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Copyright Royalty Board

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.

In the Matter of MECHANICAL AND DIGITAL PHONORECORD DELIVERY RATE ADJUSTMENT PROCEEDING	)	Docket No. 2006-3 CRB DPRA

RIAA'S BRIEF CONCERNING THE RELEVANCE OF EVIDENCE OF THE COPYRIGHT OWNERS' NON-MECHANICAL STREAMS OF REVENUE

INTRODUCTION

The Recording Industry Association of America ("RIAA"), through its undersigned counsel, respectfully submits this Brief Concerning the Relevance of Evidence of the Copyright Owners' Non-Mechanical Streams of Revenue in response to the Judges' colloquy with counsel for the RIAA yesterday afternoon during trial and the Judges' oral order to file written arguments on this issue. For the reasons set forth below, the Court should not strike any portion of the testimony of RIAA expert witness Terri Santisi, and the Court should allow other testimony concerning the Copyright Owners' non-mechanical licensing revenue.

First, evidence concerning the Copyright Owners' non-mechanical streams of licensing revenue is directly relevant to this Court's inquiry and to each of the four Section 801(b)(1) objectives. The statutory language of the four statutory factors does not put blinders on the Court's consideration of evidence and indeed compels the Court to look not simply at the specific products at issue in the relevant proceeding, but also at the "industries" as a whole. This Court and prior tribunals have repeatedly held as such, both in final decisions and discovery orders. As discussed in more detail below and in the RIAA's prior briefing on this matter, which is attached hereto (Exhibit A -- *RIAA's Opposition to NMPA, SGA, and NSAI's Motion In Limine to Exclude Evidence Relating to Revenues Generated from Non-Mechanical Licenses* (Jan. 18, 2008)),[1] both the Librarian and the CARP in the PES I proceeding and the Copyright Royalty Tribunal (CRT) in the Mechanicals CRT proceeding accepted and relied on evidence concerning copyright owners' income and costs from other products or services that were not at issue in the relevant proceeding in analyzing the statutory factors. This Court has followed this precedent, both in its discovery orders and in its recent SDARS decision.

RIAA recognizes that Congress has made reproduction and distribution rights distinct and separately licensable from other rights like performance. As copyright owners, record companies would never deny that the Copyright Owners here are entitled to appropriate and separate compensation for each of the separate uses made of their works. Nor do we suggest that mechanical rates should go down just because other royalty revenues of the Copyright Owners have recently increased. But Congress has also created the four factors set forth in Section 801(b)(1). That statute tells this Court that mechanical royalties due for certain uses of a work -- and the effects of those royalties on all participants in the process of commercializing a work -- cannot be considered in isolation from other revenues deriving from the same activity and investment of the record companies in creating sound recordings. To the contrary, in Section 801(b)(1) Congress recognized that mechanical royalties are related to other revenue streams and should not be set in ignorance of them.

For example, as discussed below, the Court cannot evaluate whether any potential rate that it might select will "maximize the availability of copyrighted works to the public" without evidence on all of the incentives that go into the creation of musical compositions. Dr. Landes,

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[1] RIAA has attached its Opposition to the Copyright Owners' motion as Exhibit A hereto, and expressly incorporates all of the arguments therein.

the Copyright Owners' own expert, has made this argument repeatedly. Similarly, in the fourth statutory factor Congress specifically required the Court to consider whether the rate it has selected needs to be adjusted in light of the need to minimize disruption of the affected industries. The Court cannot meaningfully make this evaluation absent evidence of the economic condition of each industry *as a whole*, including all revenue streams and how they will be affected by a change in mechanical rates. The other statutory factors similarly compel examination of more than simply the costs and revenues of mechanical-royalty bearing products. To exclude evidence concerning other streams of income in the manner the Court has suggested would contravene the intent of Congress and thus constitute legal error.

Second, consideration of data such as that in Ms. Santisi's testimony is essential to allowing RIAA to rebut the extensive evidence that the Copyright Owners themselves have submitted to the Court about costs and revenues that relate to non-mechanical income sources. Throughout this proceeding, Copyright Owners have put in evidence about their costs without distinguishing between costs attributable to mechanical-royalty bearing products and costs attributable to their other large revenue streams (synch and performance). Similarly, they have put in evidence about their overall revenues and how they relate to mechanical revenues. In addition, they have submitted evidence about all of the record companies' costs and revenues, with no effort made to distinguish between revenues from mechanical-royalty-bearing products and revenues from other products. As discussed in RIAA's response to the Copyright Owners' original motion in limine and below, the record in this case is already laced with evidence on these matters from the Copyright Owners themselves. Were the Court to deny RIAA the ability to rebut these claims by introducing this evidence, it would unfairly prevent it from testing the innumerable claims that Copyright Owners have made about their own costs, risks, and revenues.

Third, while RIAA recognizes the Court's independent right to determine the admissibility of evidence in this proceeding, Copyright Owners have waived the right to object to any of this evidence. As the Court knows, shortly before the direct case hearing, the Copyright Owners filed a motion *in limine* to exclude evidence related to revenues generated from non-mechanical licenses. RIAA opposed that motion, arguing, among other things, that (1) evidence of the Copyright Owners' revenues from non-mechanical licenses was probative of issues raised by numerous of the Copyright Owners' witnesses; (2) this Court had previously held that the Copyright Owners' non-mechanical revenues were relevant; (3) the Copyright Owners' revenues from non-mechanical licenses was relevant to the four statutory factors under Section 801(b). *See RIAA's Opposition to NMPA, SGA, And NSAI's Motion In Limine to Exclude Evidence Relating to Revenues Generated from Non-Mechanical Licenses* (Jan. 18, 2008) (attached hereto as Exhibit A). The Copyright Owners, however, abandoned the motion at trial. They never asked the Court for argument or resolution of the motion, never objected when RIAA submitted such evidence, and in fact introduced considerable evidence about the Copyright Owners' non-mechanical licensing revenue. Copyright Owners cannot now seek to revive this issue.

For all of these reasons, the Court should accept into the record and consider evidence concerning the non-mechanical incomes sources of the Copyright Owners.

DISCUSSION

I. Evidence of the Copyright Owners' Non-Mechanical Revenues Is Relevant Under Each of the Four Section 801(b)(1) Objectives.

Evidence of music publishers' and songwriters' non-mechanical licensing revenues is relevant to the analysis required by the four statutory objectives of Section 801(b)(1) and therefore admissible. Section 801(b)(1) does not limit the scope of this Court's inquiry to quantifying and assessing the impact of mechanical royalty revenues alone. Certainly Section 801(b)(1) contains no language expressly imposing such a cramped limitation on the scope of the Court's inquiry. To the contrary, Section 801(b)(1) identifies in broad terms an array of policy objectives, including "maximizing the availability of creative works to the public," providing a "fair return" and a "fair income" under "existing economic conditions," reflecting the "relative roles of the copyright owner and the copyright user" with respect to sound recordings of musical works, including their costs, investments, and risk, and minimizing the disruptive impact of rate changes "on the structure of the industries involved." 17 U.S.C. § 801(b)(1). The breadth of these provisions makes clear that Congress did not intend this Court to blind itself to non-mechanical licensing revenues that make up more than half of the music publishers' and songwriters' revenue today.

Indeed, non-mechanical revenues are so intertwined with the evidence in this proceeding concerning mechanical royalty revenues that it would be virtually impossible as a practical matter to extract it – and would create a factual record that is at odds with the books and records of the parties. For example, while revenues of the music publishers can fairly readily be sorted into mechanical and non-mechanical categories, the same is not true for publisher expenditures. In no instance to date have the Copyright Owners sought to separate out the money that they invested in writer advances, other forms of A&R or licensing activities of publishers, or the activities of writers into money invested in generating mechanical royalty revenue and money invested in generating other forms of licensing revenue from the same musical works. Nor is there any reason to think that they could. Yet because the same core investments on average yield more non-mechanical revenue than mechanical revenue the failure to sort out these expenditures would cause publisher investments to be greatly overstated in comparison with their returns, distorting the outcome that the four factor test would yield.

Evidence depicting the complete financial situation of the participants has routinely been admitted in royalty rate proceedings. Indeed, in the first mechanical royalty rate-setting proceeding, the Copyright Royalty Tribunal ("CRT") expressly *ordered* music publishers to compile and submit "representative aggregate data concerning the financial condition of the music publishers." *Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords*, 46 Fed. Reg. 10466, 10467 (Feb. 3, 1981) ("1981 Mechanicals Decision"). This data was to include, among other things, "[d]omestic and foreign revenues from mechanical royalties, performance fees, [and] print license revenues." *Id.* at 10475.[2] *See also Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25394, 25408 (May 8, 1998) ("1998 DPRSRA Decision") (approving of Copyright Arbitration Royalty Panel's consideration of "[Copyright Owners'] revenues generated from the exercise of other rights granted to them under the Copyright Act" in order to "demonstrate the financial health of the industries").

As discussed below, the Copyright Owners' non-mechanical revenues are relevant to each of the four Section 801(b)(1) factors.

A. Maximizing Availability.

The non-mechanical licensing revenues of Copyright Owners are relevant to determining the royalty rate that will "maximize the availability of creative works to the public." *See* Section

[2] Because the particular information eventually received from music publishers proved to be "not a reliable indicator of the financial condition or profitability of the music publishing industry" due to methodological shortcomings in the NMPA's compiling of the data, *id.* at 10483, the CRT eventually determined that the information did not provide clear guidance under the facts of that case. *Id.* Nonetheless, the CRT did not hesitate to emphasize that "it was valuable for the Tribunal to be aware of the financial status of copyright owners and users." *Id.*

801(b)(1)(A) (the first factor). Prior tribunals have held that this policy objective relates directly to the production of creative works that are released to the public, 1981 Mechanicals Decision, 43 Fed. Reg. at 10479, and this Court's analysis in the SDARS case is consistent with this focus on incentives. Of note, in the SDARS decision, the Court focused on issues related to potential promotion of, or substitution for, other revenue streams in its discussion of the incentives to create and make available new works. In so doing, the Court looked at the evidence concerning the impact of the SDARS service on other revenue streams not subject to the statutory license at issue in that proceeding. *In the Matter of Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, No. 2006-1 CRB DSTRA Fed. Reg. 4080, 4095 (Jan. 24, 2008) ("SDARS Decision"). This Court also relied upon and quoted Dr. Ordover's analysis that "[copyright owners'] incentives to produce new music are based on revenues from *all* available sources." SDARS Decision, 73 Fed. Reg. at 4090 (emphasis added).

The Court's observation in SDARS was correct as a matter of economic theory and simple common sense. First, it is not possible to determine a rate that will maximize the availability of works to the public without understanding the broader economic context in which songwriters and music publishers operate. Songwriters do not make decisions about whether to create musical works based solely on the possibility of earning mechanical royalties; they take into account the full spectrum of royalties that may be available to them as a result of their creative endeavors. That is a concept that is widely understood among economists, including even the Copyright Owners' main expert witness, Dr. Landes, who testified in the direct case that "mechanical royalties are not the only determinant of the 'availability of creative works to the public' because creators also receive compensation from other sources." CO Trial Ex. 22 (Landes Amended WDT ¶ 30). Indeed, as discussed below, the relevance of other royalty streams is particularly relevant here because those royalty streams result directly from the creation of sound recordings.

Similarly, it is not possible to set a rate that will maximize availability of creative works to the public without taking into account the impact of that rate on recorded music companies – companies that are essential to making creative works available by their creation and distribution of sound recordings. If the mechanical royalty rate were set so high that it led recorded music companies to cut back on the number of musical works they record, it would lead to a *reduction*, rather than an increase, in the availability of creative works to the public – an outcome that would of course frustrate the objective of Section 801(b)(1)(A).

In considering the incentives motivating writers, publishers *and* record companies to make works available to the public, it is essential to recognize that there is a fundamental imbalance between record companies and the Copyright Owners in terms of their dependence on the sale of copies of sound recordings of musical works. Recorded music companies earn roughly 90 percent of their revenues from sales of musical works resulting in payment of mechanical royalties, while songwriters and music publishers get less than half their revenues from mechanical royalties. CO Trial Ex. 41, at RIAA_0008423 (record companies); RIAA Trial Exhibit 78 (Santisi WRT Table A) (publishers). It follows that an increase in the mechanical rate may have a greater effect on the incentives motivating record companies than a reduction would have on the incentives of songwriters or publishers. Unless the Court takes this differential into account, it could set a rate that, perversely, causes a net reduction in the availability of musical works to the public – precisely the opposite of what Congress intended in the first Section 801(b)(1) factor.

B. Fair Return and Fair Income under Existing Economic Conditions.

The Copyright Owners' non-mechanical revenue is also relevant to the "fair return" to copyright owners under Section 801(b)(1)(B). This objective is stated broadly, and requires consideration of "existing economic conditions" -- all applicable economic conditions, not just a small subset of them. The CRT has, in fact, expressly so held. *See* 1981 Mechanicals Decision at 10483 (noting that, notwithstanding methodological limitations of the data in that case, it was "valuable" to have data on the financial status of copyright owners in considering "how to balance fair return as against fair income.").

The reason why it is necessary to take into account other streams of revenues when balancing fair return for Copyright Owners and a fair income for recorded music companies is that songwriters, publishers and record companies alike devote resources to the creation of creative works that produce no revenue for any of them until the finished sound recording is produced, distributed and marketed. But when that happens, they all enjoy multiple streams of revenue (writers and publishers to a much greater degree than record companies).

To be clear, the investments of the recorded music companies lead *directly* to additional streams of revenue for songwriters and publishers. As the testimony of Ms. Santisi explained, a songwriter whose work is incorporated into a sound recording released to the public by a record company will not only earn mechanical royalty revenues, but may also earn performance revenues from radio and concerts and synchronization revenues from the use of the work in movies or TV – revenue that is in large measure generated from the use of the sound recording that was created and distributed in the first place by the record company. Santisi WRT at 18-19. Moreover, the creation of a recording and the record company's efforts to market it – efforts that, as Ms. Santisi demonstrated, can require the investment of millions of dollars for a single release, *id.* at 12 – often lead to revenue not involving the sound recording. For example, songwriters and music publishers can earn revenue from the sale of lyrics and sheet music, from the merchandising of products containing lyrics or music, and from live performance of the work because the record company made the song popular. These revenues would not exist were it not for the recorded music company's efforts to market and popularize the sound recording. *Id.* at 19. Yet while record companies spend substantial sums of money to create and market sound recordings, operating at razor-thin profit margins, music publishers and songwriters have reaped the benefits of those efforts in the form of rapidly rising performance and synchronization revenues, leaving music publisher profit margins in a range as high as 24 to 32 percent, Tr. 5/7/09 at 5101 (rough).

A proper reading of the second statutory factor compels the conclusion that this overall picture should be considered in this proceeding. Where recorded music companies, through their investments, create, market and popularize a sound recording and enable songwriters and publishers to reap the benefits of multiple revenue streams, a fair return and fair income cannot be determined if the economics of the whole enterprise of writing and acquiring musical works, producing and marketing recordings of them, and then exploiting both the musical works and sound recordings in multiple ways is not taken into account. Any other approach, for example, could lead to absurd results in circumstances where mechanical revenues have been going down but performance revenue is increasing due to a shift in the preferred forms of consumption of music. A court focused solely on mechanical rates might respond by raising rates, even though a broader perspective would show that such a change is unwarranted.

Finally, as the Court recognized in the SDARS case, products or services subject to the statutory license may have a promotional or substitutional impact on other revenue streams, which might impact both the first and second statutory factors. SDARS Decision, 73 Fed. Reg. at 4094-96. There is no legitimate dispute in this case that the creation of sound recordings for sale through products such as CDs and digital downloads promotes the other revenue streams (such as synch and performance) that music publishers and composers enjoy; absent a mechanical license and creation of the sound recording from a composer's musical composition for sale, those other revenue streams would not exist for the composer. As Dr. Slottje explains, as an economic matter, mechanical licensing actually promotes other forms of revenue generation for music publishers and songwriters. Slottje WRT at 16. Dr. Landes appears to agree (albeit only with respect to first uses), explaining that mechanical licensing the first use of a sound recording "cannot be understood apart from the expected future licensing revenues they make possible." Landes WRT at 41.

C. Relative Roles, Contributions and Risks.

Evidence concerning the parties' revenue from non-mechanical licensing is also critical to a determination of the relative risks and contributions of the parties in the mechanical licensing context. Section 801(b)(1)(C) broadly requires the Court to set a rate that achieves the objective of "reflect[ing] the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication." Prior tribunals and this Court's decision in the SDARS case have made clear that evidence concerning the parties' revenue from non-mechanical licensing is relevant to this factor in several ways.

First, the Court cannot accurately evaluate the relative risk taken by the record companies, music publishers, and songwriters in the creation of a mechanical copy of a sound recording without evaluating the relative importance of mechanical royalties to their total income. As the Copyright Owners' own expert, William Landes, has testified, "A music publisher's revenue reflects the return to a diversified portfolio of songs and songwriters, and *it is a well known theorem of finance theory that a diversified portfolio of independent risks will be less risky than any individual component of that portfolio.*" Landes WRT ¶ 23 (emphasis added). Similarly, Dr. Landes testifies that "economics also supports shifting a greater burden of the risk to a party if that party is better able to diversify that risk than are others." Landes WRT ¶ 37. These principles dictate that in evaluating how much risk the Copyright Owners are taking with respect to their investments in the creation of songs, the Court should not look at mechanical royalty income in isolation, but as part of a risk portfolio. That portfolio, for the songwriters and music publishers, includes substantial revenues from performance, synchronization and other uses that reduce the risk that their investments in songs will be negatively affected by market conditions affecting mechanical uses.

For similar reasons, in the PES I proceeding, the Librarian focused *not* solely on the risks incurred by the record companies in activities related to the statutorily licensed service, but on a broader evaluation of risk and a broad range of evidence about the record companies' business. Thus, in assessing the risks that the record companies faced, the Librarian concluded that the copyright owners in that case had "adapted to the vagaries of the music business, and as an industry, have shown consistent growth in units shipped and dollar value of records, CDs, and music videos from 1982-1996." 63 Fed. Reg. 25394, 25407 (May 8, 1998) ("PES I Librarian's Decision"). The Court's decision in the SDARS proceeding appears consistent with this approach, as the Court did not separate out risks related to the SDARS' music business from its non-music programming, but focused on the risks to the entire business, including statutory and non-statutory components. SDARS Decision, 73 Fed. Reg. at 4096-97.

Second, evidence concerning the Copyright Owners' revenues from non-mechanical licensing is relevant to the Court's comparison of the Copyright Owners' costs and investments relative to those of the record companies. The minimal investments that the Copyright Owners make on average result in more non-mechanical revenue than mechanical revenue. Thus, those investments can only be assessed when compared against their diversified revenue streams. In contrast, the relatively substantial investments that the record companies undertake become even larger when measured against their revenue base, which depends overwhelmingly on revenue from the sale of sound recordings. The Court cannot gain an accurate understanding of the relative significance of the parties' costs and investments unless they are viewed relative to the parties' very different revenue portfolios.

Third, as to the relative contribution of record companies, the publishers' non-mechanical income is relevant because it arises out of the record companies' efforts to develop, create, invest in, and market sound recordings. Were it not for the sound recording that is created by the record companies and distributed by them to the public at large, there would be far less of a market for synchronization and performance licenses in the first place. Thus, because they derive from record company investments, the publishers' non-mechanical income is relevant as additional evidence of the relatively greater contribution of record companies.

Fourth, as to the opening of new markets for creative expression, the Copyright Owners' non-mechanical revenue streams are directly relevant as evidence of the record companies' efforts to open new markets from which the Copyright Owners benefit. Thus, in the PES I proceeding, the CARP looked at whether the PES would open markets for record companies by assisting them in growing other revenue streams, not just revenues from the PES. Similarly, the Librarian focused in detail on how the activities of the PES affected the other revenue streams, such as sales of CDs. PES I Librarian's Decision at 25407. Here, the record companies' activities are the source of the vast majority of the Copyright Owners' revenues -- including old and new markets for music.

D. Disruption of the Structure of the Industries.

The financial condition of the Copyright Owners is also relevant to the "disruption" factor under Section 801(b)(1)(D). Notably, this objective calls upon this court to consider "the structure of the industries involved," not just one line of business. If Congress had intended this Court to limit its inquiry to disruption in the particular revenue stream at issue in the proceeding, it would have said so, and not directed this Court to consider the much broader structure of the industries.

Thus, in the SDARS case, for example, the Court focused on what it perceived the SDARS could afford to pay -- based on the entirety of their current business model, including statutory and non-statutory services. SDARS Decision, 73 Fed. Reg. at 4097-98. And in the PES I proceeding, the Librarian upheld the CARP's analysis of the disruption factor, which explicitly focused on the revenue sources of the record companies other than those from the statutory license at issue. The CARP had found no likelihood of disruption to the record companies because the record companies had other revenue streams of sufficient size that a low rate would not harm them. PES I Librarian's Decision, 63 Fed. Reg. at 25408 (discussing analysis of non-statutorily licensed revenue streams).

Similarly here, determining disruption requires an evaluation of non-mechanical income to accurately assess the total health of the music publishing and songwriting industries.

Otherwise, it is impossible to establish what disruptive impact, if any, will occur from a particular rate change. Failing to consider non-mechanical income would skew this Court's vision of the Copyright Owners by implausibly suggesting that publishers and songwriters only or primarily rely on mechanical royalty income. Evidence that songwriters and music publishers enjoy high revenues and profits from several sources, the very evidence that the RIAA presents, provides a more accurate picture of how the music publishing industries operate – as robustly profitable enterprises cushioned by the collection of multiple streams of income. RIAA has never suggested that copyright owners are not entitled to mechanical royalties because they earn performance and synchronization revenues. Rather, RIAA seeks to use the financial condition of the relevant industries in precisely the way Congress intended when it created the fourth Section 801(b) factor

II. The Record in This Proceeding Demonstrates the Relevance of Evidence Concerning <u>All</u> of the Copyright Owners' Streams of Licensing Revenue.

Given the relevance of the Copyright Owners' non-mechanical income streams to the Section 801(b)(1) factors, it is unsurprising that the Copyright Owners themselves have already moved into evidence huge volumes of evidence concerning their various income streams.

In their written direct case, the Copyright Owners saturated the record with evidence concerning their non-mechanical costs and revenues. RIAA previously documented this evidence in its Opposition to the Copyright Owners' motion *in limine*. *See, e.g.* Exhibit A, at 5 (providing examples of Copyright Owner testimony about non-mechanical revenue); Exhibit A, at 9 (providing examples of Copyright Owner testimony concerning their overall costs). The Copyright Owners did not limit their presentation of financial data to the costs and revenues associated with mechanical licensing. To the contrary, they offered extensive testimony on the allegedly declining *overall* revenues and costs of songwriters and publishers. *See* Exh. A, at. 6-

10 (collecting references to Copyright Owner testimony). In addition, the Copyright Owners submitted testimony about the *record companies'* non-mechanical revenues. *See* Exhibit A, at 9-13.

During the direct case hearing, the Copyright Owners likewise presented several witnesses who testified about the non-mechanical revenues earned both by publishers and songwriters. *See, e.g.*, 1/28/08 Tr. 226:3-226:11 (Carnes); 1/28/08 Tr. 227:7-228:12 (Carnes); 1/28/08 Tr. 230:16-231:16 (Carnes); 1/29/08 Tr. 544:16-547:5 (Faxon); 1/29/08 Tr. 580:7-581:20 (Faxon). Furthermore, the Copyright Owners examined RIAA witnesses on the issue of non-mechanical income received by record companies. *See, e.g.*, 2/26/08 Tr. 4756:6-4757:14 (Munns).

Indeed, the Copyright Owners moved into evidence testimony from their main expert witness that their non-mechanical revenue streams are relevant to the first statutory factor (maximizing the availability of creative works to the public). Professor Landes testified that "mechanical royalties are not the only determinant of the 'availability of creative works to the public,' because creators also receive compensation from other sources (such as performance royalties)." CO Trial Ex. 22 (Landes Amended WDT ¶ 30).

The Copyright Owners introduced all of this evidence about their non-mechanical revenue into the record without objection by the RIAA or the Court. RIAA also submitted evidence about the Copyright Owners' non-mechanical revenue streams. Although the Copyright Owners initially filed a motion *in limine* to exclude some of that evidence, the Copyright Owners effectively waived that argument by failing to ask the Court for argument on or resolution of that motion. For instance, the Copyright Owners failed to object to Dr. Teece's direct testimony about the publishers' rising non-mechanical royalties and diversified revenue streams compensate for any decline in mechanical royalties. *See, e.g.*, 2/19/08 Tr. 3657-3660 (Teece).

In rebuttal, the Copyright Owners have continued to pursue a strategy of presenting extensive testimony about the non-mechanical sources of revenue for both publishers and songwriters. For example, in his written rebuttal report, Professor Landes testifies at length about the *total* royalties going to songwriters, recognizing that mechanical revenues alone do not provide a complete picture of songwriters' relevant income. *See, e.g.*, Landes WRT ¶¶ 17-21, Figures 4a, 4b, 5a, 5b, 6, 7, 8, 9. Figures 8 and 9 specifically depict songwriters' mechanical royalty income relative to their total royalty income. Dr. Landes's testimony is thus comparable to Ms. Santisi's testimony in that it examines music publishers' mechanical revenue relative to music publishers' total revenue. Both experts examine the Copyright Owners' mechanical royalties relative to their overall royalties.

Similarly, the Copyright Owners' witness Mr. Faxon asserts in his written rebuttal testimony that an increase in the mechanical rate is necessary to create incentives for the creation of new musical works by songwriters. *See* Faxon WRT ¶ 3. RIAA must be allowed to test that assertion by introducing evidence of the many alternative revenue streams that provide incentives to create new musical compositions, making an increase in the mechanical rate unnecessary. Ms. Santisi's rebuttal testimony provides this Court with quantifiable evidence that such a rate increase is not necessary to create incentives for the creation of new creative works and not justified by the relative contributions and risks of the parties. Accordingly, like all of the similar evidence admitted by the Court in the direct case, Ms. Santisi's testimony should remain part of the record.

Because the Copyright Owners were allowed to present extensive evidence of their non-mechanical revenue streams into evidence during the direct case – and have submitted rebuttal testimony that contains similar evidence – it would be fundamentally unfair to strike the testimony of Ms. Santisi and other RIAA witnesses that is designed to rebut that evidence. To strike RIAA's rebuttal testimony would be to deny RIAA the opportunity to rebut the Copyright Owners' direct case and would result in an unbalanced record.

CONCLUSION

For the foregoing reasons, the Court should not strike any portion of the testimony of RIAA expert witness Terri Santisi, and the Court should allow other evidence related to the Copyright Owners' streams of non-mechanical license revenue into the record.

Respectfully Submitted,

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May 8, 2008

CERTIFICATE OF SERVICE

I hereby certify that on the 9th day of May 2008, I caused a true and correct copy of the foregoing **RIAA'S BRIEF CONCERNING THE RELEVANCE OF EVIDENCE OF THE COPYRIGHT OWNERS' NON-MECHANICAL STREAMS OF REVENUE (PUBLIC VERSION)** to be served upon the following by electronic mail:

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Exhibit A

PUBLIC VERSION

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Copyright Royalty Board

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.

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

RIAA'S OPPOSITION TO NMPA, SGA, AND NSAI'S MOTION *IN LIMINE* TO EXCLUDE EVIDENCE RELATING TO REVENUES GENERATED FROM NON-MECHANICAL LICENSES

INTRODUCTION

The Recording Industry Association of America ("RIAA") respectfully submits this opposition to the motion *in limine* of the National Music Publishers' Association, Inc. ("NMPA"), the Songwriters Guild of America ("SGA"), and the Nashville Songwriters' Association International ("NSAI") (collectively, "Copyright Owners") to exclude evidence relating to revenues generated from non-mechanical licenses.

The Copyright Owners' motion seeks to create an unreasonable double standard. The Copyright Owners cannot seriously dispute the probative value of their revenues from non-mechanical licenses given that they have themselves introduced their overall revenues as an issue in this proceeding in an attempt to paint a (false) picture of their alleged financial hardship. At the same time that they seek to strike testimony from RIAA concerning the Copyright Owners' other revenue streams, the Copyright Owners are themselves trying to introduce such evidence. They cannot have their cake and eat it too. In addition, the Copyright Owners attempt to dump data into the record, through their witness Helen Murphy, about all of the record companies' revenues (including from sources other than products which require the payment of mechanical royalties) in an effort to show (incorrectly) that the record companies are doing just fine.

The Copyright Owners' attempt to exclude evidence of their non-mechanical revenues is both dramatically unfair and wholly inconsistent with this Court's prior decisions and other cases litigated under Section 801(b)(1). The Copyright Owners cannot be permitted to make their own financial condition a central point of their direct case and then seek to exclude evidence that contradicts the conclusions they draw. Indeed, in granting RIAA's discovery motions seeking revenue information from the Copyright Owners in this proceeding, this Court has already held that such information is directly related to the Copyright Owners' written direct statement.

The evidence the Copyright Owners seek to exclude is plainly relevant to the four statutory factors under Section 801(b)(1). In the 1981 Mechanicals proceeding, the Copyright Royalty Tribunal found that information about music publishers' financial condition was relevant under Section 801(b), and there is no reason to reach a different conclusion now. The motion is nothing more than an attempt by the Copyright Owners to shield from the Court's eyes the fact that the Copyright Owners are in vastly better financial health than the record companies, and to prevent the development of a record that squarely contradicts the Copyright Owners' claims of financial difficulties. Indeed, documents produced from the Copyright Owners' own files plainly show that publishers' and songwriters' performance and synchronization revenues have remained immune to the financial hardships that have plagued record companies. The Copyright Owners want to prevent the Judges from hearing testimony on these matters or, apparently, reviewing this information because it will undermine their claims. That is not, of course, a valid basis for excluding information from the record.

In addition, this Court should reject the Copyright Owners' motion because it falls far short of satisfying the standard set by Federal Rule of Evidence 403. Under that rule, a trial court has the discretion to exclude evidence if "its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence." Here, not only is the information probative of the Copyright Owners' testimony about their financial condition and of the Section 801(b) factors, but the Copyright Owners have not even tried to show (nor could they) that information about their non-mechanical license revenue would result in unfair prejudice, confusion or delay. The motion should be denied.

BACKGROUND

The Copyright Owners' motion, on its face, is difficult to fathom. After submitting extensive testimony about their own overall costs and revenues, and seeking massive discovery into all record companies' revenues in this case, the Copyright Owners now claim that financial data about some of their revenues should be off-limits.

The reason they take such a wholly inconsistent position is obvious: the Copyright Owners do not want the Court to know that they are doing vastly better financially than the record companies. While record companies are facing declining revenues and are laying people off because of rapidly declining sales, the Copyright Owners have increasing revenues, have continued to have large margins, and are largely insulated from the difficulties the record companies are facing. The Copyright Owners want to hide the fact that a significant decrease in the rate would have little impact on their business.

The Copyright Owners' attempt to exclude their own financial data highlights a fundamental aspect of the music industry over the last many decades, which will be the subject of much testimony by witnesses on both sides of this proceeding: the division of labor between the record companies and the music publishers. As the written direct cases demonstrate, record companies undertake the vast majority of the investment, cost, and risk in making sound recordings and it is the sound recording from which both record companies and music publishers earn their revenues, whether through sale, performance, synch, or otherwise. Although record companies make the vast majority of the investments, they are denied revenue from important and significant forms of consumption, notably performance of those works.

All of that effort and expense by the record companies redounds to the benefit of the Copyright Owners because they earn money both from sales of sound recordings and from their performance -- including in many contexts where record companies are prohibited from earning revenue (such as terrestrial radio performances). Virtually all of the Copyright Owners' revenue streams are dependent on the labor of the record companies, including mechanical royalties, much of synch licensing, and much of the performance revenue. By comparison, music publishers invest very little themselves, living comfortably as an annuity business.

The division of labor in the music industry has many important ramifications for this proceeding, including the following: 1) record companies make most of the investments, face most of the risk in the music industry, and suffer the most when sales are down, and 2) music publishers invest little and are insulated from much of this risk because of their diversified revenue streams which do not depend on sales (and thus do not depend on mechanical royalties). Thus, it should hardly be a surprise that the evidence in this proceeding will show that the Copyright Owners are earning far higher margins and are in far better financial shape than the record companies. By this motion, the Copyright Owners seek to hide this reality from view.

DISCUSSION

I. Evidence of the Copyright Owners' Revenues from Non-Mechanical Licenses Is Probative of Central Issues in This Proceeding.

A. The Copyright Owners Have Raised the Issue of Their Non-Mechanical Revenues by Submitting Testimony About Those Revenues.

The Copyright Owners' written direct case repeatedly makes the claim that they are entitled to a higher rate because their mechanical royalty revenue is declining *as a share of their overall revenue from all sources*. *See* Landes Amended Expert Report ¶ 30 ("mechanical royalties are an important, but declining percentage of total royalties earned"); *id.* Figs. 1-3 (showing percentage of writer and publisher income attributable to mechanical, performance and synchronization licensing); Robinson WDT ¶ 19 (claiming that Famous Music's "total revenues from mechanical royalties has also decreased" as a percentage of "our total revenues" from 1998 to 2006); Firth WDT ¶¶ 54, 59 (comparing BMG Music Publishing's mechanical revenues as a percentage of total revenues for the time periods 1995-2001 and 2005); Firth WDT ¶ 26 (discussing advances as a proportion of "total revenue"); Israelite WDT at ¶ 48 ("the share of revenue derived from mechanical royalties no longer matches the effort required to earn mechanical royalties").

As RIAA will show, that mechanical revenues are down as a percentage of overall revenues provides no economic or other justification for an increase in the mechanical rate. Indeed, the Copyright Owners' claim merely highlights the fact that they are earning dramatically more from other revenue streams -- such as synch and performance of sound recordings. The large and growing revenues that the Copyright Owners receive from other sources 1) are principally dependent (as mechanical royalties are) on the creative efforts and financial efforts of the record companies (relevant to the third statutory factor); 2) show that there are ample incentives to create musical works if the Court reduces the mechanical rate, as RIAA believe is necessary (relevant to the first statutory factor); 3) minimize the risk that Copyright Owners face in the marketplace because of their more diversified revenue streams (relevant to the third statutory factor) and 4) show that a reduction in the royalty rate will not disrupt the Copyright Owners' operations in any meaningful way (relevant to the fourth statutory factor).

In any event, it is the Copyright Owners who have injected their overall revenues into this case to support their contention that the mechanical royalty rate should be increased. It is wholly unfair to hamstring RIAA from presenting evidence on precisely the same issues. Evidence of non-mechanical revenues is essential to refute the constant refrain in the Copyright Owners' testimony that revenues are down, songwriters are facing financial struggles, and the vitality of their industry is threatened as a result. Though woefully lacking in evidentiary support, that theme has been advanced in this case repeatedly by the music publisher and songwriter witnesses. *See, e.g.*, Israelite WDT ¶ 13 (increase in mechanical royalties is necessary "to ensure the continued vitality of American music."); *id.* ¶ 48 (songwriters make "the same level of effort for a smaller financial return"); Peer WDT ¶ 59 ("In recent years, fewer and fewer pure songwriters have been able to make an adequate living from songwriting"); Firth WDT ¶ 60 ("the tribunal has the opportunity to correct this historical injustice"); Doyle WDT ¶ 41 (although costs continue to increase, "our revenue, based primarily on the mechanical royalties we receive, has not been keeping pace"); *id.* ¶ 50 ("every year proves harder for us financially"); Carnes WDT ¶ 11 ("[T]he vast majority of professional songwriters live a perilous existence. In fact, American songwriters have endured decades of decline."); Paulus WDT ¶ 14 ("Not many composers of serious music can rely on the proceeds of their compositions to make a living.");

id. ¶ 19 ("We need an increase in the mechanical royalty rate so that we can keep creating."); Bogard WDT ¶ 15 ("it is getting harder and harder for professional songwriters to build a career"); Friedman WDT ¶ 6 ("the American songwriter has faced steady declines in sales and opportunities and increasing difficulties").

Notwithstanding this steady drumbeat in the Copyright Owners' testimony, the evidence disclosed in discovery shows that increases in performance and synchronization revenue outweigh any alleged decreases in mechanical revenue and that overall revenues are *up*. The Copyright Owners assert that the vitality of their professions is at risk – but the evidence disclosed in discovery shows that they (in stark contrast to the record companies) are generating enviable profits. The Copyright Owners' motion is nothing more than an effort to ask the Court to accept their unsupported assertions about their financial condition at face value and to exclude evidence that contradicts and discredits their claims.

Evidence contradicting the Copyright Owners' claims -- all of which they now want the Court to ignore -- is overwhelming. Information produced by the Copyright Owners in discovery confirms that while record companies have suffered greatly in recent years, the situation is precisely the *opposite* for the major music publishers. The information shows that publishers have experienced substantial increases in overall revenues – much of it performance revenues and revenues from "the vibrant and burgeoning market for film, television, commercial and video game synch licenses." Firth WDT ¶ 59.

For example:

- EMI Music Publishing: Its performance and synch income have [[redacted]] *from FY2000 to FY2007. During that period,* EMI MP's overall revenues have [redacted]]. CO04024775-4777.[1]

- BMG Music Publishing: Overall North American revenues [[redacted]] from 2003 to 2005, and US licensing revenues ([[redacted]] in performance and synch) are expected to [[redacted]]. CO05006916; CO09008681; CO05005948. North American profits [[redacted]], and US profits are expected to continue to [[redacted]]. *Id.*

- Universal Music Publishing Group: US revenues and profits [[redacted]]. Performance and synch were [[redacted]] During that time period profits went from [[redacted]]. CO09011653; CO09011173; CO09014265.

- Sony/ATV: From 2000 through 2007, overall revenues [[redacted]]. Performance revenues [[redacted]]. CO07004889; CO07004903; CO07004917.

- Warner/Chappell Music: Complete US financials were not disclosed, but from 2002 through 2007 (as forecast mid-year), total worldwide revenues [[redacted]]. Over this same period, there was a [[redacted]]. CO08003872-3873.

- Famous Music Publishing: From 2001 to 2006, overall revenues [[redacted]]. This is explained by [[redacted]] over the same time period. CO02000636-0641.

[1] Portions of this brief contain discovery material that was designated "Restricted" by the Copyright Owners under the Protective Order. Pursuant to Paragraph 10(c) of that Order, RIAA is submitting copies of the affidavits and Rule 11 certifications served on RIAA by the Copyright Owners in connection with the cited discovery materials. This brief does not contain material designated "Restricted" by RIAA.

B. The Copyright Owners Contend That All of Their Costs Are Relevant and Those Costs Can Only Be Evaluated Against All Revenues.

Although the Copyright Owners contend in their motion that non-mechanical revenues are unrelated to this proceeding, they have not hesitated in their written direct case to emphasize music publishers' overall *costs* as a justification for increasing the mechanical royalty rate. *See* Robinson WDT ¶ 19 (declines in mechanical royalties "have been coupled with a variety of increased costs"); Peer WDT ¶ 14 ("We expend considerable time and money on finding new talent"); *id.* ¶ 51 (higher mechanical royalty rates are "necessary for publishers such as Peermusic to continue their critical role in the creation of new music"); Firth WDT ¶ 26 ("maintaining a roster of songwriters requires a significant capital investment by the music publisher"); Doyle WDT ¶ 41 ("Providing the services we provide to songwriters, and providing them well, is an expensive endeavor."); Faxon WDT ¶¶ 12-23 (discussing array of costs incurred by EMI Music Publishing in making musical works available).

Many of these expenditures will inevitably yield benefits in the form of non-mechanical royalty revenues, and those revenues are relevant to assessing the extent of the alleged costs. Indeed, the costs are frequently expressed as a percentage of the publishers' total revenues. *See, e.g.*, Faxon WDT ¶ 16 (discussing costs of advances as a percentage of revenues). Where the Copyright Owners are citing their costs in support of the need for an increased royalty rate, fairness requires that their revenues be included in the record as well. The Court should not make a decision on the basis of one side of the ledger but not the other.

Finally, many of the Copyright Owners' witnesses expressly highlight their efforts to seek out non-mechanical royalty revenues. *See, e.g.*, Robinson WDT ¶ 31 ("an important component of our promotional efforts involves seeking out synchronization, performance and other non-mechanical licensing opportunities, which are often useful in generating interest in our compositions"); *id.* ¶¶ 32-33 (discussing Famous' synch licensing practices); *id.* ¶ 55 (discussing Famous' efforts to register "cue sheets" for film and television shows); *id.* ¶ 56 (discussing efforts to track licenses and collect royalties, including for "synchronization" licenses); Peer WDT ¶ 38 (Peermusic's efforts to seek synchronization uses shows that "our commitment to our songwriters and their works never ends"); *id.* ¶ 43 (discussing Peer's licensing of its songs in the form of digital sheet music); *id.* ¶ 44 (discussing Peer's efforts to collect "performance" revenues); Firth WDT ¶ 40 ("[a]n important tool in promoting our songs and our songwriters is finding synchronization opportunities"); *id.* ¶ 47 (discussing BMG Music Publishing's "employees dedicated to negotiating synch licenses and . . . employees dedicated to drafting synch agreements"); *id.* ¶ 48 (noting "vastly increased" universe of songs available for synch licensing as opposed to "a few years ago"); *id.* ¶ 51 (highlighting BMG MP's efforts to distribute song lyrics on the internet "and thus assure that songwriters are compensated for their written compositions"); Faxon WDT ¶ 21-22 (EMI Music Publishing's efforts to develop synch licensing opportunities for songwriters included among list of "investments that usually are made at a significant risk"); *id.* ¶ 27 (highlighting synch licensing and other non-mechanical licensing opportunities sought on behalf of Alicia Keys); Doyle WDT ¶¶ 31-32 (at Major Bob, negotiation of synch licenses is among the "investments we make" to the development and promotion of songwriters); Carnes WDT ¶ 23 (one of the benefits provided by music publishers is that they "promote songs for use in television shows, movies and other media that enable songwriters to earn synchronization royalties").

Copyright Owners cannot emphasize their efforts to earn non-mechanical royalties, claim that they are part of their investment or contribution, and then claim that the revenues to be earned therefrom are irrelevant. This is not only a matter of relevance, but of fundamental fairness. The Copyright Owners cannot claim credit for their expenditures on non-mechanical activities yet seek to exclude evidence of the revenues those expenditures generate.

C. The Copyright Owners Rely Heavily on the Record Companies' Non-Mechanical Revenues in Their Own Testimony; They Cannot Submit Such Evidence and Then Claim Their Own Revenues Are Irrelevant.

The Copyright Owners take the position that their non-mechanical revenues are not relevant to this proceeding, but at the same time claim that *all* of the record companies' revenues are relevant and must be considered. Once again, the Copyright Owners' motion cannot be squared with their own direct case.

The Copyright Owners have proffered a witness, Helen Murphy, to make the claim that record companies are doing well and can "afford" a massive increase in the mechanical royalty rate. As will be shown, Ms. Murphy's testimony is riddled with inconsistencies and presents a wholly deceptive picture of the record industry today. For present purposes, however, what is most relevant about her testimony is that she purports to make her unrealistic claims by looking at all record company revenues (not just revenue from sales of sound recordings which involve mechanical licensing).

Thus, in her calculations purporting to reflect record company revenues and profits, Ms. Murphy takes into consideration record company "net licensing income" – that is, income derived from a wide range of activities not covered by Section 115 of the Copyright Act. *See* Amended Report of Helen Murphy ("Murphy Report") ¶ 14 n.6 (explaining that she "added net sales revenues and net licensing income" and that "[t]otal revenues, defined in this manner, is a commonly used and relied upon measure of record company revenues"). Indeed, references to non-mechanical licensing income are included throughout her statement and the associated exhibits. *See, e.g.*, Exh. 3A (separate line item for "net license income" in chart showing total revenues, operating profits, and operating margins of record companies); Exh. 4A (record company line items for "local license income," "foreign licensing income," "mobile income" and "e-business" in analysis of record company financials); Exh. 4A (record company line item for "royalty and licensing income"); Exh. 4A (record company line items for "domestic licensing" and "international licensing"); Exh. 4A (record company line item for "net license income").

These total revenue figures, which include a wide array of non-mechanical revenue streams, form the basis for virtually every conclusion in Ms. Murphy's report. For example, she uses total revenues to calculate the record companies' operating profits and operating margins. *See* Murphy Report ¶¶ 14, 29, 37; Exh. 3A. She uses this "total revenues" figure to calculate the percentage of revenues that are represented by digital sales. *Id.* ¶¶ 38, 40; Exh. 7A. She uses total revenue figures to calculate revenue and profitability forecasts for the next five years. *Id.* ¶ 42; Exh. 8A. Finally, she uses total revenues to calculate mechanical royalty expenses as a percentage of total revenues. *Id.* ¶ 54; Exh. 10A.

In addition to relying on non-mechanical revenues as part of total revenues, Ms. Murphy also expressly singles out the fact that "record companies . . . have begun to exploit additional sources of revenue" as one of the principal reasons for her optimism about the record industry's future. Murphy Report ¶ 17. In that vein, she notes: "Most major recorded music companies have changed their business models and product mix. They have evolved from selling primarily physical product and licensing film and TV to selling physical and digital product, and new services such as subscription, satellite radio and internet radio, mobile, videos, ad-supported audio, podcasts and artist partnerships." *Id.* (emphasis added). Thus, she concludes: "I expect the record companies' ability to exploit these new revenue streams will further bolster their financial performance." *Id.* Later in her report she expressly returns to this theme, noting that "[t]he number and variety of revenue sources provides another reason to expect improved financial performance in the digital age." *Id.* ¶ 41.

The Copyright Owners cannot claim that record companies' other revenue sources -- which are relatively small in comparison to their overall revenues -- are highly relevant and then demand that their own revenues be hidden from view. If "services such as . . . satellite radio and internet radio, mobile, videos, audio, [and] podcasts" are relevant to an analysis of the record companies' finances and future prospects, *see* Murphy Report ¶ 17, there is no reason why non-mechanical revenue streams such as performance and synchronization revenues – revenue streams which are growing at a rapid pace – should not be taken account when they benefit Copyright Owners. Indeed, as will be shown, Copyright Owners have large and growing other revenue streams -- insulating them from the impact of a decrease in the mechanical royalty rate -- and record companies have few such revenue streams, meaning that an increase in the mechanical royalty will have a far greater -- and potentially devastating -- impact.

D. This Court Has Previously Held That the Copyright Owners' Revenues Are Relevant.

In ruling on motions to compel in this proceeding, this Court has already recognized the relevance of the information that the Copyright Owners now seek to exclude, and this Court has rejected the same arguments that the Copyright Owners now make. First, RIAA and DiMA filed a motion to compel the Copyright Owners to produce documents related to the financial condition of music publishers, including documents showing publishers' revenues and costs broken out by category (expressly including performance royalties, synchronization royalties, print royalties, ringtone royalties, and all other significant revenue sources). This Court granted the motion, noting that that "Copyright Owners do not dispute the relevance or scope of the production" sought by RIAA and DiMA. *See Order Granting Motion of RIAA and DiMA to*

Compel Copyright Owners to Produce Documents Related to Financial Condition of Music Publishers, Including Financial Projections, Docket No. 2006-3 CRB DPRA, at 2 (Dec. 11, 2007).

RIAA and DiMA filed another motion seeking to compel similar information related to songwriters. This Court granted the motion and again found that "the relevance to this proceeding of the requested documents is not in dispute." *See Order Granting Motion of RIAA and DiMA to Compel Copyright Owners to Produce Documents Related to Financial and Membership Data and Producer Agreements of Jud Friedman*, Docket No. 2006-3 CRB DPRA, at 1 (Nov. 27, 2007).

Second, RIAA and DiMA filed a motion to compel the production of catalog valuations prepared by music publishers. The Copyright Owners opposed that motion, making many of the same arguments they make here. In particular, the Copyright Owners asserted that "[a] catalog's value is based on factors in addition to mechanical royalty revenues (including revenue from other income streams) *that are not within the scope of this Court's inquiry*." *See* Opp. to RIAA and DiMA's Joint Motion to Compel Documents related to the Valuation of Music Publisher Catalogs at 5 (Oct. 19, 2007) (emphasis added). This Court squarely rejected the Copyright Owners' argument and stated unequivocally that "documents regarding catalog valuations . . . are critical in understanding the financial wherewithal of music publishers." *See Order Granting Motion of RIAA and DiMA to Compel Copyright Owners to Produce Documents Related to Valuation of Music Publishing Catalogs*, Docket No. 2006-3 CRB DPRA, at 2 (Nov. 13, 2007). The Court held that these documents were directly related to the Copyright Owners' witness testimony concerning the potential financial impact of a mechanical royalty increase. *Id.*

In issuing these decisions on motions to compel, the Court was simply building on its past, consistent record of holding that financial information about the businesses of the parties that come before the Court are relevant in proceedings to set royalties. Thus, in the webcasting proceeding, the Court compelled SoundExchange to produce detailed financials concerning all of the major record companies. *See Order Granting in Part and Denying in Part the Motion of Digital Media Association and its Member Companies, NPR, and the Radio Broadcasters to Compel SoundExchange to Produce Documents Directly Related to the Record Labels' Financial Condition and the Economics of the Sound Recording Market*, Docket No. 2005-1 CRB DTRA (Mar. 27, 2006). The Court issued similar rulings in the SDARS case. *See, e.g., Order Granting in Part and Denying in Part the Motion of XM Satellite Radio Inc., Sirius Satellite Radio, Inc., and Music Choice to Compel SoundExchange to Produce Documents Concerning the Record Labels' Financial Condition*, Docket No. 2006-1 CRB DSTRA (May 17, 2007).

There is no basis for reaching a different conclusion now.[2] Information concerning the non-mechanical license revenues of the Copyright Owners is necessary to test the Copyright Owners' repeated assertions that they are financially struggling. As with catalog valuations, evidence about these revenues is "critical in understanding the financial wherewithal of music publishers." Nov. 13, 2007 Order at 2.

[2] Indeed, the "directly related" standard that RIAA satisfied in its motions to compel is arguably a more stringent standard than the relevance standard set forth in the Federal Rules of Evidence.

E. Evidence of the Copyright Owners' Revenues from Non-Mechanical Licenses Is Relevant under the Four Statutory Factors of Section 801(b).

Even if the Copyright Owners' testimony did not make it relevant, evidence of non-mechanical revenues would still be admissible under an independent analysis of the four statutory factors of Section 801(b).

As a threshold matter, evidence of the type at issue here has routinely been admitted in royalty rate proceedings. Indeed, in the first mechanical royalty rate-setting proceeding, the Copyright Royalty Tribunal expressly *ordered* music publishers to compile and submit "representative aggregate data concerning the financial condition of the music publishers." *Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords*, 37 CFR 307, 46 Fed. Reg. 10466, 10467 (Feb. 3, 1981) ("1981 Mechanicals Decision"). This data was to include, among other things, "[d]omestic and foreign revenues from mechanical royalties, performance fees, [and] print license revenues." *Id.* at 10475.[3] *See also Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 37 CFR 260, 63 Fed. Reg. 25394, 25408 (May 8, 1998) ("1998 DPRSRA Decision") (approving of Copyright Arbitration Royalty Panel's consideration of "[Copyright Owners'] revenues generated from the exercise of other rights granted to them under the Copyright Act" in order to "demonstrate the financial health of the industries").

Here, too, review of the four statutory factors under Section 801(b) demonstrates that it would be "valuable for the [Court] to be aware of the financial status of copyright owners."

[3] Because the particular information eventually received from music publishers proved to be "not a reliable indicator of the financial condition or profitability of the music publishing industry" due to methodological shortcomings in the NMPA's compiling of the data, *id.* at 10483, the CRT eventually determined that the information did not provide clear guidance under the facts of that case. *Id.* Nonetheless, the CRT did not hesitate to emphasize that "it was valuable for the Tribunal to be aware of the financial status of copyright owners and users." *Id.*

1981 Mechanicals Decision at 10483. First, non-mechanical revenues of Copyright Owners are relevant to maximizing the availability of creative works to the public, *see* 17 U.S.C. 801(b)(1)(A), because "[copyright owners'] incentives to produce new music are based on revenues from *all* available sources." *In the Matter of Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, No. 2006-1 CRB DSTRA (Dec. 3, 2007), slip op. at 39 ("2007 SDARS Decision") (emphasis added).

The Copyright Owners do not seriously dispute this point. Indeed, their own expert, Dr. Landes, expressly recognizes that "mechanical royalties are not the only determinant of the 'availability of creative works to the public' because creators also receive compensation from other sources." Landes Amended Expert Report ¶ 30. The Copyright Owners also acknowledge throughout the course of their written statements that songwriters' general financial condition is relevant to first statutory factor. They assert in their statements that a mechanical rate increase "would help to maximize the availability of creative works" because "[h]igher rates will allow songwriters to work on writing songs rather than working at other jobs to pay their bills." Israelite WDT ¶ 47; *see also* Faxon WDT ¶ 45 (claiming that a consequence of declining sales is that "there is less money available to support the creative process, meaning that there are many creative works, including great works, that are never composed").

Second, the evidence at issue in this motion is also relevant to the "fair return" to copyright owners under Section 801(b)(1)(B). *See* 1981 Mechanicals Decision at 10483 (notwithstanding methodological limitations of the data in that case, it was "valuable" to have data on the financial status of copyright owners in considering "how to balance fair return as against fair income."). In his written testimony, Dr. Teece explains the relevance of non-mechanical revenue under the second statutory factor: copyright owners' performance and synchronization royalties "would not occur (or would occur only rarely and at low levels) without the sound recording having been created by the record companies." Teece WDT at 87. Thus, these revenues are appropriately considered as part of the compensation that copyright owners receive for their contribution, but as a result of the efforts and investment of record companies who create the sound recordings. As Dr. Teece explains, these other royalties should be taken into account in determining the mechanical royalty rate. *See id.* Given that the Copyright Owners argue that "[m]aking the same level of effort for a smaller financial return is simply unfair," Israelite WDT ¶ 48, it stands to reason that the inverse must also be true: where the total "financial reward" copyright owners reap for their efforts turns out to be *larger* than in the past, as the data produced in discovery now shows, the determination of a fair return in mechanical rate must take into account the total revenue generated by a musical work.

Third, as to the statutory factor relating to the relative roles, contributions, costs and risks of copyright owners and users, *see* Section 801(b)(1)(C), songwriter and music publisher revenue from non-mechanical licensing is relevant in multiple ways. (1) These other revenue sources are necessary to understanding the costs and investments that the Copyright Owners claim to make. The minimal investments that Copyright Owners undertake become even smaller when measured against their diversified revenue streams. (2) The existence and magnitude of these other revenue sources demonstrates that Copyright Owners face minimal risk from a reduced mechanical royalty rate. Thus, in the PES I proceeding, the Librarian, in assessing the risks that the record companies faced, concluded that the copyright owners in that case had "adapted to the vagaries of the music business, and as an industry, have shown consistent growth in units shipped and dollar value of records, CDs, and music videos from 1982-1996." 63 Fed. Reg. 25394, 25407 (May 8, 1998) ("PES I Librarian's Decision"). (3) As to the relative contribution of record companies, the publishers' non-mechanical income is also relevant because it arises out of the record companies' efforts to develop, create, invest in, and market sound recordings. Were it not for the sound recording that is created by the record companies and distributed by them to the public at large, there would far less of a market for synch or performance licenses in the first place. (4) These other revenue streams are relevant to the record companies' efforts to open new markets from which the Copyright Owners benefit. Thus, in the PES I proceeding, the CARP looked at whether the PES would open markets for record companies by assisting them in growing other revenue streams, not just revenues from the PES. Similarly, the Librarian focused in detail on how the activities of the PES affected the other revenue streams, such as sales of CDs. PES I Librarian's Decision at 25407. Here, the record companies' activities are the source of the vast majority of the Copyright Owners' revenues -- including old and new markets for music.

Finally, the financial condition of the Copyright Owners is also relevant to the "disruption" factor under Section 801(b)(1)(D). Evidence that songwriters and music publishers enjoy high revenues and profits from several sources, as the information obtained in discovery shows, strengthens the conclusion that they will be able to adapt to any new rates without significant disruption to the publishing industry. Indeed, Dr. Teece has analyzed RIAA's rate proposal in the context of publishers' overall revenues to demonstrate that the proposal would not be disruptive to the publishing industry. *See* Teece WDT at 109-10. Thus, the Copyright Owners' revenues from all sources is relevant to the fourth Section 801(b) factor.

The Copyright Owners cobble together bits and pieces of citations from various opinions of this Court and its predecessors to contend that their overall financial condition is not relevant, but none is remotely on point. Notably, the Copyright Owners fail to identify *any* precedent from *any* tribunal which has held that evidence of the overall financial revenues of copyright owners is inadmissible in a rate-setting proceeding. The best they can find are two cases that stand for the obvious -- namely, that Copyright Owners are entitled to performance as well as mechanical royalties, and that their earning of one should not preclude their earning of the other as well. *See* Mot. at 6-7 (citing *1980 Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players*, 46 Fed. Reg. 884, 889 (1981); 1998 DPRSRA Decision at 25408). But these decisions have nothing to do with the issue at hand. RIAA has never suggested that copyright owners are not entitled to mechanical royalties because they earn performance and synchronization revenues. Rather, RIAA seeks to use the financial condition of the Copyright Owners the way this Court and its predecessors have repeatedly used it -- as a factor to be considered in the determination of reasonably royalty rates "that satisfy all of the objectives set forth in Section 801(b)(1)(A)-(D)." 2007 SDARS Decision at 16; *see also* 1998 DPRSRA Decision at 25408 (financial condition of copyright owners is relevant to "demonstrate the financial health of the industries").[4]

II. There Is No Prejudice to Admitting This Testimony.

Federal Rule of Evidence 403 is not just a test of the probative quality of evidence; rather, to exclude evidence, the Copyright Owners must demonstrate that the prejudice, confusion, or undue delay of the evidence substantially outweighs its probative value. The Copyright Owners have not even tried to show that the information at issue would cause

[4] Nor are the Copyright Owners aided by the 1981 CRT's decision to exclude singer-songwriter revenue from consideration, *see* Mot. at 8-9. For one thing, as already noted above, that very same Tribunal expressly permitted (indeed, it *ordered*) the preparation and submission of aggregate financial music publisher revenue of the type sought to be excluded here. In any event, the Copyright Owners could not credibly call for the exclusion of singer-songwriter revenue here, given the number of their witnesses who expressly testify about singer-songwriters and their licensing of sound recordings through controlled composition clauses. *See, e.g.*, Israelite WDT ¶ 28; Robinson WDT ¶ 24; Peer WDT ¶¶ 55-59; Firth WDT ¶ 45(a).

prejudice that would outweigh its probative value. Rather, they simply assert in conclusory fashion that the evidence would waste time and confuse the issues. *See* Mot. at 2. But for the reasons discussed above, the disputed information is highly relevant to issues in this proceeding and its introduction would thus enable RIAA and this Court to test the Copyright Owners' assertions and examine the Section 801(b) factors.

Nor is there a risk of prejudice or confusing the decisionmaker because the Judges in this case are more than capable of assessing the information. Rule 403 is concerned with the effect of prejudicial testimony on juries, not judges. *Schultz v. Butcher*, 24 F.3d 626, 632 (4th Cir. 1994) ("[W]e hold that in the context of a bench trial, evidence should not be excluded under 403 on the ground that it is unfairly prejudicial. . . . Rule 403 was designed to keep evidence not germane to any issue outside the purview of the jury's consideration. For a bench trial, we are confident that the district court can hear relevant evidence, weigh its probative value and reject any improper inferences.").

III. Each of the Specific Challenged Statements Is Relevant and Admissible.

For the reasons set forth above, information about the Copyright Owners' revenues from sources other than mechanical royalties should be deemed admissible as a general matter. Nonetheless, RIAA also briefly addresses each of the specific statements that the Copyright Owners seek to exclude. *See* Mot., Ex. A. Notably, in their motion the Copyright Owners fail to explain the particular alleged infirmities of the various witnesses' testimony, leaving RIAA and this Court to guess.

Testimony of Glenn Barros, page 21: Mr. Barros is the President and CEO of Concord Music Group, which is both a record company and a music publisher. On the page of testimony that the Copyright Owners seek to exclude, Barros explains that "[d]espite the relatively bad times in the recording business, it is a pretty good time to be a music publisher," because publishing revenue shows "steady growth," and because performance, synchronization and other income sources have "more than offset the decline in mechanical revenue." Because of his dual role as an executive of a record company and publisher, Barros brings a unique perspective to the proceeding, and this testimony appears in the section of his written statement that discusses the relative risks and returns of record companies and publishers. It is thus plainly relevant to the second and third statutory factors in the Section 801(b) analysis.

Testimony of Victoria Bassetti, pages 20-21: In the portion of her testimony that the Copyright Owners seek to exclude, Bassetti compares the relatively meager efforts by publishers to combat piracy to the anti-piracy efforts by record companies, and the relative impact of piracy on music publishers and record companies. Mot., Ex. A (Bassetti) at 20-21. Bassetti's testimony relates to the risks undertaken by record companies and publishers in making music available to the public, *see* Section 801(b)(1)(C). This testimony is essentially the record company analog to the testimony by several of the publishers regarding the impact of piracy on their businesses and their efforts to combat piracy. *See, e.g.*, Israelite WDT ¶ 27 ("rampant music piracy of the late 1990s . . . dramatically undercut the mechanical royalty stream"); Robinson WDT ¶ 23 ("the emergence of digital music has significantly increased our litigation costs, as we have been forced to represent copyright owners on a variety of new fronts in the battle against piracy"); Faxon WDT ¶ 45 ("Piracy . . . has played a major role in this decline."). The publishers cannot present testimony on this issue and at the same time prevent RIAA from doing the same.

Testimony of Professor Teece, pages 58-69: In the portion of this testimony that is at issue, Dr. Teece compares publishers' mechanical revenues to their overall revenues. Mot., Ex. A (Teece) at 59-61. As discussed above, this is of course exactly what the publishers do in their testimony when they say mechanical revenues have decreased as a percentage of overall revenues. The only difference is that unlike the publishers' witnesses, Dr. Teece provides extensive data to support his testimony. The relevant section of Dr. Teece's testimony also uses data about publishers' overall revenue to show that a significant reduction in the mechanical rate would have only a modest effect on publishers' revenue. Mot., Ex. A (Teece) at 62. As discussed above, this is plainly relevant to the second statutory factor, concerning fair return, as well as the fourth statutory factor, concerning marketplace disruption. Finally, Dr. Teece also offers testimony about music publisher profitability, publisher profit margins, and the low risks of the publishing business. Mot., Ex. A (Teece) at 63-69. This testimony relates to the third statutory factor concerning the "relative . . . cost [and] risk" of the copyright owner and copyright user. Accordingly, it should not be precluded here.[5]

[5] The Copyright Owners also seek to exclude page 12 of RIAA's Introductory Memorandum from evidence. But legal memoranda are not evidence in this proceeding and there is thus no reason for the Court to decide whether to exclude that page from evidence.

CONCLUSION

For the foregoing reasons, RIAA respectfully requests that this Court deny the Copyright Owners' motion.

Respectfully Submitted,

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January 18, 2008

CERTIFICATE OF SERVICE

I hereby certify that on the 18th day of January 2008, I caused a true and correct copy of the foregoing **Opposition to NMPA, SGA, and NSAI's Motion *In Limine* to Exclude Evidence Relating to Revenues Generated from Non-Mechanical Licenses** (Public Version) to be served upon the following by electronic mail and overnight UPS:

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