

Testimony of

# Mr. Gary Parsons

April 26, 2006

TESTIMONY

of

GARY PARSONS

CHAIRMAN OF THE BOARD OF DIRECTORS

XM SATELLITE RADIO INC.

on

PARITY, PLATFORMS AND PROTECTION:

THE FUTURE OF THE MUSIC INDUSTRY IN THE DIGITAL RADIO REVOLUTION

BEFORE THE COMMITTEE ON THE JUDICIARY

U.S. SENATE

April 26, 2006

Mr. Chairman and Members of the Committee, I am pleased to appear on behalf of our 800 employees who have made XM Satellite Radio America's most popular satellite radio company. Thank you for providing us with the opportunity to share our vision for creating a powerful new broadcast medium that promotes the enjoyment, sale, and distribution of music. As we look to the future of the music industry, we hope to help it grow by enhancing the discovery of music by our six and a half million subscribers and, with Sirius, our combined industry audience of some eleven million subscribers across the country.

Today, XM subscribers pay approximately \$150 per year to listen to over 170 channels of entertainment, sports, news, talk, and other programs, including 69 channels of commercial-free music programming. Until recently, most of our subscribers heard their favorite programs only at home or in their cars and trucks. To add to their enjoyment, we first developed a hand-held device that could receive XM live and store up to five hours of programming. In response to growing consumer demand, we are bringing new portable personal products to market that will allow our subscribers to store up to 50 hours of programming, to enjoy their music on the go, and to purchase additional music tracks -- even entire albums -- with ease from the new Napster online music service.

Unfortunately, as often is the case with new technological innovations, some apparently believe that what is good for consumers is bad for content owners. As a result, we have been threatened with litigation and now face the prospect of device-crippling legislation in this and other Congressional Committees.

I am here to tell you why the proposed Perform Act would impose a new tax on your constituents, would stifle technological innovation, would discriminate against satellite radio, and in our view would even harm performing artists and the music industry. But before talking about the legislation, I will tell you about our company, our new products, and what we are doing to promote the sale of music as an alternative to illegal peer-to-peer file sharing networks.

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About XM

XM is one of the great American high-tech success stories of this decade. Using spectrum purchased at auction for nearly \$90 million, we launched our subscription service late in 2001. Since then, we have invested nearly \$3 billion in building a state-of-the-art network for the delivery of radio programming. Despite the challenges of launching a business in an economic recession and at the height of the dot.com bust, XM has grown into an enormously popular consumer business. And we soon hope for it to be a cash-positive business as well.

We continue to make huge investments not only in technology, but also in gifted individuals.

We employ rocket scientists, electrical and broadcast engineers, consumer electronics wizards, athletes, a public radio legend, traffic reporters, marketing experts, and some of the world's foremost

music experts. Unfortunately, we also have been forced to employ more and more lawyers.

#### Relationship to the Music Industry

Since the launch of our service, XM and the music industry have enjoyed a symbiotic relationship. Without compelling content, our multi-billion dollar, state-of-the-art delivery system would not have attracted nearly seven million subscribers. Nor would the music industry have received tens of millions of dollars from us. Having made that investment, we are now delivering a wide diversity of music to millions of enthusiastic, paying music fans. We have demonstrated that you can build a business that promotes the interests of both consumers and the music industry. As an industry, satellite radio is the single largest contributor of performance royalties to artists and record labels. In fact, XM and Sirius pay more in performance royalties than all other digital broadcasters and webcasters combined. Likewise, XM and Sirius pay huge royalties to composers and publishers. We respect, appreciate, and compensate creators of music. In short, through the investment of enormous amounts of risk capital, we have created a new source of royalty payments for rights holders.

In addition to these new royalty payments, we continue to provide the music industry with a powerful promotional platform. Airplay has long been an essential promotional tool for music. In fact, Congress exempted traditional radio from paying sound recording performance royalties precisely because it recognized its promotional value. XM provides the same if not greater promotional value to artists and labels, and yet we do not enjoy this same exemption. Even for HD digital radio, broadcasters are exempt from the sound recording performance royalty obligations that XM pays. In fact, as you know, recent payola allegations suggest that record labels (that collect money from satellite radio) actually pay traditional radio stations to play their music. Despite this disparate treatment, we are not here today to ask you to change current law, but instead to help you understand the competitive environment in which we operate.

Over the past two decades, playlists at traditional radio stations have been shrinking, forcing the public to endure an endless repetition of the same handful of songs. The variety of formats has declined as well. By contrast, XM offers our subscribers 69 channels of commercial-free music. We have over two million titles in our collection, and play approximately 160,000 different tracks each month.

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We have something for everyone: 24-hours per day of bluegrass, blues, classical, country, hip hop, jazz, opera, pop, and rock and roll. We have channels devoted to emerging artists. We have a channel for artists that as yet are unsigned to any major record label. Our "Deep Tracks" channel has helped reinvigorate the careers of many rock stars of the 1960s and '70s, and we have provided the opportunity for bands to perform live in the "XM Café" at our recording studios. XM presents a series called "Artist Confidential" and music shows hosted by stars as diverse as Bob Dylan, Quincy Jones, Tom Petty, Wynton Marsalis, and Snoop Dogg to help our listeners understand more about music from the artists' perspective. Our channel 73, "Frank's Place," features the greatest singers of American Popular Song, from its namesake Frank Sinatra to greats such as Ella Fitzgerald, Sarah Vaughan, Tony Bennett, and Rosemary Clooney.

At the touch of a button, XM listeners see the name of the performing artist and the name of the song they are hearing. Unlike broadcast radio stations, which rarely announce what they play, XM is a powerful tool for educating consumers hungry to discover and buy more music.

In doing so, we provide promotional value and royalty compensation never offered to the record industry by traditional radio. And yet the music industry continually attacks us for bringing great new products to market.

#### New Devices

From the outset, we have been committed to offering consumers the best and most innovative products, while respecting copyright. Our subscribers want more than just the ability to hear great music at home or on the highway. Last year, we introduced a line of products called XM2GO. These portable products allow consumers to listen to XM live or to record up to five hours of programming, and thus to enjoy XM even when they cannot receive a satellite signal, such as at the gym or on an airplane flight.

We are building on the success and the functionality of the XM2GO devices with the Samsung Helix and the Pioneer Inno. Like the XM2GO, these new personal portable devices enable consumers to listen to live XM or to record content they receive over satellite radio. A subscriber can program these devices, like "time-shifting" on a VCR, to record a program that they

cannot listen to live. The devices also will offer the type of functionality consumers have come to expect from their everyday personal portable music devices. The XM Helix and Inno players give consumers the ability to organize and hear the content they have recorded in any order they choose. In addition, the new devices include the ability for consumers to store songs from their personal music collection, and even to mix those songs with new music they hear on satellite radio. And if they enjoy a song they have heard or recorded, they can "bookmark" a song to buy later on CD, or they can purchase that song lawfully online from Napster and have it downloaded directly to the device.

As a responsible business, we specifically designed our products to comply with the Audio Home Recording Act (AHRA). When it adopted the AHRA in 1992, Congress created the legal framework for companies like XM to manufacture and distribute devices that can record digital music. As you will recall, that legislation allows consumers to digitally record music from CDs and broadcast transmissions for personal use, but prevents making digital copies from copies. In addition, under the AHRA manufacturers pay royalties on the sale of devices. The millions in revenues paid by manufacturers are shared with everyone in the music industry, under a formula

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enacted by Congress with the support of all music industry stakeholders. In return, manufacturers, distributors, retailers, and consumers are immune from lawsuits based on copyright infringement. This represented a balanced compromise that won the unqualified support from the recording industry, the music industry, and the consumer electronics industry.

Congress intended the AHRA as a comprehensive and forward-looking compromise solution for the recording industry's concerns, for all new digital recording devices. And so did the recording industry. Then-RIAA president Jay Berman testified before this Committee that the AHRA "will eliminate the legal uncertainty about home audio taping that has clouded the marketplace," and "will allow consumer electronics manufacturers to introduce new audio technology into the market without fear of infringement lawsuits... ." In supporting the passage of the AHRA, Mr. Berman assured Congress that they would not have to revisit the home recording controversy for every new generation of digital recorder, proclaiming that the AHRA "is a generic solution that applies across the board to all forms of digital audio recording technology. Congress will not be in the position after enactment of this bill of having to enact subsequent bills to provide protection for new forms of digital audio recording technologies."

In reliance on the AHRA, XM has invested in the design and manufacture of our new generation personal portable radio products. In compliance with the AHRA, these new generation devices do not allow any of the recorded content to be moved off the device in digital form. The only output on these devices goes to your headphones, in analog form. The new Helix and Inno products promote personal listening, not Internet piracy.

Notwithstanding payment of millions of dollars in performance royalties, millions more in AHRA royalties, and the limitations we designed into the devices so that XM content will not be uploaded to the Internet, XM still faces opposition from the music industry. We have heard it said that allowing consumers to record satellite radio turns our radio service into an unlawful download business. We disagree. We have heard it said that we are now giving consumers for the first time the ability "to slice and dice" music as they see fit. We disagree. And we have been told our devices will cannibalize the sale of recorded music, rather than promote sales as XM has done since its inception. We emphatically disagree.

As an initial matter, we strongly reject the music industry's efforts to roll back the longestablished ability of consumers to record off the radio for personal use. We are particularly disappointed that the head of the RIAA has sought to vilify our law-abiding customers in testimony before the House Judiciary Committee, when he accused home tapers using new technology of "boldly engag[ing] in piracy with little fear of prosecution." XM listeners are avid music fans and some of the music industry's best customers, not pirates. And XM, and the consumer electronics manufacturers that build our new products in compliance with the AHRA, are not pirates either. Recording content off of satellite radio is not the same as downloading music and has nothing to do with piracy:

? When a consumer wishes to download a song from Napster or iTunes, he can acquire that specific song on-demand within seconds of entering the name of the song. By contrast, XM subscribers have no ability to choose what XM plays or, therefore, what songs they can record.

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? When a consumer buys a download from an Internet service, she can typically copy the song onto multiple devices and even burn it on to CDs. If a subscriber records a song from XM, the song is output only to her headphones. It cannot be burned directly to a CD, moved to any other device, or uploaded to the Internet.

? When a consumer purchases a download, he gets the full song from beginning to end. When a subscriber records a song off of XM, the recording is no substitute for the original. Just like recordings made using a tape recorder from FM radio, songs recorded off XM include DJ chatter, overlapping parts of the preceding and following songs, and they may even have a few seconds cut off.

? A download service, unlike XM, knows exactly what the consumer is downloading and can charge for every download. XM, like any radio service, has no way to know how many subscribers are listening at any given time, no less whether or what any subscriber may be recording. That is precisely why Congress created a royalty payment pool under the AHRA of funds to be shared among the music industry, based on general digital recording for personal use.

In short, we are providing our subscribers greater value from their XM subscription: the ability to take XM with them everywhere, on the go in their busy lives.

These new personal portable XM devices are merely today's equivalent of recording off the radio, with the kinds of flexibility that consumers have come to expect from new digital technology. We are giving our subscribers the tools to enjoy music they have lawfully acquired, with the capability to listen to that music in any order they want, to skip over songs they don't like, and to put together lists of songs for listening when jogging, commuting, or shopping - including when shopping for CDs. When a consumer records television programming on a TiVo, he or she can search for a particular episode and disaggregate it from the other recorded content. Like TiVo, we give consumers the tools to maximize their personal, non-commercial listening experience. But unlike a TiVo recorder, we cannot offer a program guide to tell our subscribers what songs are coming or when to record.

As in the days of reel-to-reel tape and later with analog cassettes, consumers can record from XM programming and decide when and in what order to listen to it. No doubt a few of you remember the experience of recording a song off the radio, using a razor blade to cut the tape, and with the help of Scotch® tape re-arranging the songs to make a party list of favorites. Our devices, like many other lawful products on the market today, simply update the tools for personal recording into the 21st century. These devices offer our subscribers the convenience of digital recording technology that they get from every other new digital media device they own. But just because a device makes personal recording convenient does not, and should not, make it illegal.

#### Concerns with Proposed Legislation

The proposed Perform Act would give the recording industry unwarranted control over the business of satellite radio, and would unfairly change the rules governing our upcoming royalty rate arbitration just as that arbitration is about to begin. We have three principal concerns.

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First, the proposed Perform Act will lead to a new tax being imposed on our subscribers.

Under current law, enacted just a few years ago in 1998 -- with the full support of the recording industry -- we pay performance royalties to record labels under the formula set forth in section 801(b) of the Copyright Act. Congress specifically chose that formula for satellite radio because it would take into account our "technological contribution, capital investment, cost, risk, and contribution to the opening of new markets," and would avoid disruption to our business.

Moreover, Congress perceived that standard as fair to the recording industry, because that same section 801(b) formula governs the rates that the recording industry pays to songwriters and music publishers under their compulsory license. At the beginning of this year, the Copyright Office initiated the next statutorily-mandated arbitration between the recording industry and satellite radio to set those royalty rates for the next five years, and we are now in a period of negotiations over those rates. The Perform Act - on the very eve of those statutory license negotiations and arbitration - would unfairly change the rules for these negotiations and arbitration by taking away the 801(b) standard.

Under the bill, royalties would be set instead pursuant to the "fair market value" rule -- a rule that in practice would be anything but fair to XM, and that the recording industry apparently hopes

will grant them an unwarranted windfall.

Members of this Committee may remember their past experience the only time that the "fair market value" standard was ever used to set compulsory license rates. In 1999, Congress by law in the Satellite Home Viewer Improvements Act had to step in and slash by as much as 45 percent the crippling rate that had been set by the Copyright Royalty Arbitration Panel under the "fair market value" standard, because it threatened to destroy the satellite television broadcasting industry. The proposed Perform Act bill would only create a repeat performance of the SHVIA controversy for satellite radio.

Unlike the existing section 801(b) formula, the "fair market value" standard does not take into account costs that are disproportionately incurred by XM (and Sirius) over any other entity currently subject to a performance license. Of all the entities that pay performance royalties, satellite radio is the only industry that creates and pays for its entire delivery infrastructure. Webcasters like Yahoo! did not have to create the Internet, and did not have to license spectrum from the FCC. By contrast, we acquired an FCC broadcast license at a cost of \$90 million. We have spent close to a billion dollars to purchase our own dedicated transmission satellites and launch them into orbit, and we must repeat that investment to replace them on an ongoing basis after a relatively few years. We created and designed the XM transmission and receiving technology. In total, we have invested more than 3 billion dollars to create the satellite radio business, and expect to invest billions more on an ongoing basis. And still, under the section 801(b) standard, the satellite radio industry currently pays greater royalties to performers and recording artists than all other industries combined - while, of course, terrestrial radio continues to pay nothing.

Let me be clear: XM is not asking for any exemption or change to the law. XM simply wants the existing section 801(b) standards to continue to apply to our satellite radio service. That is what Congress decided in 1995 before XM obtained its broadcast license from the FCC, and what Congress re-affirmed in 1998 as we were preparing to launch our satellites and our service. If Congress truly wishes to create parity among the standards under the section 114 performance license, XM would have no objection if the section 801(b) factors were applied to all licensees. That balanced standard guarantees a reasonable royalty and a fair return to the recording industry and to

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all performing artists. Every service could receive an appropriate rate under section 801(b) based on the value each brings to the table. That would be a fair result that XM would support.

The reason the recording industry is now insisting on a different standard has nothing to do with fairness. XM and the record industry are in the middle of renegotiating their performance license. By changing the standard now, the recording industry hopes to stack the deck in its favor. It would be grossly unfair to change the standard we built our business on or to force us to accept a standard that does not take into account the huge initial and ongoing investments made by our company. We cannot understand why Congress, just as these negotiations have begun, should preempt or upend the very statutory negotiation and arbitration process it prescribed for XM.

Mr. Bronfman recently told Wall Street and the press that he believes satellite radio should pay ten times to the recording industry what it currently is paying under the statutory license, and evidently the Perform Act is the vehicle he hopes will do it. XM cannot simply absorb a substantial increase per subscriber. The Perform Act would force XM to add that fee to our monthly subscription, courtesy of the recording industry and the U.S. Congress.

Second, as an equally unwarranted but far more punitive measure, the proposed Perform Act suggests that we can no longer qualify for a statutory performance license under section 114 at all if we bring our new personal portable radios to market with the recording and sorting features we have built into them. In other words, if we want to add new features our subscribers want and expect from new technology, then we must lose the protection of a statutory license and instead be forced to get hundreds of thousands of individual licenses from artists and record labels for the more than two million songs in the XM library. That of course would be impossible. Indeed, Congress created the section 114 license in part because it recognized that such negotiations were impossible both for the services and for small recording labels and artists. Thus, by offering the new devices as now configured post enactment of the legislation, we would turn our entire business into one of willful copyright infringement.

The Perform Act would wreak massive changes to existing law, based on speculations and fears of the recording industry that, time and again, have proven wrong. For more than 50 years, consumers have been lawfully taping music off the air, producing "mix tapes", and otherwise

exercising their "fair use" rights to enjoy music in the privacy of their homes. Just as TiVo made the functionality of the VCR more user friendly, our new devices allow consumers to basically do what they have been doing for decades -- in a simple, convenient way. We can expect the RIAA to continue to wrongfully attack home tapers as pirates, but we cannot understand why anyone on this Committee would support such a fundamental attack on personal, private, and traditional home taping practices or would brand our company a willful infringer for bringing to market a device that allows your constituents to record and then listen to musical selections in whatever order they want. Again, just because our devices make personal recording off the radio more convenient does not make personal recording illegal.

Finally, we find it particularly unfair that the bill would single out satellite radio for these punitive measures. The bill would not restrict in the least the ability of anyone else to offer the same type of device. The same kind of devices that will record HD Radio programs and even current FM programs would be unaffected by this bill. Nor does the legislation affect the ability of a third party from making a radio that can record webcasts. A quick Google search for "record Internet radio" will turn up dozens of current lawful products that do all these things. And of course the bill does

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nothing to stop consumers from turning to illegal P2P networks as the principal source of music if we lose them as customers. The essence of this bill is not parity - it is discrimination against satellite radio.

In our view, in the end the proposed legislation would hurt the music industry by discouraging technological innovation, pricing some of our existing and future subscribers out of the market, limiting the valuable airplay exposure that XM gives to emerging and classic artists, and paradoxically reducing the royalties that performers and record labels otherwise might receive from a thriving satellite radio industry. It will not be the first time the music industry has tried to kill the golden goose. The record industry historically has failed to appreciate how it could capitalize on new services and new products. We are here today to stand up for our subscribers' right to enjoy XM programming for their private, personal use, and to fight for the ability of entrepreneurs to bring lawful new products to market in the face of device-crippling legislation backed by an industry reluctant to adapt to new technology.

#### Conclusion

Today, we are offering more than six and a half million subscribers and a combined industry audience of some eleven million consumers the ability to enjoy music wherever they go. We are doing so lawfully, pursuant to the statutory framework Congress established in 1992 under the Audio Home Recording Act and in 1998 when it chose the 801(b) standard to govern our performance license under section 114. We are doing so in a way that delivers tens of millions of dollars in new royalty payments to the music industry and millions more in additional royalty payments under the AHRA. And we are doing so in a way that facilitates the purchase of music and thus gives the music industry another way to compete against illegal P2P networks.

In short, we are doing it right. We are following precisely the laws that Congress designed to apply to XM and to our new generation portable personal products. Like the companies behind every new technology from the transistor radio to the iPod, XM Satellite Radio is changing existing business models. We are doing so lawfully and we are paying more in compensation to copyright owners than any other industry. So, if sued, we will vigorously defend our business, our technology, and our subscribers. And we will fight any legislation that would turn back the clock on technology or impose a new tax on the music fans who are devoted to our service, or that threatens the longhoned right of consumers to record off the radio for their private personal enjoyment.

Thank you for your consideration of our views.