

Before the
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Washington, D.C.

In the Matter of

**ADJUSTMENT OF RATES AND TERMS FOR
PREEXISTING SUBSCRIPTION SERVICES
AND SATELLITE DIGITAL AUDIO RADIO
SERVICES**

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) **Docket No. 2006-1 CRB DSTR**
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TESTIMONY OF

LAWRENCE KENSWIL

**President of Universal eLabs,
a division of Vivendi Universal's Universal Music Group**

PUBLIC VERSION

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DIRECT TESTIMONY OF LAWRENCE KENSWIL

Background and Qualifications

I am the President of Universal eLabs, a division of Vivendi Universal's Universal Music Group ("UMG"). I have headed eLabs from its founding in January 1999. Previously, I was UMG's Executive Vice President, Business and Legal Affairs. I sit on the Board of Directors of the Recording Industry Association of America and, previously, the Board of the International Federation of the Phonographic Industry.

Universal eLabs is dedicated to exploring, developing, and evolving global business and new technology strategies to deliver music to consumers in innovative ways. eLabs is comprised of a team of business, legal, and technical professionals devoted to developing, implementing, and operating new music products, programming and digital distribution initiatives across all emerging technology and convergence platforms, including Internet, mobile, physical, kiosk, home networking and set-top box systems. As President of eLabs, I oversee all of UMG's efforts to license sound recordings for electronic distribution.

About Universal Music Group

UMG is the world's largest music company with a history dating back to the 19th century. In 2005, UMG held a 31.7% share of the domestic recorded music market.

UMG includes an extensive and diverse collection of music labels — including Decca Record Company, Deutsche Grammophon, Interscope Records, Geffen Records, A&M Records, Island Records, Def Jam Records, Lost Highway Records, MCA Nashville, Mercury Nashville Records, Motown Records and Universal Records — and artists — including Beck, Black Eyed Peas, Bon Jovi, Sheryl Crow, Dr. Dre, Eminem,

Jay-Z, Diana Krall, Nelly, No Doubt, Gwen Stefani, Shania Twain, Stevie Wonder, and Sting.

UMG International operates directly or through joint ventures and licensees in 77 countries. Universal Classics Group is responsible for more than 40% of world sales in the classical music genre, and Verve Music Group is the world's largest jazz recording company. Universal Music Publishing Group owns or administers more than one million copyrights.

The Electronic Distribution Market

The Rapid Development of New Ways to Consume Music

Recognizing the considerable growth in the electronic distribution market and the potential for more in the coming months and years, UMG is transforming from a “record company” to a “music entertainment company.” UMG’s annualized revenues from electronic distribution of recorded music in the United States have grown from near zero a few years ago to approximately [REDACTED]¹ as of the first half of 2006. Universal Music Mobile, a division of UMG, was a pioneer in fusing recorded music and the burgeoning mobile phone market.

Whereas in the past UMG focused almost exclusively on selling CDs and other physical product, the future for UMG is about receiving a fair return from multiple revenue streams. Consumers now enjoy music in more ways than ever before — satellite radio, satellite and cable T.V. services, permanent digital audio downloaded tracks and albums, streaming and conditional downloads, and webcasting, mobile and wireless services, video services, and sales of other digital products (e.g., ringtones). We at UMG

¹ The information in this testimony that has been marked as restricted is proprietary and commercially sensitive information that is not generally known to the public.

are hopeful that the revenues from all of these uses of music will, in the long run, more than compensate for any lost physical sales. Because consumers value the ability to purchase music in many forms and access music from almost everywhere, UMG believes that the evolution to electronic distribution — while challenging at first for many reasons, not the least of which is digital piracy — will ultimately expand the market for music and augment UMG's revenue from sound recordings.

Digital piracy over the last few years has posed a serious threat to the industry, with physical sales declining in five of the last six years, at the same time that the economy has been growing. According to RIAA data, sales of CDs in the United States have declined 25.2% from 2000 to 2005. SX Ex. 004 DP. At the same time, the costs of identifying, developing and promoting the artists that consumers want to hear (the core of UMG's business) have not changed. Consequently, the importance of a fair return from all of these different markets cannot be overstated.

In addition, although these new revenue streams sometimes provide additional compensation for UMG, they also can substitute for sales of other UMG products, including CDs. This includes satellite radio and the pre-existing "over T.V." services. There is only so much time in the day for people to spend listening to music. With 70 or more music channels offering niche programming, satellite radio is "narrowcasting," not broadcasting. Because of the number of channels and its enormous variety, satellite radio and the other services can provide consumers with exactly the mood or genre of music that they want at a particular time, reducing the need of consumers to purchase CDs, downloads and subscription services. With such tremendous breadth and high digital audio quality, these services substitute for the other ways that people experience music —

not only for CDs, from which the record companies currently make most of their sales, but also for other digital services from which UMG derives increasingly important and substantial revenue.

UMG's Approach to Licensing

UMG's approach to licensing digital rights has evolved over time. For a period, UMG sought to license legitimate new services in the marketplace in order to create competition with peer-to-peer networks on which people could illegally download UMG sound recordings. But times have changed, and there are now many legitimate services distributing music in different forms.

In selling and licensing its products, UMG seeks to protect its sound recordings from piracy and to receive a fair return according to the value that consumers place on them. UMG does not enter into agreements for broad or blanket licenses of its catalog in the hope that it will "promote" sales of CDs or another revenue stream. Rather, UMG tries to maximize each and every revenue stream. UMG does not view as promotional the commercial exploitation by others of the very product that it seeks to sell. In attempting to price UMG's products consistent with the value to the consumer, UMG considers both the means by which its sound recordings will be distributed and how those recordings will be enjoyed by the consumer.

The Development of Portability and Wireless Services

One of the most significant developments in the digital marketplace is the availability of music via portable devices and wireless networks. In addition to consumers' traditional choice of which artists to listen to, consumers are beginning to choose when and where they want their music content delivered. Since the introduction

of the first mp3 player, consumers have been able to download music to their computers, transfer it to a portable device and take the music with them. Now consumers also can access and acquire music from anywhere, through the ever-improving wireless networks that are offering audio and video content.

Exploitation (often by others) of UMG's content is directly related to the expansion of these wireless networks. Wireless carriers need audio and video content to attract wireless customers to more expensive data packages (often an additional \$15-25 per month) and new cell phones. For them, music is a key component to selling subscriptions and equipment. Thus, they are racing to offer as much content as possible.

The market has already shown that consumers will pay a substantial sum (in addition to paying for a wireless service and a cell phone) to be able to access music and other content anywhere at any time. Consumers already pay a monthly premium of about \$5 for portable subscription services (over the monthly price for non-portable subscription services). And in the nascent market for audio and video downloads to mobile phones, sales figures from around the world and the initial trials in the United States indicate that the mobile consumer is willing to pay significantly more than the PC-based consumer of digital content.

In sum, UMG views the wireless transmission of music to be of enormous value to consumers. Indeed, UMG licenses distribution of its content over wireless networks separately from licensing for services that allow access only over fixed lines. This ensures that UMG receives fair value for the music that it provides and that consumers enjoy. The value that consumers place on portable and mobile functionality is reflected

in UMG's marketplace agreements because UMG's pricing — the rates UMG charges its licensees — is based on the value of the service to consumers.

And the same is true of satellite radio. Whether in the car or with the many available wireless hand-held devices, satellite radio subscribers can enjoy their music anytime and anywhere. Accordingly, just as our marketplace dealings show a very significant premium for wireless delivery — both in terms of what consumers are willing to pay the services and what the services pay UMG for the use of our music — the same should be true of the satellite radio services. That consumers are willing to pay \$12.95 per month for a base subscription to satellite radio shows the high value of these types of services to subscribers. It follows that the record companies are entitled to their fair share of that added consumer value as well.

Value of Marketplace Agreements

When UMG licenses its sound recordings in the marketplace for digital distribution, UMG requires licensees to pay not only reasonable royalty fees, but also to meet extensive security requirements, provide audit rights, and offer guaranteed promotional consideration. While many of these forms of consideration are difficult to quantify, there is no question that, in their absence, UMG would require additional compensation.

There are a number of ways in which these considerations are manifested in UMG's licensing practices:

First, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Second, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].

Third, [REDACTED]

[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED].

Fourth, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

Fifth, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

Sixth, [REDACTED]
[REDACTED].

Finally, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

New Media Agreements

Over the past few years, UMG has entered into agreements for a wide variety of digital rights, including Interactive Streaming and Conditional Downloads (tethered and portable), Video Streaming, Permanent Audio Downloads, and Mobile/Wireless Services. Below, I provide some representative examples of the agreements for these services.

Subscription Services (On Demand Streaming and Conditional Downloads)

UMG licenses a number of services that provide consumers with streams or conditional downloads of sound recordings. These services are interactive or “on-demand” (*i.e.*, the user can choose the specific song or album to download or stream) and are conditional (*i.e.*, the user may download the song to a PC and then play the song at will only so long as the subscription is in effect).

The conditional downloads are either non-portable or portable. With a non-portable service, a user can only listen to the music (whether as a conditional download or a stream) on a personal computer or other approved home device. Often, the same companies both offer interactive and non-interactive versions of these services. Rhapsody, for example, offers a non-portable interactive subscription service for \$9.99 per month and a non-portable, non-interactive service pursuant to the DMCA for \$4.99 per month (with discounts for annual subscribers).

A portable subscription service, by contrast, is quite a bit different. With a portable service, a user may transfer the conditional download onto a portable device that includes software to prevent further copying. Thus, users get the significantly more valuable portability function. Rhapsody offers its portable subscription service, Rhapsody To Go, for \$14.99 per month.

Non-portable Services

UMG has granted licenses to numerous non-portable services. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Portable Services

As discussed above, consumers pay a premium for services that offer portability.

UMG’s agreements with webcasters who operate portable subscription services reflect that value, and UMG receives higher royalties. UMG has entered into a few agreements with companies that operate portable services. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Video Streaming

UMG has pioneered the monetization of music videos on demand. The switch from seeing videos as promotional to recognizing that they are an important revenue stream mirrors similar developments throughout the electronic distribution market.

UMG's licenses for video agreements are a useful comparison for determining the market value of the content because all video agreements — whether non-interactive or interactive — are entirely market-driven. There is no compulsory license negatively affecting UMG's free market decisions. Among other things, UMG has complete control over the videos that it will release as part of these agreements. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].

For 2006, UMG has generally licensed music video streaming for royalties equal to [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].

Permanent Audio Download

UMG has entered into numerous permanent audio download agreements that allow services to sell individual sound recordings to users on the Internet. The common retail price for these downloads is \$0.99, although some services offer a discounted price for permanent downloads to subscribers. [REDACTED]

[REDACTED]

[REDACTED]

Mobile/Wireless Services

The market for wireless music services is developing rapidly. As discussed above, all signs are that consumers value the ability to receive music over wireless devices very highly, and that, in the marketplace, record companies have negotiated higher license rates for delivery of sound recordings to wireless devices. In negotiated agreements, UMG receives higher rates for downloads to wireless devices and video streaming over wireless networks than it does for downloads and video streaming to personal computers.

Cell Phone Tones (Ringtones and Mastertones)

Users download ringtones — digital versions of sound recordings — and use them as the ringer on their cell phones. Mastertones are ringtones that sound identical to the master sound recording (typically a portion of a sound recording under 30 seconds).

[REDACTED]

Wireless Audio Downloads

UMG is negotiating with a number of companies to offer wireless audio downloads. [REDACTED]

[REDACTED]

[REDACTED].

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



Lawrence Kenswil

Date: 10/26/06

Exhibits Sponsored by Lawrence Kenswil

Exhibit No.	Description
SX Ex. 004 DP	[Redacted]
SX Ex. 105 DR	[Redacted]