



TESTIMONY OF

VICTORIA BASSETTI

Senior Vice President, Industry & Government Affairs

EMI Music

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QUALIFICATIONS

My name is Victoria Bassetti, and I am Senior Vice President of Industry & Government Affairs, Worldwide and Vice President of Anti-Piracy, North America for EMI Music. I have been at EMI Music since 2003. I am one of two people at EMI Music who head the company's worldwide antipiracy efforts, with primary responsibility for North America. And as head of government affairs for North America, I also work to address piracy and other issues affecting the industry through legislation and other governmental action. I am a member of RIAA's Board of Directors, RIAA's Antipiracy Taskforce, and the Board of Directors of the International Federation of the Phonographic Industry ("IFPI"). Prior to joining EMI, I served as chief counsel for various Senate Judiciary Committee subcommittees. I graduated from Harvard-Radcliffe College in 1987 and Columbia Law School in 1992.

SUMMARY

The recording industry has probably always been affected by piracy, but technological changes during the last ten years have taken piracy to a level previously unimaginable. This has had, and continues to have, devastating effects that need to be taken into account in this proceeding. Piracy is significantly responsible for the decline in industry sales volume since 1999. It is hard to think of another industry that has contracted so much so quickly. Piracy has not only reduced the number of units of products we sell, it is also one of the significant price constraints on the products we sell. These effects have, in less than a decade, radically transformed the industry and its economics. In addition, record companies have had to spend tremendous sums of money to fight music piracy to ensure a market for legitimate music products (i.e., those that result in payments to writers, publishers, artists and record companies).

The experience of music publishers has been very different. To be sure, every sale lost to piracy is lost to both the record company and music publisher. However, increasing mechanical royalty rates have blunted the effects that writers and publishers feel from declining unit sales and from the attendant margin pressure that piracy places on a record company's sales. Moreover, because piracy primarily affects sales, writers and publishers have experienced increases in their substantial performance and synchronization income that have offset any declines in mechanical income. Finally, publishers have done much less to combat the piracy that has hurt the whole music industry.

In my testimony I will first describe the formidable piracy problem the industry faces today. Next, I will explain the significant injury piracy has caused. I will then describe the extensive and expensive efforts taken to combat piracy by EMI Music, as well as at the industry level in the U.S. and worldwide through RIAA and IFPI. Finally, I describe the relative lack of effort by music publishers to combat piracy.

DISCUSSION

I. Today's Piracy Problem

Music "piracy" is the illegal duplication and distribution or acquisition, or performance, of sound recordings. It is an issue that the recording industry has had to confront on some level for decades, but which has changed dramatically in the last ten years to become a defining characteristic and predominant problem for the industry. A large number of pirate peer-to-peer networks, made increasingly attractive to users by accelerating penetration of broadband internet access, coupled with ubiquitous availability of computers that readily can "rip" and "burn"¹

¹ "Ripping" is a term used to refer to converting a CD from its native format to a file in MP3, or some other compressed audio format, on a computer. "Burning" is a term used to refer to making copies of music files onto recordable CDs.

perfect digital copies, has transformed music piracy. What was once mostly a specialized commercial undertaking or small-scale individual behavior has become a nearly free and effortless activity involving tens of millions of individuals in the U.S. and hundreds of millions worldwide.

The changes that music piracy has undergone in recent years have in turn transformed the music marketplace. U.S. consumers with internet access did not pay for 51% of music they acquired in 2005.² Thus, it is not surprising that since the launch of the original Napster service in 1999, there has been a significant decline in industry sales and revenue. That decline has been offset only recently and partially by legitimate electronic delivery. There can be no doubt that piracy is a major force that fundamentally shapes the economics of the music industry and needs to be taken into account in this proceeding.

While the piracy problem is huge, it is not monolithic. Piracy takes various forms, all of them harmful. I will describe the current environment for online and physical piracy, as well as the overarching problem of pre-release piracy.

A. Online Piracy

The internet and other networks have proven to be a ruthlessly efficient means for illegally obtaining and distributing copies of sound recordings. This “online piracy” happens in various ways, but all have similar severe effects. Some examples of the types of online piracy we face today include the following:

- Public pirate networks permit millions of simultaneous users to exchange copies of recordings and offer free on-demand instant access to essentially all recorded music.

² Christman, Ed, “New Life for CDs? Study Says There is Room For Physical Product Sales to Grow,” *Billboard*, April 1, 2006. Attached as RIAA Ex. C-101-DP.

- On university campuses and within businesses, file sharing among users on a local area network (“LAN”) is common, and harder to detect and deter than on public pirate networks. With several thousand students on a campus, a LAN-based file-sharing network can easily satisfy students’ demand for recorded music.
- So-called “darknets” (i.e., file-sharing networks open to only trusted users) offer somewhat less selection but are difficult or impossible to detect, infiltrate and shut down.
- Other unlicensed and infringing services, principally websites operated from abroad, offer U.S. users a huge selection of all the most popular music for free or at nominal prices.
- “Stream ripping” software automatically identifies and separates tracks from webcasts and stores them for future playback – allowing users quickly and without charge to build the equivalent of a download library while rightsholders are paid, if at all, only for a performance. We face similar problems with on-demand subscription services and a new XM Satellite Radio music delivery service, and we inevitably will with digital (i.e. high definition) radio receiver/recorders.

Online piracy began to occur only in the late 1990s, when people began making downloads of songs available on personal websites or through the use of the file transfer protocol (“FTP”). However, the number of recordings available in any one place, and the community of people who knew how to access FTP sites, were limited. In 1999, with the launch of the original Napster, the first illegal peer-to-peer file-sharing service, it was suddenly possible for anyone with a computer and an internet connection easily to obtain any music they might want for free.

Not surprisingly, online piracy exploded. At the peak of Napster in February 2001, some 2.8 billion recordings were distributed in one month, according to internet research firm Webnoize.³ Napster was shut down shortly thereafter, but a parade of ever-worse successors has followed, including companies such as Grokster, Kazaa, eDonkey, iMesh, BearShare and LimeWire. The recording industry has aggressively fought online piracy – and has had some success in getting particular services to shut down or go legitimate – but there is always a new illegal service, and while the problem has been contained to some extent, no end to the problem is in sight.

The extent of online piracy since 1999 is staggering, and the number of people still illegally downloading music remains high today. There are at least 10 major peer-to-peer protocols (i.e., methods for peer-to-peer software to communicate) and hundreds of software client applications that utilize these protocols to enable users to exchange music illegally. As just one example, according to Download.com, the popular peer-to-peer client LimeWire has been downloaded more than 102 million times just since June of this year.⁴ LimeWire has anywhere from 2 to 6 million simultaneous users at any one time.⁵

According to IFPI data, there were an estimated 20 billion songs illegally downloaded globally in 2005.⁶ In just August 2006 alone, there were 415 million songs downloaded in the U.S. from pirate peer-to-peer networks. In contrast, 71 million songs were purchased from

³ 2001 IFPI Music Piracy Report, at 8. Attached as RIAA Ex. C-102-DP.

⁴ LimeWire download page, available at http://www.download.com/LimeWire/3000-2166_4-10552048.html?tag=pop.software (last visited Nov. 27, 2006). Attached as RIAA Ex. C-103-DP.

⁵ Thomas Mennecke, "Limewire Becomes P2P Icon," October 17, 2005, available at <http://www.slyck.com/news.php?story=956> (last visited Nov. 29, 2006). Attached as RIAA Ex. C-104-DP.

⁶ The IFPI Recording Industry 2006 Piracy Report, at 4. Attached as RIAA Ex. C-105-DP.

legitimate digital music stores.⁷ Additionally, the number of U.S. households with internet service that use pirate networks grew 19% between August 2005 and August 2006, to 7.5 million households.⁸

B. Physical Piracy

While online piracy has captured considerable media attention, the problem of physical product piracy is no less acute. Physical product piracy takes various forms:

- Burned CDs either distributed commercially or for little or no charge among friends;
- Counterfeit physical products (i.e., products that imitate legitimate products); and
- Bootleg recordings (i.e., unauthorized recordings of live concerts or broadcast performances).

As in the case of online piracy, the physical piracy landscape has changed tremendously during the last ten years. The quality of analog copies degrades with each successive generation of copying, so the quality of pirated cassette tapes that were a problem years ago was usually not very good. For roughly the first 15 years, from the introduction of the CD until the late 1990s, the CD was a reasonably secure product. The equipment required to copy CDs was expensive, so initially it was only CD plants that could create pirated CDs, and even later, specialized multi-well CD recorders were relatively rare.

All that changed in the late 1990s with the advent of high-speed CD-ROM drives with special circuitry to “rip” CDs; large, inexpensive hard drives and MP3 compression technology to permit storage of large numbers of recordings on any computer; inexpensive CD recorders;

⁷ Garrity, Brian, “From Piracy to Profit? One Year After iMesh Converted from Pirate Network to RIAA-Endorsed Play, P2P Panacea is Still a Long Way Off,” *Billboard*, Oct. 7, 2006. Attached as RIAA Ex. C-106-DP.

⁸ *Id.*

and software that has increasingly automated the process of ripping and burning CDs. CDs have become easy to copy, and to copy perfectly, at little cost and on any scale. The growth in this form of piracy is illustrated by seizures of pirated recordable CDs (“CD-Rs”), which started with 87 illegal CD-Rs during the first half of 1997, grew to 165,981 during the first half of 1999,⁹ and then increased steadily, with 3.64 million burned CD-Rs seized in 2005.¹⁰ Today, more than one in three CDs sold worldwide is illegal, with an estimated 1.2 billion illegal CDs sold in 2005.¹¹ RIAA estimates that the U.S. music industry loses well over \$300 million a year to domestic physical goods piracy alone,¹² and IFPI estimated that the value of global traffic of illegal CDs in 2005 was \$4.5 billion.¹³

C. Pre-Release Piracy

A particularly pernicious form of piracy that transcends format is leaks of albums or unfinished recordings more than a few days before an album’s official release date. The internet permits pre-release albums to reach a mass audience within hours. Users who download a pre-release album, or receive a burned CD of the pre-release album from a friend, have little reason to buy the album weeks later when it becomes available in a record store or on iTunes.

New releases are the lifeblood of the music industry. The commercial prospects of a release can be severely damaged if it becomes widely available from illegal sources when it is not yet available from legitimate ones, and the marketing plans that have been carefully

⁹ See RIAA Website article “CD/CD-R Piracy,” www.riaa.com/issues/piracy/cdcd_r.asp (last visited Nov. 21, 2006). Attached as RIAA Ex. C-107-DP.

¹⁰ RIAA 2005 Commercial Piracy Report. Attached as RIAA Ex. C-108-DP.

¹¹ The IFPI Recording Industry 2006 Piracy Report, at 4, RIAA Ex. C-105-DP.

¹² RIAA Press Release, “RIAA Identifies 12 Piracy ‘Hot Spot’ Cities,” May 3, 2006 (last visited Nov. 21, 2006). Attached as RIAA Ex. C-109-DP.

¹³ The IFPI Recording Industry 2006 Piracy Report, at 4, RIAA Ex. C-105-DP.

calculated to build “buzz” about a recording at the time it is commercially released are disrupted. Sometimes recordings that have not yet been finally mixed and mastered are leaked. Because consumers exposed to such material may not understand what they are listening to, such leaks can cause the artist reputational injury that may be even more significant than the injury caused by leaks of finished material.

II. The Effects of Piracy on the Music Industry

Piracy has had three significant effects on record companies that must be taken into account in this proceeding.

First, piracy has caused a devastating decline in sales and revenue. As described in testimony of David Teece, there has been a dramatic decline in industry sales and revenue in recent years. When EMI and the industry were first confronted with the widescale unauthorized peer-to-peer file sharing phenomenon, we began to look carefully at it to determine whether and how much damage it might be causing. An early, 2002 study by Forrester commissioned by EMI determined that as much as one-half of the industry’s decline was attributable to either indirect substitution, in which case consumers did not buy music because they knew they could download it without paying, or direct substitution, in which case consumers decided not to purchase music after downloading it for free. More recently, IFPI reported that 26% of the decline in CD units in the U.S. in 2005 was replaced by music consumption via illegal file sharing.¹⁴ Of course none of these estimates purport to measure the full extent of damages caused by illegal peer-to-peer services.

A number of academic studies have considered the effects of piracy on sales. Not surprisingly, most academics who have examined the issue have reached the obvious conclusion

¹⁴ The IFPI Recording Industry 2006 Piracy Report, at 5, RIAA Ex. C-105-DP.

that piracy has had a substantial impact on legitimate sales. For example, Professor Stan Liebowitz recently concluded that illegal file sharing is closely linked to the decline in record sales and has caused significant harm to the record industry.¹⁵ In another analysis, he found that all of the music industry's recent decline could be attributed to unauthorized file sharing.¹⁶ Another study by Alejandro Zentner found that downloads may explain a 30% reduction in the last four years in the probability of consumers buying music.¹⁷

These estimates of precisely how badly piracy affects sales vary depending on the methodology used, but even the most conservative estimates of the damage are serious and threatening to the recorded music industry.

As releases from the most popular artists are generally the ones most heavily pirated, the effect of piracy on sales can be seen in the sharp decline of high selling records in recent years. For example, according to Soundscan data the 10 top selling albums in 2000 sold a combined [REDACTED] albums, whereas the top 10 selling albums in 2005 sold only [REDACTED] albums combined. This decline in top selling albums means that record companies no longer have the same ability we once had to use big hits to offset the losses we experience from the majority of our albums that never make money. Piracy's effect on the recording industry can also be seen in the way that record sales now drop in the second week an album is on the market, reflecting the fact that by that time pirated versions are readily available online or in pirate physical form. In 1995, the average second week sales drop for the top 25 albums of that year was 35.5%. In

¹⁵ See Liebowitz, Stan, "File Sharing: Creative Destruction or Just Plain Destruction?," *The Journal of Law & Economics*, April 2006, at 24-25. Attached as RIAA Ex. C-110-DP.

¹⁶ See Liebowitz, Stan, "Testing File-Sharing's Impact by Examining Record Sales in Cities" (April 2006). Available at SSRN: <http://ssrn.com/abstract=829245> (last visited Nov. 20, 2006). Attached as RIAA Ex. C-111-DP.

¹⁷ See Zentner, Alejandro, "Measuring the Effect of File Sharing on Music Purchases," *The Journal of Law & Economics*, April 2006, at 87. Attached as RIAA Ex. C-112-DP.

1999, at the beginning of the Napster effect, that drop had increased to 40.6%. For 2006 thus far, the average second week drop off is 57.8%.¹⁸

Mechanical royalty rates exert greater economic pressure on record companies in such an environment of falling sales than they do during times of rising sales. Rates set in today's heavy piracy environment need to assume that sales declines attributable to piracy will not be regained quickly, that piracy will continue to constrain the ability of top-selling acts to reach historic highs and that piracy will always be an open avenue for music acquisition for a large number of music consumers through all or most of the rate period.

Second, piracy constrains pricing. When the main "competitors" of record companies and digital music services offer the same product to consumers for free and have almost no costs themselves, it creates significant price constraints on legitimate products and services. In order to attract consumers to legitimate online music services, it is necessary to price legitimate music in relation to the pirate market. Consumers are price sensitive and view the pirate market as a viable fall-back option to obtain music if they feel that prices are too high. Meanwhile, price has thus become a constant factor in both attracting people to buy music in the first place and in retaining people who do use legitimate digital services. In the digital and physical pirate atmosphere, EMI must constantly improve the consumer value proposition for our product and one of the points we have to compete on is price. A survey by The Taylor Research & Consulting Group found that the top reason people do not purchase music online from legitimate

¹⁸ See EMI analysis attached as RIAA Ex. C-201-DR.

services-is because of price.¹⁹ Rates set in today's heavy piracy environment need to assume that record companies will face ongoing price competition from piracy during the rate period.

Finally, as will be discussed more fully below, record companies have had to invest large amounts of money and manpower in the effort to fight piracy. Rates set in today's piracy environment need to assume that record companies will continue to contribute a disproportionate share of the costs and shoulder a disproportionate share of the risks of fighting piracy in order to make legitimate products available to the public.

III. EMI's Antipiracy Activities

EMI invests significantly in fighting piracy on all fronts. By conservative estimates, we spent approximately [REDACTED] in 2006 in direct, quantifiable costs (and not including EMI's contributions to industry-wide anti-piracy efforts). Additional antipiracy expenses, such as watermarking, are borne on a label-by-label basis.

Probably our most logistically and operationally challenging antipiracy initiative has been a comprehensive program to protect music before it is released. For example –

- We have implemented new security measures in recording studios and CD pressing plants to try to prevent pre-release leaks.
- Whenever a product is expected to sell over 100,000 units worldwide in the first year, we apply a unique watermark to each copy we distribute pre-release – such as to radio stations and reviewers. This has been a major undertaking, involving implementation of an appropriate technology solution, acquisition of special equipment, and new business processes.

¹⁹ The Taylor Research & Consulting Group, Digital Rights Management Survey: Measuring Interest in a Digital Music Locker Concept (Sept. 2006).

- We have implemented other security measures to ensure that we can enforce accountability for any future leaks, such as requiring reviewers to personally sign for their copies.
- For major releases, we develop specific pre-release security plans, and sometimes will do things like host a “listening party” for reviewers and media rather than providing review copies.
- Our antipiracy staff polices pirate peer-to-peer networks looking for pre-release leaks.
- EMI’s antipiracy staff works with our litigation group, as well as the FBI and other law enforcement agencies, to track down and take action against the sources of leaks.

This program has been successful. Since implementing it, we have not had a significant leak of a major release until the final week or so before release, when copies of the album are in warehouses and the back rooms of record stores across America. Hopefully, we have mostly put an end to the days of leaks of major albums six weeks before the street date.

In addition to the easily quantified costs of implementing this program at the outset, the necessary security measures can add significant costs to label marketing budgets, such as the cost of watermarking discs and developing and implementing security plans. In addition, extensive pre-release security requires exceptionally tight control of advance music, which creates tension with the desire to build exposure to, anticipation of, and pent up demand for forthcoming albums in advance of their release date.

[

MATERIAL REDACTED PURSUANT TO PROTECTIVE ORDER

EMI is constantly assessing the changing face of online piracy. As new piracy threats materialize, we evaluate them and create our own strategies for addressing them. For example, in the last year a more recent evolution in peer-to-peer protocols, BitTorrent, has challenged our antipiracy strategies. The speed of transmission via BitTorrent is higher than for previous peer-to-peer protocols. It is notable that this new evolution in piracy occurred after the Supreme Court's unanimous decision in *Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd.*, 545 U.S. 913 (2005), demonstrating that while the problem has been contained to some extent, no end to the problem is in sight.

On the older pirate networks, users have tended to download music on a track by track basis. Given the incredible speed of BitTorrent, however, its users are more inclined to download whole albums (or even larger files). For example, the whole Beatles catalogue could be downloaded in about three hours. BitTorrent is only the most advanced "at present" because as noted above, piracy technology is constantly evolving. File-sharing networks will continue to develop, and the industry will have to develop new technological and legal responses accordingly.

EMI is also working with peer-to-peer networks that have expressed an interest in becoming legitimate to implement filtering technologies. In the last year and a half, several major peer-to-peer networks have deployed filtering technologies which, in effect, check the files that are being transferred over the network to see if they are copyrighted, and if so, whether their transmission is authorized. If they are not authorized, the transfer is blocked. Filtering systems

are capable of processing and blocking tens of thousands of file transactions per second. These systems have been developed by other companies, but EMI has invested significant sums of money and human resources in servicing these companies with the necessary metadata and material needed to implement filtering.

To combat physical piracy, our antipiracy staff also polices auction sites such as eBay looking for sales of pirate CDs. EMI Music also made a large investment in content protection for CDs. We thoroughly studied available technologies, acquired and implemented it, made changes to manufacturing processes, developed end user licenses and labeling and customer service procedures, and incurred [REDACTED] costs. And we also applied CD content protection technology for pre-release CDs.

[REDACTED]

[REDACTED]

IV. RIAA's Industry-Wide Antipiracy Activities

Because most piracy affects the whole industry, much of the industry's response is conducted through RIAA. For fiscal years 2000 through 2006, RIAA's total antipiracy spending, including litigation costs, was about [REDACTED], or an average of about [REDACTED] per year. EMI's contribution to RIAA's industry-wide antipiracy efforts is approximately [REDACTED].

RIAA's antipiracy unit employs approximately [REDACTED] people who work full time on antipiracy efforts from its headquarters in Washington, D.C., four regional offices and four field offices.

RIAA's litigation department is authorized for approximately [REDACTED] employees, and over 90% of their work is related to antipiracy. RIAA also employs approximately [REDACTED] part-time contractors in its antipiracy efforts.

A. RIAA's Efforts to Fight Online Piracy

RIAA has pursued a four-pronged approach to fighting online piracy. This campaign has required a huge investment, but has enjoyed a measure of success.

First, you have probably heard of the litigation RIAA has coordinated on behalf of its member companies against pirate networks:

- The first such case was brought against the original Napster in July 1999 and resulted in that service shutting down in July 2001.
- The industry pursued litigation against Sharman Networks, operator of the Kazaa service, and Grokster and Streamcast, which culminated in the U.S. Supreme Court's decision in June 2005 that the services could be liable for inducing infringement by their users. One study found that in the months following this decision, the number of U.S. households that downloaded at least one song from an illegal peer-to-peer service declined by 11% (from 6.4 million households to 5.7 million).²⁰ And as a result of this decision, the record companies reached a settlement with Grokster, as well as other major pirate networks, such as BearShare. Those services have all either shut down or agreed to implement measures to prevent further infringement.
- In February 2004, U.S. record companies joined other applicants in suing Sharman Networks, operator of the Kazaa service, in Australia. By May 2003, the Kazaa software had been downloaded 239 million times,²¹ and at its peak, Kazaa had 4.2

²⁰ NPD Press Release, "Illegal Peer-To-Peer Music File Declines After Supreme Court Grokster Decision, Dec. 14, 2005, RIAA Ex. C-113-DP.

²¹ RIAA Press Release, "Kazaa Settles with Record Industry and Goes Legitimate," July 27, 2006. Attached as RIAA Ex. C-114-DP.

million simultaneous users worldwide.²² In September 2005, the Australian court found the operators of the service liable for the infringements of their users, and ordered Kazaa to implement measures to prevent further distribution of copyrighted music. In July 2006, Kazaa settled with the record companies and agreed to implement filtering technologies to prevent infringement.

Second, RIAA has brought over 18,000 lawsuits against individuals for infringing distribution of music on peer-to-peer networks. A survey found that the initial round of these cases caused the number of households illegally downloading music to drop by 35% between April and September 2003, and that 1.4 million households deleted all digital music files saved on their personal computer hard drives in August 2003.²³ RIAA and the record companies were reluctant to start these lawsuits, but ultimately felt compelled to resort to litigation because it was the only way to create a deterrent effect and educate the public that file sharing is illegal and has consequences. Survey data shows that the number one reason cited by consumers for stopping illegal peer-to-peer file sharing was concern about potential lawsuits.²⁴

Third, RIAA constantly investigates and regularly takes enforcement action against other online pirates. RIAA's team of internet specialists, aided by technology developed for RIAA, such as a 24-hour automated webcrawler, scour the internet looking for illegal recordings. Once an infringing site is identified, RIAA takes steps to prevent further infringement, ranging from sending a warning e-mail to commencing litigation if necessary. If necessary to identify an

²² *Id.*

²³ NPD Press Release, "Illegal Peer-To-Peer Music File Declines After Supreme Court Grokster Decision, Dec. 14, 2005. Attached as RIAA Ex. C-113-DP.

²⁴ NPD Press Release, "Progress Report: Digital Music Landscape Shifting, But Slowly," June 23, 2005, RIAA Ex. C-115-DP.

infringer, RIAA brings a “John Doe” suit or uses the Digital Millennium Copyright Act’s subpoena provisions to obtain information about site operators from internet service providers.

Finally, RIAA has implemented a comprehensive educational program directed at students of all ages. An education program is no substitute for vigorous enforcement efforts, but education can help keep honest people honest. Because illegal file sharing is so prevalent on university campuses, RIAA led formation of the Joint Committee of Higher Education and Entertainment Communities to develop collaborative solutions to address illegal file sharing.²⁵ RIAA has also worked with the American Council on Education and EDUCAUSE to develop a video to inform college students about the potential consequences of illegally downloading music and the many legal alternatives that exist today.²⁶ RIAA and i-SAFE are working together to develop a nationwide series of school assemblies on intellectual property for students in middle and high school.²⁷ RIAA also worked with LearningWorks and the Close Up Foundation to develop classroom materials about copyright law and the risks of online file sharing for elementary, middle and high school teachers, students, and parents.²⁸

B. RIAA’s Efforts to Fight Physical Piracy

RIAA likewise has made a huge investment in combating physical piracy. Most of this involves working with federal, state, and local law enforcement agencies and prosecutors

²⁵ RIAA Press Release, “University, Entertainment Industry Leaders Address Campus File-Sharing In New Progress Report To Congress,” Sept. 21, 2005. Attached as RIAA Ex. C-116-DP.

²⁶ RIAA Press Release, “Music Industry Debuts New Educational Video for College, University Use this Fall,” September 6, 2006. Attached as RIAA Ex. C-117-DP.

²⁷ RIAA Press Release, “RIAA, i-SAFE Announce New Partnership to Teach Young Fans About Legal Music,” June 28, 2006. Attached as RIAA Ex. C-118-DP.

²⁸ “RIAA: New Educational Materials for Young Music Fans to Hit Classrooms This Fall,” www.narm.com/Content/NavigationMenu/MediaCenter/IndustryNews/RIAAEduMaterials.htm, September 5, 2006 (last visited Nov. 29, 2006). Attached as RIAA Ex. C-119-DP.

nationwide to coordinate seizures of illegal products. RIAA-assisted raids have closed down hundreds of illegal manufacturing and distribution operations. In 2005, RIAA investigators assisted more than 800 law enforcement departments across the country in more than 4,000 antipiracy actions, making approximately 3,300 arrests and seizing more than 5 million pieces of pirated music product.²⁹ Enforcement actions were brought in 30 states against 348 manufacturers, ranging from commercial manufacturing plants to small burn-on-demand operations.³⁰ Seizures of counterfeit CDs from commercial manufacturing facilities in 2005 were up more than 424,000 units from the previous year, and seizures of piracy equipment grew by 57%.³¹

In 2003, RIAA initiated a retail antipiracy program. As part of that program, RIAA investigates businesses selling illegal CDs and music DVDs, sends demand letters, and pursues civil litigation where appropriate. RIAA also has brought suits to end infringing distribution of recordings at flea markets.

Finally, RIAA has a CD plant education program, through which it trains CD plant staff on business practices to prevent piracy.

C. **RIAA's Efforts to Fight Piracy Through Technology Development**

One final method that RIAA is employing to fight piracy is assisting in the development of more secure technologies so that music piracy will be less of a problem in the future. In the last few years, a new form of piracy has threatened to emerge which involves "stream ripping." In effect, stream ripping allows consumers to listen to radio-like streamed programming and then

²⁹ RIAA Press Release, "RIAA Identifies 12 Piracy 'Hot Spot' Cities," May 3, 2006, RIAA Ex. C-109-DP.

³⁰ *Id.*

³¹ *Id.*

to permanently capture individual tracks off the radio or streamed service. So, for example, a consumer might program his or her radio to make perfect and permanent digital copies of every Beatles song that is transmitted over radio. In effect, this form of piracy turns “performances” into distributions.

To assist in dealing with this problem, both the RIAA and IFPI have been actively engaged with a variety of industries, standard-setting organizations and government bodies in order to develop and implement technological measures to prevent stream ripping. In the United Kingdom, the IFPI negotiated a deal with that nation’s radio broadcasting organization implementing data transmission standards that will help limit the damage. In the United States, the RIAA has had extensive discussions with the National Association of Broadcasters and radio stations exploring technical measures that could be implemented.

D. IFPI’s International Antipiracy Activities

U.S. record companies also invest in the fight against music piracy on an international level. Such an international focus is necessary for U.S. companies for a number of reasons. First, services located abroad distribute infringing copies into the U.S., so action to stop those services directly affects the U.S. marketplace. In addition, infringements abroad often involve U.S. repertoire because of the international popularity of U.S.-origin recordings, so stopping those infringements has a direct benefit to the typically American creators of both sound recordings and musical works.

IFPI, which represents the recording industry worldwide, coordinates international antipiracy efforts. IFPI has an enforcement unit, consisting of ■ antipiracy investigators operating worldwide, which conducts its own antipiracy operations and coordinates and assists with the activities of IFPI affiliates in various countries around the world. In 2006, IFPI’s budget

for direct expenditures on antipiracy activities was approximately [REDACTED]. EMI contributes to IFPI, as well as other national organizations outside the U.S. In 2005, EMI contributed approximately [REDACTED] to IFPI's antipiracy efforts, and another [REDACTED] to the antipiracy efforts of national recording associations other than RIAA.

IFPI, like RIAA, focuses on enforcement, litigation, and education. IFPI has brought some 13,000 cases against users making infringing distributions over pirate networks in 17 countries outside the U.S.³² With the help of IFPI, national enforcement authorities around the world seized approximately 80 million pirated CDs in 2005, which was double the number seized in 2004.³³ They also seized 78 disc manufacturing lines (representing a production capacity of 340 million discs), and 40,000 CD burner machines.³⁴ IFPI also coordinates worldwide education efforts. For example, it operates the website www.pro-music.org, a major educational tool available in six languages. The goal of the website is to raise awareness of legitimate ways to download music (providing a gateway to more than 350 legitimate sites), the creative processes involved in making music, and copyright laws internationally.

V. Limited Effort by Music Publishers to Combat Piracy

The effects of piracy on music publishers in recent years has been very different from the effects on record companies. Publishers have not faced the decrease in overall revenue, the margin pressures or the increased costs incurred to fight piracy. Indeed, given their different mix of revenue sources and the current mechanical royalty rate, piracy has had a very different impact on publishers, as illustrated by the discussion of publisher financial performance in the

³² IFPI Press Release, "Recording Industry Launches Fresh Wave of Actions Against Illegal File-Sharing," Oct. 17, 2006. Attached as RIAA Ex. C-120-DP.

³³ The IFPI Recording Industry 2006 Piracy Report, at 4, RIAA Ex. C-105-DP.

³⁴ *Id.*

testimony of David Teece. Increases in publishers' performance and synchronization income have offset any declines in mechanical royalty income. Moreover, publishers' revenue mix is diverse. Less than half of publishers' royalty income comes from sales (i.e., mechanical royalty income). This makes publishers less vulnerable to piracy than record companies, which overwhelmingly depend on sales revenues.

Perhaps because piracy has had less of an impact on their revenues, music publishers have assumed only a small role in combating the piracy that costs all of us sales. While they have joined with us in a few major litigations, they have typically assumed a secondary role, or joined in a settlement after record companies have done the heavy lifting to get the infringer to the table. As an example, after the Supreme Court's Grokster decision, we asked the music publishers to consider a lawsuit against a small pirate network that presented a straightforward case of infringement. The publishers declined to do so, stating that they needed to save money for this mechanical royalty rate proceeding. They do not employ investigators, do not regularly enforce against infringing online uses, and do not contribute to raids of CD plants.

In fact, to some degree, publishers have disrupted antipiracy efforts. Record companies have tried for years to migrate to more secure physical formats such as SACD, DVD-Audio and copy-protected CD. However, publishers' insistence that they should get multiple mechanical royalties for the two or more instances of each recording appearing on those discs held up their deployment and may have contributed to the lack of traction these formats have had.

Rates set in this proceeding should take into account the differential exposure to piracy risk between record companies and music publishers and the difference between them in bearing significant rate changes.

CONCLUSION

Efforts by record companies individually and collectively to fight music piracy have had some success. However, we will never eradicate piracy. Piracy is constantly changing and adapting, and we need to keep evolving technologies to compete with piracy.

The dramatic change in the face of piracy over the last decade has dramatically changed the recording industry and the economics of the recording industry. Rates set in today's piracy environment need to assume that even if we continue to fight piracy aggressively, and at considerable cost, piracy will continue to significantly impact sales growth and constrain pricing through all or most of the rate period.

In addition, an important part of the technological contribution, investment and cost with respect to legitimate recorded music products is the cost necessary to preserve the market for such products in the face of an onslaught of piracy. Record companies, not publishers or writers, make that substantial contribution and investment and incur that substantial cost, and will be required to continue to do so for the foreseeable future. This contribution and investment must be taken into account in determining mechanical royalty rates.

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I declare, under penalty of perjury, that the foregoing testimony is true and correct to the best of my knowledge.



Victoria Bassetti

Date: NOV 29 2006

Exhibits Sponsored by Victoria Bassetti (Public)

Exhibit Number	Description
C-101-DP	Christman, Ed, "New Life for CDs? Study Says There is Room For Physical Product Sales to Grow," Billboard, April 1, 2006
C-102-DP	2001 IFPI Music Piracy Report
C-103-DP	LimeWire download page, available at http://www.download.com/LimeWire/3000-2166_4-10552048.html?tag=pop.software (last visited Nov. 27, 2006)
C-104-DP	Thomas Mennecke, "Limewire Becomes P2P Icon," October 17, 2005, available at http://www.slyck.com/news.php?story=956 (last visited Nov. 29, 2006)
C-105-DP	IFPI Recording Industry 2006 Piracy Report
C-106-DP	Garrity, Brian, "From Piracy to Profit? One Year After iMesh Converted from Pirate Network to RIAA-Endorsed Play, P2P Panacea is Still a Long Way Off," Billboard, Oct. 7, 2006
C-107-DP	RIAA Website article "CD/CD-R Piracy," www.riaa.com/issues/piracy/cdcd.asp (last visited Nov. 21, 2006)
C-108-DP	RIAA 2005 Commercial Piracy Report
C-109-DP	RIAA Press Release, "RIAA Identifies 12 Piracy 'Hot Spot' Cities," May 3, 2006 (last visited Nov. 21, 2006)
C-110-DP	Leibowitz, Stan, "File Sharing: Creative Destruction or Just Plain Destruction?," The Journal of Law & Economics, April 2006
C-111-DP	Liebowitz, Stan, "Testing File-Sharing's Impact by Examining Record Sales in Cities" (April 2006). Available at SSRN: http://ssrn.com/abstract=829245 (last visited Nov. 20, 2006)
C-112-DP	Zentner, Alejandro, "Measuring the Effect of File Sharing on Music Purchases," The Journal of Law & Economics, April 2006
C-113-DP	NPD Press Release, "Illegal Peer-To-Peer Music File Declines After Supreme Court Grokster Decision, Dec. 14, 2005
C-114-DP	RIAA Press Release, "Kazaa Settles with Record Industry and Goes Legitimate," July 27, 2006
C-115-DP	NPD Press Release, "Progress Report: Digital Music Landscape Shifting, But Slowly," June 23, 2005
C-116-DP	RIAA Press Release, "University, Entertainment Industry Leaders Address Campus File-Sharing In New Progress Report To Congress," Sept. 21, 2005
C-117-DP	RIAA Press Release, "Music Industry Debuts New Educational Video for College, University Use this Fall," September 6, 2006

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C-118-DP	RIAA Press Release, "RIAA, i-SAFE Announce New Partnership to Teach Young Fans About Legal Music," June 28, 2006
C-119-DP	"RIAA: New Educational Materials for Young Music Fans to Hit Classrooms This Fall," www.narm.com/Content/NavigationMenu/MediaCenter/IndustryNews/RIAA/EduMaterials.htm , September 5, 2006 (last visited Nov. 29, 2006)
C-120-DP	IFPI Press Release, "Recording Industry Launches Fresh Wave of Actions Against Illegal File-Sharing," Oct. 17, 2006.
C-201-DR	EMI Historical Soundscan Debut vs Second Week Performance Analysis Spreadsheet (RESTRICTED)