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

REPLY OF NATIONAL MUSIC PUBLISHERS' ASSOCIATION, INC., THE SONGWRITERS GUILD OF AMERICA AND THE NASHVILLE SONGWRITERS ASSOCIATION INTERNATIONAL TO THE PROPOSED CONCLUSIONS OF LAW OF THE RECORDING INDUSTRY ASSOCIATION OF AMERICA, INC. AND THE DIGITAL MEDIA ASSOCIATION

July 18, 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 Reply to the Proposed Conclusions of Law of the RIAA and DiMA in support of their proposal for rates and terms for mechanical royalties under Section 115 of the Copyright Act.

I. The Conclusions Of Law Of The RIAA And DiMA Are Informed By An Incorrect View Of Section 115 And The 1981 CRT Determination

1. To assess appropriate rates under Section 115, the relevant prior decisions have made clear that this Court should start with marketplace benchmarks selected on the grounds of independence from the statutory rate and comparability. The Court should then consider those market benchmarks in light of the four statutory factors laid out in Section 801(b) for the purpose of determining whether any adjustment to the marketplace rate is needed to achieve the objectives laid out in the statute. Those factors are to (1) maximize the availability of creative work, that is, musical compositions; (2) afford Copyright Owners a fair return and copyright users a fair income under existing economic conditions; (3) reflect the relative contributions of the Copyright Owners and users in making the product available to the public; and (4) minimize disruption to the structure of the industry. The first three are ordinarily satisfied by marketplace benchmarks without adjustment and that is true in this case. There is a very high standard for any adjustment to satisfy the fourth; essentially a threat to viability of market participants as a result of a market rate without adjustment. There is no evidence of any such threat here. The rates proposed by the Copyright Owners reflect market rates and should be adopted.

2. The Copyright Owners have laid out two marketplace benchmarks: the rates negotiated for synchronization rights and ringtones. Each is independent of the statutory rate. Synchronization rates are wholly unaffected by Section 115 and the vast majority of the ringtone agreements were negotiated before the Register's ruling that certain ringtones are subject to the statute. Each is also wholly comparable, involving the same sellers and the same rights, the criteria laid down by this Court in *In re Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 73 Fed. Reg. 4080-01 (Jan. 24, 2008) ("SDARS"). These benchmarks are corroborated by the Audio Home Recording Act of 1992, Pub. L. No 102-563, 106 Stat. 4237 ("AHRA"), a statute passed after extensive lobbying by organizations representing the respective rights holders and allocating compensation between the two.

3. They are the only independent, comparable benchmarks that have been offered to this Court. The RIAA has offered three purported benchmarks that not only fail the test of independence, but are in fact wholly derivative of the statutory rate: effective rates, controlled composition rates and first use rates. As the relevant prior decisions have made clear, and as the evidence at trial – including the RIAA's own rebuttal expert's testimony – confirms, these rates are derivatives of the statutory rate and are not independent.

4. The only other benchmarks offered by the RIAA (and the only purported benchmarks offered by DiMA) – a purported percentage rate set in *In re Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords*; Rates and Adjustment of Rates, 46 Fed. Reg. 10466 (Feb. 3, 1981) ("1981 CRT

Determination”), the agreed rate from 1997 (not offered by DiMA), and selected rates from two other countries (one in the case of DiMA) involving different rights in fundamentally different markets – fail the test of comparability. The market circumstances in 1981 simply are not comparable to today, and it makes little sense to use a benchmark derived from rates of that vintage where the industry has changed so much. RIAA PFF ¶¶ 669-72. Section 115 itself precludes use of the 1997 rate, and the 1997 Agreement setting the rate itself confirms it was non-precedential. The rates in the U.K. and Japan were set in entirely different markets, with different conditions, and for different rights. They are out of step with rates both in the United States and many other countries. The U.K. and Japan are simply not comparable to the United States.

5. Having proposed benchmarks that are not marketplace rates as required by this Court’s precedents, the copyright users then proceed to apply the 801(b) factors in exactly the way this Court has said they should not be applied: as a “beauty pageant” in which each factor is a stage of competition to be evaluated independently to determine the stage winner and the results aggregated to determine an overall winner. As this Court concluded in SDARS, the proper approach is to determine what adjustment, if any, is needed to marketplace rates to satisfy the statutory factors. 73 Fed. Reg. at 4094. In general, as this Court has held, marketplace rates will satisfy the first three factors without the need for adjustment. *Id.* at 4094-96. That is true here, just as it was in SDARS. The Court considers the fourth factor, “disruption,” to see if it requires any adjustment to marketplace rates. Here, that factor clearly weighs in favor of the Copyright Owners. To be sure, neither the RIAA nor DiMA has demonstrated the kind of “substantial, immediate and irreversible” impact “that would threaten the viability” of

any of their members that this Court held in SDARS was necessary to show disruption of the degree to require adjustment of marketplace rates. 73 Fed. Reg. at 4097.

6. It is particularly ironic that the copyright users would rely on the 1981 CRT Determination as a benchmark. Many of the arguments they make today are the same arguments the RIAA made in 1981 and the CRT rejected. In 1981, the RIAA argued that the mechanical royalty rate should not be increased because:

- "Copyrights owners are already doing extremely well under the current rate" and an increase in rate would provide them an "unearned windfall," 1981 CRT Determination, 46 Fed. Reg. at 10471; RIAA Proposed Findings of Fact ("RIAA PFF") at ¶ 359;

- Publishers earn money irrespective of whether record company loses money, 46 Fed. Reg. at 10472; RIAA PFF ¶ 1342;

- "The role of the publisher has declined . . . today publishers are simply administrators, 46 Fed. Reg. at 10472; RIAA PFF ¶ 354;

- "[M]usic publishers bear little risk" and the relationship of their risk to return is out of balance, 46 Fed. Reg. at 10472; RIAA PFF ¶ 352;

- Mechanical royalties are concentrated in the hands of a few songwriters and the Tribunal "should not consider the income of poor songwriters," 46 Fed. Reg. at 10471; RIAA PFF ¶ 531;

- All income related to the recording of a song such as "performance rights, synchronization and print sales" should be considered, 46 Fed. Reg. at 10471; RIAA PFF ¶ 355;

- There are too many songs even under the existing rate. There is no evidence that songs will increase if the rate is raised, but demand by record companies will decrease if a higher rate is set, 46 Fed. Reg. at 10473; RIAA PFF ¶ 510;

- The record companies are in a period of transition and have "suffered severe losses" because of spiraling costs, large returns, consumer price resistance, reduction in albums per customer and piracy in the form of counterfeiting and home taping - but not bad management, 46 Fed. Reg. at 10473; RIAA PFF ¶¶ 178-180;

- The "recording industry . . . bears the responsibility for opening new markets," 46 Fed. Reg. at 10473; RIAA PFF ¶ 1263;

- And the number of releases will drop if the rate is increased, artist rosters will be reduced and marketing strategies will be threatened, 46 Fed. Reg. at 10473; RIAA PFF ¶ 1128.

7. The CRT rejected these arguments, concluding that the Copyright Owners needed and were entitled to an increase in the mechanical royalty rate, and that record companies were more than capable of absorbing such an increase. The CRT observed:

> The record industry claims that an increase in the statutory mechanical rates will bankrupt great record companies, will force others to drastically cut their operations, and will force increases of 300-700 million dollars to consumers. We reject all of these claims as we find no probative evidence in the record to support them . . . . The evidence shows that the impact of mechanical royalties on both the industry and consumers is trivial, compared to the effects of expenditures such as artists' royalties, promotional expenses, and general and administrative expenses, which are within the industry's control.

46 Fed. Reg. at 10482.

8. The same is true today. Despite the massive changes in the record industry, marketing, promotional expenses and artist royalties continue to dwarf mechanical royalties. And record companies are reporting record profits. Thus, this Court should reject the RIAA's proposed rate reduction and adopt the Copyright Owners' proposed mechanical royalty rates.

9. DiMA's assertions are even less substantive than the RIAA's. Its claims boil down to the assertion that the rates should be as low as possible so that they have no effect on the ability of any prospective digital music company to launch a service, however ill-founded its business plan. There is no basis in its submissions to reject the Copyright Owners' proposed rates.

II. The Copyright Owners' Benchmarks Are Appropriate

10. The Section 115 compulsory license was enacted to curb "attempts at monopolization by copyright users." 1981 CRT Determination, 46 Fed. Reg. at 10483. It was "intended to govern *the relationship among copyright users* - and not the relationship between copyright users and copyright owners." *Id.* (emphasis in original).

11. In keeping with the anti-monopoly purpose of the compulsory license system, the Court must set a rate that "ensure[s] the *full play of market forces*, while affording the individual copyright owners a reasonable rate of return." *Id.* at 10479 (emphasis added). Thus, notwithstanding the RIAA's and DiMA's revisionist history, the compulsory license was never intended to be a shield for failed business models nor to provide access to copyrighted works without conditions. As this Court has recognized, in setting rates,

> the Copyright Royalty Judges cannot guarantee a profitable business to every market entrant. Indeed, the normal free market processes typically weed out those entities that have poor business models or are inefficient. To allow inefficient market participants to continue to use as much music as they want and for as long a time period as they want without compensating copyright owners on the same basis as more efficient market participants trivializes the property rights of copyright owners.

In re Digital Performance Right in Sound Recordings and Ephemeral Recordings, 72 Fed. Reg. 24084-01, 24089, n.8 (May 1, 2008) ("Webcasting II").

12. Because the purpose of the statute is to allow for the full play of market forces, the determination of a reasonable mechanical royalty rate should "begin with a consideration and analysis of [marketplace] benchmarks in the testimony submitted by the parties and then measure the rate or rates yielded by that process against the statutory

objectives" of Section 801(b). SDARS, 73 Fed. Reg. at 4084. Marketplace benchmarks are critical to the identification of "the parameters of a reasonable range of rates within which a particular rate most reflective the 801(b) factors can be located." *Id.* at 4088.

13. Both the Copyright Owners and the RIAA agree that the Court should begin with market benchmarks.[1] *See* RIAA Proposed Conclusions of Law ("RIAA PCL") ¶ 33.

14. The RIAA argues that the Copyright Owners' benchmarks should be rejected by this Court. As demonstrated in the Copyright Owners' Proposed Findings of Fact ("CO PFF") and Conclusions of Law ("CO PCL"), and as further detailed in the Copyright Owners' Reply to the Proposed Findings of Fact of the RIAA and DiMA ("CO RPFF"), the Copyright Owners' synchronization and ringtone rate benchmarks satisfy the legal standards of independence from the statutory rate and comparability in the sense that they involve the same seller and the same rights. They are the only legitimate benchmarks that have been advanced in this case.

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[1] By contrast, DiMA seeks to minimize the importance of marketplace benchmarks through a series of selective quotes from prior decisions. DiMA PCL ¶ 5. But even the D.C. Circuit decision on which DiMA most heavily relies makes clear that "marketplace analogies" "must be considered." *RIAA* v. *Librarian of Congress*, 176 F.3d 528, 534 (D.C. Cir 1999). The quote in text above from this Court's SDARS ruling, the other decision on which DiMA relies, demonstrates this Court's preference for starting with market benchmarks.

A. The Copyright Owners' Benchmarks Are Independent Market Benchmarks

1. Market Benchmarks Must Be Independent Of The Statutory Rate

15. To reflect a market rate, a benchmark must be independent of the statutory rate because the statutory rate acts as a cap or a ceiling on the rates that can be negotiated in the market. Every court to address the question has recognized this basic economic reality. The D.C. Circuit noted in its review of the 1981 proceeding: "The usual effect of the system is to make the statutory royalty rate a ceiling on the price copyright owners can charge for use of their songs under negotiated contracts: if the owner demands a higher price in voluntary negotiations, the manufacturer can turn to the statutory scheme, but if the owner is willing to accept less than the statutory rate, he is free to do so." *Recording Indus. Ass'n of Am.* v. *Copyright Royalty Tribunal*, 662 F.2d 1, 4 (D.C. Cir.1981) ("1981 CRT Determination Appeal"). In short, the statutory rate sets an absolute limit on the rates that Copyright Owners can negotiate.[2]

16. Where there is a statutory cap, there will always be bargaining below the cap even where the market rate would otherwise be higher. As Professor Murphy

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[2] Similarly, in *In re Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg., 25394-01, 25405 (May 8, 1998) ("PSS"), the Librarian recognized the "constraining effect the mechanical license has on copyright owners in setting a value on their reproduction and distribution right." He rejected the RIAA's claim that the marketplace places a higher value on the contributions of record companies and recording artists "[because] both groups do not share equal power to set rates in an unfettered marketplace, it is unreasonable to compare the value of the reproduction and distribution right of musical compositions – a rate set by the government to achieve certain statutory goals – with the revenues flowing to record companies from a price set in the marketplace according to the laws of supply and demand, and then to declare that the marketplace values the sound recording more than the underlying musical composition." *Id.*

explained, where the best songs are available at the statutory rate, songs that are less good will be available at a lower rate since they must compete with better songs selling at the cap. Some sellers will be more eager than others and therefore will accept less than the cap. Bargaining below a statutory cap tells the Court nothing about what pricing would be in the absence of a cap. It is an inevitable consequence of the statutory cap that rates negotiated in its shadow can never be independent. 5/15/08 Trial Tr. at 6903-06 (K. Murphy). Thus, rates that are derivative of the statutory rate are not independent and simply cannot serve as benchmarks.

2. This Court Has Chosen Benchmarks That Are Independent Of The Statutory Rate

17. In accordance with these observations, this Court has consistently chosen benchmarks that are unconstrained by a statutory rate. In Webcasting II, for example, this Court chose benchmarks from the interactive streaming market *Id.* at 24092.

18. Likewise, in *In re Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, 67 Fed. Reg. 45240-01, 45249 (Jul. 8, 2002) ("Webcasting I"), the Librarian relied on an agreement between the RIAA and Yahoo (the "Yahoo Agreement") that set a performance royalty rate for non-interactive webcasting. The Librarian explained that although the Yahoo Agreement was negotiated just prior to commencement of the Webcasting I proceeding, which set performance right rates for non-interactive streaming for the first time, the circumstances surrounding the negotiations showed that it reflected market rates unconstrained by the imminent statutory rate. *Id.* at 45245. In *SDARS*, which like this proceeding involved a reasonable rate standard under the Section 801(b) factors, the

Court likewise considered and relied on a market benchmark unconstrained by a statutory license (the interactive subscription market). *See* SDARS, 73 Fed. Reg. at 4093.

3. The Copyright Owners' Market Benchmarks Are Independent Of The Statutory Rate

19. The Copyright Owners' synchronization benchmark is an independent market benchmark. *See* CO PCL ¶¶ 38-39. Synchronization agreements are voluntary agreements, unconstrained by any statutory license.

20. The ringtone benchmark also is an independent marketplace benchmark. The vast majority of agreements that comprise the ringtones benchmark are voluntary agreements that were entered into before the Register of Copyrights' (the "Register") ruling that ringtones are within Section 115.[3] Like the Yahoo Agreement in Webcasting I, discussed above, the ringtones agreements were entered into prior to the establishment of a compulsory rate. The ringtones benchmark is, if anything, a better marketplace analogy than the Yahoo Agreement because at the time the ringtone agreements were entered into, the Copyright Owners' right to license use of their musical works in ringtones was well established.

B. The Copyright Owners' Benchmarks Are Comparable

21. A comparable benchmark will include (1) the same or similar types of rights that are at issue in the rate-setting proceeding and (2) the same or similar sellers of those rights. SDARS 73 Fed. Reg. at 4093 (holding that a benchmark was "reasonably

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[3] The Copyright Owners respectfully disagree with that determination and have appealed the Register's decision to the United States Court of Appeals for the District of Columbia.

comparable" where "[b]oth markets have similar sellers and a similar set of rights to be licensed.").[4]

22. The benchmarks proposed by the Copyright Owners fall squarely within this Court's requirements for comparability. The ringtones benchmark involves use of Copyright Owners' musical works and the same sellers of the right (songwriters and publishers). It also involves the same buyers (record companies). The synchronization benchmark concerns the same types of rights as the target market and involves the same sellers. The buyers in the synchronization market are not the record companies and digital music distributors in this action, but their market position is similar to the position of the DiMA companies. Like Apple and other distributors of permanent downloads, buyers in the synchronization market must purchase rights to both the sound recording and the musical composition.

23. The RIAA argues that this Court's rejection of a musical works benchmark in SDARS dooms any reliance on the synchronization benchmark here. But this criticism both misconstrues the argument made by the SDARS services (the "Services") in that proceeding and the relevance of the synchronization benchmark offered by the Copyright Owners. In the SDARS proceeding, the Services argued that

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4 In Webcasting II, 72 Fed. Reg. 24092, which set performance royalty rates for non-interactive streaming, this Court chose as a benchmark agreements for interactive webcasting that covered the digital performance right. *Id.* The Court explained that the chosen benchmark was appropriate because the interactive and non-interactive webcasting markets "have similar buyers and sellers and a similar set of rights to be licensed . . . both markets are input markets." *Id.* But this Court has emphasized that to be useful, a benchmark need not be perfectly analogous, and in SDARS, this Court considered benchmarks adequate when they involved the same sellers and the same rights even though the buyers were different.

the record companies should receive a rate equal to the performance royalties paid to the performance rights organizations or "PROs" (i.e., ASCAP and BMI) for use of musical works. The Court rejected the musical works benchmark because "the sellers are different and they are selling different rights." 73 Fed. Reg. at 4089; *see also* Webcasting II, 72 Fed. Reg. at 24094 (same). The Court was correct: the Services were claiming that the performance royalty rates for sound recordings should be set by adopting the rate that the Services paid to the PROs for different rights.

24. Here, the Court is called upon to value mechanical rights.[5] These are exactly the same types of rights – the rights to use the composition embedded in a sound recording – that are conveyed in the synchronization market. The sellers of those rights (the Copyright Owners) are identical in both instances. And the purchasers of the musical works and the sound recordings are buying both in a free market, where the price of the rights to musical works are unconstrained by the statutory cap. Synchronization negotiations are a clear marketplace analogy. The same is true for ringtones. Indeed, in the case of ringtones, even the buyers (record companies) are the same.

25. This Court in SDARS held that "the fact that an SDAR requires both sets of rights does not make them equivalent. Many products and services require such inputs, but that fact alone does not lead to price parity across those inputs." SDARS, 73 Fed. Reg. 4089. Here the actual market negotiations in the synchronization and ringtone markets show exactly the relative values of those rights to users when they need both. In

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[5] The Court will recall that Copyright Owners may separately receive performance rights payments when their works are used in the synchronization context. These additional rights are excluded from the benchmark rate proffered by the Copyright Owners here.

the synchronization context, users pay equally for the right in the musical work and in the sound recording.

C. The RIAA And DiMA's Criticisms Of The Copyright Owners' Benchmarks Are Baseless

26. The RIAA and DiMA have each urged this Court to reject the Copyright Owners' benchmarks on the ground that they are inconsistent with this Court's prior rulings. RIAA PCL ¶¶ 61, 145-148; DiMA PCL ¶¶ 80-81. In doing so, the copyright users have invented additional requirements for appropriate benchmarks. And, the copyright users have ignored the most legally significant characteristics of the Copyright Owners' benchmarks, namely, that they involve the same or similar rights as at issue here, and that they are not derivative of a compulsory license.

1. Professor Landes's Range Is Reasonable And Reflects Market Realities

27. The RIAA criticizes Professor Landes for the wide breadth of his range of reasonableness. RIAA PFF ¶ 819. But the multiple of the lower bound of Professor Landes's range represented by the upper bound (20%-50% of the content pool; a multiple of 2.5) is much less than the equivalent multiple for this Court's range of reasonableness in SDARS (2.75%-13%; a multiple of almost 5). 73 Fed. Reg. at 4094. The Court was not troubled by the breadth of the range in that case. And as the Librarian noted in *In re Determination of Reasonable Rules and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25394-01, 25398 (May 8, 1998) ("PSS") "the Tribunal was granted a relatively large 'zone of reasonableness'" (citing cases). The breadth of Professor Landes's range merely reflects marketplace realities. Moreover, the Copyright

Owners' proposed rates are near the low end of the range of reasonableness and so, the RIAA's and DiMA's attacks on the breadth of the range are beside the point.

2. The RIAA's Derived Demand Argument Does Not Apply To The Copyright Owners' Benchmarks

28. The RIAA claims, relying on SDARS, that the demand and supply characteristics of the ringtones and synchronization markets are different from the target market and that therefore, ringtones and synchronization rights are inappropriate benchmarks. RIAA PCL ¶¶ 44, 61. This RIAA "derived demand" argument is inapplicable to the Copyright Owners' benchmarks.

29. In SDARS, the Services argued that the rates that Music Choice, a cable music service, paid for the performance of sound recordings should be adopted as the rate for the sound recordings used by the Services (with certain "functionality adjustments" not relevant here). 73 Fed. Reg. at 4089. In other words, the Services argued that two different services with different customers and different needs for the end product would pay the same price. The Court disagreed, because, among other things, there was "no evidence" that cable TV watchers utilize the Music Choice service "except as incidental to their primary activity of television channel usage," while "substantial evidence" showed that music listening was an integral part of the consumer activity with respect to the Services. *Id*. Thus, the Court concluded the Music Choice rate would not be an appropriate rate for the Services.

30. The RIAA asserts that this decision precludes use of the synchronization and ringtones rates here because consumers value the end products – motion pictures, television programs and ringtones – differently than they value sound recordings standing

alone. But these criticisms of the Copyright Owners' benchmarks, which focus only on the needs of the ultimate consumer of the combined musical work and sound recording rights and the differences between the ultimate users of the combination, miss the mark. The point of the benchmarks is that they show the relative values purchasers of both rights put on each when the price of neither is artificially constrained by a statutory cap.

3. Benchmarks Need Not Come From The Target Market, Nor Must They Be Substitutes For the Target Right

31. Contrary to the RIAA's claim, under Section 115, this Court need not choose a benchmark that substitutes for the target product nor one that is within the target market. First, under most circumstances, a benchmark chosen from within the target market would be constrained by the statutory rate, and thus would be inappropriate as a market benchmark for that reason, as discussed above.

32. Second, substitutability is only relevant where the sellers, buyers and rights and products at issue in the proceeding are different from the benchmark sellers, buyers, rights and products. In such circumstances, substitutability is an indication that the products are subject to the same market conditions and can stand in for one another. Thus, in SDARS, relied on by the RIAA, *see* RIAA PCL ¶ 50, the Court rejected the so-called "Stern Benchmark," which assumed that the value of music programming would be the same as the value of non-music programming because, among other reasons, there was no evidence that two types of programming were actually substitutes rather than complements. 73 Fed. Reg. at 4091. *See also* Report of the Copyright Arbitration Panel, *In re Ratesetting for Digital Performance Rights in Sound Recordings and Ephemeral*

Recordings, Docket No. 2000-9 CARP DTRA 1& 2 at 41 (Feb. 20, 2002) (rejecting the musical works right as a benchmark for the performance right).

33. In contrast, where the benchmarks at issue involve the same types of rights and the same sellers, the Court has imposed no requirement that the benchmark market be a substitute. For example, in SDARS, the Court relied on rates for interactive streaming (subject to modifications for differences in the utility offered by the services) in setting rates for satellite services and non-interactive streaming though there was no determination that the end users were the same or that users considered the services to be substitutable. 73 Fed. Reg. at 4093.

34. The RIAA's substitutability argument is merely another formulation of the requirement of comparability. As the Librarian explained, where "there is no established nexus between the industries, the marketplaces in which they operate, or the rights for which the rates are set," it would be arbitrary to assume that a rate set in one industry would be appropriate for the other. Webcasting I, 67 Fed. Reg. at 45265. But here, with respect to the ringtone and synchronization benchmarks, the types of rights are the same and so are the sellers. And both show how users value one right relative to the other.

4. Benchmarks Need Not Relate To Products With The Same Or Similar Purpose As Those In The Target Market

35. The RIAA also claims that the benchmarks must relate to the products that serve the same purpose as the products in the benchmark market. *See* RIAA PCL ¶¶ 46-48. The case law relied on by the RIAA does not support this argument and, like the RIAA's "substitutability" argument, this argument is merely a re-statement of the comparability requirement. As discussed above, in SDARS, the Court relied on rates for

products where there was no determination that the end use was the same as the product in the target market. 73 Fed. Reg. at 4093.

36. In *PSS*, relied on by the RIAA, *see* RIAA PCL ¶ 47, the CRT rejected, among others, a benchmark based on the amount that certain cable movie channels pay to acquire movie programming. 63 Fed. Reg. at 25396-97. Unsurprisingly, the CRT determined that this benchmark – which involved the right to show television programming rather than the right to perform music – was not comparable because the markets and products at issue were too different. *Id.* But that determination has no relevance here, where the Copyright Owners have identified benchmarks that involve analogous rights for which the Court will set a rate and the same sellers. The Copyright Owners are not seeking to import a rate from one context to another, simply to show relative values where prices are not artificially constrained by a statutory cap.

5. The RIAA's "Sunk Costs" Argument Is Meritless

37. The RIAA also argues that the synchronization and ringtones benchmarks are flawed because the costs that go into creating a sound recording are "sunk" by the time a synchronization or ringtone license is negotiated. *See* RIAA PCL ¶ 61; RIAA PFF ¶ 866. This argument boils down to a claim that in the context of synchronization and ringtone agreements, record companies forego potential income because the costs of producing a sound recording are sunk by the time it is licensed in a synchronization agreement. This argument makes little sense and was rejected by the Court in both SDARS and Webcasting II, *see* SDARS, 73 Fed. Reg. at 4090, Webcasting II, 72 Fed. Reg. at 24094. There is no reason for the Court to come to a different conclusion here.

6. The NDMAs Are Valuable Components Of The Ringtones Benchmark

38. The RIAA attacks the ringtones benchmark because some of the agreements that comprise that benchmark – the NDMAs – are multifaceted agreements. But, the primary purpose of the NDMAs was to set rates for the musical works right in new digital products such as ringtones, so there is no evidence there were any trade-offs that affected the rates actually negotiated. As the Librarian noted in Webcasting I, where the principal purpose of the Yahoo agreement used as a benchmark was to set a rate of the use of sound recording over the internet, "trade-offs were directly tied to the considerations relating to the value of [that] right and did not affect its validity as a benchmark." Webcasting I at 45248. This is also so here, where the principal purpose of the NDMAs was to set values for each of several uses including ringtones. There is simply no reason to believe the parties negotiated lower rates for some uses than they thought were appropriate to get higher rates for others. As Professor Murphy testified, when one is pricing several separate items, especially when one does not know which will sell in what quantities, the parties have every incentive to get each price right individually. 5/15/08 Tr. at 6915-16 (K. Murphy).

39. Moreover, both economic theory and the evidence presented at trial contradict the RIAA's claim that the mastertone rates in the NDMAs are higher as a result of trade offs. First, if, as the record companies claim, they conceded to the publishers' demands on the mastertone rates in the NDMAs in order to obtain favorable terms for the other rights licensed in the NDMAs, economic theory predicts that the publishers would have been able to extract *more* favorable mastertone terms than were contained in the standalone agreements. Landes WRT (CO Trial Ex. 406) at 36-37. But,

the rates in the standalone agreements are consistent with the NDMA rates. In addition, three of the NDMAs were extended by major record companies. *See* CO RPFF Sec. VI.C.(c)(ii)(3); CO PFF ¶ 47.

40. The RIAA argues that the NDMAs are poor benchmarks because they provide blanket licenses for ringtones. As explained in the Copyright Owners' Reply to the Proposed Findings of Fact of the RIAA and DiMA, however, the NDMAs do not grant blanket licenses because they do not grant the licensee immediate access to an entire repertoire of works. CO RPFF Sec. VI.C.(c) (citing Broad. Music, Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1 (1979) (explaining that a blanket license "allows the licensee immediate use of covered compositions")). Each NDMA simply provides the right to incorporate a song in a mastertone only with the publisher's advance written approval. *Id.* at Sec. VI.C.(c)(i).

7. The Audio Home Recording Act Corroborates The Copyright Owners' Marketplace Benchmarks

41. The RIAA attacks the Copyright Owners' use of the AHRA on the ground that it is not a market benchmark. RIAA PCL ¶ 61. As explained in the Copyright Owners' Proposed Findings of Fact and Conclusions of Law, however, the Copyright Owners have advanced the AHRA not as a market benchmark but as corroboration in a legislative context of its market benchmarks. The AHRA division of royalties was the outcome of industry lobbying and reflects the industry view of an appropriate division of returns. *See* CO PFF ¶ 542. The RIAA's contention that the AHRA is too old at 15 years to be relevant is ironic in light of the RIAA's and DiMA's advancement of the 27-year-old CRT Determination as a benchmark.

III. The RIAA And DiMA Benchmarks Fail

42. The RIAA and DiMA have advanced so-called "current voluntary rates," historical rates, and international rates as benchmarks. These benchmarks do not satisfy this Court's standards and should be rejected.

A. The RIAA's So-Called "Current Voluntary Rates" Are Not Market Rates

43. As demonstrated in the Copyright Owners' Proposed Conclusions of Law, the RIAA's first use, controlled composition and other "effective rate" benchmarks are not independent of the statutory rate, but are derivatives of it. *See* CO PCL ¶¶ 56-60. Therefore, they cannot constitute market benchmarks. *See* 1981 CRT Determination Appeal, 662 F.2d at 4 ("The usual effect of the system is to make the statutory royalty rate a ceiling on the price copyright owners can charge for use of their songs under negotiated contracts: if the owner demands a higher price in voluntary negotiations, the manufacturer can turn to the statutory scheme, but if the owner is willing to accept less than the statutory rate, he is free to do so."); PSS, 63 Fed. Reg. at 25405 (recognizing the constraining effect the mechanical license has on Copyright Owners in setting a value on their reproduction and distribution right).

44. Although the RIAA claims that its first use rate is unfettered by the compulsory license because first uses are not covered by Section 115, the CRT has held to the contrary that the statutory rate acts as a "ceiling . . . even for first releases." 46 Fed. Reg. at 10482. This observation is corroborated by the marketplace evidence offered by the Copyright Owners, which shows that first use songs compete with songs subject to the compulsory license, and that the rate for first use songs is thereby constrained. CO PFF ¶¶ 694-98.

45. The Copyright Owners' Proposed Findings of Fact showed in detail why the effective rate, controlled composition rate and first use rate are inappropriate benchmarks on which to construct a statutory rate. *See id.* ¶¶ 675-98. Nothing in the RIAA's Proposed Findings or Conclusions shows otherwise. As Professor Wildman, the architect of the effective and first use rates theory, acknowledged, these rates are derivative rather than independent of the statutory rates. *See* 5/12/08 Tr. at 5893 (the effective rate "is not independent of the statutory rate" because negotiations for licenses take place in the context of the overhang of the statutory rate); *id.* at 5894 (first use rates are "influenced by the statutory rate"). Since they are products of the statutory rate, they cannot be independent and may not be used as benchmark rates.

46. Ignoring the 1981 CRT decision, the RIAA argues that the compulsory license "is not a viable option" for record companies and so it "does not and cannot operate as a ceiling." RIAA PFF ¶ 623. Thus it concludes that the fact that there is negotiating below the statutory rate means the market rate must be lower than the statutory rate. *Id.* ¶ 624. But the RIAA's premise is false. The experts, Professors Landes, Murphy and Wildman, all agreed that the statutory rate was a cap and could be effectively used as a ceiling on the rates negotiated for mechanical rights. CO PFF ¶ 560. That expert testimony was corroborated by RIAA witness Andrea Finkelstein of SONY BMG who agreed that her company would use the statutory rate if the Copyright Owners sought a rate above the statutory rate. *Id.* ¶ 561. Her testimony in this regard was consistent with that of the Copyright Owners' witnesses. *Id.* All of the testimony is consistent with the CRT's conclusion in 1981 that the statutory rate was a cap. In short, there is no evidence that the statutory rate is anything but a cap.

47. Controlled composition clauses fare no better as a valid benchmark. These rates are not independent market rates because they are agreed as one part of a series of interdependent financial arrangements between the record companies and recording artists. The economists for both sides again agreed that these rates are the result of tradeoffs in negotiations. CO PFF ¶ 687. The artist agreements provided by the record company are wholly consistent with this testimony and again, the CRT took note of this fact in its 1981 decision when it concluded that singer songwriters "freely negotiate or *their entire royalty packages*, including both artists royalties and mechanical royalties." 46 Fed. Reg. at 10483 (emphasis added). This is not surprising. As Professor Murphy testified, when individuals negotiate multipart contracts relating to a single product, the seller is principally concerned with total compensation for the entire package of rights, not the value of any one component, and the buyer is principally concerned with what it has to pay for the whole package, not any one particular component. 5/15/08 Tr. at 6912-13.[6]

48. In fallback mode, the RIAA argues that mechanical rates paid to "outside writers" who "regularly partner with artists and accept the same controlled rates because they understand that is what the marketplace demands if they are going to have their songs recorded" are a marketplace benchmark. RIAA PFF ¶ 596. The RIAA argues that these agreements "focus only on mechanical royalties." *Id.* ¶ 583. But again, the evidence is to the contrary. As Professor Wildman testified, other forms of consideration

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[6] Such agreements are in direct contrast to agreements such as the NDMAs which set rates for disparate products. In these cases, the parties have every incentive to get each individual rate correct. *See supra* ¶ 38.

factor into the economics of such arrangements. CO PFF ¶ 705. Thus, co-writers' acceptance of the controlled rates is no more relevant to an assessment of the market rate than singer-songwriters' acceptance.

49. The RIAA also argues that rates for first use licenses provide an additional benchmark for the statutory rate. This argument also fails. As Professor Wildman again conceded, "because there is substitutability between first uses and second uses," first use rates are "not independent of the statutory rate." 51208 Tr. at 5894. This testimony is consistent both with Professor Landes's testimony and with the CRT's conclusion in 1981 that copyright users "exploit the statutory rate payable under a compulsory license to keep their mechanical royalty costs as low as possible, fixing the [statutory rate] as a ceiling in all negotiations with copyright owners, *even for first releases."* 46 Fed. Reg. 10466 and 10482 (emphasis added). Moreover, first use rates are inextricably linked with controlled composition clauses and so are determined in substantial part by controlled rates.

B. The 1981 Benchmark And The Other Historical Benchmarks Should Be Rejected

50. Like the RIAA's current rate benchmarks, its historical benchmarks – the 1981 CRT Determination and the 1997 settlement agreement, which set the mechanical royalty rates currently in effect (the "1997 Settlement") – are not market benchmarks.

51. Moreover, courts have recognized that prior rate-setting proceedings and settlements are not *per se* probative of a reasonable rate. In SDARS, this Court did not credit the rates in an agreement setting rates and terms under the Section 114 and 112 statutory licenses that the Services and the RIAA had entered into in 2003, in lieu of

participating in a CARP proceeding. 73 Fed. Reg. at 4090; *see also* Proposed Findings of Fact of SoundExchange, Docket No. 2006-1 CRB DSTRA (Oct. 1, 2007) at 31. The Court ultimately set a rate that was several times higher than the rate contained in the voluntary agreement. *Id.* at 4089 (identifying the rate set in the parties' settlement as "in the range of 2.0% to 2.5%" of revenue), 4098 (setting a statutory rate of 6% of revenue, with incremental increases through the rate period).[7]

52. Similarly, in PSS, the Librarian noted that although the CARP set rates at the low end of the range of reasonableness, "[t]he Panel expressly noted that a future Panel may reach an entirely different result based on then–current economic state of the industry and new information on the Services impact on the industry." 63 Fed. Reg. at 25405.

53. As shown in further detail in the Copyright Owners' Reply to the Proposed Findings of Fact of the RIAA and DiMA Sec. VII.D, it makes little sense to use a decision nearly 30 years old to inform the current mechanical rates when all parties to this proceeding have testified to significant changes in the industry over that time period. Professor Teece, the sponsor of the 1981 CRT decision as a benchmark, himself testified about the significance of sustained disruption of industry practices. He described the industry today as "a completely different ball of wax." CO PFF ¶ 665.

54. In any event, as shown in much greater detail in the Copyright Owners' Proposed Findings of Fact, ¶¶ 667-74, the flaws in Professor Teece's rate calculation

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[7] Notably, the SDARS proceeding was the first time that a compulsory rate was set for the Services. *See* Proposed Findings of Fact of SoundExchange, Docket No. 2006-1 CRB DSTRA (Oct. 1, 2007) at 31. Thus, the 2003 agreement was set without the constraint of a statutory cap.

demonstrate that his analysis of the CRT decision is entitled to little weight. For example, although the RIAA never mentions it, during his cross-examination at trial, Professor Teece conceded that his basic initial input, the average retail price of an album in 1981, was off by 27%. The actual average retail price was $5.79, not $7.98, the figure Professor Teece used. Had Professor Teece performed this calculation alone correctly, his wholesale percentage rate would have been 38% higher than the 7.8% rate he proposed as a cap. The RIAA should not be permitted to ignore fundamental flaws in its analysis of the 1981 decision.

55. The RIAA's attempt to rely on the 1997 settlement is not permitted by agreement setting the rate which makes clear that it is non-precedential. 17 U.S.C. § 115(c)(3)(D).

C. The RIAA's And DiMA's International Benchmarks Should Be Rejected

56. The RIAA argues that this Court should consider mechanical royalty rates in the U.K. and Japan in making its determination and DiMA urges the U.K. rate as a benchmark. In support of its argument, the RIAA cites the 1981 CRT Determination. RIAA PFF ¶ 698. In the 1981 Determination, the CRT held that "the foreign experience was relevant--because it provides one measure of whether copyright owners in the United States are being offered a fair return." 1981 CRT Determination, 46 Fed. Reg. at 10483. The D.C. Circuit, in its review of the CRT decision, held that there was "nothing in the statute or its legislative history that requires the Tribunal to close its eyes to conditions in other countries while deciding what a fair return to a composer should be." 1981 CRT Determination Appeal, 10 n.23.

57. Neither decision supports the proposition that a selective presentation of cherry-picked international rates can serve as an appropriate benchmark. 2/12/08 Tr. at 2802-03 (Taylor) (testifying that no U.S., U.K. or Japanese court has ever held, with respect to one of the three countries, that the rates in the other two countries are appropriate comparators to the exclusion of the rest of the world). Indeed, the CRT rendered its 1981 Determination after having been presented with a plethora of data on international rates–from countries such as Australia, England, Japan and Western Europe. 1981 CRT Determination, 46 Fed. Reg. 10483. Here, in contrast, the copyright users have proposed benchmarks from just two countries, and have failed to establish why the mechanical rates in the U.K. and Japan are better comparables than the rates in other countries, many of which exceed the rates in the United States. CO PFF ¶ 722-23.

58. Foreign royalty rates should not be considered where, as here, they involve different bundles of rights and were promulgated in markets that operate under different licensing schemes. *See* Webcasting I, 67 Fed. Reg. at 45248. In Webcasting I, the RIAA took the position that foreign royalty rates should not be considered in setting the performance royalty rate under Section 114. *Id.* The Librarian agreed, reasoning that it was appropriate to disregard evidence of foreign rates "[b]ecause it is not possible to ascertain whether any of the rates offered in the survey of foreign countries represented a fair market rate, or that the rights in these countries are equivalent to the rights under U.S. law." *Id.* This Court should follow the Librarian's approach because here, the Copyright Owners have established that the U.K. and Japanese licenses include different bundles of rights, such as performance rights, and were not set under the 801(b) factors standard. CO RPFF Sec. VII.E.

59. Moreover, the copyright users failed to present competent evidence to support their international benchmarks. Professor Teece admitted to having failed to conduct the necessary analysis to establish the RIAA's international rates as benchmarks, (*id.* Sec. VII. E) and Messrs. Boulton and Taylor conceded that they had not performed the analysis necessary to compare the revenue in the U.S., U.K. and Japan. *Id.* Sec. XI.F.1. Similarly, Ms. Guerin-Calvert admitted that she had not independently analyzed the market similarities and differences between the U.S. and U.K. *Id.*[8]

IV. The 801(b) Factors Require No Adjustment To The Rates Proposed By The Copyright Owners

60. The Copyright Owners and the RIAA agree that after identifying appropriate market benchmarks, the Court should then weigh the Section 801(b) policy considerations to determine whether any adjustments to the benchmark rate need be made. *See* CO PCL ¶ 68; RIAA PCL ¶ 62.

61. As this Court explained in SDARS, in choosing a rate that satisfies the four 801(b) statutory objectives from a range of reasonableness, "the issue at hand is whether the[] [four] policy objectives weigh in favor of divergence from the results

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[8] The RIAA claims that the Copyright Owners initially argued that international rates should not be considered, then subsequently submitted evidence "making foreign comparisons" of its own. RIAA PCL ¶ 138. But the Copyright Owners' evidence on international rates was submitted not to present affirmative evidence under the 801(b) factors but to *rebut* the RIAA's incorrect and unsupported contention that the royalty rates in Japan and the UK are good comparators by submitting evidence of the range of international rates in the market. Mr. Fabinyi testified that his analysis was intended to focus on the question of whether the U.S. mechanical rate of 9.1 cents when compared to rates for physical and digital products in other countries was the highest in the world. 5/15/08 Tr. at 6717-18 (Fabinyi). The Copyright Owners did not identify any of these rates as appropriate benchmarks or appropriate consideration under Section 801(b).

indicated by the benchmark marketplace evidence." SDARS, 73 Fed. Reg. at 9094. Thus, 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. Here, there is no need to adjust the rate based upon the statutory factors if the Copyright Owners' benchmarks are used. Certainly, an analysis of the four factors provides no support for decreasing the mechanical royalty rate from what a proper benchmark implies.

62. Although the RIAA argues that the Court is compelled to look "broadly at the future of the music industry," RIAA PCL ¶ 65, the RIAA's application of the 801(1)(b) factors is calculated to do the opposite. The RIAA paints a picture of an industry in peril – despite the extensive evidence that record company profits are at an all time high – and asserts that the problems the industry faces can only be solved by reducing the mechanical royalty rate, even though marketing, overhead, and artist royalty costs dwarf mechanical royalties. These claims, and the facts and legal arguments that the RIAA marshals to support them are meritless.

A. Factor 1 – Maximizing The Availability Of Creative Works

63. The first statutory factor calls for a rate that will "maximize the availability of creative works to the public." *See* 17 U.S.C. 801(b)(1)(A). As explained in the Copyright Owners' Proposed Conclusions of Law, this factor requires the rate be

set high enough to provide songwriters and music publishers with an economic inventive to create and disseminate musical works. 1981 CRT Determination, 46 Fed. Reg. at 10479; s*ee generally* CO PCL ¶¶ 74-80.

1. <u>The RIAA</u>

64. The RIAA argues, without any legal basis, that the Court must set a rate that maximizes the availability of *sound recordings* rather than musical works because musical works can only be made available to the public when embedded in sound recordings. RIAA PCL ¶ 69. This argument fails for at least three reasons.

65. First, Section 115 was enacted to ensure that, for a fee, musical compositions would be available to all potential copyright users, and by extension to the public. Under the Section 115 compulsory license, no single copyright user can monopolize a musical work or its exploitation. Thus, in 1981, the CRT recognized that "the statutory rate payable under Section 115 of the Act is intended to encourage the creation and dissemination of *musical compositions*." 1981 CRT Determination, 46 Fed. Reg. at 10479 (emphasis added). The statutory purpose simply does not include maximizing the creation and dissemination of sound recordings. Nor is it to distribute such works as part of sound recordings; it is simply to incentivize "the creation and dissemination of musical compositions." 1981 CRT Determination, 46 Fed. Reg. at 10479. As the CRT held in the 1981 proceeding:

> *This encouragement we find takes the form of an economic incentive and prospect of peculiarly 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.

Id. (emphasis added).

66. Second, the record companies' contributions to the creation and dissemination of sound recordings are already taken into account under the third statutory factor, which requires this Court to consider the relative roles of copyright users and owners in "the product made available to the public." 17 U.S.C. 801(b)(1)(C). Thus, that records companies contribute to the creation of sound recordings, *see* RIAA PCL ¶ 68, is no reason to consider those contributions under the first statutory factor.

67. Third, Congress has established several distinct sets of rights in music – including rights in musical compositions and sound recordings – and the relevant copyright owners (whether they are songwriters, publishers, or record companies) are entitled to receive reasonable compensation for the exploitation of each of those rights. *See* PSS, 63 Fed. Reg. at 25408 ("The Panel never implied that the record companies should receive anything less than the reasonable compensation under the DPRSA, nor that their revenues from exercise of the distribution and reproduction rights are meant to compensate them for the use of their creative works under the new statutory license."); *In re 1980 Adjustment of Royalty Rate for the Coin-Operated Phonorecord Players*, 46 Fed. Reg. 884-01, 889 (Jan. 5, 1981) ("1981 Jukebox Determination") ("We reject the contention that the copyright owners are paid for jukebox performances by mechanical royalties derived from record sales. 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."). Here, the Court must address the Copyright Owners' mechanical rights and set a rate that maximizes their incentive to create musical works.

Numerous other proceedings exist to maximize the creation of sound recordings and ensure that adequate incentives exist to produce those creative works.

68. Likewise, the RIAA's contention that its incentives to create sound recordings will be decreased if the mechanical royalty rate is increased, *see* RIAA PCL ¶ 72, is not relevant to the analysis here. This argument was considered and roundly rejected by the CRT. *See* 1981 CRT Determination, 46 Fed. Reg. at 10479 ("RIAA argues that if the Tribunal were to grant a rate increase, recording companies would have to take serious steps to deal with these new costs, like reducing the number of releases, thereby reducing the quantity of creative works available to the public . . . . The Tribunal was not persuaded by these arguments.").

69. The RIAA has failed to carry the burden of proving that an increase in the mechanical rate would lead to reductions in sound recordings. Indeed, it has failed to present any evidence to suggest that a reduction in the mechanical rate, which accounts for a small fraction of record company costs (and that varies precisely in proportion to copies actually sold of any particular musical work, but not at all in relation to the number of records recorded) has any effect on songs actually recorded and released. There is no evidence that savings in mechanical royalties would go to greater investments in artists or songs. CO PFF ¶¶ 753-56.

70. The RIAA has also claimed that the existence of bargaining below the statutory rate is evidence that songwriters are adequately incentivized to write songs, *see* RIAA PCL ¶ 75, and the rate is too high. *See* RIAA PFF ¶ 577. As explained in the Copyright Owners Reply to the Proposed Findings of Fact of the RIAA and DiMA Sec. VII.C.1.(c), however, this phenomenon is a reflection of the fact that songwriters are

often subject to controlled composition clauses, which are negotiated with myriad other terms and do not reflect the value placed on musical works. Moreover, it is well established that the statutory rate acts as a cap. *See* 1981 CRT Determination Appeal, 662 F.2d at 4; PSS, 63 Fed. Reg. at 25405.

71. As Professor Murphy also testified, songwriting is no different than any other profession. An increase in compensation will lead to an increase in production or quality as songwriters are able to spend more of their time writing songs and need to spend less time earning enough money in other ways to put food on the table. 5/15/08 Trial Tr. at 6884-87 (K. Murphy). There is no reason to believe that songwriters can live on the hedonic compensation their profession offers more readily than any other professional.

72. Furthermore, there is nothing new in the fact that some Copyright Owners obtain less than the statutory rate. The same was true in 1981, when the CRT noted that many Copyright Owners were not even obtaining the 2 ¾ cent statutory rate. Rather than considering this a reason to lower the statutory rate, the CRT considered it evidence meriting an increase. 46 Fed. Reg. at 10483.

2. DiMA

73. DiMA argues that allowing the digital music companies to grow is the only way to ensure access to music and the best way to achieve this, according to DiMA, is to pay the Copyright Owners as little as possible. DiMA PCL ¶ 33. DiMA, like the RIAA, fails to appreciate that this factor, maximizing the availability of creative works, is focused on musical compositions rather than distribution of sound recordings. Moreover, the evidence shows that the permanent downloads market is growing, and that the rate

proposed by the Copyright Owners would not hurt the sellers of permanent downloads. CO PFF ¶¶ 406; 464-66, Tables 10 D-E.

B. Factor 2 – To Afford A Fair Return To Copyright Owners And A Fair Income To Copyright Users Under Existing Economic Conditions

74. The second policy consideration requires this Court to set a rate that provides Copyright Owners a "fair return" and Copyright users a "fair income" under "existing economic conditions." 17 U.S.C. 801(b)(1)(B). The Librarian has explained that the very process of:

> consider[ing] proposed marketplace benchmarks, including all the economic data, and weigh[ing] the record evidence in light of the statutory objectives . . . is structured so that it affords the copyright owners reasonable compensation and the users a fair income--the purpose of the second statutory objective. Accordingly, a recommended rate so calculated achieves this final statutory objective, in that it reflects the balance between fair compensation for the owners and a fair return to the users.

63 Fed, Reg. at 25409. As the CRT explained in 1981, the rate that it set satisfied the second statutory factor because it "will permit entry into the music market by a potential copyright user and will afford record companies the opportunity to earn a fair income." 46 Fed. Reg. at 10480.

75. Here, the RIAA and DiMA have not presented persuasive evidence that the Copyright Owners' proposed rates for physical and digital download products would limit entry to the recorded music or permanent downloads markets, nor that it would deny the RIAA and DiMA companies a fair income.[9]

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[9] The RIAA argues, and the Copyright Owners agree, that Section 115 licenses are not blanket licenses. RIAA PCL ¶ 29. The significance of the individual nature of the

1. The RIAA

(a) Existing Economic Conditions

76. The RIAA claims that here, the "existing economic conditions" are a "period in which the record companies have faced . . . enormous challenges . . . and in which music publishers are making healthy profits far beyond a reasonable risk-adjusted return on capital." RIAA PCL ¶ 80. The record companies described the industry in almost exactly the same terms in 1981. *See* 1981 CRT Determination at 10472 ("According to the recording industry . . . . music publishers bear little risk and the relationship of their risk to return is out of balance . . . . 1979 . . . was a year in which the [recorded music] industry suffered severe losses.").

77. Although the record companies plead poverty, and contrast their circumstances to the conditions that prevailed in the past, *see* RIAA PCL ¶¶ 80-87, the record shows that after a brief period of unprofitability, the record companies reported their highest profits ever in the years 2004 and 2005. *See* CO PFF ¶ 439. Thus, just like in 1981, the financial condition of the record companies is not a justification for a low mechanical royalty rate and this Court should reject the RIAA's arguments just as the CRT did. *See* 1981 CRT Determination at 10482.

Section 115 license is that, as the RIAA observes, it requires the Court to consider the individual songwriter. *Id.* ¶ 30. Thus, in 1981 the CRT held that "in our view the fair return required by the statute is not to songwriters as a group but as individuals," because "[w]hat mechanical royalty fees are paid by the same copyright users, or other copyright users, to other copyright owner[s] obviously has no effect on whether the individual copyright owner is receiving a fair return for the individual uses of his songs." 46 Fed. Reg. at 10482. Thus, the individual nature of the compulsory license requires the Court to set a rate that will afford a fair return to each Copyright Owner, not Copyright Owners in the aggregate.

78. Moreover, the relevant time period for this Court's purposes is the period for which it is setting a rate – 2008-2012. The record companies finances look very good today. CO PFF ¶¶ 438-456; CO RPFF Sec. II.A.1, 2. And the only forecast they have produced shows the next four years look even better. CO RPFF Sec. III.C. Although several record companies failed to produce in discovery, much less introduce into evidence, documents containing financial forecasts for the 2007-2012 time period, those record companies have hardly been shy about their view of the future. CO PFF ¶¶ 475-77; CO RPFF Sec. III.C. Edgar Bronfman Jr., Chairman and CEO of Warner Music Group, predicted "profitable growth" in large part because of the growth in the digital market. *Id.* And, the existing projections show that the majors are expected do well over the next five years, both in terms of revenues and profits. At least one forecast for the entire recorded music industry for the 2007-2012 time period shows, contrary to the RIAA's unsubstantiated claims, that the industry's top line revenues are expected to stabilize during this time period as growing digital sales make up for the loss of physical sales. *Id.* There is simply no basis for their cries of poverty with respect to the relevant time period.

(b) Fair Income

79. As this Court explained in SDARS, the "fair income" identified in the statute is "not the same thing as guaranteeing [copyright users] a profit in excess of the[ir] fair expectations . . . Nor is a fair income one which allows the [copyright user] to utilize its other resources inefficiently. In both senses, a fair income is more consistent with reasonable market outcomes." 73 Fed. Reg. at 4096. The record companies have historically enjoyed lower profit margins than they enjoy today. CO RPFF Sec. II.A.

Thin margins are nothing new. There were many years of mechanicals at the rates the record companies now seek to have this Tribunal impose that they failed to earn higher profits. The conclusion is inescapable that for this industry, managed as it has been by the record companies, the profit margins earned today, or even lower, are consistent with reasonable market outcomes.

80. Likewise, "fair income" should not be assessed based on the relative risks or record companies and music publishers. As the RIAA's witness, Terri Santisi, testified, the recorded music business has always been more risky than the music publishing business. 5/7/08 Tr. at 5241-44. There is no evidence the "risk gap" between record companies and publishers has increased. Moreover, the record shows that Copyright Owners, both music publishers and songwriters, face the same tough economic times that record companies face, including piracy and declining sales volumes. *See* CO PFF ¶¶ 236-237 (songwriters), 343, 348 (publishers). Music publishers should not be penalized for running efficient businesses, and record companies should not be rewarded for running inefficient ones.

81. The RIAA claims that the "fair income" required under Section 115 is different from the "fair income" required under Section 114 and discussed in SDARS, because the latter does not have an anti-monopoly purpose. *See* RIAA PCL ¶ 97 n.3. The RIAA's argument ignores the basic canon of statutory construction that identical terms within a statute bear the same meaning. *Sorenson* v. *Secretary of Treasury*, 475 U.S. 851, 860 (1986). Thus, the Court's interpretation of "fair income" should be the same across licenses.

82. Furthermore, precisely because the Section 115 license was created to prevent monopolistic behavior by copyright users, its "application . . . is limited by the market deficiency which justifies its existence." 1981 CRT Determination, 46 Fed. Reg., at 10479. To satisfy its legislative purpose, the statutory license must ensure "reasonable market outcomes," and nothing more. SDARS, 73 Fed. Reg. at 4096. To the extent that Section 115 was motivated by 100-year-old concerns about potential monopoly power by copyright users acquiring exclusive rights to a musical work, that factor has no bearing on the Court's considerations today. Although the RIAA Proposed Conclusions of Law make some allusions to the dangers of monopoly over musical works, there is not a scrap of evidence in the record to suggest that anybody actually has such market power. No adjustment is required to the market rates to adjust for fears of market power that have no basis in reality.

(c) Fair Return

83. The RIAA claims that the Copyright Owners interpret a "fair return" to mean a rate that "ensure[s] that publishers receive as much in mechanical revenue as they received in past years." RIAA PCL ¶ 88. This is incorrect. The Copyright Owners seek a rate that will provide a fair return based upon the market benchmarks that they have identified and existing economic conditions, which include a large decline in mechanical collections. *See* CO PFF ¶ 257; *see also id.* ¶ 235. The songwriters lose revenues just as much as the record companies when sales fall. Fewer sales multiplied by the same royalty results in a reduction in return. Fewer sales with a lower mechanical rate, as the RIAA proposes, is a double blow. K. Murphy WRT (CO Trial Ex. 400) at 6. Since the costs of writing a song are largely, if not entirely, fixed costs, songwriters reasonably

expect a higher rate per copy when sales fall. 5/15/08 Tr. at 6879-80 (K. Murphy). That is not to say that the absolute return to the Copyright Owner will not fall when sales fall, only that the rate per copy may need to be increased.

84. It is not the Copyright Owners but the record companies that rely on "historical data" to justify their proposed rates. It is the RIAA that repeatedly invokes mischaracterizations of the 1981 CRT Determination to derive a faulty benchmark. *See e.g.* RIAA PCL ¶ 92.

85. The RIAA claims that the CRT "did not agree" that the publishers historically received approximately 11% of wholesale revenues and therefore adopted a smaller increase corresponding to 5% of the suggested retail price at the time. RIAA PCL ¶ 92. First, there is no indication that the CRT set a rate based on a percentage of revenue. The CRT instituted a penny rate and rejected a percentage of revenue model. 1981 CRT Determination at 10477. Second, contrary to the RIAA's characterization, the CRT held that "[t]he evidence . . . shows that in the period 1964 through 1974, aggregate royalties actually paid to copyright owners declined from an average of about 11.2 percent of record sales at wholesale to about 7.2 percent, thus relegating copyright owners to a substantially weakened economic position vis-à-vis the users of their creative works." 46 Fed. Reg. at 10481. Thus, the RIAA's interpretation of the 1981 CRT determination is entitled to no weight.

86. The RIAA also claims that publishers are the "culprits in terms of taking money out of songwriters pockets," and that publishers frequently take 50% of the revenues paid to songwriters. RIAA PCL ¶ 96. There is no evidence to support this assertion. The evidence is uniform that the normal split of royalties between songwriters

and publishers is 75% to the songwriter and 25% to the publisher. CO PFF ¶¶ 309. The evidence is also undisputed that publishers financially support songwriters, often for years before they achieve success and that publishers write off millions of dollars in unrecouped advances. *Id.* ¶¶ 313-16.

2. DiMA

87. DiMA argues that the Copyright Owners are seeking a rate based on the "supposed connection between iTunes and iPods." DiMA PCL ¶ 44. The implication is that the Copyright Owners are unfairly seeking to set a rate based on either iTunes' success or Apple's iPod sales, without taking into account other parts of the permanent downloads market, and thus may be seeking to deny the DiMA companies a fair income.

88. iTunes accounts for 85% of permanent download sales. CO PFF ¶ 353. Thus, iTunes' success is probative of the health of the permanent downloads market in general. The evidence at trial showed that the permanent download market is flourishing and is expected to grow. *Id.* at 468. Although DiMA claims that the other entrants into the permanent download market are not faring as well as iTunes, DiMA only presented evidence concerning such services as Napster, MediaNet and RealNetworks. These are all subscription services that garner the majority of their revenue from limited download and interactive streaming activities. CO RPFF Sec. X.I.E.2. The relevant rates for these businesses have been resolved by the parties' settlement.

89. The "connection between iTunes and iPods" to which DiMA objects appears to be Apple's practice of discounting music to promote the sales of iPods. CO PFF ¶ 383; 2/25/08 Tr. at 4305 (Cue). Apple has publicly acknowledged this business plan, *see* CO RPFF ¶ 388 and, contrary to DiMA's representation, the Copyright Owners

requested documents on this topic, none of which were provided. *See* Copyright Owners' First Set of Document Requests to Apple, Inc., Docket No. 2006-3 CRB DPRA (Aug. 13, 2007).

90. The essence of DiMA's argument appears to be that the mechanical rates should be set so low that any digital music provider should be free to enter the market without concern about its ability to pay the mechanical rate. The evidence relating to Apple demonstrates conclusively that a well-run business with an effective business plan can and will flourish in this market. It is the inefficient services, with ineffective business plans, who seek to enter the market on the backs of the Copyright Owners and to benefit from a lower rate. As this Court held in SDARS:

> Affording copyright users a fair income is not the same thing as guaranteeing them a profit in excess of the fair expectations of a highly leveraged enterprise. Nor is a fair income one which allows the SDARS to utilize its other resources inefficiently. In both these senses, the fair income is more consistent with a reasonable market outcomes.

173 Fed. Reg. 4080 at 4095.

C. Factor 3 – Reflect The Relative Contributions And Risks Of The Copyright Owner And User

91. Songwriters and publishers play a vital role in creating the product that is provided to the public because they provide an essential input – the song. *See* 1981 CRT Determination, 46 Fed. Reg. at 10480 ("The evidence shows that the songwriter is the provider of an essential input to the phonorecord: The song itself. The music publisher collaborates with the songwriter in the creative process.").

92. Moreover, the evidence shows that nearly two thirds of songwriters earn 50% of their income from mechanical royalties and publishers may earn as much as 56% of their revenues from mechanicals. During the 15-year period from 1991 to 2006, mechanical royalties have never been more than 11% of record labels' total costs. CO PFF ¶ 435. Although the RIAA claims that the industry cannot survive mechanicals at such a rate, the 1981 CRT Determination demonstrates that it can and has. 46 Fed. Reg. at 10481. Thus, the impact on songwriters and publishers of a change in the mechanical royalty will be much more significant than the impact on record companies. Most significantly, songwriters cannot diversify their risk because they can only invest in their creative output.

1. The RIAA

93. The RIAA claims that the record companies' business model is "changing radically" and that this may require an adjustment in the RIAA's favor. *See* RIAA PCL ¶ 101, citing PSS, 63 Fed. Reg. at 25407. Again, the RIAA is simply arguing that the record companies are facing declining sales and revenues while the music publishers are facing less difficult economic times. As the Copyright Owners have shown in their Proposed Findings of Fact, there is no basis for this assertion. *See, e.g.,* CO PFF ¶¶ 344, 438-456. Record company profits are at an all time high. Forecasts show a bright future over the period for which rates are being set. The facts here are in stark contrast to those that the Librarian found in the PSS decision on which RIAA relies. There, the Librarian found that the Services were facing a perilous future and "it is far from clear whether the Services can survive." 63 Fed. Reg. at 25407. The RIAA has made no comparable

showing here. Here the record companies are thriving, not facing the risk of extinction the Services faced.

94. The RIAA claims that Copyright Owners benefit from substantial investments that the record companies make in sound recordings and that under SDARS, Copyright users' on-going investments may weigh in favor of a discount on the rates. RIAA PCL ¶ 102. In SDARS, however, the Court held that such considerations were subsumed in the consideration of the fourth statutory factor – disruption to the industry. 72 Fed. Reg. at 4096.

95. The RIAA further claims that its members' expenditures in the promotion of sound recordings reduce the risks that music publishers face and that this is relevant to the third statutory factor. *See* RIAA PCL ¶ 103. But there is no more evidence of these promotional benefits in this proceeding than there was in SDARS. There, this Court noted "the mere assertion that airplay is promotional without more is insufficient. Indeed, the quality of evidence presented . . . on this issue consisted largely of such assertions . . . a handful of consumer testimonial emails or anecdotes." 73 Fed. Reg. at 4095. Therefore, as a factual matter, this argument should be disregarded.

96. Even if the facts supported it, the argument would be of little weight. In PSS, relied on by the RIAA, the Librarian explained that the digital music services (the "PSS Services") had a promotional benefit for the record companies because they exposed listeners to sound recordings that they might not otherwise hear. 63 Fed. Reg. at 25407-08. (The Librarian also noted that the PSS Services did not appear to substitute for record sales. *Id.*) Here such promotion as there is benefits both the record companies

and the Copyright Owners since it increases sales of the finished product to the benefit of both.

97. Likewise, although the RIAA claims that "with respect to the opening of new markets" it "is critical to consider whether record companies are the sole or primary outlet for musical works or whether they are merely one of many distributors," RIAA PCL ¶ 104, the RIAA has not presented evidence that it plays a more active role than the Copyright Owners in this regard. *See* SDARS, 73 Fed. Reg. at 4096. For example, both copyright users and Copyright Owners have contributed to the opening of the digital music market by fighting piracy and licensing works for digital distribution. *See* CO PFF ¶¶ 366, 374, 394.

98. Finally, the RIAA argues that Copyright Owners face less risk from a change in the mechanical rate than record companies because they have "multiple outlets" for their works. RIAA PCL ¶ 100. But, although record companies may have substantial risks and costs, the CRT found that they are able to pass these risks to other parties by, for example, recouping recording costs from artist royalties. *See* 1981 CRT Determination, 46 Fed. Reg. at 10480. And the other outlets available to Copyright Owners are not relevant to setting the rate for their mechanical rights. *Infra* ¶¶ 104-12.

2. **DiMA**

99. DiMA claims that its contributions are such that the Court should choose the "lowest possible rate." DiMA PCL ¶ 55. This is exactly the argument that the Court rejected in SDARS and in Webcasting II. In both decisions, the Court rejected the argument that the copyright users were entitled to a rate that allowed them to use as much of the copyright owners' physical works for as long as they wanted for as little as they

wanted. SDARS, 73 Fed. Reg. at 4086; Webcasting II, 72 Fed. Reg. at 24089. As this Court noted, that argument trivialized the rights of Copyright Owners. *Id.* While DiMA companies contribute to the distribution of sound recordings, their contributions are subsidiary to and dependant on the contributions of others, and thus do not merit a reduction in the rate. *See* CO PCL ¶ 96 (citing SDARS, 73 Fed. Reg. at 4096). The investments that DiMA companies make in their own businesses are most appropriately considered below, under the disruption factor.

D. Factor 4 – Disruption Of The Industry

100. In assessing the fourth factor, disruption to the industries involved, the courts have set a very high threshold. This Court is not required to set a mechanical royalty rate that avoids "all impacts whatsoever." 1981 CRT Determination, 46 Fed. Reg. at 10486. To the contrary, this Court has held that a rate can be disruptive enough to require an adjustment of a market 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, 73 Fed. Reg. at 4097. There is no evidence to suggest that the Copyright Owners' proposed rates would cause any disruption of the magnitude required to depart from market derived rates. Nor do the record companies make any argument that any record company or digital music provider would have its viability challenged by the adoption of the penny rates the Copyright Owners seek.

1. The RIAA

101. The RIAA claims that it meets this Court's high standard for disruption. It claims that an increase in the mechanical royalty rate would be far more detrimental to the record companies than the increase was to the Services in SDARS because in contrast to the Services, which were new business with prospects for large future profits, the record companies are in an established industry in which the market is declining. *See* RIAA PCL ¶ 109. The opposite is true. As noted above, for record companies the evidentiary record demonstrates that profitability is on the rise and it confirms that mechanical royalties are only a small fraction of overall expense and substantially less than the rising artist royalties that are freely negotiated in the absence of a compulsory license. CO PFF ¶¶ 421-56; CO RPFF Sec. II.A.3.(b), (c). 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. *See,* CO PFF ¶¶ 421-41. Rhetoric and one reference to the testimony of its expert Bruce Benson aside, the RIAA offers no evidence to the contrary. Benson's testimony has been fundamentally undermined on cross-examination. *See* CO RPFF Sec. II.A.2.(c).

102. The RIAA also argues that record companies will not be able to absorb an increase in the mechanical royalty rate. RIAA PCL ¶ 113. The RIAA claims that in 1981, the record companies' ability to pass increases in costs on to consumers was one of the justifications for the increase in the rate. *Id.* But the CRT's core observation was that mechanical royalties are merely one of the record companies' many expenses, including "artist royalties, promotional expenses, and general administration expenses, which are within the industry's control," and all of which were much more substantial than

mechanical royalties. 1981 CRT Determination, 46 Fed. Reg. at 10480, 82. Today, those same expenses – artist royalties, marketing, and overhead – are much greater than mechanical royalties and comprise a larger percentage of the record companies' costs. *See* RIAA PFF ¶¶ 72-73. And, as in 1981, those costs are within the record companies' control and are absorbed or passed on to consumers as the record companies determine is most appropriate. *See also* SDARS, 73 Fed. Reg. at 4097 ("despite predictions of impending doom . . .of excessively high rates are set in this proceeding or similar dire predictions for record companies if exceedingly low rates are set . . . the rate set here is just one component that will impact future of both [copyright owners and users]."). Thus, the record companies' financial condition and cost structure is no basis to adjust the mechanical royalty rate.

2. DiMA

103. DiMA claims that a rate must be set to avoid "an adverse impact on digital music distributors' ability to 'attain a sufficient subscriber base' or 'generate sufficient revenues to reach consistent Earnings Before Interest Taxes depreciation and Amortization profitability or positive free cash flow.'" DiMA PCL ¶ 63, quoting SDARS, 73 Fed. Reg. at 4097. DiMA's argument is perplexing. The rates for subscription services have been settled. Thus, the subscriber bases of the subscription services are not relevant. Although some subscription services may also sell permanent downloads, there is no evidence in the record upon which to conclude that increased subscriber levels would lead to a change in the services' ability to sell permanent downloads. Moreover, the permanent download market is thriving, and Apple, which controls 85% of that market, is showing excellent profits. The largest permanent

download provide, iTunes, has experienced exponential growth and substantial profits. CO PFF ¶ 381. There is no evidence that its viability, or the viability of any other efficient competitor, would be affected by an increase in mechanical rates. Thus, the financial condition of the DiMA companies provides no justification for a low rate.

E. The Copyright Owners' Non-Mechanical Royalty Income Does Not Justify A Reduction In The Rate

104. The RIAA claims that in the mechanical royalty rate must be calibrated to take into account the Copyright Owners' non-mechanical sources of income. *See, e.g*. RIAA PCL ¶ 76. The RIAA is incorrect.

105. The Copyright Act makes clear that Copyright Owners are afforded several separate and distinct rights with regard to musical works, including the exclusive rights to reproduce, distribute or perform their works. *See* 17 U.S.C. § 106 (1)-(6). The copyright laws mandate separate ratesetting proceedings to determine reasonable compensation for licenses to exercise many of these rights. *See, e.g.*, 17 U.S.C. § 801(b)(1) (stating that the Court must determine reasonable rates and terms for the licenses provided for by sections 112(e), 114, 115, 116, 118, 119, and 1004 of the Copyright Act). The RIAA's implication that Copyright Owners' other revenue streams may be used to decrease the mechanical royalty rate is simply an attempt to play one independent right off against another, deny the benefits conferred by Congress on the Copyright Owners, and defeat the purpose of separate proceedings to determine rates for distinct rights.

106. Courts have repeatedly recognized that blurring the lines between different rights would frustrate the Congressional purpose behind the Copyright Act. In the 1981

Jukebox Determination, the CRT refused to consider the Copyright Owners' mechanical royalties from record sales in determining their royalties for jukebox performances. 46 Fed. Reg. at 889. The CRT reasoned as follows: "We reject the contention that copyright owners are paid for jukebox performances by mechanical royalties derived from record sales. 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." *Id.*

107. The Librarian reached the same conclusion in PSS. There, the RIAA asserted an objection to the consideration of revenues from distinct licenses that is analogous to the Copyright Owners' position here. Specifically, the RIAA "object[ed] to the Panel's constant reference to revenues generated from the distribution and reproduction rights." PSS, 63 Fed. Reg. at 25408. The Librarian acknowledged the RIAA's concern, but decided not to set aside the Panel's analysis because it was clear that the Panel had *not* used that evidence as a basis to reduce the copyright owners' compensation under the DPRSRA. Specifically, the Librarian explained that the Panel's analysis was permissible only because "[t]he Panel never implied that the record companies should receive anything less than reasonable compensation under the DPRSRA, *nor that their revenues from the exercise of the distribution and reproduction rights are meant to compensate them for the use of their creative works under the new statutory license*." *Id.* (emphasis added).

108. The cases on which the RIAA relies are not to the contrary. The RIAA argues that in SDARS, the Court "focused on issues related to potential promotion of, or substitution for other revenue streams in its discussion of incentives to create and make

available new works" under the first statutory factor. RIAA PCL ¶ 121. But the Court doubted the relevance of the "absolute levels of promotion/substitution in the SDARS market alone" and focused its inquiry on whether any of the evidence presented established that the promotional or substitutional effects in the target market were sufficiently different from the benchmark market to necessitate an adjustment of the rate implicated by the market benchmarks.[10] *Id.* at 4094-95. (The Court determined that no adjustment was required. *Id.*) Thus, the Court found information about the broader incentives of the copyright owners to be meaningful only to the extent that it shed light on differences between the target market and the benchmark market. The Court declined to give any further consideration to substitution and promotion effects under the second statutory factor. *Id.* at 4096.

109. The RIAA does not – and cannot – argue that the Court considered the other revenues of the copyright owners in SDARS under the third and fourth factors. It does claim, somewhat opaquely, that the Services' "entirety of their current business model, including statutory and non statutory components" was examined, but it does not

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[10] The RIAA also notes that the Court "relied on and quoted Dr. Ordover's analysis that copyright owners' incentives to produce new music are based on revenues from all available sources." RIAA PCL ¶ 121. But, the Court considered that analysis in the context of benchmarks, not in its analysis of the 801(b) factors. *See* SDARS, 73 Fed. Reg. at 4090 (criticizing Dr. Woodbury's benchmark analysis because it did not take into account that "recording companies will necessarily make future investment decisions based on their best estimates of the revenue sources available to them in the future from all sources including revenue streams derived from the SDARS' use of sound recordings" and citing Dr. Ordover's Written Direct Testimony.) As noted below, the principal relevance of this observation by Dr. Ordover is that it undermines the RIAA's current argument that investments in sound recordings are "sunk costs" that should not be considered in connection with assessment of the synchronization and ringtone benchmarks.

explain the relevance of the result. RIAA PCL ¶ 135, Having reviewed the business, the Court specifically noted that the Services' "non-music programming" was not relevant to the Court's analysis and, the "risk to the entire business" that the Court considered included first, the Services' investments in satellite technology and second, the Services' failure to attain profitability – both of which were necessary to their survival. *Id.* at 4096, 97.

110. In the 1981 CRT determination, relied in by the RIAA, RIAA PCL ¶ 125, the CRT heard evidence about the financial condition of the record companies, the songwriters, and the publishers, including the publishers' profitability and the sources of songwriters' non-mechanical income. 46 Fed. Reg. at 10474-77. There is no indication in the decision that the CRT reduced the mechanical royalty that would otherwise be owed to Copyright Owners on account of such other income or overall profitability.

111. The CRT did not analyze or address the financial condition of the Copyright Owners at all under the first and third, and fourth factors. Under the second factor, the CRT considered the "entire record of this proceeding . . . including available economic data" and determined that an increase was warranted. *Id.* at 10481. The CRT also explained, in its discussion of the financial condition of the copyright users and copyright owners, that "while it was valuable for us to be aware of the financial status of both the recording industry and the copyright owners, the financial information received provided no clear guidance as to how to balance fair return as against fair income." *Id.* at

10482.[11] Thus, although the CRT was presented with evidence of the financial condition of all the parties, it did not use it in setting the mechanical rate.

112. The RIAA's argument that the Court ruled at trial that the Copyright Owners have "waived arguments" concerning the relevance of the songwriters' and publishers' non-mechanical sources of income is meritless. RIAA PCL ¶ 116. To the contrary, in its ruling, the Court declined to strike evidence of the Copyright Owners' non-mechanical income from the record, but left open the question of relevance:

> The relevance of that revenue will have to be treated as a matter of weight as opposed to admissibility. And the numerous questions by this judge as to why is that being presented will have to be considered in the deliberations as to what, if any, weight to give to evidence on revenue other than mechanical royalty revenue.

5/19/08 Tr. at 7202 (Sledge CJ).

V. CPI Increases Are Warranted

113. The RIAA opposes the Consumer Price Index ("CPI") adjustment proposed by Copyright Owners. RIAA PCL ¶ 160. Since the last contested ratesetting proceeding in 1981, however, the mechanical royalty rate has always included a mechanism for periodic rate adjustments. The 1981 regulations provided for increases in 1983, 1984 and 1986. CO PFF ¶ 119. In 1987, pursuant to a joint proposal endorsed by the RIAA, the CRT established a schedule of rate increases based on the CPI. *Id.* ¶ 120.

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[11] Although the RIAA claims that the CRT determined that economic data did not provide clear guidance because of defects in the Copyright Owners' data, RIAA Conclusions at 44, n. 5, the CRT criticized both parties' presentation of financial data. 1981 CRT Determination at 10482 (criticizing Copyright Users), 10483 (criticizing Copyright Owners).

Similarly, the 1997 Agreement provided for increases over the ten-year period it covered that have had the effect of keeping pace with inflation. *Id.* ¶ 121.

114. In 1981, the CRT held that "it is necessary to set the rate in a manner that will respond to changes in record prices" and determined that it would adjust the mechanical royalty rate on December 1 of each year based upon the change, if any, in the average suggested retail price of albums in the proceeding year. 46 Fed. Reg. at 1485-86. The D.C. Circuit reversed the adjustment procedures adopted by the CRT because although the CRT had jurisdiction to adopt a reasonable mechanism for automatic rate increases between ratesetting proceedings – which could equally appropriately be tied to record prices or to a CPI measure – it did not have jurisdiction under the Copyright Act to commence annual ratesetting proceedings. CRT Determination Appeal, 662 F.2d at 17.[12] Most importantly, the Court of Appeals observed that a reasonable rate should take inflation into account:

> It is obvious . . . that the purchasing power of the return to the copyright owners is an essential element in determining the fairness of the return, *see* 17 U.S.C. § 801(b)(1)(B) (1976), in evaluating the effectiveness of the rate in maximizing the availability of musical works, *see id.* § 801(b)(1)(A), and in setting a rate that reflects the relative roles of copyright owners and users, *see id.* § 801(b)(1)(C), particularly where the owners' rate is fixed by law and the users remain free to charge what the market will bear.

Id. at 10 n.24. Thus, under this Court's precedent, and past practice under Section 115, CPI adjustments are an appropriate way to ensure that mechanical royalty remains reasonable over the entire rate period. In addition, Professor Landes endorsed the CPI,

[12] Following the Court of Appeals' decision, the CRT issued regulations mandating specific periodic adjustments of the rate.

and explained the measure that the Copyright Owners proposed to use. *See* Landes WRT (CO 406) at 6, n.5.

115. The RIAA argues that CPI adjustments are inappropriate under SDARS and Webcasting because the Copyright Owners have not submitted a benchmark agreement that includes an express CPI adjustment. RIAA PCL ¶ 160. Neither case requires the Copyright Owners to submit such an agreement. Moreover, in each case, unlike here, no CPI adjustment mechanism was warranted. In SDARS, the Court adopted a percentage of revenue rate. Therefore, absent evidence to the contrary, the Court had no reason to assume that periodic increases in the rate would be necessary to ensure that the real value of the rate did not decline. 73 Fed. Reg. at 4098 n.42. In Webcasting II, the Court set a rate that included yearly increases. Thus the Court concluded that no further adjustments for inflation were needed. Webcasting II, 72 Fed. Reg. at 24096. Here, the Court should adopt a single penny-rate, rather than a percentage of revenue rate. Therefore, a mechanism to adjust the rate for inflation will be needed, and CPI adjustments are an appropriate way to accomplish this goal.

VI. There Is No Requirement For A Rate For General DPDs

116. The RIAA argues that the Copyright Owners' rate proposal is underinclusive and fragmented. RIAA PCL ¶¶ 164-70; RIAA PFF ¶ 1741-51. Not only are the arguments advanced by the RIAA unpersuasive, but it is the RIAA's rate proposal that is inconsistent, fragmented and unnecessarily complicated.

117. For example, the RIAA's proposal provides three different definitions of the revenue base to which its percentage rates would be applied, and calls for the revenue base to differ depending on whether the Section 115 licensee is a record company selling

products to a distributor, a record company selling products directly to consumers, or a digital music service. *See* RIAA Amended Proposed Rates and Terms of the Recording Industry of America, Inc., *In re Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding*, Docket No. 2006-3 CRB DPRA (Mar. 10, 2008) at 2-4. Indeed, the RIAA's rate proposal is so confusing that RIAA witnesses could not explain how the proposed revenue definition it contains would work in the real world. *See* 5/13/08 Tr. at 6135-37 (Eisenberg).

118. The RIAA also argues that the Court must set a royalty rate for so-called "general DPDs." RIAA PCL ¶ 167. As a threshold matter, no statutory requirement mandates the Court to set a general rate for DPDs. Under Section 115, the Court is directed to set rates for "activities" specified under Section 115, which on its face, permits the Court to set rates on an activity by activity basis. The RIAA argues that the Court is nonetheless required to set a rate for general DPDs based on their misreading of the Register's review of SDARS. *See* RIAA PCL ¶ 167, citing Review of Copyright Royalty Judges Determination, 73 Fed. Reg. 9143, 9146 (Feb. 19, 2008). In the Register's review of SDARs, however, the Register simply determined that the Court had erred in failing to set a distinct minimum rate for incidental DPDs in accordance with the language of Section 112, which states that rates under Section 112 "shall include a minimum fee for each type of service offered by transmitting organizations." 17 U.S.C. 114(e)(4). Thus, the Register's opinion has no application here.

119. According to the RIAA, without a royalty rate for general DPDs, technological innovation in the industry will be stifled and new products will not come into the market. RIAA PCL ¶ 170; RIAA PFF ¶ 1745-46. These concerns are illusory.

All of the technological innovation in the music industry over the last decade occurred without a rate for general DPDs. Moreover, as demonstrated in the Copyright Owners' Proposed Reply to the Proposed Findings of Fact of the RIAA and DiMA, the record companies have not established that there was any product the copyright users were unable to bring to market because of licensing difficulties. CO RPFF ¶ Sec. X.B. Similarly, the RIAA has not identified any existing products for which the Copyright Owners have not proposed a rate.

120. Finally, disputes between the Copyright Owners and copyright users concerning whether new products are licensable under Section 115 would not be solved by setting a general rate for DPDs, as the Court has recognized. *See* 2/14/08 Tr. at 3351-53 (A. Finkelstein; Roberts, J.). For example, such a dispute arose over ringtones, with the Copyright Owners arguing, among other things, that ringtones were not within the compulsory license because they are derivative works, and the RIAA arguing that ringtones were nevertheless covered by Section 115. *See* CO PFF ¶¶ 129-34; Ringtones Opinion, 71 Fed. Reg. at 64304. A general rate for DPDs would do nothing to resolve such controversies.

VII. Increased Rates Are Merited For Long Songs

121. The RIAA claims that the Copyright Owners have not put forward sufficient evidence concerning long songs to justify a rate that differentiates between long and short works. *See* RIAA PCL ¶ 162. The current rates, however, differentiate between the two. And, in 1981, the CRT also determined that it was appropriate to distinguish between long and short compositions. *See In re Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords*, 46 Fed.

Reg. 62267 (Dec. 23, 1981). In addition, at trial, the Copyright Owners presented evidence that creating certain longer classical works requires more time than creating short ones and that classical composers are compensated at a higher rate for longer works. 1/31/08 Tr. at 915 (Paulus) (explaining that writing an opera may take as long as 13-14 months, while writing a choral piece may take a month); Paulus WDT (CO Trial Ex. 7) at 6.

122. The case relied on by the RIAA is not to the contrary. RIAA PCL ¶ 163, citing Webcasting I. In Webcasting I, the CARP rejected the RIAA's request that a higher rate be set for long songs because the RIAA had not presented evidence "that the marketplace valued a classical sound recording, or a similar sound recordings of longer than average duration at a different rate." 67 Fed. Reg. at 45260. The Librarian affirmed the CARP's ruling, but noted that "RIAA has raised a valid point and future CARPs should carefully consider how to value performances of longer recordings, such as classical music, to ensure that the copyright owner is fully compensated." *Id.* Here, the Copyright Owners have presented evidence that long works are valued at a higher rate in the industry than short works. Moreover, unlike in the Webcasting I proceeding, which was the first proceeding to set rates digital performance royalty rates for webcasters, here there is a past practice of setting higher rates for long works.

VIII. The Court Should Retain The Penny Rate For Physical Products And Permanent Downloads

123. The RIAA and DiMA argue that this Court should abandon the penny-rate that has been in place for nearly a century in favor of a revenue-based rate. RIAA PCL ¶¶ 171-183; DiMA PCL ¶ 72. This Court has held, however, that a revenue-based metric

should only be used where there is "persuasive evidence" that a usage-based metric cannot be calculated. *See* Webcasting II, 72 Fed. Reg. at 24089. As explained in the Copyright Owners' Conclusions of Law ¶ 105, a usage rate is readily calculable here, and has been in place since 1909.[13]

124. The reasons for rejecting revenue-based rates are clear. First, revenue-based metrics are merely imperfect proxies for usage. Webcasting II, 72 Fed. Reg. at 24089; Webcasting I, 67 Fed. Reg. at 45249 (rejecting a revenue-based approach in favor of a per-use approach because "it is directly tied to the right being licensed"). Consequently, revenue-based rates do not provide Copyright Owners with compensation in proportion to the usage of their works. In Webcasting II, the Court rejected each of the revenue-based metrics proposed by the copyright users and owners in part because of this defect. The Court explained that under the copyright owners' proposal, which included both minimum usage and percentage of revenue components, copyright owners might be entitled to share in revenues that were not attributable to music. By contrast, under the copyright users' proposal, the copyright owners might be "forced to allow extensive use of their property without being adequately compensated" due to failures in the webcasters' business that were unrelated to music. *Id.*

125. Here, as in Webcasting II, the RIAA and DiMA percentage of revenue proposals threaten to deny Copyright Owners fair compensation for the use of their

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[13] The RIAA notes that in SDARS, the Court adopted a percentage of revenue measure. In SDARS, however, the Court explained that the revenue-based metric was adopted because "we have no true per performance fee proposal us nor sufficient information from evidence of record to accurately transform any of the parties' proposals into a true per performance fee." 73 Fed. Reg. at 4085. Here, the Copyright Owners have proposed the continuation of the penny rate, which measures usage.

musical works. Under both the RIAA and the DiMA rate proposals, the Copyright Owners' mechanical royalties would be reduced if their works are sold in bundles with other products, at a combined price lower than the standalone prices of the bundled products. CO PFF ¶¶ 612-16. And the evidence shows that the largest seller of downloads, Apple, uses music as a "loss leader" to promote the sales of iPods. *Id.* ¶ 610.

126. Moreover, although a percentage of revenue rate requires clear definition of revenue so as to properly relate the royalty to the value of the rights being provided, Webcasting II, 72 Fed. Reg. at 24089, the RIAA and DiMA have not provided clear definitions. At trial, neither the RIAA nor DiMA witnesses could articulate the meaning of their respective revenue definitions. The RIAA's witness, Mr. Eisenberg, struggled to explain the treatment of certain discounts provided to distributors of physical product in return for promotional benefits. *See* 5/13/08 Tr. at 6135-37 (Eisenberg). Ultimately, he could not explain how such discounts would be treated under the RIAA's revenue definition and whether and under what circumstances the discounts would reduce the return to Copyright Owners. *Id.* at 6136-37.

127. Similarly, DiMA's witnesses gave strikingly inconsistent explanations of the treatment of bundled products under DiMA's definition of revenue. *Compare* 5/6/08 Tr. at 4918 (Guerin-Calvert) (explaining that Copyright Owners would receive "4.8 cents per track" for bundled products) *to* 5/13/08 Tr. at 6180-81 (Sheeran) (explaining that Copyright Owners would receive 3.3. cents per track for bundled products).

128. In support of their percentage rate proposal, the RIAA points to PSS, in which the parties agreed that a percentage rate would be appropriate, s*ee* RIAA PCL ¶ 176 (citing PES, 63 Fed. Reg. at 25395-96), and Webcasting I, in which the Librarian

determined that the definition adopted was substantively correct because it reflected industry practice. S*ee* RIAA PCL ¶ 177 (citing Webcasting I, 67 Fed. Reg. at 45268). Neither of those circumstances is present here.

129. The RIAA also argues that "what matters is that the rates adopted achieve the objectives set forth" in Section 801(b) and that "a percentage of revenue is vastly superior to a cents rate for a wide variety of reasons." RIAA PCL ¶¶ 172, 174. It fails however to connect the two assertions. The evidence shows that a percentage rate for physical products and permanent downloads is far less effective in achieving every one of the four objectives in Section 801(b). *See* CO PCL ¶ 110; CO PFF ¶¶ 644-48, CO RPFF Sec. X.

130. Most significantly, under the fourth factor, a percentage rate would be very disruptive to the music industry. *See* CO PCL ¶ 110; CO PFF ¶¶ 644-48; CO RPFF Sec. X.E. The RIAA acknowledges as much when it concedes a significant transition period would be required before the industry could adjust to such a rate because no participant currently has systems to accommodate it in the United States. RIAA PCL ¶¶ 184-90. Further, a percentage rate would disrupt contracts between songwriters and publishers and require changes in the recordkeeping and licensing arms of the publishers and record companies. *See* CO PFF ¶¶ 644-48.

131. A percentage rate would also ill-serve the first Section 801(b) factor because it would not maximize the availability of musical works. Under a percentage of revenue metric, compensation is not proportional to usage. Thus, as Professor Murphy explained, a percentage rate would not incentivize songwriters to write more songs. *See* 5/15/08 Tr. at 6900-02 (K. Murphy).

132. With respect to the third factor, a percentage of revenue rate would not guaranty the Copyright Owners a fair return because it would leave the users free to use more of their works in any product without any increase in compensation. *See* Webcasting II, 2 Fed. Reg. at 24089. For example, a record company that wanted to include 20 songs in a CD selling at a given wholesale price would pay no more in mechanical royalties than if it wished to include 10. The Copyright Owner for each work would receive only half the compensation.

133. Finally, with respect to the third factor, a percentage rate would fail to reflect the relative contributions of the Copyright Owners because their total compensation would remain static regardless of the amount of their works contributed or the importance of that contribution. And, of course, each Copyright Owner's individual compensation would not increase the more his or her works were used. Thus, a percentage rate would work in inverse proportion to the Copyright Owners' contributions.

IX. This Court Has No Jurisdiction To Adopt The Bulk Of RIAA's Proposed Terms

134. The RIAA has proposed a number of terms that would dilute the requirements of the compulsory license. The RIAA seeks to change the date on which DPDs are deemed to be distributed; to water down the reporting and certification protections that Section 115 affords to the Copyright Owners; to relieve the obligation to pay royalties on "locked content"; and to codify their view that only a single mechanical payment is due for multiple instances of the same song on a phonorecord. The RIAA has failed to adduce any evidence that would support such changes. More importantly, five

of the six terms proposed by the RIAA cannot be fixed by this Court because their adoption would require modification of the express requirements established by Congress in Section 115 of the Copyright Act.

A. Accounting For Digital Phonorecord Deliveries

135. The RIAA continues to advocate a term with respect to changing the definition of when a DPD is "distributed" under Section 115 notwithstanding its belief that the term, "as a legal matter . . . is outside the scope of the Judges' jurisdiction." RIAA PFF ¶ 1765. In essence, the RIAA proposes a term that would define the word "distributed" in Section 115 as "reported."

136. Section 115(c)(2) states 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). Again, under the terms of the statute, such payments "shall be made on or before the twentieth day of each month and shall include all royalties for the month next preceding." 17 U.S.C. § 115(c)(5). The current regulations mirror the statutory requirement. They provide that a DPD "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).

137. The RIAA proposes that for DPDs distributed by a party other than the compulsory licensee, the Court should modify Section 201.19(a)(6) to provide that a DPD is considered made and distributed "in the accounting period in which it is reported to the compulsory licensee" instead of the month in which it was actually distributed. Second Amended Proposed Rates and Terms of the RIAA at 7. This modification is beyond the authority of this Court which is charged with implementing the royalty

scheme established by the legislature, not amending it. And that scheme requires payment of a royalty within twenty days of the end of the month in which distribution occurs. 17 U.S.C. § 115(c)(5). If the RIAA has a quarrel with the wisdom of the scheme, it must take its complaint to Congress because only Congress has the power to address it.

B. Signing Statements Of Account

138. The RIAA offers no jurisdictional basis for the Court to modify signature and oath requirements contained in the Copyright Act. Section 115(c)(5) requires that:

> Each monthly payment shall be made under oath and shall comply with requirements that the Register of Copyrights shall prescribe by regulation. The Register shall also prescribe regulations under which detailed cumulative annual statements of account, certified by a certified public accountant, shall be filed for every compulsory license under this section. The regulations covering both the monthly and the annual statements of account shall prescribe the form, content, and manner of certification with respect to the number of records made and the number of records distributed.

17 U.S.C. § 115(c)(5). The RIAA submits that its proposed term would modify regulations established by the Register that require the signature and oath of a "duly authorized officer of the corporation" on monthly and annual statements of account to permit the signature of "any duly authorized agent." *Compare* 37 C.F.R. § 201.19(e)(6) and (f)(6)(i) *with* Second Amended Proposed Rates and Terms of the RIAA at 7. In fact, the RIAA's proposed term would eliminate the oath requirement established by Congress in 115 itself. This Court has no authority to adopt such modifications of the statutory scheme.

139. There is no evidence in the record to support the RIAA's request that any authorized agent be allowed to sign accounting statements in place of the Register's

requirement that they be signed by an officer. *See* CO PFF ¶ 881. The RIAA argues that it would be "simply not practicable" (RIAA PFF ¶ 1771) for an officer to sign, but offers no explanation why this "looser standard" (5/6/08 Tr. at 4780 (Roberts, J.)) should be adopted. Signature under oath by an officer ensures review at an appropriately senior level at the record company. It is a valuable protection for Copyright Owners which should be retained absent evidence of anything more than inconvenience to support a change.

C. Audits

140. The RIAA's proposed term amending the regulations to eliminate the required annual statement of account certified by a Certified Public Accountant suffers from the same primary deficiency as the signature term discussed above: the requirement is contained in Section 115 itself. Congress laid out the requirement that annual statements of account be "detailed," "cumulative," and "certified by a certified public accountant." 17 U.S.C. § 115(c)(5). Congress explained this obligation in 1976: "In order to increase the protection of copyright proprietors against economic harm from companies which might refuse or fail to pay their just obligations, compulsory licensees will also be required to make a detailed cumulative annual statement of account, certified by a Certified Public Accountant." H.R. Rep. No. 94-1476 at 111 (1976).

141. The RIAA ignores the statute entirely and proposes that the Court simply amend the regulations to eliminate the statutorily required certified statement of account as redundant of audits of financial statements in the ordinary course of business. RIAA PFF ¶ 1774. The Court has no power to ignore the statutory requirement.

142. The RIAA claims that the compulsory license's annual certification is "redundant" because record companies conduct annual corporate audits and publishers audit the record companies as well. RIAA PFF ¶ 1774. First, the "annual corporate audits" conducted by the record companies are at the financial statement level. *See* A. Finkelstein WRT (CO Trial Ex. 84) at 26. They are not focused on the accuracy and completeness of specific statements of account related to particular musical works. As a result, a general corporate financial statement audit is wholly different from the work required by a CPA when certifying the cumulative statements of account particular to each musical work as required by Section 115.

143. Second, compulsory licensing should not compel the Copyright Owners to find and catch the cheaters. The RIAA's suggestion that certification of an annual statement is "superfluous in this day and age where the publishers are going to do an audit" (5/12/08 Tr. at 5759-60 (A. Finkelstein)) turns the system established by Congress on its head. Reliance on publishers' audits would shift the burden of ensuring the accuracy of record companies' accounts to the Copyright Owners. As Alfred C. Pedecine, Senior Vice President and Chief Financial Officer of HFA, testified, HFA does conduct time-consuming and costly Royalty Compliance Examinations to identify licensees' unpaid royalties. Pedecine WRT (CO Trial Ex. 394) at 12; see also 2/5/08 Tr. at 1431 (Israelite). However, the Court should not reward the record companies' delinquency by converting HFA's verification of the record companies' royalty reports into a substitute for record companies' own verification by an independent CPA when licensees choose to avail themselves of the compulsory license. The Court recognized this responsibility of licensees in the Satellite Radio proceedings: "The responsibility of

timely submitting royalty payments and statements of account rests with the statutory licensee." 73 F.R. at 4100.

144. Further, the RIAA's perceived "redundancy" simply does not exist for record companies other than the four majors. As Mr. Pedecine testified, "[f]or smaller and medium sized licensees (which are typically record companies as well), audits are not automatic, but rather are triggered by factors that suggest an RCE is necessary." Pedecine WRT (CO Trial Ex. 394) at 8. For the smaller licensees, RCEs are done "on a more judgmental basis, usually triggered by some criteria, such as whether a given licensee has a history of noncompliance with licenses [or] some empirical indicator may tell us that it might be worth looking at them." 5/19/08 Tr. at 7037 (Pedecine).

D. Locked Content

145. The RIAA proposes another modification to Section 115's definition of "distribution" in its "locked content" term. The RIAA asks the Court modify Section 115's definition of distribution for recordings that are encrypted or degraded and then preloaded on a device or transmitted by DPD for limited previewing until the customer purchases the full, non-degraded form. RIAA PFF ¶ 1674. The RIAA argues that such "locked content" should not be considered "distributed" and therefore subject to royalty payments until the customer "unlocks" the content and is given permanent access to the recording. *Id.* ¶ 1676.

146. The Register of Copyrights recently issued a Notice of Proposed Rulemaking which confirms that the authority to adopt such a term lies with Congress and the Register, not the Court. *See* Notice of Proposed Rulemaking, *Compulsory License for Making and Distributing Phonorecords, Including Digital Phonorecord*

Deliveries, Docket No. RM 2000-7 (July 10, 2008) at 12-14. Moreover, the Register rejected the very proposal advanced by the RIAA here. *Id.* at 28-29. The Register noted that, "The Office takes notice that some commenters have asserted that certain DPDs, known as 'locked content' . . . should not be considered distributed until the product is 'unlocked.'" *Id.* at 28. However, under the Register's proposed definition of DPDs, "all delivered DPDs are considered distributed regardless of such so-called 'locks.'" *Id.* "Despite the presence of such technological protections, 'locked content' appears to satisfy the requirements for being both phonorecords and DPDs." *Id.* at 28-29.

E. Multiple Instances

147. The Court similarly lacks authority to adopt the RIAA's proposed "multiple instances" term because it would modify two provisions of Section 115. The RIAA proposes that term that would change Section 115 to provide that where multiple fixations of the same sound recording are distributed as part of a single transaction, "such fixations together shall be considered the same track." Second Amended Proposed Rates and Terms of the RIAA at 6.

148. As demonstrated in the Copyright Owners' Proposed Findings of Fact ¶¶ 886-88, the RIAA's proposed term falls outside the scope of the Court's authority because it modifies Section 115(c)(2)'s requirement that royalty be paid "for every phonorecord made and distributed." In addition, it would modify Section 115(d)'s definition of a DPD: "each individual delivery of a phonorecord by digital transmission of a sound recording which results in a specifically identifiable reproduction by or for any transmission recipient of a phonorecord of that sound recording." 17 U.S.C. § 115(d).

149. The type of "multiple fixations" proposed by the RIAA would enable the user to play the musical work "on multiple devices or at different levels of sound quality." RIAA PFF ¶ 1680. These "fixations" are therefore "specifically identifiable reproductions" under Section 115(d)(2), unlike the RIAA's analogy to the right and left stereo channels of a track. *See id.* ¶ 1681. The Court lacks the authority to modify these statutory provisions.

F. Clarification Of Covered Reproductions

150. Unlike the five terms discussed above, the RIAA's proposed term clarifying the definition of covered reproductions does not contravene the express authority of the Court and the Copyright Owners do not oppose the adoption of such term.

X. The Court Should Adopt The Copyright Owners' Proposed Terms

151. Unlike five of the six terms proposed by the RIAA, the Copyright Owners' proposed terms fall squarely within the Court's express authority and are designed to address the specific, rampant problem of late and incomplete payments of mechanical royalties. *See* CO PFF ¶¶ 844-45. Adoption of the Copyright Owners' proposed terms would create meaningful incentives for licensees to pay in a timely and complete manner, and would achieve Section 801(b)(1)'s objective of affording Copyright Owners a fair return for their creative works.

A. 1.5% Late Payment Fee

152. The RIAA does not dispute that record companies frequently fail to make complete and timely mechanical royalty payments. Indeed, the RIAA's own witnesses conceded as much at trial. *See* 2/14/08 Tr. at 3258 (C. Finkelstein); 5/12/08 Tr. at 5692

(A. Finkelstein). But although the RIAA acknowledges the problem of its members' late payments, it disputes the propriety of a late fee that would compensate the Copyright Owners for it. As described at length in the Copyright Owners' Reply to the Proposed Conclusions of Law of the RIAA and DiMA Sec. XIV.A, the RIAA offers excuses for why the Copyright Owners should continue to bear the costs of the record companies' tardiness. All are attempts to distract attention from the record companies' chronic late payments and the obvious need for the same statutory remedy imposed by this Court in the Webcasting II and SDARS.

153. In particular, the RIAA argues that the Copyright Owners should be content with their existing remedies of license termination and infringement litigation. As demonstrated in Copyright Owners' Proposed Findings of Fact, these are costly, burdensome, and severe remedies that do not fully compensate the Copyright Owners for the lost time value of late payments. CO PFF ¶¶ 852-53. Moreover, the Copyright Owners must provide licensees with a notice and 30 days to cure before terminating licenses and bringing an infringement action. 17 U.S.C. §115(c)(6); *see also* 5/19/08 Tr. at 7049 (Pedecine). The 30-day cure period creates the anomalous situation where a licensee can wait to pay until presented with a notice of termination, cure without paying late payment penalties, and leave the Copyright Owners without any recourse to obtain compensation for the lost time value of money. Neither audits by HFA, nor the available termination and infringement remedies can remedy the consequences of this conduct.

154. The RIAA also argues that this Court lacks jurisdiction to adopt the Copyright Owners' proposed late payment fee. RIAA PFF ¶ 1782. But, under Section 803(c)(7) "A determination of the Copyright Royalty Judges may include terms with

respect to late payment . . . ." 17 U.S.C. § 803(c)(7). And, although the RIAA claims that the Copyright Owners' proposed term conflicts with the existing payment regulations set forth in 37 C.F.R. § 201.19(e)(4), that regulation speaks only to the computation of royalties that are due, and not to the consequences of the copyright user's failure to abide by its obligations.

155. The RIAA claims that in SDARS, the Court adopted a late fee in order to compensate for the absence of a statutory termination fee and that here, a late fee is not necessary because the Copyright Owners have the right of termination under 17 U.S.C. § 115(c)(6). RIAA PCL ¶ 241. The RIAA misconstrues SDARS. In SDARS, the Court held that in setting a late a fee, its goal was to create an "effective incentive" to the licensee to make timely payments. 72 Fed. Reg. at 4099. Here, the Copyright Owners have demonstrated that the existing termination right does not accomplish this goal. CO RPFF Sec. XIV.A.

B. Pass-Through Assessment

156. The Copyright Owners' proposed 3% pass-through assessment would compensate Copyright Owners for the inability to directly audit a distributor's records and for the additional delay of royalty payments that occur when a licensee authorizes another entity to distribute works on the licensee's behalf. The RIAA argues that Copyright Owners should not be entitled to this pass-through assessment because it would thwart the Congressional objective of permitting pass-through licensing. RIAA PCL ¶ 244-246. The Copyright Owners do not seek to challenge the legitimacy or objectives of the statutory scheme which permits pass-through licensing arrangements.

The proposed assessment would merely compensate Copyright Owners for the record companies' delayed payments that occur in the case of these pass-through arrangements.

C. Reasonable Attorneys' Fees

157. As a part of its proposed late payment fee term, the Copyright Owners seek compensation for the reasonable attorneys' fees they expend in the course of collecting late payments. The RIAA argues that Copyright Owners already have the right to collect attorneys' fees under Section 505 and that Section 505 contains "important limits" which cannot be circumscribed. RIAA PFF ¶ 1824; RIAA PCL ¶ 252-55. But, as the Copyright Owners demonstrated in their Proposed Findings of Fact, the attorneys' fees provision of Section 505 is insufficient because in order to obtain such compensation, Copyright Owners would have to take the "draconian" step of terminating a license and instituting an infringement action. 1/30/08 Tr. at 641 (Faxon). Instituting legal action is not only expensive and time-consuming, but it damages long-term business relationships between Copyright Owners and licensees. *Id.*; 5/19/08 Tr. at 7041 (Pedecine). Section 505 does not provide a suitable remedy to Copyright Owners who need legal assistance to collect past due royalties and late fees, but do not wish to sever long-term business relationships by terminating a license and filing an infringement action against a licensee.

D. Specific Licensing And Reporting

158. The Copyright Owners seek a modification of the existing recordkeeping regulations to require licensing and reporting of the royalties earned for each specific configuration and, in the case of pass-through arrangements, that licensees identify the online retailer through which digital deliveries occurred. Under the existing regulations

(37 C.F.R. §§ 201.18(d)(1)(v)(D), 201.19(e)(3), (f)(4)), notices and royalty reports have to provide certain information concerning the configurations in which the licensee is distributing music, but such regulations lack a requirement that licensees distinguish among permanent downloads, limited downloads and interactive streams (or any other digital format) in taking licenses or reporting under licenses. The Copyright Owners seek this additional level of detail to ensure that they are able to conduct more accurate audits with additional and critical pieces of information about what products are being licensed. *See* Israelite WDT (CO Trial Ex. 11) at 16; Pedecine WRT (CO Trial Ex. 394) at 16.

159. The RIAA argues that the Court does not have the jurisdiction to set a term for configuration-specific licensing because such a term would not be a "notice . . . of the use of works" under the meaning of Section 115(c)(3)(D). The Copyright Owners' proposed term is within the meaning of Section 115(c)(3)(D), which empowers the Court to "establish requirements by which copyright owners may receive reasonable notice of the use of their works under this section, and under which records of such use shall be kept and made available by persons making digital phonorecord deliveries" and is consistent with the Court's consideration of similar terms in SDARS. 73 Fed. Reg. at 4101. Moreover, as a notice and recordkeeping term, it is well within this Court's jurisdiction under 803(c)(3).

E. Reserves

160. As noted in *Copyright Owners' Memorandum Regarding the Authority of the Copyright Royalty Judges to Set Terms*, Docket No. 2006-3 CRB DPRA, at 3 n.2 (February 22, 2008), the Copyright Owners do not propose a term with respect to reserves.

XI. The RIAA And DiMA May Not Rely On Expert And Lay Witness Testimony That Is Not Supported By Competent Evidence

161. The mere assertions of RIAA and DiMA witnesses absent competent and persuasive evidence should be rejected by this Court.

162. In *SDARS*, this Court rejected SDARS' and Sound Exchange's argument that there was a net substitution/promotion difference between the interactive subscription service benchmark and the SDARS marketplace, holding that the parties had not presented "[an] acceptable empirical basis for quantifying promotion/substitution for purposes of adjusting rates . . . [or] persuasive evidence that would be useful for quantifying the magnitude of this asserted effect or deriving a method for translating such magnitudes into a rate adjustment." SDARS Determination, 73 Fed. Reg. at 4095. This Court went on to hold that the party's "mere assertion[s]" without more, were insufficient. *Id.*; *see also* Webcasting I, 67 Fed. Reg. 45259 (rejecting the testimony of a witness, concerning differential rates for non-commercial broadcasters, who lacked expertise in the area and provided only anecdotal evidence); Webcasting II, 72 Fed. Reg. at 24089 (dismissing witness assertion concerning the necessity of a percentage of revenue rate in the absence of supporting evidence).

163. Likewise, federal courts have rejected expert and lay witness testimony on reliability grounds. In *Johnson* v. *Gordon*, 409 F.3d 12, 25 (1st Cir. 2005), the Court held that the opinion of plaintiff's copyright infringement expert lacked an adequate foundation and therefore was not entitled to any weight. Specifically, the Court found that plaintiffs' expert "had not performed technical analysis of type used by musicologists to detect samples in sound recordings, had not noted existence of sampling in his report, and could not point to sheet music corresponding to relevant sound recordings to indicate

where sampling might have occurred." *Id.* In *JGR, Inc.* v. *Thomasville Furniture Indus, Inc.*, 370 F.3d 519, 525-26 (6th Cir. 2004), the Sixth Circuit held that the District Court had abused its discretion in permitting a lay witness, who had no first-hand knowledge of the retailer's business either as an officer or director and had failed to test the accuracy of the information he was provided, to testify about a company's loss profits and loss business where the witness.

164. In light of the above precedent, this Court should reject much of the testimony of RIAA and DiMA witnesses whose testimony at trial was proven to be unfounded. These instances are set forth in the Copyright Owners' Proposed Reply to the Proposed Findings of Fact of the RIAA and DiMA. We give some examples here.

165. The RIAA argues that record companies have cut all costs except for mechanical royalties. In support of this argument, the RIAA cites Professor Teece's analysis of mechanical royalties as a percentage of record industry wholesale revenue. RIAA PFF ¶ 218-19. The RIAA's reliance on Professor Teece's analysis is undermined by his admissions at trial that he did not know what costs were included in the data on which he based his analysis and the underlying data work was flawed. 2/19/08 Tr. at 3726-29, 3826-28 (Teece). The RIAA also relies on Professor Teece for the proposition that there is downward pricing pressure in the digital market, but have presented no evidence of Professor Teece having conducted a price sensitivity study to support such an assertion. RIAA PFF ¶ 262.

166. Similarly, the RIAA cites Mr. Benson for his digital profitability analysis. RIAA PFF ¶ 316-23. However, as illustrated at trial and in the Copyright Owner's Proposed Findings of Fact, Mr. Benson's numbers are suspect. CO PFF ¶ 449-54. Mr.

Benson in conducting his analysis did not rely on profitability records maintained by the major record labels and did speak to any financial officer of any major label to confirm that he had reached accurate results. *Id.* ¶ 453. Moreover, Mr. Benson's analysis omits the financial results of the majors' distribution companies. *Id.* ¶ 454.

167. The RIAA relies on the testimony of Mr. Rosen to establish that the creation of mastertones is routine. RIAA PFF ¶ 169. But at trial Mr. Rosen conceded that he had no current knowledge of the creation process for mastertones, 02/14/08 Trial Tr. at 3539 (Rosen), and the portions of his written direct testimony that addressed the creative aspects of producing mastertones were stricken from the record. *See id.* at 3549-50.

168. DiMA cites Ms. Guerin Calvert for the proposition that the U.K. Settlement Agreement represent an appropriate benchmark. DiMA PFF 313-14. However, Ms. Guerin-Calvert admitted that she had not conducted an independent analysis of the U.S. and U.K. markets and that the revenue base in the two markets was different. 5/6/08 Trial Tr. at 4972-73, 4874 (Guerin-Calvert). Similarly, DiMA cites Ms. Guerin-Calvert for the proposition that there is downward pressure on prices in the digital market. *See* DiMA PFF ¶ 48. However, Ms. Guerin-Calvert admitted at trial that she had not conducted a demand elasticity study. 2/26/08 Tr. at 4582 (Guerin-Calvert).

XII. Certain of the RIAA's Arguments Are Precluded By The Doctrine of Judicial Estoppel

169. Under the equitable principle of judicial estoppel, "where a party assumes a position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position" in a

subsequent action. *New Hampshire* v. *Maine*, 532 U.S. 742, 749 (2001). This principle is intended to protect the integrity of the judicial process, and may be asserted by litigants who were not parties to the original proceeding. *See Ryan Operations GP* v. *Santiam-Midwest Lumber Co.*, 81 F.3d 355, 360 (3d Cir. 1996) ("[T]he integrity of the court is affronted by inconsistency notwithstanding the lack of identity of those against whom it is asserted."). In this proceeding, the record companies have taken positions that are entirely inconsistent with their arguments they successfully advanced in SDARS and before the Register of Copyrights.[14] The record companies should not be permitted to "play fast and loose with the courts" by deliberately changing positions according to the exigencies of the moment." *New Hampshire*, 532 U.S. at 747, 755 (applying judicial estoppel to bar litigant from advancing an interpretation of a key geographic term that was inconsistent with a prior definition adopted by the court at the litigant's urging).

170. In SDARS, the record companies claimed that "record companies' incentives to produce new music are based on revenues from all available sources" and that therefore, it was vital for them to "receive from each distribution channel revenues that reflect the value of their contributions." 73 Fed. Reg. at 4090, 4096; *see also* SX

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[14] The RIAA and its members companies are bound by SoundExchange's representations in SDARS. The record companies are members of RIAA and are their interests were represented by SoundExchange before this Court in SDARS and Webcasting. Moreover, SoundExchange was formerly associated with the RIAA. *See* Webcasting II, 72 Fed. Reg. at 24014. Courts do not hesitate to find privity among the parties — and to apply estoppel principles — in similar circumstances. *See, e.g., Expert Electric, Inc.* v. *Levine*, 554 F.2d 1227, 1233 (2d Cir. 1977) (individual contractors bound by administrative order involving contractor association); *Astron Indus. Assoc.* v. *Chrysler Motors Corp.*, 405 F.2d 958, 961 (5th Cir. 1968) (parent corporation in privity with its subsidiary and collaterally estopped from challenging an issue previously settled by the subsidiary).

Findings at ¶ 800. The Court relied in part on this representation in rejecting the musical works benchmark offered by the Services. The Court explained that it was not reasonable to assume that record companies would disregard sunk costs in licensing their rights for distribution to the SDARS because "record companies will make future investments decisions based on their best estimates of the revenue sources available to them in the future from all sources." 73 Fed. Reg. at 4090. In the rebuttal phase of this proceeding, which commenced less than one year after SDARS was concluded, the record companies argued the exact opposite. Here they claim that in ringtone and synchronization agreements, the record companies do not seek to maximize their revenues because the costs of creating the underlying sound recordings have already been "sunk." RIAA PFF ¶¶ 866-67. This representation is entirely inconsistent with the representation the record companies made in SDARS. It is also entirely inconsistent with their present argument that the Court should look at all of the revenues that the Copyright Owners receive for other rights. They should be estopped from making it.

XIII. Ringtones Are Outside The Scope Of The Compulsory License

171. The evidence in this proceeding demonstrates that that the creation of mastertones is not a rote process, but a creative one that results in a musically balanced composition. *See* CO PFF ¶¶ 890-906. Nonetheless, the RIAA claims mastertones that are "merely" excerpts of preexisting sound recordings are not derivative works and are therefore within the scope of the Section 115 compulsory license. *See* RIAA PFF ¶¶ 1687, 1705.

172. The RIAA claims that Ms. Finell's analysis of the mastertones presented in this proceeding focused on questions of "creativity and training" rather than

originality, and therefore, that her testimony was inapposite "to determine whether [mastertones] are derivative works." *Id.* at 1705, 1708. Under settled law, however, for a work to be considered derivative, it must be original in that it must have a "requisite level of creativity." The "requisite level of creativity" is "extremely low; even a slight amount will suffice. The vast majority of works make the grade quite easily, as they possess some creative spark, no matter how crude, humble or obvious it might be." *Feist Publ'ns, Inc.* v. *Rural Tel. Serv. Co*., 499 U.S. 340, 346 (1991); *see also Buklew* v. *Hawkins*, 329 F.3d 923, 926, 929 (7th Cir. 2003) (formatting decisions, including "the choice and size of font, the size of cells and columns, whether and where to use color, and the wording of labels and headings . . . and whether to use boldface or italics" may satisfy the originality requirement); *Tempo Music, Inc.* v. *Famous Music Corp.*, 838 F. Supp. 162, 171 (S.D.N.Y. 1993) ("While we agree that melody generally implies a limited range of chords which can accompany it, a composer may exercise creativity in selecting among these chords . . . the choice of chords influences the mood, feel and sound of a piece . . . . We reject the . . . argument that the proper focus in determining originality is not whether the composer exercised 'creative choices,' but on the result of those choices.") (citations omitted). Creativity in the selection of what to include in a compilation or abridgment may satisfy the standard of originality. *See Feist Publ'ns, Inc*., 499 U.S. at 346; *Waldman Publishing Corp*. v. *Landoll*, 43 F.3d 775, 782 (2d Cir. 1994) (holding that the selection of which episodes to include in abridgments of classic books among other things satisfied the originality requirement).

173. It is equally well established that the determination of whether a musical work has the requisite level of creativity to be derivative requires factual findings. *See,*

e.g., Woods v. *Bourne Co.,* 60 F.3d 978, 991 (2d Cir. 1995) (stating that, in determining whether "a work is sufficiently original to be a derivative work," "most courts, including this one, apparently view the process as purely a factual inquiry"). In fact, the Register acknowledged as much in the ringtone decision, but failed to heed the consequences of this rule.

174. As Judith Finell testified, creating the mastertones introduced into evidence in this proceeding required creative musical judgment, including determining which segment of the song to incorporate into the mastertone, selecting the iteration of that segment to use, and determining how best to edit that segment. Finell WRT ¶¶ 43-46. The mastertones themselves – the result of this creative process – are complete, original musically balanced works that stand well on their own and include all the characteristic elements and structures that are found in full-length musical works – facts in direct conflict with the RIAA's contention that the creation of mastertones is routine and that mastertones are mere excerpts and with the Register's ruling – in the absence of any factual findings – that "such excerpts do not contain any originality and are created with rote editing" 71 Fed. Reg. at 64312; *see* Finell WRT ¶¶ 47-49.

175. Apparently recognizing the factual record before the Court conflicts with the Register's ruling, the RIAA argues, without evidentiary support, that ringtones are arrangements under Section 115a)(3). RIAA PCL ¶ 208. As the RIAA concedes, however, the Register ruled that the "arrangement privilege as it applies to mastertones is irrelevant except to the extent that some of these types of ringtones may actually tinker with the style and interpretation of the underlying work." *In re Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding*, 71 Fed. Reg. 64303, 64308 (Nov. 1,

2006) (the "Ringtones Opinion"). She opined that the question of whether particular mastertones may be arrangements is "a factual question, which goes beyond the scope of this proceeding." The RIAA has not presented any factual evidence on the matter that would allow this Court to make factual findings with respect to whether mastertones are arrangements.

Conclusion

For the foregoing reasons, and those set forth in the Proposed Findings of Fact, Proposed Conclusions of Law and Reply to the Proposed Findings of Fact of the RIAA and DiMA, 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 18, 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 18th day of July 2008, I caused true and correct copies of the restricted version of the Copyright Owners' Reply to the Proposed Conclusions of Law of the RIAA and DiMA to be served in hard copy, as well as on CDs containing the same documents in PDF format, via Federal Express on the following parties:

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