LECG

Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding before the U.S. Copyright Royalty Board

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1 Introduction and scope of work

Background

1.1 I have been instructed by the Record Industry Association of America ("RIAA") to prepare an expert report in connection with the Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding before the U.S. Copyright Royalty Board ("the US Proceedings").

My instructions

1.2 I have been asked to explain certain aspects of the recent settlement of the reference to the UK Copyright Tribunal under sections 119, 121 and 126 of the Copyright and Designs and Patents Act 1988 regarding the licence terms for the supply of musical compositions online ("the UK online music dispute").

1.3 Specifically, I have been asked to consider:

- the UK online music dispute;
- the MCPS-PRS Alliance's new joint online licence scheme ("the New JOL"), which reflects the settlement between the Alliance and certain of the applicants;
- the effective royalty rates in the New JOL at current UK market prices; and
- a conversion of the royalty rates in the New JOL to the equivalent rates that would apply if the royalty was paid on wholesale prices in the UK.

My background

1.4 My full name is Richard Edward Stanley Boulton. I am a part time director of LECG Ltd, which specialises in the provision of expert economic and financial services. I am a Fellow of the Institute of Chartered Accountants in England and Wales, and a Fellow of the Academy of Experts. I am also a qualified barrister, practising from One Essex Court, Temple, London, having been called to the Bar in 2003.

1.5 Before joining LECG, I spent 20 years at Arthur Andersen, the last 11 years as a partner. My experience at Arthur Andersen included several global management positions, including number two executive worldwide (1997-2000), and over 15 years' client work as a consultant on strategic, financial and economic issues.

1.6 My experience in licensing matters includes:

- expert reports and oral evidence to the UK Copyright Tribunal in the matter: *BPI and others v MCPS and others (2006)*, concerning licence terms for the supply of musical compositions online;
- expert reports and oral evidence to the UK Copyright Tribunal in the matters: *BSkyB v PRS* (1997), *AIRC v PPL* (1992) and *TV Listings* (1990);
- advice to the British Broadcasting Corporation ("BBC"), the Association of Independent Radio Companies ("AIRC") and other UK broadcasters on their negotiations with collective licensing bodies over the last twenty years;
- advice to Radio Telefís Éireann ("RTE") on its 2003 negotiations with the Irish Music Rights Organisation ("IMRO") relating to the appropriate level of the tariff for broadcasting of IMRO's repertoire. This work included the provision of an expert report on behalf of RTE;
- advice to the Monopolies and Mergers Commission ("MMC") in connection with the MMC's 1988 investigation into Collective Licensing;
- expert evidence to the EC Commission Competition Directorate on the level of a reasonable royalty for video airplay in connection with a complaint made by Music Television Europe ("MTVE") under Article 82 (ex Article 86) of the Treaty of Rome;
- assisting licensors and licensees in licensing negotiations and advising on the level of a reasonable royalty in various other industries including manufacturing, pharmaceuticals, consumer goods, publishing and software;
- the valuation of patents, copyrights, trademarks, brands and other intangible assets; and
- author of articles and reports on IP matters, and co-author of a business book on creating wealth from intangible assets.

1.7 My broader professional experience includes:

- quantification of damages in approximately 100 litigations, including many of the UK's largest commercial disputes;

- expert evidence on damages for patent infringement (including written and oral evidence in the *Gerber Garments Technologies Inc v Lectra Systems Ltd* damages enquiry and the *Hoechst Celanese v BP Chemicals* account of profits enquiry);
- leading a team of 40 people responsible for the fraud investigation into the management of Bank of Credit and Commerce International ("BCCI") on behalf of the majority shareholders;
- board level responsibility for various "eBusiness" start-ups involving both business-to-consumer (B2C) and business-to-business (B2B) commerce. These new ventures included an online community for intellectual property professionals, and a company providing internet-based training; and
- advising numerous companies on strategy and business planning, with particular emphasis on media clients and new business models.

1.8 Full details of my qualifications and experience are contained in Appendix 1.

1.9 In preparing this report, I have been assisted by Greg Harman, a director of LECG, and by Andrew Wynn, a managing consultant at LECG. I have supervised all the work performed and the opinions expressed herein are my own. My views should not be regarded as representative of any other person within LECG.

Sources of Information

1.10 In the course of preparing this report, I have relied on the following documents:

- the New JOL (attached as RIAA Ex. N-101-DP);
- transcripts from the proceedings of the UK Copyright Tribunal hearing concerning licence terms for the supply of musical compositions online, Days 1 and 2 (attached as RIAA Ex. N-102-DP and RIAA Ex. N-103-DP);
- BPI Market Information No. 275 (attached as RIAA Ex. N-104-DP);
- UK album PPD data provided by OCC and compiled by Millward Brown (attached as RIAA Ex. N-105-DP);
- UK album retail price data provided by AudioTrak (attached as RIAA Ex. N-106-DP);

- the BPI press release of 28 September 2006, "Companies agree digital royalties deal", available at www.bpi.co.uk (attached as RIAA Ex. N-107-DP);
- MCPS-PRS Alliance's press release of 28 September 2006, "*Companies agree digital royalties deal*", available at www.mcps-prs-alliance.co.uk/press/ (attached as RIAA Ex. N-108-DP);
- MCPS-PRS Alliance's press release of 9 October 2006, "*More companies agree digital royalties deal*", available at www.mcps-prs-alliance.co.uk/press/ (attached as RIAA Ex. N-109-DP);
- MCPS-PRS Alliance's press release of 11 October 2006, "*Another company agrees digital royalties deal*", available at www.mcps-prs-alliance.co.uk/press/ (attached as RIAA Ex. N-110-DP);
- the MCPS Ringtone Licence available at www.mcps-prs-alliance.co.uk (attached as RIAA Ex. N-111-DP);
- the PRS Ringtone Licence available at www.mcps-prs-alliance.co.uk (attached as RIAA Ex. N-112-DP);
- information on how the MCPS-PRS Alliance splits revenue available under "*Joint Online Distribution - General Questions*" at www.mcps-prs-alliance.co.uk (attached as RIAA Ex. N-113-DP);
- Apple press release of 7 September 2005, "iTunes Music Store Number One in the UK with 80% Market Share", available at http://www.apple.com/pr/library/2005/sep/07itms.html (attached as RIAA Ex. N-114-DP);
- Extracts from iTunes, Napster, and Virgin Digital web-sites (attached as RIAA Ex. N-115-DP); and
- "MCPS Licensing Scheme Summaries", extract relating to the AP1, AP2 and AP2A schemes, available at www.mcps-prs-alliance.co.uk (attached as RIAA Ex. N-116-DP).

Confidentiality

1.11 Much of the information currently before the UK Copyright Tribunal hearing concerning licence terms for the supply of musical compositions online is confidential. I have relied solely upon information in the public domain. The

publicly available information includes transcripts of the proceedings and the New JOL.

Structure of my report

1.12 In Section 2, I set out the relevant background to the UK online music dispute. I provide a summary of the parties to the dispute and the products and services covered by the dispute. I also provide a brief summary of licence terms that were in dispute, to the extent they are relevant to the royalty on products considered in the US Proceedings.

1.13 In Section 3, I discuss the principal terms of the New JOL that are relevant to the US Proceedings, being those relating to the royalty on permanent downloads and/or limited downloads and on-demand streaming.

1.14 In Section 4, I determine the effective royalty rates in the New JOL at current UK market prices. I then convert the royalty rates in the New JOL to equivalent rates based on current wholesale prices in the UK.

1.15 Section 5 contains my expert declaration.

2 The UK online music dispute

Introduction

2.1 This section explains my involvement in the UK online music dispute, the services covered by the disputed licence scheme, the primary services offered by each of the licensees that were parties to the dispute, and the role of the BPI. I also discuss the licence terms that have been disputed to the extent they are potentially relevant to the US Proceedings.

My involvement in the UK online music dispute

2.2 In January 2006 I was instructed by the following parties to the UK online music dispute:

- MusicNet (UK) Limited ("MusicNet"), Yahoo! UK Limited ("Yahoo"), AOL (UK) Limited ("AOL"), RealNetworks Limited ("RealNetworks"), Napster LLC ("Napster"), Sony United Kingdom Limited ("Sony") and iTunes S.à.r.l. ("iTunes"). Together these parties are referred to as the Music Service Providers ("MSPs");
- O2 (UK) Limited ("O2"), T-Mobile International (UK) Limited ("T-Mobile"), Vodafone UK Content Services Limited ("Vodafone") and Orange Personal Communication Services Limited ("Orange"). Together these parties are referred to as the Mobile Network Operators ("MNOs"); and
- the British Phonographic Industry Limited ("BPI"), a music industry association, which I understand is broadly comparable to the RIAA.

2.3 Henceforth, I refer to all the above-mentioned parties as "the Applicants".

2.4 I was instructed by the Applicants to provide expert evidence on (i) the structure and level of a reasonable royalty for the supply of music content online and (ii) a number of specific accounting issues relating to industry profitability and revenue unbundling. During the course of the proceedings, I produced four expert reports, plus a letter to my Instructing Solicitors, and gave oral evidence to the Copyright Tribunal ("the Tribunal").

The disputed licence scheme

2.5 The mechanical and performing rights involved in the supply of music content online in the UK are licensed collectively by the Mechanical-Copyright Protection

Society Limited ("MCPS") and Performing Right Society Limited ("PRS") (together "the Alliance"). The Alliance's licence scheme for online music was referred to the Copyright Tribunal by the BPI and certain of the MSPs. The scheme grants rights with respect of mechanical and communication to the public rights.

2.6 Physical audio products are licensed under a separate set of schemes through the MCPS. Under the MCPS licensing schemes (AP1, AP2, AP2A) for the use of musical compositions in the manufacture of physical audio products, the record companies are the licensees. Under the terms of those schemes, a mechanical royalty of 8.5% is levied on the Published Price to Dealer ("PPD") unless no PPD exists, in which case a royalty of 6.5% is applied to the retail price.[1] The PPD is not the equivalent of a wholesale price, as it does not take into account any other discounts offline retailers receive. It is best thought of as a wholesale list price.

2.7 In contrast, under the Alliance's licence scheme for online music, the licensees are the retailers of online music products (i.e. the MSPs and MNOs) and the royalty for online music is levied on the retail price.

Services covered by the New JOL

2.8 The settlement agreements between the Alliance and the BPI, MNOs and certain of the MSPs are confidential. However, the principal terms on which their references were settled are set out in the New JOL. The following categories of products are covered by the New JOL[2]:

- **Permanent Downloads Services** are a service by which a musical composition is communicated to the public in the form of a download and where such download may be retained by the user on a permanent basis. There are no limits on how often users can listen to their downloaded music files. Depending on the licensing conditions applicable, a user may also be permitted to transfer music files to a portable music player or to "burn" (i.e. copy) a limited number of times to CDs.
- **Limited Download / On-Demand Streaming Services** are a service whereby a user may receive a musical composition by streaming on-demand and/or may download a musical composition but where such download may not be retained by the user on a permanent basis. On-

1 Source: RIAA Ex. N-116-DP.

2 These descriptions are based on the definitions in the New JOL.

demand streaming services enable users to pay a periodic subscription or a per-use fee for the right to listen to a portfolio of sound recordings on an "on-demand" basis. Limited downloads grant users access to sound recordings as long as the user continues to pay the subscription fee. Users can download music files to their computer (and in some cases transfer the files to a portable music player), but if the user's subscription lapses DRM software renders the files unplayable. On-demand streaming allows users to listen to tracks using streaming technology. Unlike limited downloads, a user must be connected, either by wired or wireless technology, to the service provider. Payment for on-demand streaming can be on a per stream basis, or more typically via monthly subscription.

- **Webcasting Services**[3] are a service by which musical compositions are communicated to the public over the internet and no permanent or temporary copy of any Musical Work is retained by the User; and such service is neither a Permanent Download Service, a Limited Download/On-Demand Streaming Service nor a Simulcast Service[4].

Limited Download/On-Demand Streaming sub-categories

2.9 The following sub-categories of Limited Download/On-Demand Streaming services are specified in the New JOL:

- **Limited Subscription Services** are where the user pays to the licensee a regular fee in order to access the service, and gains access, only while such fee continues to be paid, to 20,000 musical compositions or less;
- **PC Subscription Services** are where the user pays to the licensee a regular fee in order to access the service, and gains access, only while such fee continues to be paid, to in excess of 20,000 musical compositions. In addition, the user can store and listen to musical compositions accessed through the service on a personal computer, but is unable to store and

[3] The New JOL includes a set of sub-categories within Webcasting Services. The sub-categories are not discussed in this report since the royalty rates for webcasting services are not under review in the US Proceedings. The definition of the sub-categories within webcasting is disputed by certain parties to the UK online music dispute.

[4] Simulcast Service means the broadcast of a programme via the internet where such broadcast is simultaneous with the broadcast of such programme via a traditional terrestrial, satellite or cable television or radio service; and is made from the website or other service of the originating broadcaster.

listen to musical compositions accessed through the service on a portable device.

- **Portable Subscription Services** are as for PC Subscription Service, but the user can store and listen to musical compositions accessed through the service on a portable device.
- **Other Limited Download/On-Demand Streaming Services** relate to Limited Download/On-Demand Streaming services that are not covered by the above three sub-categories.

Online music services offered by the applicants

2.10 The table below indicates the primary online music service offered by each of the MSPs and MNOs:

Table 1: Primary online music service offered by each MSP / MNO

Primary online music service offered	MSP / MNO
Permanent Download Service	Sony, iTunes, O2, T-Mobile, Vodafone, Orange
Limited Download Service / On-Demand Streaming Service	MusicNet, Napster
Webcasting Service	Yahoo, AOL, RealNetworks

Source: LECG analysis.

Role of the BPI

2.11 The British Phonographic Industry Limited ("BPI") is a British record industry trade association, which represents producers and licensors of audio and audio-visual recordings of music and other data. The BPI represents hundreds of UK record companies, who together issue approximately 95% of commercial sound recordings in the UK. The members include the four "majors", EMI, Sony BMG, Universal and Warner.

Potentially relevant online music licence terms in dispute

2.12 I have listed below the licence terms that were in dispute as part of the Copyright Tribunal proceedings in the UK that may be relevant to the US Proceedings. I have excluded terms relating solely to webcasting services since the royalty rates for webcasting services are not under review in the US Proceedings:

- royalty rate for Permanent Download Services;
- royalty rate for Limited Download Services/On-Demand Streaming Services;
- minima for Permanent Download Services;
- minima for Limited Download Services/On-Demand Streaming Services; and
- definition of gross revenue (i.e. the revenue base to which the royalty rate is applied).

2.13 I discuss each licence term in more detail in the next section.

3 The settlement of the UK online music dispute

Introduction

3.1 In this section I consider the terms in the New JOL that are potentially relevant to the US Proceedings and a number of issues that are in my view relevant to the use of the New JOL as a comparable for other services or in other jurisdictions.

The settlements

3.2 In September 2006, the BPI settled their dispute with the Alliance by a settlement agreement valid for three years ("the BPI Settlement Agreement"). By the same settlement agreement, the MNOs and iTunes also settled their respective disputes with the Alliance, except for the definition of the revenue base. The BPI Settlement Agreement appended and incorporated an agreed licence scheme for online music ("the New JOL").

3.3 Whilst the BPI has entirely withdrawn its reference to the Tribunal, there remain disputes between iTunes, the MNOs and the Alliance concerning the extent, if at all, to which advertising revenues should be included within the revenue base in the New JOL (the so-called "disputed contentions" in the continuing Tribunal reference).

3.4 In October 2006, Napster and MusicNet agreed to withdraw their references to the Copyright Tribunal after coming to a settlement with the Alliance based in part upon the BPI Settlement Agreement and incorporating the New JOL ("the ODS Settlement"). A few days later, the Alliance came to a settlement with Sony Connect ("the Sony Settlement"). Despite withdrawing their references, Napster, MusicNet and Sony ensured that they benefit from any gains made by iTunes with respect to iTunes' disputed contention.

3.5 The remaining MSPs, AOL, Yahoo and RealNetworks, all of whom are involved principally in the provision of webcasting services as far as online music is concerned, have not settled their references. At the date of this expert report, the Tribunal hearing is continuing with reference to the definition of the revenue base and the reasonableness of the New JOL as it applies to Webcasting Services.

Use of the New JOL as a comparable

3.6 The New JOL includes terms negotiated and agreed between online music licensees and the Alliance for each term of the scheme. It is in my view relevant to note the following points about the settlements.

3.7 Firstly, the settlement agreements are the product of negotiations between a licensor and licensees in the context of litigation. The costs and risks inherent in such litigation mean that the terms agreed may not be the same as those that would result from free market negotiations (absent such litigation) or that would have been imposed by a Tribunal decision. For example, each party may agree to terms that are above or below what they consider to be reasonable in order to avoid the costs and uncertainties of a Tribunal decision. This does not mean to say that the agreements are not relevant as comparables; indeed, it should be noted that many comparable agreements are similarly the product of settled proceedings.

3.8 Second, it is important to recognise that the New JOL has been agreed as a package. The fact that the parties have agreed to the overall terms of the New JOL says little about their views on individual terms. For example, certain of the Applicants may have been prepared to make concessions with regard to the definition of gross revenues in return for agreement on the royalty rate. It is therefore necessary to be cautious in treating specific terms of the New JOL as though they were separately negotiated comparables.

3.9 Finally, the settlements contain agreements on every term of the online music licence save for the disputed contentions. When reviewing specific terms of these agreements, it is appropriate to consider the relevance and relative importance of the particular term under review to the parties that agreed it. For example, iTunes is the market leader for permanent download sales, but it does not currently operate any webcasting services. Other things being equal, the agreement by iTunes to commercial terms in respect of downloads is likely to be more relevant and reliable evidence as to the product of an open market negotiation than its agreement to terms that relate solely to webcasting.

Royalty rates and minima

3.10 Those licence terms in the New JOL that are most directly relevant to the US Proceedings, namely the royalty rates for permanent downloads, limited downloads and on-demand streaming services, have been agreed by the BPI and

all the MSPs/MNOs that offer these services without any disputed contentions. This is also true of the relevant minima. The table below sets out the relevant royalty rates and minima from the New JOL:

Table 2: Royalty rates and minima agreed in the New JOL

Music service	Royalty rate	Minima
Permanent Download Service	8%	£0.04 per download
Limited Download/On-Demand Streaming Service: Portable Subscription	8%	£0.60 per subscriber per month
Limited Download/On-Demand Streaming Service: PC Subscription	8%	£0.40 per subscriber per month
Limited Download/On-Demand Streaming Service: Limited Subscription	8%	£0.20 per subscriber per month
Limited Download/On-Demand Streaming Service: Other	8%	£0.0022 per musical composition played

Source: New JOL.

Use of percentage royalties in the New JOL

3.11 All the parties in the UK online music dispute proposed a revenue-based royalty. This is consistent with the AP1, AP2, and AP2A licences for physical audio products, which are also revenue-based royalties. In my opinion, a revenue-based royalty is appropriate for permanent downloads, limited downloads and on-demand streaming because there is a clear link between the contribution of the licensor and the revenues generated by the licensee. In these circumstances, the revenue share incentivises the licensor to increase the value of its inputs.

3.12 A revenue-based royalty requires less frequent review since it responds to changes in price and volumes whereas a quantity-based royalty responds only to changes in volumes. This is important in the nascent online music market where there is significant potential for changes in licensees' business models that may result in substantially different pricing structures to those observed currently.

Definition of the revenue base

3.13 Royalties payable under the New JOL are calculated as the product of the royalty rate and revenue base for each music service. As noted above, there are still disputed contentions relating to the revenue base currently before the Tribunal. The disputed contentions concern the extent to which advertising revenue should be included in the revenue base. I have not taken account of advertising revenue in my calculations in Section 4. I have therefore assumed that the revenue base is determined only by the revenue from sales of permanent downloads and limited downloads / on-demand streaming subscriptions received from the various music services. I do not believe that this is likely have a material effect on my conclusions, since advertising revenue is not a significant revenue stream for those MSPs that are not webcasters.

The split between royalties for mechanical and communication to the public rights

3.14 I understand that the US Proceedings relate solely to the mechanical right whereas the New JOL covers both mechanical and communication to the public rights. The New JOL does not give any information as to how the royalty should be split between the mechanical and communication to the public rights. I discuss how the royalty may be split in paragraphs 4.22 to 4.24 below.

4 Calculation of equivalent royalty rates for wholesale prices

Introduction

4.1 In Section 4, I determine whether the effective royalty rates in the New JOL at current UK market prices are determined by the royalty rate applied to the revenue base, or the minima. I then convert the royalty rates in the New JOL to equivalent wholesale rates based on current UK wholesale prices.

Effective royalty rates at current market prices

4.2 In this sub-section, I discuss the market prices for online music products based on publicly available data. I have used the prices advertised by the largest MSPs. I have not been able to create a weighted average price based on the selling price of all of the MSPs. The prices listed are the current market prices and the prices that persisted throughout 2006.

4.3 The online music market is relatively new and is growing quickly. Therefore, the prices of the services discussed below may change, which would change the calculations in this section. However, my calculations reflect the market conditions at the time of the settlement. Arguably, they are more relevant than results from future market prices, which in any case cannot be predicted with any confidence.

4.4 The current market price for permanent downloads within the UK market is £0.79. iTunes, the UK market leader with an estimated 80% market share, sells all of its permanent downloads for £0.79. Most other MSPs, including Napster, sell permanent downloads at this price.

4.5 In terms of subscription services, the UK market is nascent with few existing price points. Napster, the UK market leader, charges £9.95 per month for its PC Subscription Service and £14.95 per month for its Napster-to-go Portable Subscription Service. Two other MSPs currently offering subscription services are Virgin Digital and HMV, who charge £9.99 and £14.99 for PC and Portable Subscription Services respectively.[5]

[5] See RIAA Ex. N-115-DP for current UK online music prices.

4.6 I am not aware of any services that meet the definition of a Limited Subscription service contained in the New JOL or of the pricing of any non-subscription-based limited download or on-demand streaming services.

4.7 It is important to bear in mind that while the VAT rate in the UK is 17.5%, EU legislation stipulates that for e-commerce businesses, such as the MSPs, VAT need only be paid in the country in which the MSP is registered. For example, iTunes is registered in Luxembourg where the standard rate of VAT is 15% with reduced rates for some specific products. The result of this is that the actual deduction of VAT from the retail price will vary from MSP to MSP.

4.8 The table below summarises current market prices for permanent downloads and limited download/on-demand streaming services. I have used a standard UK VAT rate of 17.5% in my calculations, although, as I noted above, the actual rate paid by individual MSPs may vary.

Table 3: Average UK retail prices for online music products

Music product	Market price including VAT	Market price excluding VAT at 17.5%
Permanent Download Service	£0.79 per download	£0.67 per download
Limited Download/On-Demand Streaming Service: Portable Subscription	£14.95 per subscriber per month	£12.72 per subscriber per month
Limited Download/On-Demand Streaming Service: PC Subscription	£9.95 per subscriber per month	£8.47 per subscriber per month
Limited Download/On-Demand Streaming Service: Limited Subscription	N/A	N/A
Limited Download/On-Demand Streaming Service: Other	N/A	N/A

Source: LECG analysis.

4.9 The royalty payable for online music in its various forms depends on the royalty rate, the revenue base and, where applicable, the minima. For all the services discussed below, the revenue base is defined as the sales price less VAT (at 17.5%).

4.10 The New JOL states that where the royalty calculated with reference to the royalty rate and base is less than the specified minimum, the minimum should apply. The following table compares the royalty calculated from the royalty rate applied to the revenue base and the minima.

Table 4: Effective royalty rates for online music products in the UK

Music product	Calculated Royalty	Minima	Effective royalty
Permanent Download Service	£0.054 per download	£0.04 per download	Calculated royalty
Limited Download/On-Demand Streaming Service: Portable Subscription	£1.018 per subscriber per month	£0.60 per subscriber per month	Calculated royalty
Limited Download/On-Demand Streaming Service: PC Subscription	£0.677 per subscriber per month	£0.40 per subscriber per month	Calculated royalty
Limited Download/On-Demand Streaming Service: Limited Subscription	N/A	£0.20 per subscriber per month	N/A
Limited Download/On-Demand Streaming Service: Other	N/A	£0.0022 per musical composition played	N/A

Source: LECG analysis and the New JOL.

4.11 For all the online music products listed above, the current market prices are sufficiently high to ensure that the royalty payable, calculated as the royalty rate multiplied by the revenue base, is in excess of the minima prescribed by the New JOL. Consequently, when performing a conversion of the UK royalty rates to wholesale equivalent rates in the UK, the effective rate is in all cases the royalty rate of 8% multiplied by the retail price excluding VAT.

The role of minima in the New JOL

4.12 In my evidence in the UK proceedings, I concluded that there is no need for minima where the Alliance receives a revenue-based royalty. However, I noted that it may be appropriate to set minima if it is thought necessary either (i) to protect the Alliance's members from the risk that their products are given away or

packaged in a way that is not monetised; and/or (ii) to reflect the fact that the copyright use has a value even where it is not monetised. I suggested that if the Tribunal were minded to set minimum charges, they should be set at no more than half the calculated royalty.

4.13 The minima originally proposed by the Alliance did not meet these criteria: they approximated to (and in some cases exceeded) the royalty payable based on the royalty rate multiplied by the revenue base at current market prices. As the analysis in Table 5 indicates, the minima in the New JOL for permanent downloads, limited downloads and on-demand streaming are between 59% and 74% of the calculated royalty.

Equivalent royalty rates for wholesale prices

4.14 I understand that the RIAA will propose mechanical royalties based on wholesale prices. In order to convert the royalties payable for online music in the UK to a wholesale equivalent, two adjustments are necessary: (i) in the UK the royalty rate is applied to retail revenue (excluding VAT), while the rate I am calculating would be applied to wholesale revenue; and (ii) in the UK the royalty is paid by the MSP concerned, whereas, under the RIAA's proposal, the royalty would be paid out of the record companies' wholesale revenue.

4.15 In this report, I have only calculated the equivalent wholesale rate for permanent downloads. I do not have access to publicly available data on UK wholesale prices for limited downloads.

Calculation steps

4.16 The steps necessary to convert the UK retail rates into a wholesale rate equivalent are as follows[6].

4.17 First, as the royalty for online music in the UK is paid on retail revenue excluding VAT, I have removed VAT from the retail price.

4.18 Second, I have calculated the royalty payable by multiplying the royalty rate of 8% times revenue excluding VAT.

[6] Distributions to members of the MCPS and PRS are subject to commissions. This may not reflect the situation in the US and therefore may warrant an additional adjustment.

4.19 Third, I have increased the UK record companies' wholesale price by the royalty payable. Effectively, I have assumed that the question as to who bears the royalty will not affect the split of profits between the record companies and the MSPs.

4.20 Fourth, I have calculated the royalty as a percentage of the wholesale price plus the royalty.

4.21 Finally, I have adjusted the royalty to reflect the fact that the UK royalty covers both mechanical and communication to the public right, whereas the US royalty is for the mechanical right only.

Adjustment to reflect the two rights covered by the UK royalty

4.22 The New JOL is a joint licensing scheme that covers both mechanical and communication to the public rights. It does not explain how the royalties are split between the MCPS, with respect to the mechanical right, and the PRS, with respect to the communication to the public right.

4.23 However, the MCPS-PRS Alliance provides guidance as to how the revenues should be split between the two collecting societies. The Alliance states:

> *"MCPS and PRS Boards have agreed that income from Joint Online Licences should be split as follows:*
>
> - *Download services - 75% to MCPS and 25% to PRS*
> - *On demand streaming services - 50% to each society*
> - *Internet radio and webcasts - 25% to MCPS and 75% to PRS*
>
> *In the case of licensees providing more than one type of service, if the revenue cannot be separately identified, the 50/50 split applies."*[7]

4.24 I have therefore, for illustrative purposes, reduced the adjusted rates in my calculations by 25% to exclude my estimate of the royalty relating to the communication to the public right.[8]

Calculation of an adjusted rate

4.25 The adjusted rate for permanent downloads is shown in the table below:

Table 5: UK permanent download royalties on a wholesale price basis

Music service	Value	Calculation guide	Source
Retail price (incl. VAT)	£0.79	[A]	iTunes and Napster[9]
Retail price (excl. VAT)	£0.67	[B] = [A] / 1.175	LECG calculation
Musical composition royalty at 8%	£0.0537	[C] = [B] x 8%	LECG calculation
Expressing this as a percentage of the wholesale price of a permanent download:			
Wholesale price (excl VAT)	£0.47[10]	[D]	BPI Market Information
Wholesale price plus royalty	£0.52	[E] = [C] + [D]	LECG calculation
Royalty as % of wholesale price plus royalty	10.3%	[F] = [C] / [E]	LECG calculation
Estimate of the mechanical royalty as % of wholesale price plus royalty[11]	7.7%	[G] = [F] x [3/4]	LECG calculation

Source: LECG analysis.

4.26 Based on taking three quarters of the royalty as a percentage of the wholesale price (including the musical composition royalty), the UK rate of 8% of retail price

7 Source: www.mcps-prs-alliance.co.uk

8 Ringtones are a music-related online product that is covered by separate licences for the mechanical right and the communication to public right. Whilst I do not believe the overall rate in these agreements is a reliable comparable for the licences at issue in the US Proceedings they do provide some evidence of the split between the two rights for online services. The licence fee payable to the MCPS with respect to the mechanical right is the greater of 10% of the retail price or £0.10 per ringtone. The licence fee payable to PRS with respect to the communication to the public right is the greater of 5% of the retail price or £0.05 per ringtone payable to PRS. This would suggest a split of 66.7% to the MCPS and 33.3% to the PRS.

9 I have assumed an average retail price of £0.79. iTunes sells all permanent downloads for £0.79 and is clearly established as the UK market leader with an estimated 80% market share. Napster also sells all its permanent downloads at £0.79.

10 I understand that the BPI use an assumption of £0.47 per permanent download when calculating trade revenue from permanent downloads. An example of the use of this assumption can be seen in BPI Market Information No. 275 (attached as RIAA Ex. N-104-DP).

11 This calculation assumes that the record companies pay a performance royalty equal to 25% of the musical composition royalty shown.

less VAT for permanent downloads suggests the mechanical royalty would be 7.7% of the UK wholesale price (including the musical composition royalty).

Conclusion on adjusted rates

4.27 In the table below, I present a summary of the current market prices, royalties expressed in pounds sterling and mechanical royalty payments expressed as a percentage of the UK wholesale price (including the musical composition royalty) for permanent downloads.

Table 6: Summary of calculations for permanent downloads

Music service	Retail price	UK royalty	Mechanical royalty as % of wholesale price plus royalty
Permanent Download Service	£0.79	£0.0537	7.7%

Source: LECG analysis.

4.29 I would not expect a royalty rate set as a percentage of the wholesale price for limited downloads and on-demand streaming to be higher than the rate for permanent downloads.

5 Expert declaration

5.1 I set out below the standard declaration signed by expert witnesses appearing before the English courts under the Civil Procedure Rules.

5.2 I, Richard Boulton, declare that:

- I consider that my duty in providing written reports and giving evidence is to help the US Copyright Royalty Judges and that this duty overrides any obligation to the parties who have engaged me. I confirm that I have complied with that duty;
- I believe that the facts I have stated in this report are true and that the opinions I have expressed are correct;
- I have endeavoured to include in my report those matters, which I have knowledge of or of which I have been made aware, that might adversely affect the validity of my opinion;
- I have indicated the sources of all information I have used;
- I have not, without forming an independent view, included or excluded anything which has been suggested to me by others;
- I will notify my instructing attorneys immediately and confirm in writing if for any reason this report requires any correction or qualification;
- I understand that: my report, subject to any corrections before swearing as to its correctness, will form the evidence to be given under oath or affirmation; I may be cross examined on my report; and
- I have not entered into any arrangement where the amount or payment of my fees is in any way dependent on the outcome.

Richard Boulton

Appendices

LECG

Appendix 1 – Curriculum Vitae

LECG

Richard Boulton, Director, LECG

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BIO
Richard is a director of LECG and also a barrister at One Essex Court.

Richard advises LECG clients on strategic, regulatory, economic, and valuation issues. He has been instructed in over 100 litigations, including many of the UK's largest commercial disputes, and has led several major fraud investigations. He has given oral evidence in the High Court, Copyright Tribunal and before the European Commission (Competition Directorate). Richard has co-written a best selling business book on intangible assets.

Richard spent 20 years with Arthur Andersen (11 as a partner). He left Arthur Andersen in June 2001. His experience at Arthur Andersen included several global management positions, including number two executive worldwide; 15 years' client work as a consultant on financial and economic issues, particularly in the media and energy sectors; and, substantial experience as an expert in major commercial litigation.

His management experience covers strategy, technology, marketing, operations and finance. He played a major role in building Arthur Andersen's $2bn consulting business with leadership positions in the UK and globally. He was for three years the firm's managing partner of strategy, with responsibility for both long term direction setting and day to day operations.

QUALIFICATIONS
MA in Modern History, Oriel College, Oxford University, 1978-1981
Postgraduate Diploma in Law (Distinction), College of Law, 2002
Bar Vocational Course (Outstanding), BPP Law School, 2003

PROFESSIONAL MEMBERSHIPS
Fellow of the Institute of Chartered Accountants of England and Wales (ACA 1984, FCA 1996)
Fellow of the Academy of Experts, 1994

PRESENT POSITIONS
LECG, Director, 2002 – present
One Essex Court, Barrister, 2004 - present

PREVIOUS POSITIONS
Arthur Andersen 1981 – 2001
Management positions:

- Global Managing Partner - Business Consulting (2000-2001), responsible for a business with revenues of $2 billion and 11,000 people.
- Chief Information Officer (2000-2001), responsible for 2,000 technology personnel worldwide.
- Global Managing Partner – Strategy (1997-2000), responsible for the firm's four service categories (assurance, business consulting, corporate finance and tax)
- UK Head of Business Consulting (1995-1997)
- UK Head of Economic and Financial Consulting (1994-1997)
- European Head of Litigation Services (1994-1997)

PROFESSIONAL EXPERIENCE

Intellectual property

Expert reports and oral evidence to the UK Copyright Tribunal in the matter: BPI and others v MCPS and others (2006), concerning licence terms for the supply of musical compositions online

Advising a European manufacturing firm in relation to the acquisition of a portfolio of intellectual property (including leading the negotiations as to the monetary value of those rights).

Valuation of a disputed net profit participation agreement in the music industry.

Advising a UK pharmaceutical company in relation to damages arising out of abuse of a dominant position.

Currently advising a large global pharmaceutical company in relation to a UK patent infringement.

Advisor to an international business in the oil industry in relation to damages for patent infringement.

Advising a global manufacturer on the level of a reasonable royalty for 17 different patents.

Advisor to a global European manufacturer on a major patent infringement claim.

Valuation of all the intellectual property owned by a global European manufacturer, including several major brands and over 5,000 patents.

Expert report and oral evidence to the EC Commission DGIII and DGIV on the level of a reasonable royalty for video airplay in connection with a complaint under Article 86 of the Treaty of Rome.

Expert report and oral evidence in the High Court (Patents Court) in the Hoechst Celanese v BP account of profits enquiry (1998).

Expert report and oral evidence in the High Court (Patents Court) in the Gerber Garments Technologies Inc v Lectra Systems Ltd damages enquiry (1995).

Expert report and oral evidence to the UK Comptroller General of Patents in connection with the level of a reasonable royalty for a licence of right.

Expert report and oral evidence to the EC Commission DGIII and DGIV on the level of a reasonable royalty in connection with a complaint under Article 86 of the Treaty of Rome.

Expert reports and oral evidence to the UK Copyright Tribunal relating to the level of a reasonable royalty on three occasions (BSkyB v PRS (1997), AIRC v PPL (1992), TV Listings (1990)).

Expert report and evidence in a major confidential arbitration relating to damages arising from patent infringement (manufacturing industry).

Quantification of damages and expert advice on the level of a reasonable royalty in a number of other cases relating to copyright and patent infringements and licence of right registrations.

Assistance in licensing negotiations and advice on the level of a reasonable royalty in various industries, including consumer products, manufacturing, pharmaceuticals, performing rights and other copyright (music, video, publishing, software) and brand names.

Advice on arm's length royalty rates in the context of tax structuring and intercompany transfer pricing agreements (including expert advice on the UK's largest transfer pricing dispute).

Valuation of brands, trademarks, patents and publishing rights.

Competition and regulatory experience
Economic advisor to the Office of the Rail Regulator (ORR) on economic aspects of the restructuring of the rail network. Significant work on track access charges and the facilitation of competition between train operators.

Expert reports on two cases under the Restrictive Trade Practices Act.

Advisor to the BBC on the MMC enquiry into collective licensing.

Prepared submissions to OFTEL on behalf of the ITV Association re the pricing of access to the telecoms network.

Advisor to regulated companies in the gas, electricity, media, and telecoms industries.

Authored "Tuning in: Making the BBC more Accountable", a response to the Government's Green Paper on the future of the BBC.

Damages analysis
Quantification of damages in approximately 100 litigations, including many of the UK's largest commercial disputes (e.g. Argyll v Guinness, Ferranti litigation, and several large claims involving investment banks, accounting firms and other professional advisers).

Quantification of lost profits in the context of several insurance claims arising out of fire, flood, and other causes of business interruption. Specific cases include the quantification of the impact on production and profits of an explosion at a copper smelting plant in Utah; and the assessment of lost profits due to fires at various manufacturing plants in England

Expert report submitted to the Office of Fair Trading on the methodology for computation of lost profits on the termination of a photocopier supply agreement.

Expert evidence includes Senate v Alcatel (the leading authority on post acquisition warranty disputes).

Analysis of the causes and quantification of delays and cost overruns on several major construction projects.

Other client experience
Assisted the Scott Inquiry into the sale of arms to Iraq.

Led a major fraud investigation into BCCI on behalf of the majority shareholders (leading a team of 40 people).

Led the investigation into the Bombay stock market scam on behalf of a major international bank.

Expert reports for the underwriters on the Ikarian Reefer.

Advised clients in many industries on strategic and valuation issues.

PUBLICATIONS
"The use of intellectual property as security for debt finance", produced on behalf of the Intellectual Property Institute, March 1997.

"The calculation of damages for patent infringement", Managing Intellectual Property, June 1995.

"Trends in intellectual property damages in the US and UK", International Commercial Litigation, December 1995.

"Financial Remedies for patent infringement", International Commercial Litigation, November 1996.

"Cracking the Value Code: How Successful Businesses are Creating Wealth in the New Economy", published by Harper Business in April 2000 (translated into 15 languages).

ADDITIONAL PROFESSIONAL ACTIVITIES
Frequent speaker at international conferences on management and business issues (e.g. Keynote speaker at the IFAC Conference, 2000).

Regularly quoted by leading media outlets including Fortune, Forbes, Business Week, Financial Times, Wall Street Journal, Times, Bloomberg and CNN.

Chairman of IBC's conference on "Patent and Technology Licensing – Creating a Successful Profit Centre for the 21st Century" (October 1996).

Keynote speaker at various conferences on Intellectual Asset Management.