFR 382.11 (2008) (emphasis added); *see Sirius XM Initial Submission* at 18 (describing “core precept” that Sirius XM should not pay for non-statutory activities).

SoundExchange disagrees, arguing that as Sirius XM never packaged or marketed separately performances of pre-’72 recordings, revenues generated on account of those performances do not fall within the regulatory exclusions from Gross Revenues. *SoundExchange Memorandum of Law* at 4-5. Additionally, SoundExchange points to the “the avoidance of doubt” clause noting it does not identify pre-’72 recordings as excludable. Finally, SoundExchange asserts that it would be absurd to construe the regulatory word “programming,” or any of the other excluded categories, as embracing the “performance of sound recordings,” as the regulation at issue already uses the phrase “performance of sound recordings.” *Id.* at 5.

Addressing SoundExchange’s first and last assertions, the Judges find that the language of the paragraph (3)(vi)(D) exclusion clearly embraces revenue properly attributable to the performance of pre-’72 recordings. Contrary to SoundExchange’s argument, the word “programming” is not redundant of the phrase “performance of sound recordings.” In ordinary parlance, broadcast music programming consists of the aggregation of sound recordings played pursuant to a sequence selected by the broadcaster. In the 2006 *SDARS I* proceeding, XM’s Executive Vice President for programming, Eric Logan, testified that the “fundamental value proposition” for XM was that it aggregated a “diverse variety of programming” into a single “170-channel platform” Sirius XM Ex. 20 (Direct Testimony of Eric Logan on behalf of XM

Satellite Radio Inc., *SDARS I* ¶¶ 2, 12, 14 (Jan. 17, 2007). The word “programming” as used in the regulations should be read to include programming across a satellite platform and within or across channels, consisting of both older music, such as pre-’72 recordings, and relatively more contemporary music, *i.e.*, music that falls within the collection of post-’72 recordings.

The Judges reject SoundExchange’s assertion that the final words of the regulation, “for the avoidance of doubt”, preclude an exclusion of revenue from pre-’72 recordings. In paragraph (3)(vi)(D) of the Gross Revenues definition, the phrase “for the avoidance of doubt” follows immediately after the phrase “is separately licensed, including by a statutory license” The string of four items that follows is comprised of “separately licensed uses.” Thus, the syntax of the paragraph makes it clear that the “for the avoidance of doubt” clause does not address, and therefore does not prohibit exclusions for, performances that are “exempt from any license requirement,” such as performances of pre-’72 recordings.³¹

The Judges also discount SoundExchange’s argument that an interpretation of “programming, products, and/or other services” as embracing “the performance of sound recordings” would yield a result that is linguistically “nonsensical.” *SoundExchange Memorandum of Law* at 5. Quite the contrary, substituting “the performance of sound recordings” for “programming, products, and /or other services” in this manner would cause the regulation to be understood as excluding revenue from “the performance of

³¹ The Judges interpret “exempt from any license requirement” in this regulation to refer to licensing under the federal Copyright Act. The Judges do not assume that this regulation refers to any “license requirement” that may exist under any other body of law.

sound recordings ... for which the performance of sound recordings and/or the making of ephemeral recordings is exempt from any license requirement” That interpretation plainly is not “nonsensical.”

Finally, the Judges conclude that it would be anomalous to require Sirius XM to pay for pre-’72 recordings under a federal compulsory license when, by the unambiguous statutory language in section 301 of the Copyright Act, those recordings are not subject to federal copyright protection. Further, it seems implausible to the Judges that the parties did not understand, or that they could reasonably have failed to understand, that the language “exempt from any license requirement” included pre-’72 sound recordings. Indeed, it is not clear exactly what other sound recordings that phrase would cover *except* for pre-’72 sound recordings.

(b) Sirius XM’s Estimate of Revenue Attributable to Pre-’72

Recordings

During the course of the *SDARS I* rate period, Sirius XM appears to have used two different methods to estimate revenue attributable to its performance of pre-’72 recordings. According to the evidence before the Judges relating to the referred questions, [REDACTED]³² Declaration of Catherine Brooker ¶ 23 (Brooker Decl.).³³ [REDACTED] *Id.* ¶ 24. SoundExchange does not dispute Ms. Brooker’s description of the two ways in which Sirius XM applied the pre-’72 exclusion. *See SoundExchange Initial Submission* ¶¶ 12-13.

³² All redactions in this publication were proposed by the participants and approved by the Judges. None were made by the Office of the Federal Register.

³³ Ms. Brooker is Vice President of Corporate Finance for Sirius XM. It is unclear to the Judges whether Ms. Brooker’s reference to the period [REDACTED] includes the entire 2007-08 pre-merger period.

2. The Upcharge for Premier Service: Paragraph (3)(vi)(B) Revenue

Exclusion

During the *SDARS I* period, Sirius XM offered (under different names before and after the merger of Sirius and XM) both a Base subscription package that included channels performing broadcasts of sound recordings covered by the statutory license, and a Premier subscription package that included the Basic package *plus* premium channels that did not make use of sound recordings subject to the statutory license.³⁴ Brooker Decl. ¶ 13; *see* Declaration of Brian S. Wood ¶¶ 8-10 (Wood Decl.).³⁵ At all times, Sirius XM offered the Basic package as a stand-alone product. The parties acknowledge that subscription revenue paid for the Basic package is part of the Gross Revenues royalty base.

Sirius XM did not offer the additional channels included in the Premier package as a separate, standalone product. Rather, Sirius XM customers could obtain those Premier additional talk and other non-music channels as part of a package that included all channels in the Basic package. Sirius XM treated the Premier package as a service “offered for a separate charge” and thus excludable under paragraph (3)(vi)(B) of the regulatory definition of Gross Revenues.³⁶

³⁴ The Basic package also includes non-music programming, but the value of those non-music channels is not relevant to the present issues.

³⁵ Mr. Wood is a Sirius XM Consultant and former Senior Advisor for Sales and Operations to Sirius XM’s President.

³⁶ The regulatory language on which Sirius XM relies to justify this Upcharge exclusion states that “Gross Revenues” shall exclude “revenues recognized by licensee for the provision of . . . channels, programming, products and/or other services offered *for a separate charge* where such channels use only incidental performances of sound recordings.” 37 CFR 382.11, paragraph (3)(vi)(B) of the definition of “Gross Revenues” (emphasis added).

SoundExchange challenges Sirius XM's exclusion asserting it is not supported by the text of the regulation, in that Sirius XM did not offer the Premier channels "for a separate charge" as required by the regulation. *SoundExchange Memorandum of Law* at 18-19. SoundExchange also notes that Sirius XM regularly invoiced and billed customers a combined price rather than a separate price for the basic and premium components of the Premier package. *Id.* at 21 (and record citations therein). Further, SoundExchange points out that, when marketing the premium package, Sirius XM did not "give recipients the opportunity to purchase just the premium channels," nor did it "identify a price for the premium channels." *Id.* (and record citations therein).

Sirius XM does not deny that it did not consistently call out the "additional upcharge" on marketing materials or customer bills. However, Sirius XM contends that its communications with customers "left no doubt that all subscribers whether existing subscribers looking to upgrade or new subscribers deciding which combination of content they preferred" were presented with information making it clear that "for \$4.04 more," they could "obtain[] the additional premium channels." *Sirius XM Rebuttal Submission* at 13. As explained by Brian Wood, Sirius XM's consultant and former employee, it was perfectly plain that the premium package represented a charge for the basic package, plus the additional charge for the additional premium channels. Wood Decl. ¶¶ 13-18; *see Sirius XM Initial Submission* at 9-11, 16.

The Judges find and conclude that the language in the revenue exclusion described in paragraph (3)(vi)(B) did *not* permit Sirius XM to exclude from the Gross

Revenues royalty base the price difference, *i.e.*, the Upcharge, between the Premier package and the Basic package.

Construction of a regulation “must begin with the words in the regulation and their plain meaning.” *Pfizer v. Heckler*, 735 F.2d 1502, 1507 (D.C. Cir. 1984); *see also Freeman v. Dep’t of the Interior*, 37 F. Supp. 3d 313, 331 (D.D.C. 2014). In the present case, the plain language of the regulation disallows this revenue exclusion. Sirius XM did not offer the premium channels “for a separate charge.” Sirius XM’s use of a bundled price is inconsistent with the regulatory requirement that premium channels must be priced at a “separate charge.” In ordinary usage, the adjective “separate” is defined as: “detached, disconnected, or disjoined; unconnected; distinct; unique; being or standing apart; distant or dispersed; existing or maintained independently; individual or particular.” <http://www.dictionary.com/browse/separate> (last visited January 3, 2017). The Judges can find no portion of this definition that applies to the bundled subscription charge at which Sirius XM priced its Premier package. Indeed, a “bundled” charge is the *antithesis* of a separate charge. *See* <http://www.thesaurus.com/browse/bundled?s=t> (classifying “separate” as an antonym of “bundle”) (last visited January 3, 2017). Thesaurus entries, like dictionary definitions, are valuable sources for the ascertainment of the meaning of statutory and regulatory words and phrases. *See, e.g., McLaughlin v. Richland Shoe Co.*, 486 U.S. 128, 133 (1988) (relying on thesaurus as aid in statutory interpretation).

The Judges recognize that dictionary definitions and thesaurus entries are not necessarily dispositive as to the meaning of statutory (or regulatory) language. *See, e.g.,*

Yates v. U.S., ___ U.S. ___, 135 S. Ct. 1074, 1081-82 (2015) (“the plainness or ambiguity of statutory language is determined not only by reference to the language itself, but as well by the specific context in which that language is used, and the broader context of the statute as a whole.”) (citation omitted). Accordingly, in ascertaining the meaning of the “separate charge” requirement, the Judges also look to the context in which the “separate charge” provision was adopted. That contextual analysis explains why the *SDARS I* regulations distinguish a “separate charge” from other charges when classifying revenue to be included in or excluded from the royalty base.

First, the Judges consider the express language in the *SDARS I Determination* regarding this “separate charge” issue as it relates to a premium service – the precise issue here.

[T]he *SDARS* definition of “gross revenues” excludes monies attributable to premium channels of nonmusic programming that are offered for a charge separate from the general subscription charge for the service. The separate fee generated for such nonmusic premium channels is not closely related to the value of the sound recording performance rights at issue in this proceeding. Therefore, this proposed exclusion serves to more clearly delineate the revenues related to the value of the sound recording performance rights at issue in this proceeding.

SDARS I, 73 FR at 4087 (emphasis added).

Second, the *SDARS I Determination* also noted that the “separate charge” exclusion from Gross Revenues was designed to “enhance business flexibility” in a manner that offset the flexibility foregone by the Judges’ rejection of a “per play metric.” *Id.* at 4086. In reaching this conclusion, the Judges again made reference to use of a separate charge for a premium nonmusic service:

The SDARS argue that a “per play” rate provides the SDARS with more business flexibility because it allows them to respond to any substantial increases in fees by economizing on the plays of sound recordings so as to reduce their royalty costs. While the general proposition of enhancing business flexibility is usually advantageous (at least to the party obtaining such flexibility) ... the same flexibility may be achieved by other means.

...

For example, in light of the definition of “gross revenues” herein below in this determination, *the SDARS could offer wholly nonmusic programming as an additional, separately priced premium channel/service* without having the revenues from such a premium channel/service become subject to the royalty rate and, thereby, achieve the desired flexibility of offering more lucrative nonmusic programming without sharing the revenues from that programming with the suppliers of sound recording inputs.

Id. at 4086 and n.20 (emphasis added; citations omitted). The Judges thus deemed the “separate charge” to be necessary in order for the revenue-based royalty structure to offer

the analogous flexibility benefit of a per-play metric – *specifically with regard to a nonmusic premium package.*

The Sirius XM interpretation of the “separate charge” requirement to include its Upcharge for the Premier subscription package does not relate to the benign and appropriate “flexibility” benefit of permitting Sirius XM to perform fewer royalty-bearing sound recordings in order to minimize royalty costs. Rather, the bundle of royalty-bearing and premium non-royalty-bearing channels in a single price introduces an economically indeterminate and self-serving “flexibility” that simply confuses the issue as to which portion of the entire subscription price reflects which type of channel.

Sirius XM’s Upcharge methodology is “economically indeterminate” because it ignores the fundamental economic reason why downstream sellers such as Sirius XM decide to bundle products within one offering price—to maximize *revenue* from the sale of *both* products.³⁷ As SoundExchange notes, in the record Sirius XM candidly acknowledged that the opportunity to increase total revenues was the *raison d’etre* for offering the Premier channels only in a bundle with the Basic channels. *See SoundExchange Initial Submission* ¶¶ 56-57, 65 (and record citations therein).³⁸ When this pricing/revenue bundling phenomenon exists, a seller who owes revenue-based royalties to the provider of only one of the bundled inputs has created *an indeterminate*

³⁷ More precisely, Sirius XM engaged in “mixed bundling,” by which “consumers get to buy the bundle or instead purchase one or more of the products separately.” C. Thomas and S. C. Maurice, *Managerial Economics: Foundations of Business Analysis and Strategy* at 609 (11th ed. 2013). In contrast to “pure bundling,” by which products are *only* available for purchase as a bundle, economists believe that “mixed bundling” is the more profitable method of bundling products. *See* H. Varian, *Price Discrimination*, § 2.6 (in R. Schmalensee and R. Willig, 1 *Handbook of Industrial Organization*, Ch. 10 (Elsevier 1989).

³⁸ Despite admitting that it does not know how consumers would react to “unbundling,” Sirius XM asserts self-servingly and without evidentiary support that separate pricing of the premium package for \$4 would diminish subscriptions to and revenues from the basic package. *See SoundExchange Initial Submission* ¶ 56; SoundExchange Ex. A.204 (citing Frear Dep. 12:10-22).

revenue base, absent some additional data or information from which to identify or reasonably estimate the revenues attributable to each item in the bundle. The price difference between the bundle and an unbundled item fails to reflect the revenue attributable to each item. Rather, that price difference is necessarily *severed* from the calculation of revenue attributable to each item.

SoundExchange's expert, Dr. Lys, cogently explained why the bundled price fails to satisfy the economic purpose of the regulatory "separate charge" requirement:

First, [e]stimating the standalone value of incremental products as the difference between the bundled price and the standalone price ... inappropriately assigns all of that premium or discount to the incremental products.

Second, there would be no reason to bundle the incremental content of the premium package if in fact [its] value ... was [merely] the difference between the selling price of the [Premier] and [Basic] [packages]. In other words, if that were the case, Sirius XM could simply offer the incremental content as a standalone subscription. The fact that [it] did not do so is prima facie evidence that the value of the incremental content is not simply the difference between the [Premier] and [Basic] packages.

Third, the implied value of the same incremental good can vary dramatically depending upon which offered bundle is used determine the incremental value.

Lys Expert Report ¶ 82. In short “[t]he price differential between two bundles set by a profit-maximizing firm . . . need not equate to the price that the incremental goods would command on a standalone basis.” *Id.* at ¶ 85.³⁹

Sirius XM made no attempt to rebut Professor Lys’s economic point regarding bundling and the concomitant indeterminacy in allocating revenue as between or among the bundled items. Rather, its expert, Mr. Wills, attempted to present an analogy which only served to underscore Dr. Lys’s analysis. Specifically, Mr. Wills focused instead on a *singular* “reasonable buyer.” *Wills Expert Rebuttal Report* at 13. However, the essence of the bundling process is to segregate buyers into heterogeneous sub-classes of buyers, each of which is comprised of “reasonable” buyers with a *different – not singular –* WTP.

Moreover, Mr. Wills’s point that “when additional features are available at additional cost . . . the reasonable buyer can do the simple math to compute the cost differential, and decide whether the additional features are worth the additional cost” *misses the economic point. Id.* In any market transaction (and regardless of whether the market is monopolized, competitive or somewhere in-between), some consumers have a WTP greater than the market price for a bundle of products or a bundle of product characteristics, as compared with their WTP if the products were offered separately. If the seller cannot engage in bundling (or some other form of price discrimination) consumers with a WTP above the market-clearing price realize the benefit of the “consumer surplus” described *supra*. The consumer surplus is value foregone by the seller. By bundling, the seller captures some of that consumer surplus. *See, e.g., W.*

³⁹ A party that relies on a bundle of values to support or oppose a proposed statutory rate should introduce competent and persuasive evidence of the separate values of the constituent parts of the bundle.

Adams and J. Yellen, “*Commodity Bundling and the Burden of Monopoly*,” 90 Q.J. Econ. 475, 476 (1976) (profitability of bundling stems “from its ability to sort customers into groups with different reservation price characteristics, and hence to extract consumer surplus.”).⁴⁰

Third, the Judges find guidance in the *Rehearing Order in SDARS I*. In their *Initial Determination*, the Judges approved a Gross Revenues exclusion that covered revenues attributable to “data services.” SoundExchange moved for rehearing on this issue, arguing “there is no way to determine the value [data services] contribute to the overall subscription price” and thus “how much revenue should be deducted from the revenue base” because data services “*are not separately priced*,” and predicting that “[t]he parties almost certainly will not agree on the value of such services.”

SoundExchange Motion for Rehearing at 7 (Dec. 18, 2007) (emphasis added). In response, Sirius XM asserted that SoundExchange offered nothing but “speculation” that Sirius XM “will not properly recognize revenues for the provision of data services” Response ... to SoundExchange Motion for Rehearing at 10 n.8 (Jan. 4, 2008).

Although the Judges styled their decision as an “*Order Denying Motion for Rehearing*,” they in fact modified their Initial Determination to clarify that only data services offered for a “separate charge” could be excluded from the revenue base. The

⁴⁰ Mr. Wills also pays lip service to the correct accounting principle of “faithful representation,” that links accounting form to economic substance: “Faithful representation means that financial information represents the substance of an economic phenomenon rather than merely represent its legal form. Representing a legal form that differs from the economic substance of the underlying economic phenomenon could not result in faithful representation.” *Wills Rebuttal Report* at 14 and n.27 (quoting *FASB Statement of Financial Accounting Concepts No. 8, September 2010*). However, by ignoring the economic substance of bundled pricing, Mr. Wills’s analysis essentially does the opposite – placing form over economic substance—allowing accounting principles to obscure the principles relating to the economics of bundling.

Judges accomplished this by adding the “separate charge” language that they had included in the paragraph (3)(vi)(B) exclusion, the language on which Sirius XM relies now to justify its single, bundled charge for its Premier package (*i.e.*, Basic + additional channels). Citing that language in paragraph (3)(vi)(B) of the Gross Revenues definition, the Judges stated that “to avoid any doubt as might be suggested by SoundExchange’s arguments, we hereby clarify that subsection (3)(vi)(A) of the definition of Gross Revenues at § 382.11 Definitions, dealing with data services also does not contemplate an exclusion of revenues from such data services, where such data services are not offered for a separate charge from the basic subscription product’s revenues. ... The phrase ‘offered for a separate charge’ will be added to the regulatory language of subsection (3)(vi)(A)” *Rehearing Order* at 4-5 and n.5. Thus, the *SDARS I* Judges clearly understood that a failure by Sirius XM to set separate charges for bundled services that included services both in the royalty base and outside the royalty base would be contrary to the regulatory scheme, rendering the royalty base indeterminate.

Consistent with the Judges’ reliance on the “separate charge” language in the paragraph (3)(vi)(B) exclusion to clarify and amend the paragraph (3)(vi)(A) exclusion, the Judges now conclude that Sirius XM’s combined charge for the Premier package is inconsistent with the plain meaning of the paragraph (3)(vi)(B) exclusion and with the purpose of the “separate charge” requirement, *viz.*, to clearly distinguish between revenue *included in* the royalty base and revenue *excluded from* the royalty base.⁴¹

⁴¹ By contrast, the absence of a “separate charge” requirement for pre-’72 sound recordings was reasonable. The Sirius XM business model without dispute had always integrated pre-’72 recordings with other recordings across its channel lineup for a single Basic subscription price. Thus, it would be impractical and unreasonable to require Sirius XM to parse out a “separate charge” for pre-’72 recordings. Rather, Sirius

The Judges thus conclude that the Sirius XM Premier package is not a service offered for a separate charge. Consequently any revenues Sirius XM excluded from its Gross Revenues royalty base attributable to the incremental Upcharge for the channels in the Premier package were improper.

Conclusion

Based on the foregoing findings and reasoning, the Judges answer the District Court by concluding that Sirius XM properly interpreted the revenue exclusion to apply to pre-'72 sound recordings. Given the limitations on the Judges' jurisdiction, they defer to the District Court to determine whether Sirius XM developed a consistent, transparent, reasonable methodology for valuing those exclusions. The Judges also conclude that Sirius XM was incorrect to claim a revenue exclusion based upon its Premier package upcharge, as that Premier package was not a service offered for a separate charge. The Judges' responses to the District Court are based upon that reasoning.

The Judges issued the Amended Decision to the parties in interest on September 11, 2017. This published Amended Decision redacts confidential information that is subject to a protective order in the proceeding. The Register of Copyrights reviewed this ruling and found no legal error.

XM attempted to fashion a reasonable alternative approach to estimating the pre-'72 revenue exclusion [REDACTED].

SO ORDERED.

Dated: November 8, 2017.

Suzanne M. Barnett,
Chief Copyright Royalty Judge.

Jesse M. Feder,
Copyright Royalty Judge.

David R. Strickler,
Copyright Royalty Judge.

Approved By:

Carla D. Hayden,
Librarian of Congress.

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