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

In the Matter of Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding	Docket No. 2006-3 CRB DPRA

PROPOSED CONCLUSIONS OF LAW
OF NATIONAL MUSIC PUBLISHERS' ASSOCIATION, INC.,
THE SONGWRITERS GUILD OF AMERICA, AND
THE NASHVILLE SONGWRITERS ASSOCIATION INTERNATIONAL

July 2, 2008

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National Music Publishers' Association, Inc. ("NMPA"), the Songwriters Guild of America ("SGA") and the Nashville Songwriters Association International ("NSAI") (collectively, the "Copyright Owners") respectfully submit their Proposed Conclusions of Law in support of their proposal for rates and terms for mechanical royalties under Section 115 of the Copyright Act.

I. The Court's Authority Under Section 801(b) of the Copyright Act

1. This proceeding was initiated pursuant to 17 U.S.C. § 804(b)(4) to set the royalty rates and terms for the statutory mechanical license provided by 17 U.S.C. § 115. *See Adjustment or Determination of Compulsory License Rates for Making and Distributing Phonorecords*, 71 Fed. Reg. 1454 (Jan. 9, 2006). For the compulsory license created by Section 115, this Court is authorized to determine the "reasonable terms and rates," 17 U.S.C. § 801(b)(1), that are payable "for every phonorecord made and distributed in accordance with the license." *Id.* § 115(c)(2).

2. Section 801(b) of the Copyright Act directs the Court to set "reasonable terms and rates" to achieve the following objectives:

> (A) To maximize the availability of creative works to the public.
>
> (B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.
>
> (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.
>
> (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

Id. at § 801(b)(1).

3. The Court has "full independence in making determinations concerning adjustments and determinations of copyright royalty rates and terms," 17 U.S.C. § 802(f)(1)(A)(i), except that the Court may consult with the Register of Copyrights "on any matter other than a question of fact," *id.*, and shall refer to the Register any "novel material question of substantive law" concerning the interpretation of the Copyright Act. *Id.* § 802(f)(1)(B).

4. In addition, in exercising its independent judgment, the Court is bound by certain regulations. Specifically,

> [t]he Copyright Royalty Judges shall act in accordance with regulations issued by the Copyright Royalty Judges and the Librarian of Congress, and on the basis of a written record, prior determinations and interpretations of the Copyright Royalty Tribunal, Librarian of Congress, the Register of Copyrights, copyright arbitration royalty panels (to the extent those determinations are not inconsistent with a decision of the Librarian of Congress or the Register of Copyrights), and the Copyright Royalty Judges (to the extent those determinations are not inconsistent with a decision of the Register of Copyrights that was timely delivered to the Copyright Royalty Judges pursuant to section 802(f)(1) (A) or (B), or with a decision of the Register of Copyrights pursuant to section 802(f)(1)(D)), under this chapter, and decisions of the court of appeals under this chapter before, on, or after the effective date of the Copyright Royalty and Distribution Reform Act of 2004.

17 U.S.C. § 803(a)(1).

5. The Court must support its determination by setting forth the findings of fact on which it relies based on the record before it. 17 U.S.C. § 803(c)(3).

6. The rates and terms set by this proceeding will take effect on the first day of the second month after the Court's final determination. *See* 17 U.S.C. § 803(d)(2)(B). They will not apply retroactively, except as to activities for which no royalty rate has previously been set, *id.*, and will remain in effect until successor rates and terms are determined in proceedings set to

begin in 2011, *see id.* § 804(b)(4), unless the parties enter into a contrary agreement. *See id.* § 115(c)(3)(B), (C); *see also* National Music Publishers' Association, Inc.'s, the Songwriters Guild of America's, and the Nashville Songwriters Association International's Motion To Confirm the Effective Date of New or Adjusted Mechanical Royalty Rates, Docket No. 2006-3 CRB DPRA (Mar. 28, 2008).

7. As the parties notified the Court on May 15, 2008, a partial settlement has been reached among all parties concerning "limited downloads and interactive streaming, including all known incidental digital phonorecord deliveries" (the "Partial Settlement"). *See* Joint Motion to Adopt Procedures for Submission of Partial Settlement, Docket No. 2006-3 CRB DPRA (May 15, 2008). Pursuant to Section 801(b)(7)(A), the Court is required to adopt the terms of a settlement reached by all participants in the proceeding in its final determination.[1]

8. Where all of the participants have entered into a settlement agreement, the Court shall "adopt [such agreement] as a basis for statutory terms and rates." 17 U.S.C. § 801(b)(7)(A). Thus, once the settlement is filed, the Court shall incorporate its terms into the final disposition.

II. The Scope of Section 115

9. The Copyright Act grants the owner of a copyright in a musical work the exclusive rights to reproduce and distribute that work. 17 U.S.C. § 106(1), (3). Notwithstanding the rights guaranteed by Congress for the Copyright Owners, their ability to prevent reproduction and distribution of their musical works is limited by Section 115. That provision establishes, among other things, a compulsory license for "phonorecords of a nondramatic musical work

[1] The Court's May 27, 2008 Order on the Joint Motion To Adopt Procedures For Submission of Partial Settlement granted the parties relief from the obligation to submit findings of fact and conclusions of law regarding interactive streaming and limited downloads.

[that] have been distributed to the public in the United States under the authority of the copyright owner." 17 U.S.C. § 115(a)(1). Thus, once a musical work has been distributed with the permission of the copyright owner, all copyright users have access to the work and may copy and distribute it (within certain limitations) as long as they pay the applicable royalty to the copyright owner.

10. The compulsory license was introduced in 1909 to prevent certain copyright users from monopolizing the music industry by acquiring exclusive rights for the reproduction of musical works and to guarantee "access to copyright music" to all copyright users. *Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords: Rates and Adjustments of Rates*, 46 Fed. Reg. 10466, 10483 (Feb. 3, 1981) (the "1981 Mechanical Rate Determination"). The license was thus intended to regulate the horizontal relationship between copyright users (rather than the vertical relationship between copyright users and copyright owners), *id.*, while "ensuring that music publishers and songwriters receive an appropriate royalty." *Mechanical & Digital Phonorecord Delivery Rate Adjustment Proceeding*, Docket No. RF 2006-1 (Oct. 16, 2006), 71 Fed. Reg. 64303, 64306 (the "Ringtones Opinion").

11. As a corollary, it is well-established that to the extent the compulsory license operates to limit the exclusive rights of copyright owners, it must be construed narrowly. *Id.* at 64307. In the words of the 1981 Mechanical Rate Determination, "the statutory rate should work to ensure the full play of market forces, while affording the individual copyright owners a reasonable rate of return for their creative works." 45 Fed. Reg. at 10479. "The legislative history of the Act makes clear that Section 115 of the Act contemplates the compulsory use of an individual song, by an individual record manufacturer, after voluntary negotiation with an

individual copyright owner has failed. Further, in exchange for that compulsory use, the Act contemplates a per-unit rate of compensation payable to the copyright owner on an individual basis by a copyright user." *Id.* Thus, the critical issue for this Court in setting the mechanical rate is the return to an individual songwriter for an individual use of a musical work.

12. The Section 115 compulsory license has certain limitations. Among, others, it does not encompass the right to create derivative works based on the licensed work. 17 U.S.C. § 115(a)(2).

13. The Copyright Act also permits parties in the marketplace to agree to rates different from the statutory rate, within certain limitations described below. *See* 17 U.S.C. § 115(c)(3)(E) ("License agreements voluntarily negotiated at any time between one or more copyright owners of nondramatic musical works and one or more persons entitled to obtain a compulsory license . . . shall be given effect in lieu of any determination by the Librarian of Congress and Copyright Royalty Judges.").

A. The Scope of the Section 115 License

14. Until the mid-1990s, the compulsory license was relevant primarily to "the making and distribution of phonorecords," such as records, cassettes, and CDs. Ringtones Opinion, 71 Fed Reg. at 64303. In 1995, Congress passed the Digital Performance Right in Sound Recordings Act ("DPRA"), Pub. L. No. 104-39, 109 Stat. 336, recognizing that "digital transmission of sound recordings was likely to become a very important outlet for the performance of recorded music" and that "new technologies also may lead to new systems for the electronic distribution of phonorecords with the authorization of the affected copyright owners." Ringtones Opinion, 71 Fed. Reg. at 64305 (quoting S. REP. NO. 104-128, at 14 (1995)). The DPRA amended Section 115 to include digital phonorecord deliveries ("DPDs") in the compulsory mechanical licensing scheme and granted holders of compulsory licenses the

right to "distribute or authorize the distribution of a phonorecord of a nondramatic musical work" by means of a DPD. 17 U.S.C. § 115(c)(3)(A). As the Register of Copyrights (the "Register") has stated, in enacting the DPRA, "Congress wanted to reaffirm the mechanical rights of songwriters and music publishers in the new world of digital technology." Ringtones Opinion, 71 Fed. Reg. at 64305; *see* S. REP. NO. 104-128, at 37 ("The intention in expanding the mechanical compulsory license to digital phonorecord deliveries is to maintain and reaffirm the mechanical rights of songwriters and music publishers as new technologies permit phonorecords to be delivered by wire or over the airwaves rather than by the traditional making and distribution of records, cassettes and CDs.").

B. Ringtones Are Outside the Scope of The Compulsory License

15. On August 1, 2006, the RIAA moved to refer to the Register pursuant to 17 U.S.C. § 802(f)(1) the question whether distribution of a "mastertone" by means of digital transmission is a DPD licensable under Section 115. Motion of RIAA Requesting Referral of a Novel Material Question of Substantive Law, Docket No. 2006-3 CRB DPRA (Aug. 1, 2006) (the "Referral Motion").[2] The Copyright Owners opposed the Referral Motion on the grounds that it presented mixed questions of law and fact. Opposition of NMPA, SGA and NSAI to Motion of RIAA Requesting Referral of a Novel Material Question of Substantive Law, Docket No. 2006-3 CRB DPRA (Aug. 8, 2006).

16. On September 14, 2008, the Court referred two questions to the Register: whether ringtones (whether monophonic or polyphonic, or mastertones) constitute DPDs subject

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2 Mastertones are a type of ringtone. A ringtone is a digital audio file that is downloaded to a mobile phone or similar portable device in order to personalize the ring that alerts the consumer to an incoming call or message. Monophonic ringtones are rudimentary works that contain only a musical work's melody (or a portion of the melody). Polyphonic ringtones contain a musical work's melody and harmony (or a portion thereof). Mastertones are ringtones that are derived from full-length sound recordings. *See* Findings of Fact ¶ 117.

to statutory licensing under Section 115, and, if so, what are the legal conditions and/or limitations on such statutory licensing. Order Granting in Part the Request for Referral of a Novel Question of Law, Docket No. 2006-3 CRB DPRA (Aug. 18, 2006).

17. On October 4, 2006, the Copyright Office held a hearing on these questions. Transcript of Oral Argument, *In re Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding*, Docket No. RF 2006-1 (Oct. 4, 2006).

18. The Register issued a decision on October 16, 2006. In that ruling, the Register held, "we believe that ringtones (including monophonic and polyphonic ringtones, as well as mastertones) qualify as digital phonorecord deliveries ("DPDs")." Ringtones Opinion 71 Fed. Reg. at 64303.

19. The Register went on to state, however, that "whether a particular ringtone falls within the scope of the statutory license will depend primarily upon whether what is performed is simply the original musical work (or a portion thereof), or a derivative work (*i.e.*, a musical work based on the original musical work but which is recast, transformed, or adapted in such a way that it becomes an original work of authorship and would be entitled to copyright protection as a derivative work)." *Id.* The Register expressly stated "that Section 115, by its terms, concerns only the rights to reproduce and distribute phonorecords of works, leaving derivative works outside its confines." *Id.* at 64310. Thus, according to the Register, with respect to ringtones that "contain a portion of the full length musical work" and other additional material "[t]he determination of whether such a ringtone . . . results in a copyrightable derivative work is a mixed question of fact and law that is beyond the scope of this proceeding," and "the[] status [of such ringtones] as derivative works need not be determined in this proceeding, but are more appropriately determined on a case-by-case basis by the courts." *Id.* at 64313.

20. Notwithstanding the jurisdictional limits recognized by the Register, she nonetheless determined that certain mastertones "simply copy a portion of the underlying musical work and cannot be considered derivative works because such excerpts do not contain any originality and are created with rote editing." *Id.* at 64312. According to the Register, "[r]ingtones that are merely excerpts of a preexisting sound recording fall squarely within the scope of the statutory license, whereas those that contain additional material may actually be considered original derivative works and therefore outside the scope of the Section 115 license." *Id.* at 64304.

21. The Copyright Owners appealed the Register's Ringtones Opinion to the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") on the grounds, among others, that it exceeds the Register's jurisdiction and authority and violates applicable statutes. Petition for Review and Notice of Appeal, *NMPA, Inc., et al.* v. *Library of Congress, et al.*, Docket No. 06-1378 (D.C. Cir. Nov. 16, 2006).

22. As the Copyright Owners will argue on appeal, the evidence in this proceeding demonstrates that creating a mastertone is a creative process that results in a complete musically balanced work that stands on its own. As explained in the Copyright Owners' Proposed Findings of Fact (the "Findings of Fact"), the creation of mastertones requires creative musical judgment, including determining which segment of the song to incorporate into the mastertone, selecting the iteration of that segment to use, and recognizing how best to edit that segment. The mastertones themselves are complete, musically balanced works that include all the characteristic elements and structures that are found in full-length musical works. *See* Findings of Fact ¶¶ 890-906. There is no evidence in the record to the contrary; all of the evidence in the record is in direct contradiction of the Register's ruling.

C. Certain Voluntary Agreements Are Permitted By Section 115

23. Section 115(c)(3)(E) of the Copyright Act allows parties to enter into voluntary license agreements that supersede the rates and terms set by this Court. Thus, parties in the marketplace often bargain for rates below the statutory rate. One example is controlled composition clauses in record company contracts with singer-songwriters. Controlled composition clauses reduce mechanical royalties in two primary ways. First, such clauses usually impose a percentage rate reduction from the statutory mechanical royalty rate for songs written by the singer-songwriter and his or her co-writer. The common practice is for the record companies to require a reduction to 75% of the statutory amount (that is, a 25% reduction). Second, these clauses impose a cap on the number of songs (typically, 10 songs) for which the record company will pay mechanical royalties, which, in tandem with the 25% reduction described above, further ratchets down the mechanical royalties paid to songwriters. *See* Findings of Fact ¶¶ 241-50.

24. In response to publishers' and songwriters' concerns with this practice, Congress limited the applicability of controlled composition clauses in the DPRA. Thus, Section 115 provides that the statutory rate shall apply to DPDs "in lieu of any contrary royalty rates specified in a contract pursuant to which a recording artist who is the author of a nondramatic musical work grants a license under that person's exclusive rights in the musical work . . . or commits another person to grant a license in that musical work . . . to a person desiring to fix in a tangible medium of expression a sound recording embodying the musical work." 17 U.S.C. § 115(c)(3)(E)(i). However, "a contract entered into on or before June 22, 1995," is exempt from this proscription. *Id.* § 115(c)(3)(E)(ii)(I). Thus, controlled composition clauses in artist contracts that postdate June 22, 1995 are not applicable to sales of DPDs.

III. Rates Should be Set on the Basis of Comparable Market Benchmarks

25. The ultimate obligation of the Court is to set "reasonable terms and rates of royalty payments" in accordance with the four statutory factors set forth in Section 801(b).

26. The determination of a reasonable mechanical royalty rate should "begin with a consideration and analysis of [marketplace] benchmarks and testimony submitted by the parties, and then measure the rate or rates yielded by that process against the statutory objectives" of Section 801(b). *In re Determination of Rates and Terms for Preexisting Subscription Servs. & Satellite Digital Audio Radio Servs.*, 73 Fed Reg. 4080, 4084 (Jan. 24, 2008) ("SDARS Determination"). Marketplace benchmarks are critical to the identification of "the parameters of a reasonable range of rates within which a particular rate most reflective of the four 801(b) factors can be located." *Id.* at 4088.

27. In determining a mechanical rate that satisfies the Section 801(b) statutory objectives, "the issue at hand is whether the[] [four] policy objectives weigh in favor of divergence from the results indicated by the benchmark marketplace evidence." *Id.* at 4094. The analysis of the four factors is not "a beauty pageant" where each factor represents a stage in the competition between the parties to be "evaluated individually to determine the stage winner and the results aggregated to determine an overall winner." *Id.* Instead, for each factor, the "question is whether it is necessary to adjust the result indicated by marketplace evidence in order to achieve th[e] policy objective." *Id.* at 4094-96.

A. Selecting Appropriate Marketplace Benchmarks

28. A meaningful marketplace benchmark provides insights into "what is paid for music elsewhere under similar circumstances," *1980 Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players*, 46 Fed. Reg. 884, 889 (Jan. 5, 1981) ("Jukebox License

Proceeding"), and indicates how the policy considerations outlined in Section 801(b) can be efficiently achieved.

29. "'[C]omparability' is a key issue in gauging the relevance of any proffered benchmarks." SDARS Determination, 73 Fed. Reg. at 4088. As this Court has explained, appropriate benchmarks define a "zone of reasonableness that excludes clearly noncomparable marketplace situations." *Id.* A meaningful benchmark will be "indicative of the prices that prevail for services purchasing similar music inputs" in transactions that include "similar sellers and a similar set of rights to be licensed." SDARS Determination, 73 Fed. Reg. at 4088, 4093; *accord Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 72 Fed. Reg. 24084, 24092 (May 1, 2007) (**"**Second Webcasting Determination"). "[A]ctual marketplace agreements pertaining to the same rights for comparable services" offer the best evidence of the market rate. *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recording and Ephemeral Recordings*, Webcaster I, 67 Fed. Reg. 45240, 45247 (July 8, 2002) (the "First Webcasting Determination"); *see also Public Broadcasting Entities*, 43 Fed. Reg. 25068, (June 8, 1978) (noting that voluntary agreements can "provide[] useful guidance").

30. In contrast, "a proposed benchmark that does not reflect accurately the characteristics and dynamics of the industries subject to the proposed rate" should be rejected. *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25394, 25404 n.24. (May 8, 1998) (the "PSS Determination").

31. A meaningful benchmark must be independent and not derivative of the statutory rate. "[I]it is difficult to understand how a license negotiated under the constraints of a compulsory license, where the licensor has no choice but to license, could truly reflect 'fair

market value.'" *Noncommercial Educational Broadcasting Compulsory License*, 63 Fed. Reg. 49823, 49834 (Sept. 18, 1998).

32. Here, the relevant market is the market for mechanical rights for phonorecords. An appropriate benchmark should be derived from a comparable market in which users seek to license the rights to both the musical compositions embedded in sound recordings and the sound recordings themselves. The market benchmarks should be freely negotiated transactions not subject to a statutory cap so they can provide insight to the market rate for mechanical licenses that would prevail if the market were unconstrained by a compulsory license.

B. The Copyright Owners' Benchmarks Are Comparable and Independent

33. The Copyright Owners' have proposed the *only* comparable marketplace benchmarks in this proceeding.

34. The Copyright Owners' benchmarks are predicated on the testimony of their economic expert, Professor Landes. His principal benchmarks are derived from numerous voluntary agreements in the mastertone and synchronization markets. Those agreements satisfy every test for a relevant marketplace benchmark.

35. First, the mastertone and synchronization agreements upon which Professor Landes relied involve the same right for which the statutory rate is being set in this proceeding – the right to use a copyrighted musical composition. This is consistent with this Court's requirement that benchmarks involve rights similar to those for which a rate is being set, SDARS Determination, 73 Fed. Reg. at 4088, and with this Court's recognition that actual marketplace agreements that involving such rights are the best evidence of the market rate. Second Webcasting Determination, 72 Fed. Reg. at 24092.

36. Moreover, because the rights at issue in this proceeding involve the distribution of musical compositions embedded in sound recordings, the benchmarks relied on by Professor Landes appropriately provide information regarding the *relative* valuation of the musical composition and sound recording when both rights are free from the constraint of a statutory license. Thus, under Professor Landes's benchmarks, "[e]ven though the absolute value of prerecorded music may differ across uses, the division of total content value between the sound recording (or master) and the publisher (which together supply the 'content pool')" is probative of what a reasonable royalty would be "when rights to the sound recordings are negotiated freely but the right to the mechanical is subject to compulsory licensing and rate setting." Landes WDT (CO Trial Ex. 22) at 25.

37. Second, the mastertone and synchronization agreements involve the same sellers of those rights – the copyright owners of musical compositions and of sound recordings. As Professor Landes recognized, it is essential that benchmarks be "indicative of the prices that prevail for services purchasing similar music inputs" in transactions that include "similar sellers." SDARS Determination, 73 Fed. Reg. at 4088.

38. Third, none of the agreements relied upon by Professor Landes is materially influenced by a statutory license, which as the Register has noted, is critical where what is sought is a market rate. *Noncommercial Educational Broadcasting Compulsory License*, 63 Fed. Reg. 49823, 49834 (Sept. 18, 1998). As Professor Landes explained, although mastertones became subject to the statutory license upon the issuance of the Ringtones Opinion, the vast majority of the mastertone licenses that he examined and which comprised his benchmark pre-dated that determination. Synchronization rights are unconstrained by a statutory license.

39. The most probative benchmarks arise from voluntary market transactions. Landes WDT (CO Trial Ex. 22) at 22-23. These transactions provide critical information regarding market participants' willingness to buy and sell. *Id.* at 22. As Professor Landes explained, "economists view benchmarks that arise in voluntary transactions in competitive markets as the best way of valuing products and services, including intellectual property such as music." Landes WRT (CO Trial Ex. 406) at 28. Prices that are the result of voluntary market transactions tend to promote economic efficiency. 2/7/08 Tr. at 2078 (Landes).

40. For corroboration, Professor Landes also considered the Audio Home Recording Act of 1992 (the"AHRA"), Pub. L. No. 102-563, 106 stat. 42, 37, which, though "not strictly the result of voluntary exchange in a competitive market[,] . . . reflects the outcome of competing interest groups in the legislative context and thus provides evidence of the relative value of copyrighted songs and sound recordings." Landes WRT (CO Trial Ex. 406) at 29. Like the mastertone and synchronization benchmarks, the AHRA concerns the royalties earned by copyright owners of musical compositions and sound recordings.

41. Consistent with this Court's practice of choosing a rate from a "zone of reasonableness," Professor Landes analyzed these benchmarks to determine a "range of reasonableness" from which an appropriate statutory rate could be set. *See* SDARS Determination, 73 Fed. Reg. at 4088. Specifically, as discussed in detail in the Findings of Fact, based on his review of the large volume of free-market transactions in the mastertone market and synchronization rights market, as well as the corroboration provided by the division of royalties in the AHRA, Professor Landes determined that copyright owners of musical compositions receive between 20 and 50% of the content pool—that is, the total amount paid by licensees for the rights to both compositions and sound recordings—when unconstrained by a compulsory

license. Landes WDT (CO Trial Ex. 22) at 26; see also Landes WRT (CO Trial Ex. 406) at 29. This represents the "range of reasonableness" for the mechanical statutory license royalty rate. Landes WRT (CO Trial Ex. 406) at 29.

42. The benchmarks identified by Professor Landes involve comparable markets that are unconstrained by a compulsory license, and in which licenses are obtained for both the underlying musical work embedded in the sound recording and for the sound recording itself. As a result, these benchmarks provide highly probative marketplace evidence of a reasonable mechanical royalty rate.

43. Fundamental and undisputed economic principles dictate that the statutory rate established under Section 801(b) acts as a ceiling on mechanical royalty rates. Although there may be bargaining below that rate, licensing will not occur at rates above the statutory rate. As a result the statutory license acts as a cap on the rates that are set in the marketplace, even if voluntary negotiations in the absence of the compulsory license would lead to higher royalty rates. *See* Landes WDT (CO Trial Ex. 22) at 12-15; *see* Findings of Fact ¶¶ 558-60. As a result, in applying market derived benchmarks, the statutory rate must be set at a level that is both consistent with those benchmarks and adequate to create proper incentives to create musical works.

44. These fundamental economic principles must inform a reasonable statutory rate under Section 801(b) and are distinguishable from the "bargaining room" theory rejected by the CRT in the 1981 Decision. There, the tribunal rejected "[a] rate that is deliberately fixed above the level that the market can bear – so that a lower rate can be negotiated in the marketplace." 46 Fed. Reg. at 10478. But nothing in the 1981 Decision precludes this Court from considering in its determination of a reasonable statutory rate the indisputable fact that the statutory rate acts as

a ceiling on mechanical license rates. Indeed, it would make no sense to set a statutory rate without consideration of that critical market fact.

C. The Copyright Owners' Proposed Rates Are Well Within The Zone of Reasonableness

45. The Copyright Owners' proposal for physical products of 12.5 cents per song (or 2.40 cents per minute of playing time) would provide the Copyright Owners with no more than 24% of the content pool. Landes WDT (CO Trial Ex. 22) at 33.

46. This figure was derived by applying the Copyright Owners' proposed rate to information on revenues and costs compiled by the RIAA's experts. Specifically, Professor Landes took wholesale revenues for physical products reported by record companies for 2005, the most recent year available at the time, and deducted manufacturing and distribution costs to identify a content pool for physical products. *Id.*; *see* also 2/7/08 Tr. at 2163-68 (Landes). These deductions are appropriate because manufacturing and distribution costs are primarily attributable to physical products. 2/7/08 Tr. at 2164 (Landes). Using this content pool, Professor Landes then assumed that the Copyright Owners' proposed rate—12.5 cents—would apply to all tracks on physical products without any possibility for negotiation below the statutory rate. Landes WDT (CO Trial Ex. 22) at 33. Under this assumption and using the RIAA's own data, Professor Landes found that the Copyright Owners' proposal would result in the allocation of 24% of the content pool to musical compositions sold on physical products. *Id.*; *see also* 2/7/08 Tr. at 2162-68 (Landes).

47. Professor Landes also adjusted his calculation to account for negotiations that have historically occurred below the statutory rate—*i.e.*, the difference between the statutory rate and the "effective rate." Landes WDT (CO Trial Ex. 22) at 33. Once again using the record companies' own data, Professor Landes found that the Copyright Owners' proposal, when taking

into account the prevalence of discounting in the most recent year available, would likely result in mechanical royalty payments representing 18% rather than 24% of the content pool. *Id.*

48. These calculations demonstrate that the Copyright Owners' rate proposal for physical products proposed by the Copyright Owners is reasonable. The proposal falls within the zone of reasonableness implied by Professor Landes' benchmarks of 20 to 50% of the content pool. Indeed, it is at the lower end of the range.

49. By contrast, the RIAA's proposed royalty rate for physical product—9% of wholesale revenue—falls well short of the market derived benchmarks. As a result, it is not a reasonable royalty rate.

50. The Copyright Owners propose a rate of 15 cents per song (or 2.90 cents per minute of playing time) for permanent downloads. The higher rate for digital products reflects the fact that permanent downloads are primarily a singles market. Landes WDT (CO Trial Ex. 22) at 38-39. The "blended rate" paid for physical phonorecords—which takes into account the fact that bundles include songs of varying value—is too low, and therefore, not reasonable, for permanent downloads. *Id.* at 39. Professor Landes analyzed the Copyright Owners' proposed rate by determining the percentage of the content pool it implied and comparing that percentage to the range derived from his benchmarks.

51. Professor Landes divided the proposed mechanical royalty rate of 15 cents by 70 cents, the amount that record companies typically receive per track when licensing sound recordings for sale as individual downloads. Landes WDT (CO Trial Ex. 22) at 36; *see also* 2/7/08 Tr. at 2178 (Landes); Enders WDT (CO Trial Ex. 10) at 48 (providing remuneration paid to major record companies by Apple). Doing so, Professor Landes found that the Copyright Owners' proposal would result in the allocation of approximately 21% of the content pool for

permanent downloads to the musical composition. 2/7/08 Tr. at 2178-79 (Landes); *see also* Landes WDT (CO Trial Ex. 22) at 33-34. Professor Landes also explained that because record companies are compensated differently for the sale of albums, the content pool calculation would differ slightly for albums. 2/11/08 Tr. at 2478-79 (Landes). Thus, he performed an adjustment, based on the assumption that there are 13 tracks per album (the average tracks-per-album figure used by the RIAA), and determined that the Copyright Owners' proposal would result in the allocation of only 28% of the content pool to musical compositions for digital albums. 2/11/08 Tr. at 2478-79 (Landes). This is a reasonable rate. In fact it is at the lower end of the range of reasonableness derived from the comparable market benchmarks.

52. By contrast, the rates proposed by both the RIAA and DiMA for permanent downloads fall far below the range of reasonable rates derived from the benchmarks. Neither the RIAA's proposed rate of 9% of wholesale revenue nor DiMA's proposed rate of 6% of applicable receipts falls within the zone of reasonableness derived from Professor Landes' benchmarks.

53. Finally, the rate for ringtones equal to the greatest of 15% of revenue, one-third the total content costs paid for mechanical rights to musical compositions and rights to sound recordings or 15 cents per ringtone for ringtones is reasonable. It represents about one third of the content pool, falling right in the middle of the range of reasonableness. *See* Findings of Fact ¶¶ 543-56.

D. The RIAA and DiMA Benchmarks Are Neither Comparable Nor Independent

54. In contrast to the Copyright Owners, the RIAA and DiMA have chosen benchmarks that do not reflect independent market rates drawn from relevant markets for comparable products and, therefore, are inappropriate benchmarks from which to set a reasonable statutory mechanical royalty rate under Section 801(b).

1. The RIAA's Benchmarks Fail to Provide Any Guidance for A Reasonable Royalty

55. The RIAA urges the adoption of benchmarks based on the "effective" rate and rates for first uses of compositions. But neither of these purported benchmarks provides appropriate guidance as to a reasonable statutory royalty because they are predicated on rates that are derivative of the statutory rate, rather than reflecting independent market transactions. To the extent that the RIAA is also proposing benchmark based on rates in the United Kingdom and Japan, that benchmark fails under applicable precedent because the rates comprising the benchmark are drawn from different licensing regimes in countries with different markets for recorded music. Any proper consideration of international rates would show that the rates proposed by the Copyright Owners are, in fact, in line with rates in many other countries. And to the extent that the RIAA attempts to revive a benchmark based on the 1981 Mechanical Rate Proceeding, which it proposed as a benchmark in the direct phase of the proceeding but withdrew on rebuttal, the utility of that benchmark is undermined by the concededly transformational changes in the recorded music industry in the last 30 years, since the decision.

56. The effective mechanical royalty rate – the average rate at which mechanical licenses are paid in the market – is not an appropriate benchmark. Benchmarks should reflect rates that parties would reach in voluntary negotiations *unconstrained by a statutory rate*. *See Noncommercial Educational Broadcasting Compulsory License*, 63 Fed. Reg. 49823, 49835 (Sept. 18, 1998). As the RIAA's rebuttal economist, Professor Wildman, acknowledged, the effective rate is not "independent of the statutory rate." 5/12/08 Tr. at 5893 (Wildman).

57. The effective rate cannot be a market rate because, as Professor Wildman concedes, the statutory rate acts as a cap on the mechanical license rates that will be paid. As long as copyright users have recourse to a compulsory license, no copyright user will agree to

rates higher than those set forth in the compulsory license. *Id.* at 5900. As Professor Murphy concluded, the effective rate will always be lower than the statutory rate and, therefore, is not independently determined. K. Murphy WRT (CO Trial Ex. 400) at 17; 5/15/08 Tr. at 6903-06 (K. Murphy). Thus, the effective rate is derivative of the statutory rate and cannot serve as a benchmark. *See Noncommercial Educational Broadcasting Compulsory License*, 63 Fed. Reg. 49823, 49834 (Sept. 18, 1998) (noting that a rate negotiated under constraint of compulsory license is not a market rate). It would be entirely circular to conclude to the contrary.

58. The effective rate is not an independent rate for another reason: it is largely the product of application of controlled composition clauses to the statutory rate. But controlled composition clauses are expressed as a percentage of the statutory rate. By definition, therefore, as Professor Murphy concluded, they are derivative of the statutory rate and are not independent market rates. K. Murphy WRT (CO Trial Ex. 400) at 14-17.

59. The effective rate cannot be used as a benchmark for another reason: if it were, there would be an inescapable tendency for rates to approach zero over time. After the resetting of the rate based on the pre-existing effective rate, the new effective rate would necessarily fall below the new statutory rate. At the next rate setting proceeding, the now lower effective rate would then become the statutory rate until the next rate-setting proceeding, when it would be lowered again, and so on in a never ending decline. No appropriate market benchmark would lead to such a result.

60. The RIAA's "first use" benchmark fails for similar reasons. As Professor Wildman conceded, the first use rate is "influenced by the statutory rate," 5/12/08 Tr. at 5894 (Wildman). That is so because first use songs compete with, and may be substituted by, songs that are available under the compulsory license. In addition, rates for first uses are frequently

dictated by controlled composition clauses which are not independent market rates but rather are set as a percentage of the statutory license. *See* Findings of Fact ¶¶ 694-98.

61. The RIAA's reliance on mechanical rates in the United Kingdom and Japan also fails the test for an appropriate benchmark that can be used to set a reasonable royalty rate under Section 801(b). "[A] proposed benchmark that does not reflect accurately the characteristics and dynamics of the industries subject to the proposed rate" cannot serve as the basis of a statutory rate. PSS Determination, 63 Fed. Reg. at 25404 n.24.

62. The RIAA has failed to carry its burden of demonstrating that the U.K. and Japanese rates were set in comparable markets. To the contrary, the weight of the evidence demonstrates that these rates were set on the basis of different considerations, in different legal regimes, and in markets that differ in fundamental ways from the U.S. market. Among other things, the U.K. has neither a compulsory licensing structure nor enforced controlled composition clauses. And, although the RIAA seeks to rely on the percentage of revenue rates in those two jurisdictions, the record is devoid of any effort to correlate the revenue bases to which those rates would apply in a manner that would allow the Court to conclude that the rates proposed by the RIAA are comparable to the rates in the U.K. and Japan. Each of these failures, detailed in the Findings of Fact ¶¶ 709-25, leads to the conclusion that the U.K. and Japanese rates cannot be employed as a benchmarks for setting a reasonable royalty under Section 801(b). And, in fact, the RIAA's expert, Professor Wildman, expressly refused to endorse those rates as benchmarks here.

63. To the extent that the RIAA seeks to rely on the 1981 Mechanical Rate Determination, its principal benchmark in the direct trial, that reliance is misplaced. Massive changes have occurred in the recorded music market since the time of that decision, including

but not limited to, the growth of the digital market, the rise of digital piracy, and the current re-orientation and reorganization of the record companies—facts that the RIAA does not dispute. A rate set in an earlier proceeding cannot serve as an appropriate benchmark when there has been a fundamental change in market conditions. *See* Designation as a Preexisting Service, Docket Nos. RF 2006; RF 2006-3 (Oct. 20, 2006) 71 Fed. Reg. 64639, 64641 n.7 (Nov. 3, 2006) (noting that when the CARP set rates in a previous proceeding, it specifically noted that "a future CARP may reach an entirely different result based on the then-current economic state of the industry and new information on the Services' impact on the marketplace").

2. The DiMA Benchmarks Are Inappropriate for Setting a Reasonable Royalty

64. DiMA has similarly failed to provide any appropriate benchmarks that can be used as the basis for setting a reasonable mechanical royalty rate.

65. DiMA has pointed to the recent settlement agreement concerning mechanical and performance royalties in the U.K. (the "U.K. Settlement"). No DiMA witness offered any testimony explaining how the U.K. Settlement could serve as a basis for setting a reasonable royalty. Putting that infirmity to one side, the U.K. Settlement fails as a benchmark for all of the reasons discussed in connection with the RIAA's benchmarks—namely, the express failure to account for differences in the market and licensing regimes between the U.K. and U.S. markets.

66. DiMA, too, at various times has cited the 1981 Mechanical Rate Determination as a benchmark to be employed by the Court. During the rebuttal trial, DiMA's economist, Ms. Guerin-Calvert, withdrew her reliance on that nearly 30 year old decision. 5/6/08 Tr. at 4865-66 (Guerin-Calvert). And for good reason: all the changes that have occurred in the recorded music industry have eviscerated any utility of the 1981 Mechanical Rate Determination as a benchmark for setting reasonable rates in this proceeding.

67. In short, the RIAA and DiMA's proposed benchmarks provide no guidance in setting a reasonable mechanical royalty rate.

E. The 801(b) Policy Considerations Do Not Require Adjustments to The Benchmarks Offered by the Copyright Owners

68. After selecting benchmarks that define the zone of reasonableness, the Court then must assess whether the four statutory factors in Section 801(b) require the market derived benchmark rate to be adjusted. SDARS Determination, 73 Fed. Reg. at 4094.

69. The policy considerations reflected in the first factor – to maximize the availability of creative works – ordinarily will be satisfied by the same process that identifies market benchmarks. Under this factor, market benchmarks would need to be adjusted only to reflect "the relative difference between the benchmark market and the hypothetical target market." SDARS Determination, 73 Fed. Reg. at 4094-95.

70. Likewise, the second statutory factor, which seeks to afford the copyright owner a fair return for his or her creative work, and the copyright user a fair income under existing economic conditions, is typically consistent with reasonable market outcomes, and would only need to be adjusted where the benchmark marketplace reflects "the exercise of unfair market power." *Id.* at 4095.

71. The third statutory factor, which directs the Court to set a rate "[t]o reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication," is particularly well-suited to marketplace evidence, because the relative contributions and roles of market participants are what the market is designed to assess. *See, e.g.*, *Amusement & Music Operators*, *Ass'n v. Copyright Royalty Tribunal,* 676 F.2d

1144, 1157 (7^{th} Cir. 1982). Indeed, in the context of Section 114 proceedings, the Court recognized that "such considerations would have already been factored into the negotiated price in the benchmark agreements." Second Webcasting Determination, 72 Fed. Reg. at 24092 (internal quotation marks omitted).

72. Here, no adjustment is needed to the benchmarks and rates proposed by the Copyright Owners to take into account the first three statutory factors. Professor Landes identified market benchmarks that closely approximate the "hypothetical target market." SDARS Determination, 73 Fed. Reg. at 4094-95. As a result, the first three 801(b) factors are already adequately reflected in the Copyright Owners' benchmarks.[3]

73. The fourth factor, which directs the Court to "minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices," cannot be addressed by "marketplace evidence, standing alone," and must be considered separately. *Amusement & Music Operators*, 676 F.2d at 1157. The record evidence shows that the rates that the Copyright Owners have proposed would not be disruptive, and, therefore, no adjustment to the market benchmarks is required to satisfy the fourth statutory factor.

1. Section 801(b)(1)(A): To Maximize The Availability of Creative Works To the Public

74. The first statutory factor, Section 801(b)(1)(A), calls for a rate that will "maximize the availability of creative works to the public." This principle forms the very core of American copyright law, which seeks "to secure a fair return from an 'author's' creative labor" as a means to "stimulate artistic creativity for the general public good." *Twentieth Century*

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3 Were any adjustment needed under the factors, the adjustment should be an upward adjustment to account for the "exercise of unfair market power" by record companies, SDARS Determination, 73 Fed. Reg. at 4095, which leverage power to impose controlled composition clauses on artists and songwriters.

Music Corp. v. Aiken, 422 U.S. 151, 156 (1975). The Supreme Court has recognized that to effectuate the Framers' intent for copyright to be "the engine of free expression," our copyright system "supplies the economic incentive to create and disseminate ideas." *Harper & Row Publishers, Inc. v. Nation Enters.*, 471 U.S. 539, 558 (1985). In most circumstances, Congress has created rights in artistic works and relied upon the free market to provide the appropriate level of incentives. Where, as here, Congress has created a right and required a compulsory license, it remains the case that "an effective market determines the maximum amount of product availability consistent with the efficient use of resources." SDARS Determination, 73 Fed. Reg. at 4094.

75. It bears noting that the bulk of mechanical rights payments goes to songwriters, not music publishers and any change in the rate – up or down – will affect songwriters much more dramatically than music publishers. The record evidence is that the typical music publishing contract provides for 75% or more of the payments to go to the songwriter.

76. Songwriters supply songs – the most basic component in maximizing creative works to the public. And, as the Copyright Owners established at trial, mechanical royalties represent an essential component of the incomes of songwriters and are therefore a vital incentive for the creation of musical works. *See* Findings of Fact ¶¶ 223-29. Under the current rate, however, songwriters have difficulty supporting themselves and their families. As one songwriter witness explained, "the vast majority of professional songwriters live a perilous existence." Carnes WDT (CO Trial Ex. 1) at 3. Moreover, because of piracy, consolidation in the music industry, and the increased use of controlled composition clauses by record companies, songwriters' mechanical income is in decline. *See* Findings of Fact ¶¶ 235-79.

77. Music publishers contribute to the availability of music by discovering songwriters, supporting them creatively and financially, and promoting their songs. *See* Findings of Fact ¶¶ 295-303. Once a publisher discovers a songwriter, the publisher will sign the writer and pay advances that are recoupable against future earnings. Advances provide songwriters with financial support so that they can focus on songwriting. *See* Findings of Fact ¶¶ 304-16. Publishers also invest in the creative development of their writers by giving songwriters access to their creative staffs and by suggesting potential co-writers. *See* Findings of Fact ¶¶ 317-23. Finally, music publishers promote the songs of their writers to artists, managers, producers and A&R representatives, among others. *See* Findings of Fact ¶¶ 324-32. Simply stated, the publishers make a critical contribution to providing songs and recorded music to the public.

78. Like songwriters, music publishers are heavily reliant on mechanical royalties to finance the work that they do for songwriters and they too have suffered from the decline in mechanical income. *See* Findings of Fact ¶ 343.

79. The RIAA has argued that decreasing the mechanical rate will increase returns to songwriters and publishers because a reduced mechanical rate will allow record companies to release more songs, thereby off-setting the decrease in the mechanical rate through increases in volume. The record does not, however, support the contention that record companies will reinvest savings on mechanical royalties in A&R or other efforts to increase the number of recordings released. Thus, there is no reason to believe that a decreased royalty would maximize the availability of creative works to the public. *See* Findings of Fact ¶¶ 653-801.

80. The RIAA has also attempted to prove through the testimony of Professor Slottje that songwriters are adequately compensated by means of a hedonic wage and that no increase in the mechanical rate is required to incentivize songwriters to continue to create musical

compositions. Professor Slottje's argument is inconsistent with the first 801(b) factor and identical to the argument raised by RIAA and rejected in the 1981 Mechanical Rate Proceeding:

> [T]he statutory rate payable under Section 115 of the Act is intended to encourage the creation and dissemination of musical compositions. This encouragement we find takes the form of an economic incentive and the prospect of pecuniary reward – royalties payable at a reasonable rate of return. The evidence shows that under the statutory objectives governing a reasonable adjustment of the statutory rate, the Tribunal must afford songwriters a financial and not merely a psychic reward for their efforts.

1981 Mechanical Rate Determination, 46 Fed. Reg. at 10479.

2. Section 801(b)(1)(B): "[t]o afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions."

81. The "fair return" required by Section 801(b)(1)(B) "is not to songwriters as a group but as individuals." *Id.* Whereas the record companies can ensure themselves a fair return through their pricing policies, a songwriter has no such option, *id.* at 10486, because the right of songwriters and music publishers to earn a fair return depends upon the availability of a sufficient statutory rate of return. *Id.* at 10479-80.

82. The Supreme Court has rejected the idea that the creator's reward is "a secondary consideration of copyright law," *Eldred v. Ashcroft*, 537 U.S. 186, 212 n.18 (2003) (internal quotation marks omitted); instead, because "[t]he profit motive is the engine that ensures the progress of science," "copyright law *celebrates* the profit motive, recognizing that the incentive to profit from the exploitation of copyrights will redound to the public benefit by resulting in the proliferation of knowledge." *Id.* (internal quotation marks omitted). Thus, "copyright law serves public ends by providing individuals with an incentive to provide private ones." *Id.*

83. The weight of the evidence leads inescapably to the conclusion that the Copyright Owners' proposed rates will insure a fair return and the rates proposed by RIAA and DiMA will not.

84. The point is essentially conceded by the Copyright Users. Instead of asserting that its proposed reduction in rates would ensure songwriters a fair return, the RIAA urges that any cuts in the mechanical rates will be offset by increases in other income streams such as performance and synchronization revenue. *See, e.g.*, Teece WDT (RIAA Trial Ex. 64); at 62; Santisi WRT (RIAA Trial Ex. 78) at 17-22. Putting to one side the fact that the evidence does not bear out the RIAA's claim, the argument is diametrically opposed to the one made by the record companies in the ratemaking proceeding before the Court that directly preceded this one, SDARS. There, the record companies asserted in response to the argument that the rate they were seeking should be tempered by alternative sources of revenue: "[t]hat copyright owners may have other markets in which they sell their sound recordings provides no basis for reducing the return here." Proposed Conclusions of Law of SoundExchange, Inc., Docket No. 2006-1 CRB DSTRA (Jan. 24, 2008), at ¶ 44. Yet they urge the opposite conclusion here.

85. Previous copyright tribunals have recognized that other sources of revenue have little if any relevance to the setting of a reasonable statutory rate, reasoning that Congress has decided to create different revenue streams for copyright owners. *See, e.g.*, 1980 Jukebox License Proceeding, 46 Fed. Reg. at 889 ("We recognize that performing rights are distinct from recording rights. The Congress has determined that copyright owners are entitled to be paid reasonable fees for both."); PSS Determination, 63 Fed. Reg. at 25408 (noting approvingly that CARP had not implied that record company "revenues from the exercise of [additional] rights are meant to compensate them for the use of their creative works under the new statutory

license"). The purpose of this proceeding is to set the rate for one of those congressionally created rights. And if income that songwriters and music publishers have pursued from other revenue streams is allowed to compensate for inadequate mechanical royalties, then Congress's goal of promoting the musical works that are subject to mechanical royalties will be thwarted.

86. In any event, the RIAA's "alternative revenue" stream argument focuses largely on publisher revenue. As set forth in the Findings of Fact, songwriters depend heavily on mechanical income and any decrease for one songwriter likely will not be made up by other revenue. Indeed, as a record company executive conceded, songwriters are struggling and will struggle more in the face of a rate cut. Findings of Fact ¶ 234.

87. The rates proposed by the Copyright Owners would also satisfy the second prong of this statutory factor's test by guaranteeing copyright users a fair income.

88. The evidence is incontestable that nothing about the Copyright Owner's proposed download rates will deprive DiMA's members of a fair income. The digital market is flourishing, and is projected to continue to grow. *See* Findings of Fact ¶¶ 457-466. The DiMA companies have presented no evidence that they would fail to earn a fair income under the royalty rates proposed by the Copyright Owners. The record shows that iTunes, the dominant seller of permanent downloads, is profitable and would continue to be profitable if the 15 cent permanent download rate were adopted, whether or not Apple absorbs the cost. The evidence also shows that there has been substantial new entry into the permanent download business and DiMA has not established that new entrants would be precluded from entering the business, and thriving in it, by the Copyright Owners' proposed rate.

89. Nor is there evidence that demonstrates that the record companies will not earn a fair income under the Copyright Owners' proposed rates. To the contrary, substantial evidence

adduced at trial shows that record company profitability has been increasing due to streamlining of the physical business and improved margins on digital sales, which have relieved the record companies of substantial manufacturing, distribution and returns expense. *See* Findings of Fact ¶¶ 417-456. Record companies have also identified, and have begun to exploit, other new revenue streams through "360 contracts," synchronization deals and performing rights royalty collections. See findings of Fact ¶¶ 418-420 The economics of digital distribution should lead to even greater profitability as the share of digital sales continues to grow. At least one major record company, EMI, has expressly so concluded. *See* RIAA Trial Ex. 9; 2/13/08 Tr. at 3164-65 (C. Finkelstein); *see also* H. Murphy WDT (CO Trial Ex. 15); CO Ex. 8A.

90. In light of that economic evidence, the RIAA's claim that the record companies simply cannot afford to pay what the available benchmarks indicate is a reasonable rate is entitled to no weight. The argument is the same one that has been tried without success before. In the 1981 Mechanical Rate Proceeding, the RIAA made similar claims that changes in the landscape of the recorded music industry required a reduction in the mechanical rate in order for the record companies to earn a fair income. See Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords (C.R.T. 1981), 46 Fed. Reg. 10466 at 10472, 10477 (Feb. 3, 1981). The tribunal rejected the assertions as against the weight of the evidence, including financial information from the record companies themselves. *See id.* at 10480-82. The same conclusion is compelled here.

3. Section 801(b)(1)(C): "[t]o reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication."

91. The third factor, which focuses on the relative contributions and risks of the market participants, is essentially a marketplace inquiry. Given the substantial contributions made by songwriters and music publishers, there is nothing in this prong of 801(b) that suggests that a reasonable royalty should be anything other than one that comports with the Copyright Owners' benchmarks.

92. The evidence overwhelmingly supports the conclusion reached in the 1981 Mechanical Rate Determination: "the songwriter is the provider of an essential input to the phonorecord: The song itself." 1981 Mechanical Rate Determination, 46 Fed. Reg. at 10480. As the NSAI motto says "It all begins with a song." Bogard WDT (CO Trial Ex. 2) at 6. Aside from individual songwriters, the songwriter organizations represented in these proceedings have also made important contributions on behalf of their members. They provide creative support to aid songwriter development, lobby Congress to make musical works more available, and take steps to combat piracy and its drain on creative production. *See* Findings of Fact ¶¶ 92-99. There is no basis on which to conclude that the songwriter's signal contribution to the creation of recorded music has diminished in any way.

93. The evidence further confirms that the songwriters' critical contribution comes at great risk. Most struggle their entire careers, working other jobs to make ends meet while working long hours to make modest returns even on the rare hit. *See* Findings of Fact ¶¶ 223-34.

94. The evidence is also entirely consistent with the determination made in the 1981 Mechanical Rate Determination that music publishers are essential creative and financial

partners with songwriters. As that Tribunal held, in language that is equally apt today, "[t]he music publisher collaborates with the songwriter in the creative process." 1981 Mechanical Rate Determination, 46 Fed. Reg. at 10480. The RIAA has attempted to deride the vital contributions that music publishers make to the creation of music—contributions that the songwriter witnesses readily endorsed. But the overwhelming weight of the evidence established that music publishers—both majors and independents—are responsible for discovering and developing songwriters and then assisting them in sharing their creativity with the public. This requires significant financial investments and involves substantial risks. Publishers provide advances to songwriters, which typically constitute a large percentage of the publishers' yearly expenses. In addition, the success rate of songwriters is very low. Thus, the recoupment rates of publishers are low, and yearly write-offs are high. *See* Findings of Fact ¶¶ 290-340.

95. The Copyright Owners do not deny that record companies also make meaningful contributions to the recorded music industry. But those contributions are not as outsized and one-sided as the RIAA attempted to portray them at trial. Nor are those contributions such that, when considered in connection with the vital and complementary roles played by songwriters and music publishers, there is any reason to adjust the market benchmarks in setting a reasonable royalty rate.

96. Nor do the Copyright Owners seek to demean the contribution of DiMA companies to the development and growth of the digital distribution market. But, once again, the role must be put in context. Digital distributors make important contributions, but ones that are "subsidiary to and dependent on the creative contributions of others." SDARS Determination, 73 Fed. Reg. at 4096. The financial investments that DiMA companies have made do not dictate

in any way a statutory rate that is anything other than a reasonable royalty based on market benchmarks.

4. Section 801(b)(1)(D): "[t]o minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices"

97. Turning to the fourth statutory factor, a rate can be disruptive in the sense that it requires an adjustment of a market based benchmark only

> if it directly produces an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for either the [copyright users] or the copyright owners to adequately adapt to the changed circumstances produced by the rate change and, as a consequence, such adverse impacts threaten the viability of the music delivery service currently offered to consumers under this license.

SDARS Determination, 73 Fed. Reg. at 4097. There has been no evidence whatsoever to support the conclusion that adoption of the Copyright Owners' proposed rates would cause any disruption of the magnitude required to depart from a market-derived rate. Nor is there any record support on which to base a conclusion that a single record company or digital music provider would have its viability challenged by adoption of the increased penny rates the Copyright Owners seek.

98. As for the record companies, the evidentiary record demonstrates that profitability is on the rise. And the undisputed testimony and documentary evidence reveals that mechanical royalties are only a small fraction of overall expense of record companies, and substantially less than the rising artist royalties that are freely negotiated in the absence of a compulsory license. The relatively small share of expenses attributable to mechanical royalties precludes a finding that an increase would be sufficiently disruptive to threaten the viability of any record company.

99. The RIAA introduced no evidence to the contrary. All it could muster was the conclusory and empirically unsupported testimony of Ms. Santisi that an increase in mechanical

royalties would somehow reduce A&R spending. That is far from the concrete showing of imminent harm required to demonstrate disruption. *See* SDARS Determination, 73 Fed. Reg. at 4097 (determining that a rate from the high-end of the zone of reasonableness would be disruptive under the fourth factor because it could restrain the "SDARS ability to successfully undertake satellite investments during the license period," which would disrupt consumer satellite radio service).

100. As for the DiMA companies, the picture is just as clear. The evidence shows that the digital market is growing rapidly. The largest permanent download provider by far, iTunes, has experienced exponential growth. Expert evidence supplied by the Copyright Owners—and essentially confirmed by iTunes—shows that iTunes can easily absorb the increases in the penny rate that are sought on the basis of market benchmarks. Although DiMA attempted—without success—to prove that other digital companies are facing a precarious future, those companies are predominantly subscription services for which rates have been agreed to in the Partial Settlement. There is no evidence before the Court to support the conclusion that the Copyright Owners' rates threatens the vitality of the permanent download market, or any player in it, in any respect.

101. By contrast, there is substantial evidence to suggest that the draconian cut in royalties sought by RIAA and DiMA would cause disruption to the Copyright Owners. Copyright owners rely upon income from existing works to "finance the production and publication of new works." *Eldred*, 537 U.S. at 207 n.15 (internal quotation marks omitted). A reduction in mechanical rates would have a disproportionate impact upon songwriters, who collect 75% of the already shrinking pot of mechanical royalties and will, by their accounts and those of the Copyright Owners' economists, disrupt their ability to continue their creative

endeavors. *See* Findings of Fact ¶¶ 230-256. And such a reduction would materially impact the ability of music publishers to play the vital role in the creation of music that songwriters depend upon to exercise their creative craft. *See* Findings of Fact ¶¶ 341-342.

* * *

102. In sum, the Copyright Owners' proposed rates are based on appropriate marketplace benchmarks, are reasonable and satisfy each of the Section 801(b) factors.

IV. Retention of the Penny Rate for Physical Product And Permanent Downloads Is Appropriate

103. The penny rates proposed by the Copyright Owners are usage-based rates that are more appropriate measures for a reasonable royalty under Section 801(b) than the percentage of revenue rates proposed by the RIAA and DiMA.

104. A reasonable royalty rate should be calibrated directly to the use of music. By contrast, revenue "merely serves as a proxy for what we really should be valuing, which is [usage]." Second Webcasting Determination, 72 Fed. Reg. at 24089 (internal quotation marks omitted). In Webcasting, this Court rejected a percentage of revenue rate because "there was no persuasive evidence . . . that a usage-based metric is not readily calculable and, that as a consequence, the Copyright Royalty Judges must resort to some proxy metric in reaching their fee determination." *Id; cf.* SDARS Determination, 73 Fed. Reg. at 4085 (adopting a revenue-based fee structure "because we have no true per performance fee proposal [that seeks to tie payment directly to actual usage of the sound recording by the licensees] before us nor sufficient information from evidence of record to accurately transform any of the parties' proposals into a true per performance fee proposal").

105. There is no evidence here that the value of the mechanical license is not "readily calculable." Since 1909, the mechanical royalty has been calculated on a penny basis. And,

even the RIAA and DiMA, both of which favor a percentage of revenue metric, have provided the Court with alternative proposed penny rates or minima.

106. A particular infirmity of a percentage of revenue rate is that payments to the Copyright Owners do not increase with increased usage of their work. A percentage of revenue metric creates the risk that Copyright Owners would be "forced to allow extensive use of their property without being adequately compensated due to factors unrelated to music use." Second Webcasting Determination, 72 Fed. Reg. at 24090. That is true because the interests of the Copyright Owners and users represented by the RIAA and DiMA are not perfectly aligned Landes WRT (CO Trial Ex. 406) at 22. Both the Copyright Owners and RIAA and DiMA companies seek to maximize their own profits, not revenues.

107. The RIAA and DiMA percentage of revenue proposals also beg the difficult questions of how to choose a revenue definition and then how to interpret it. As demonstrated by the different and conflicting revenue definitions submitted by the parties, that difficulty is acute. *See* Findings of Fact ¶¶ 609-622. That provides another reason why a penny rate is preferable to a percentage-based royalty. As this Court concluded in the Webcasting decision, "[t]he absence of persuasive evidence of what constitutes an unambiguous definition of revenue that properly relates the fee to the value of the rights being provided militates against reliance on a revenue-based metric." Second Webcasting Determination, 72 Fed. Reg. at 24090-91.

108. A percentage-based royalty scheme is also more difficult to administer, audit and enforce. *Id.*. That provides yet another reason why it is inferior to a penny rate. There is ample evidence in the record that Copyright Owners already face challenges in being paid on a fair and timely basis under the existing penny rate. *See* Pedecine WDT (CO Trial Ex. 394) at 4-5. The complexities of collection and audit can only increase under a percentage of revenue rate.

109. Finally, the penny rate has been in place for nearly one hundred years. Both copyright users and owners have structured their business relationships and business practices in accordance with its requirements, and both copyright users and owners have grown their businesses under the penny rate. Nothing about a penny-based royalty has impeded the growth of the digital market and the introduction of new products and services. *See* Findings of Fact ¶¶ 623-633.

110. By contrast, a departure from the penny rate would wreak havoc on existing contractual relationships between songwriters and music publishers and would require record companies to revise their royalty collection and recordkeeping practices. *See* 2/29/08 Tr. at 479 (Faxon) (explaining that the percentage rate would be "hugely disruptive to [EMI MP's] contractual relationships."). In the absence of a compelling reason—and there is none in the record—there is no reason to impose this disruption on the Copyright Owners. After nearly a century, the hurdle to abandon the penny rate should be very high indeed.

V. For Ringtones, a Percentage of Revenue Rate With Minima Is Appropriate

111. Both Copyright Owners and the RIAA have proposed that ringtone rates be set at a percentage of revenue. The main difference between the proposals of the parties is that the Copyright Owners include a minimum payment, while the RIAA proposal does not.

112. Penny rate minima are needed to ensure that the Copyright Owners receive compensation that correlates with the use of their works**.** *See* Second Webcasting Determination at 24090. Record companies impose such minima in their ringtone agreements and have offered no reason why Copyright Owners should be deprived of the protection they carve out for themselves in free market agreements.

VI. The Court Has Authority to Set The Copyright Owners' Proposed Terms

113. The Court possesses broad authority to determine reasonable terms of royalty payments, *see* 17 U.S.C. §§ 115(c)(3)(C), 801(b)(1), and "full independence" in doing so, *id.*§ 802(f)(1)(A)(i).

114. The Court is specifically authorized by the Copyright Act to set terms concerning late payments, notice, and recordkeeping. Section 803(c)(7) of the Act authorizes the Court to "include terms with respect to late payment," and, although the Court is ordinarily bound by regulations issued by the Librarian of Congress and by other provisions of the Copyright Act, *see* 17 U.S.C.§ 803(a)(1), the Court is specifically empowered by Section 803(c)(3) to issue notice and recordkeeping terms "in lieu of [requirements] that would otherwise apply under regulations." Congress explained that "issues relating to notice and recordkeeping or to notices of use are often integral to the issues of rates and terms of payment; therefore, the CRJs are best equipped to handle this task." H.R. REP. NO. 108-408, at 36 (2004). *See* RIAA's Brief on the Jurisdiction of the United States Copyright Royalty Judges to Set Certain Terms and Motion to Strike Terms Outside that Jurisdiction (Feb. 22, 2008).

115. In setting terms, this Court has exercised its discretion to "adopt royalty payment and distribution terms that are practical and efficient." SDARS Determination, 73 Fed. Reg. at 4098 (quoting Webcaster II, 72 Fed. Reg. at 24,102).

VII. The Copyright Owners' Terms Are Authorized and Reasonable

116. Copyright Owners seek terms setting (A) a late fee of 1.5%; (B) a pass-through licensing assessment of 3%; (D) reasonable attorneys fees for amounts expended to collect past due royalties and late fees; (E) clarification of the applicability of rates; and (F) specific licensing and reporting requirements. Each of the terms proposed by the Copyright Owners falls within the express statutory authority of the Court, is reasonable and should be adopted.

A. Late Fee of 1.5%

117. Copyright Owners have proposed a late fee of 1.5% per month from the day payment should have been made to the date payment is actually received by the Copyright Owners. As a "term with respect to late payment[s]," this provision is well within the Court's authority to adopt. *See* 17 U.S.C. § 803(c)(7). In both SDARS and Webcasting, this Court imposed terms requiring a late fee of 1.5%, and held that such a fee "strikes the proper balance" between "providing an effective incentive to the licensee to make payments timely" and "not making the fee so high that it is punitive." SDARS Determination, 73 Fed. Reg. at 4099; *accord* Second Webcasting Determination, at 24107. The late fee sought by the Copyright Owners is identical to the late fees record companies charge to the digital music services to whom they license the right to distribute sound recordings. [4]

118. The record shows, moreover, that a late fee is needed to incentivize record companies to end their practice of making late and incomplete payments the, Copyright Owners' existing remedies are not adequate and have resulted in hundreds of millions of dollars in unpaid royalties. *See* Findings of Fact ¶¶ 851-855**.** Thus, the 1.5% late payment term proposed by the copyright owners is reasonable and should be adopted.[5] *See* Findings of Fact ¶¶ 843-847.

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[4] The Harry Fox Agency cannot simply adopt late fees unilaterally because they will not be accepted by licensees if they are not part of the statutory scheme. The copyright users always have the option of "going statutory" and avoiding royalty terms they do not like. Thus, the statutory terms act as a "cap" on the terms that can be imposed, just as the statutory rates act as a "cap" on the rates that can be charged. *See* Findings of Fact ¶¶ 558-61.

[5] The RIAA has suggested that 37 C.F.R. § 201.19(e)(4) preempts any regulation the Court might issue concerning late fees. *See* RIAA's Brief on the Jurisdiction of the United States Copyright Royalty Judges to Set Certain Terms and Motion to Strike Terms Outside that Jurisdiction (Feb. 22, 2008). That regulation speaks only to the computation of royalties that are due, however, not to the consequences of a copyright user's failure to abide by its obligation within the authorized time period.

B. Pass-Through Assessment of 3%

119. As a "term with respect to late payment[s]," the 3% pass-through assessment is within the authority of the Court to adopt. As demonstrated in the Findings of Fact, pass-through licensing results in payment delays and impairs the Copyright Owners' ability to uncover unpaid royalties through audits. *See* Findings of Fact ¶¶ 862-65. Thus, the 3% pass-through assessment proposed by Copyright Owners, which will compensate the Copyright Owners for such losses, is reasonable and should be adopted.

C. Reasonable Attorneys Fees Expended to Collect Past Due Royalties and Fees

120. The Copyright Owners have requested a term that provides for the recovery of reasonable attorneys fees expended to collect past due royalties and fees. Like the late payment and pass through assessment, this term relates to late payments and is thus within the Court's jurisdiction. The imposition of attorney's fees is required to compensate Copyright Owners for chronically late payments and to provide an additional incentive for record companies to pay royalties on time. *See* Findings of Fact ¶¶ 841-847. The term is reasonable and should be adopted.

121. The RIAA has claimed that attorneys' fees are already addressed in Section 505 of the Copyright Act. Section 505, however, only grants reasonable attorneys fees to parties that prevail in a civil action for infringement under the Copyright Act. *See* 17 U.S.C. § 505.

D. Clarification of Applicable Rate

122. The Copyright Owners have requested clarification that the date on which the mechanical license rate should be calculated is the date a phonorecord is distributed, and not the date it is manufactured, in accordance with Section 115(c)(2). As a recordkeeping term, this provision is within the Court's jurisdiction. Moreover, the provision reflects the language of the Copyright Act, which provides that a royalty is payable for every phonorecord "made and

distributed." And, it is consistent with the regulations for digital products, which provide that the date of digital transmission – not manufacture – is the relevant date for determining the applicable royalty rate. *See* 37 C.F.R. § 201.19(a)(6). Thus, this term is reasonable and should be adopted by the Court.

E. Specific Licensing and Reporting

123. Copyright Owners seek a term requiring copyright users to specify the configuration for which they are seeking a license. Under existing licensing and reporting regulations, copyright users need not specify the particular type of DPD for which they are seeking a license. This ambiguity hinders Copyright Owners' ability to conduct accurate audits.

124. As a record keeping term, the proposed provision is within the Court's jurisdiction. This Court has adopted new or amended notice and recordkeeping requirements in their discretion where the parties "sufficiently demonstrate the need for and the benefits of variances with existing regulations." SDARS Determination, 73 Fed. Reg. at 4101. Here, Copyright Owners have demonstrated that current regulations hamper HFA's ability to conduct audits, which recover hundreds of millions of dollars owed to copyright owners. Thus, this term is reasonable and should be adopted by the Court in lieu of the existing regulation.

F. The Appropriate Definition of Revenue

125. Copyright Owners have advanced a definition of revenue that seeks to include all revenue that can be attributed to music. This appropriately expansive definition is essential to ensure that Copyright Owners are compensated under any business model in which the nominal price attributable to the music containing their compositions does not reflect the full and fair value of what is being received for the music. The evidence presents numerous examples of the risks that the Copyright Owners face with respect to a narrower definition, both with respect to bundled products and otherwise. *See* Findings of Fact ¶¶ 609-622. Given the rapidly changing

face of the landscape for the delivery of music, it is imperative that any definition of revenue that the Court may adopt anticipate and address these risks, to the fullest extent practicable. Only the Copyright Owners' definition of revenue ensures that it will "properly relate the fee to the value of the rights being provided." SDARS Determination, 73 Fed. Reg. at 4087.

VIII. The RIAA's Terms Are Neither Authorized Nor Reasonable

126. By contrast to the terms proposed by the Copyright Owners, the RIAA has proposed terms that fall outside the jurisdiction of this Court and that seek to water down the protections of the Copyright Act. Specifically, the RIAA seeks terms relating to (A) the accounting for DPDs; (B) the signing of statements of account; and (C) audits. The RIAA also seeks two terms relating to its Alternative Rate Request: locked content and multiple issuances. The proposed terms are either beyond the Court's authority, or unsupported by the record, or both.

A. Accounting for DPDs

127. The RIAA seeks to treat DPDs distributed by pass through licensees as distributed on the date the distribution is reported to the "compulsory licensee," *i.e.*, the record company. As noted above, current regulations provide that "[a] digital phonorecord delivery shall be treated as a phonorecord made and distributed on the date the phonorecord is digitally transmitted." 37 C.F. R.§ 201.19(a)(6)(i). This Court must abide by regulations issued by the Register pursuant to the Copyright Act, except as they pertain to notice and record keeping. *See* 17 U.S.C. § 803(c)(3). This Court will enact "new and/or amended recordkeeping and notice requirements only where the parties sufficiently demonstrate the need for and the benefits of variances with existing regulations." SDARS Determination, 73 Fed. Reg. at 4101. The RIAA previously conceded that a virtually identical proposed term concerning the distribution date of DPDs was beyond the Court's authority to adopt because it was neither a record keeping nor a

notice term. *See* Findings of Fact ¶¶ 841-871. Thus, the current term is likewise beyond the Court's authority.

128. Even if the Court had the authority to address this proposed term, the RIAA has failed to present any evidence to support its assertion that it should be adopted.

B. Signing Statements of Account

129. The RIAA's next term is likewise beyond this Court's authority to adopt. The RIAA seeks a term that would permit annual statements of account to be signed by any "duly authorized agent" of the compulsory licensee. Section 115(c)(5) expressly directs the Register to determine requirements for the provision of monthly and annual statements of account by the compulsory licensee. It does not provide for review of such requirements by the Court. Pursuant to this provision, the Register has promulgated regulations that require, as relevant here: (1) the signing of statements of account under oath; and (2) annual certifications of statements of account by a licensed certified public accountant. *See* 37 C.F.R. § 201.19(e), (f). This Court has no statutory authority to override this regulation and thus no authority to adopt the term proposed by the RIAA.

130. Moreover, the RIAA has provided no persuasive evidence in support of this term; its only justification for adopting it is to eliminate the need for an officer of a corporation to sign "hundreds or thousands" of accounting statements each month. When weighed against the protection that the current requirement provides to the Copyright Owners, that justification is simply insufficient.

C. Audits

131. Likewise, the Court has no authority to enact the RIAA's third proposed term. Both Section 115 and 37 C.F.R. § 201.19(f)(6)(ii)(A) require that each annual statement of account "be certified by a licensed Certified Public Accountant." Section 115 requires "detailed

cumulative annual statements of account, certified by a certified public accountant." 17 U.S.C. § 115(c)(5). Under Section 201.19(f)(6)(ii)(A), the CPA must certify, among other things, that an examination of the annual statement of account was conducted in accordance with generally accepted auditing standards and that the examination included tests of accounting records and other necessary auditing procedures. In addition, the CPA must certify that the annual statement of account presents fairly the number of phonorecords made and distributed and the amount of applicable royalties for the year. *See id.*

132. In the place of these longstanding and significant protections, the RIAA seeks to substitute a watered-down "audit performed in the ordinary course of business according to generally accepted auditing standards by an independent and qualified auditor." *See* Findings of Fact ¶¶ 889-881. No provision of the Copyright Act empowers the Court to substitute an "ordinary course audit" for an accountant's certification. Therefore, the Court is bound by existing regulations.

D. Locked Content

133. The RIAA seeks to modify the Copyright Act's definition of "distribution" to permit "locked content products" to be considered distributed for royalty payment purposes only once the product is "unlocked" rather than when the product is embedded in a device or distributed to a consumer. The RIAA's proposed term would require a modification to the Copyright Act's definition of distribution and its associated regulations. *See* 17 U.S.C. § 115(c)(2); 37 C.F.R. § 201.19 (a)(6)(i). Such a modification would fall well outside the Court's authority to modify notice and recordkeeping provisions and may not be adopted.

E. Multiple Uses

134. The RIAA proposes a term that would allow copyright users to pay only once for products that contain more than one fixation of a sound recording. The RIAA's proposed term,

however, conflicts with the Copyright Act's provision that "the royalty under a compulsory license shall be payable for every phonorecord made and distributed in accordance with the license." 17 U.S.C. § 115(c)(2). Rather than compensating Copyright Owners for each copy "made and distributed," the RIAA's proposed term would eliminate payments for certain works depending on whether they are sold in conjunction with other works. This Court has no statutory authority to override the Copyright Act and thus no authority to adopt the term proposed by the RIAA.

Conclusion

For the foregoing reasons, and those set forth in the Proposed Findings of Fact, the Copyright Owners respectfully request that the Copyright Royalty Judges adopt the proposals set forth in the Amended Proposed Rates and Terms of National Music Publishers' Association, Inc., the Songwriters Guild of America, and the Nashville Songwriters Association International, dated July 2, 2008.

Dated: July 2, 2008

Respectfully submitted,

NATIONAL MUSIC PUBLISHERS' ASSOCIATION, INC.

THE SONGWRITERS GUILD OF AMERICA

NASHVILLE SONGWRITERS ASSOCIATION INTERNATIONAL

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CERTIFICATE OF SERVICE

I hereby certify that on this 2nd day of July 2008, I caused true and correct copies of the Copyright Owners' Proposed Conclusions of Law to be served in hard copy, as well as on CDs containing the same document in PDF format, via Federal Express on the following parties:

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