TESTIMONY OF

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## INTRODUCTION

I am General Counsel and Executive Vice President of the International Federation of the Phonographic Industry ("IFPI"). IFPI is an association that represents the recording industry worldwide. In my current position, I am responsible for legal affairs at IFPI, including all issues relating to litigation, licensing, and regulatory matters.

In the last twenty-five years, the United States has gone from having one of the lowest mechanical royalty rates in the world to having one of the highest. The United States is also one of the only countries in the world not to use a percentage royalty structure for mechanical licensing. In my testimony, I will discuss these and other important international trends that are useful benchmarks in considering changes to the U.S. mechanical royalty rates. I will also explain why countries worldwide view a percentage rate system as a critical element to their mechanical royalty schemes.

My testimony will also highlight the important similarities between the U.S. recording industry and the recording industries in the U.K. and, to a lesser extent, Japan. These three countries represent the world's most developed music markets, having the world's highest levels of record sales and releases. The U.S. and U.K. record industries also have a distinct international focus, distributing more music than any other countries. Additionally, I will discuss how all three countries' recording industries have undergone similar changes in recent years, with online sales and online music piracy changing the marketplace.

Given the parallels between the recording industries in the U.S., U.K., and Japan, and the market forces affecting each of them, the mechanical royalty rate schemes in the U.K. and Japan provide useful guidance in reassessing the direction of U.S. mechanical royalty rates. As I will discuss in more detail, the U.K. mechanical royalty rates for online music have recently been the

subject of a UK Copyright Tribunal reference which resulted in a settlement in September 2006 between the British Phonographic Industry ("BPI"), various online and mobile service providers, and the Mechanical-Copyright Protection Society ("MCPS") and Performing Right Society ("PRS"), which administer mechanical and performance rights on behalf of music publishers and songwriters in the U.K. For reasons that I will discuss, the U.K. settlement for online mechanical royalty rates, together with the rates set by the U.K. Copyright Tribunal in 1991 for physical copies of music (which still apply today), suggest that mechanical royalty rates even lower than those in the U.K. would be appropriate in the U.S. for the next five years.

## BACKGROUND

### I. Personal Background

I first joined IFPI in 1997, from the Brussels office of Wilmer, Cutler & Pickering (now WilmerHale). I worked at IFPI as a legal adviser, senior legal adviser, and then Deputy General Counsel. One of my responsibilities at IFPI during this time was to advise recording associations and record companies around the world on issues related to mechanical royalties, including providing advice when they were negotiating for, or involved in proceedings related to, revised mechanical royalty rates. In order to perform this function, it was important that I have an understanding of what the rates and terms were around the world, as well as keeping current on mechanical royalty-related changes and proceedings.

In 2004, I left IFPI to become General Counsel of the BPI, the recording industry association in the U.K. whose counterpart in the U.S. is RIAA. I was at BPI when a proceeding before the U.K. Copyright Tribunal was initiated to set the mechanical and performance royalty

rates for online music.[1] I was involved in formulating BPI's rate proposal and evidence. I was also responsible for liaising between the member record companies and our attorneys.

I returned to IFPI and assumed my current position in December 2005. In changing jobs, it was agreed that I would continue to play an active role in the running of BPI's case before the Copyright Tribunal. I was also closely involved in the negotiations that eventually led to a settlement; I will discuss the elements of that settlement later in my testimony.

In my current position as General Counsel, I am still involved in advising member companies and associations on issues related to mechanical royalties. I am also responsible for IFPI's internet anti-piracy strategy and all other regulatory and litigation matters affecting IFPI.

## II. IFPI Background

IFPI represents the recording industry worldwide, with more than 1,450 member record companies in 75 countries, and affiliated industry associations in 48 countries. IFPI's Secretariat is based in London, and it has regional offices in Brussels, Hong Kong, Miami, and Moscow. IFPI represents its members at the international, regional, and national levels, and acts as an umbrella for its national groups and affiliated industry associations. IFPI is closely affiliated with RIAA, and approximately 30 of its members are U.S. record companies.

One of IFPI's main activities is guiding international strategy in key areas, including anti-piracy enforcement, technology, lobbying of governments, representation in international organizations, legal strategies, litigation, and public relations. An important objective of this international strategy is the establishment of fair and reasonable mechanical royalty rates around

[1] The U.K. Copyright Tribunal is comprised of a Chairman and two deputy Chairmen appointed by the Lord Chancellor, as well as two to eight ordinary members appointed by the Secretary of State for Trade and Industry. The Tribunal operates on a panel basis and its main function is to determine the terms and conditions of licensing schemes offered by, or licensing schemes operated by, collective licensing bodies in the copyright area.

the world, so that record companies are able to maximize the availability of new recordings and have the freedom to exploit new markets while still fairly compensating songwriters and publishers.

IFPI's current priorities include promoting fair market access and adequate copyright laws, helping to develop the legal conditions and technologies for the record industry to prosper in the digital area, fighting music piracy, and promoting the value of music in the development of economies.

## DISCUSSION

### I. The Majority of Mechanical Royalty Schemes Around the World Are Percentage Rate Systems.

From my work with IFPI, I have become familiar with many mechanical royalty structures and rates around the world. Based upon my knowledge of worldwide mechanical royalty schemes (as illustrated in RIAA Ex. D-101-DP, a "Quick Reference Tariff Table Relating to Downloads and On-demand Streaming"), I can attest to the fact that almost every country in the world has recognized the advantages of using a percentage rate of either wholesale or retail prices in setting mechanical royalty rates.

Percentage rate structures are prevalent around the world because they provide a flexible and sensible method for determining appropriate mechanical royalties in changing and diverse marketplaces. A percentage rate, unlike a flat cents rate, accommodates changes in price, technology, business model, and other marketplace characteristics by preserving the balance between mechanical rates and record industry revenues. The same rate can be applied to new and different formats, without having to specifically address variations in pricing among different types of products and services. Percentage royalties also accommodate flexible pricing so as to maximize sales, such as marketing older catalog recordings at reduced prices, which

creates incentives for record companies to continue distribution of recordings that otherwise might not generate mechanical income for their writers and publishers. Finally, a percentage rate ensures that mechanical royalties respond to the evolution of music prices overall, protecting record companies against unfairly high mechanical royalties if prices fall, while at the same time allowing songwriters to benefit from higher prices.

## II. U.S. Mechanical Royalty Rates Should be Consistent with Those of Other Major Developed Music Markets.

The music industry in the U.S. is similar to the music industries in both the U.K. and Japan in many important respects. These three countries have the most developed music markets in the world, and I would expect that the similarities between these markets would lead to somewhat similar mechanical royalty rates and structures. All three countries have extremely significant record markets. For example, the U.K. is second only to the U.S. in the number of albums released per year.[2] Japan generates the second highest total retail revenue from music in the world, after the U.S., and the U.K. is third.[3] These three countries are also the world leaders in developing the online marketplace. In 2005, the U.S., Japan, and U.K. were the top three countries for digital music sales.[4]

Another feature that the U.K. and U.S. have in common is that their record companies invest particularly heavily in the areas of A&R and marketing and promotion of records; much

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[2] In 2005, 31,291 new albums were released in the U.K.. *See* BPI Statistical Handbook 2006, at p. 33. Excerpts attached as RIAA Ex. D-102-DP.

[3] *See* IFPI 2006 Global Recording Industry in Numbers, at p. 3. Excerpts attached as RIAA Ex. D-103-DP.

[4] *See id.*

more so than is typically done in other countries.[5] Record companies in both countries are also investing in developing a legitimate online music market, while at the same time facing and fighting similar significant online piracy problems. In the U.K., as throughout the world, there is a large disparity between the investments made and risks faced by record companies as compared to music publishers. Record companies in the U.K. incur tremendous expenses in A&R and promoting records that they often never recoup. Publishers start making royalties on the first album sold without having to undertake investment risks on a similar scale. Also, music publishers have not incurred the costs that record companies have in developing the online market, through tasks such as encoding whole catalogs, supplying new metadata, developing new accounting systems, and fighting internet piracy.

Another similarity between the U.K. and U.S. music industries (but not with Japan) is that they are both very international in focus. The U.K. recording industry is behind only the U.S. in number of records distributed or licensed abroad. U.K. artists accounted for 8% of all artist album sales in the U.S. in 2004.[6]

The recording industries in the U.S., U.K. and Japan have also experienced similar damaging changes in recent years. Retail spending on recorded music in the U.K. has been declining since 2001, and album retail prices fell 11% between 2000 and 2005.[7] In Japan, the number of physical units shipped annually declined approximately 14% between 2001 and 2005.[8] Although online sales have been greatly increasing in the U.K. and Japan in recent years,

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[5] For example, U.K. record companies spent approximately £206 million (or approximately $390.5 million) on A&R in 2004. *See* BPI Press Release, "Record industry reinvests 17% of turnover in new music," April 19, 2006, RIAA Ex. D-104-DP.

[6] *See id.*

[7] See BPI Statistical Handbook 2006, at p. 29, RIAA Ex. D-102-DP.

[8] *See* IFPI 2006 Global Recording Industry in Numbers, at p. 73, RIAA Ex. D-103-DP.

as in the U.S., and online is the fastest growing delivery channel for music, the online market still represents only a small portion of overall music sales – three percent of overall music sales in the U.K. and seven percent in Japan in 2005.[9] In all three countries, growth in online sales has thus far been insufficient to compensate for the drop in sales of physical products, and record companies have experienced a decline in revenue in recent years. Annual trade revenue for recorded music decreased by approximately 6% between 2001 and 2005 in the U.K., and approximately 15% in Japan.[10]

Finally, it is also significant that in the U.K. and Japan, as in the U.S., there is a mechanism in place to set reasonable royalty rates when parties cannot agree on the rate. As already noted, a Copyright Tribunal is established by statute to resolve license fee disputes. A similar arbitration mechanism exists in Japan, although in practice disputes have been resolved through mediation facilitated by the Japanese Agency of Cultural Affairs.

## III. The Mechanical Royalty Rate Structures in the U.K. and Japan.

For all of the reasons articulated above, the U.S., U.K. and Japanese recording industries are alike in many important respects, and it therefore follows that the mechanical royalty schemes in the U.K. and Japan provide useful comparables in examining the U.S. system. Below I provide a brief overview of the mechanical royalty structure in Japan, which I am familiar with from my many years advising on international mechanical royalty rates. I will also describe in some detail the separate mechanical royalty rate structures in place in the U.K. for physical and online formats, which I am very familiar with from my position at the BPI, as well as my involvement in the recent setting of the rates for online formats.

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[9] *See id.*, pp. 67 and 73.

[10] *See* IFPI 2006 Global Recording Industry in Numbers, at pp. 67, 73, RIAA Ex. D-103-DP.

A. Mechanical Royalties In Japan

The current effective mechanical royalty rate for physical formats in Japan is 4.53% of retail price. This rate, which has been in place since 1995, is achieved after packaging and shipping discounts are applied to the base rate of 6%.

The rate for online music in Japan was set by voluntary agreement between the Recording Industry Association of Japan ("RIAJ") and the Japanese Society for Rights of Authors, Composers and Publishers ("JASRAC") in 2005. The royalty system for online music in Japan is a joint royalty rate scheme, which combines royalties owed for both mechanical and performance rights. The net joint royalty rate for permanent downloads is 6.54% of retail price, after discounts of up to 15% that most providers qualify for are applied to the 7.7% base rate.[11] For on-demand streaming services the joint mechanical/performance royalty rate in Japan is 4.5%, and for webcasting it is 3.5%. A 10% discount is available for on-demand streaming and webcasting when conditions similar to those imposed for downloads are met. There are also minimum royalties that apply to each of these categories.

B. U.K. Mechanical Royalties for Physical Formats

The current mechanical royalty rate for physical products in the U.K. was set in 1991 by the U.K. Copyright Tribunal at 8.5% of PPD ("Published Price to Dealer," which is the published list wholesale price before discounts are applied). Prior to the Copyright Tribunal decision in 1991, the rate was previously 6.25% of retail price. Both the record companies and the music publishers agreed before the 1991 proceeding that the rate should be based on PPD,

[11] The conditions that must be met for the discount to apply are: 1) application of technical measures to prevent illegal reproduction of copyrighted works; 2) use of copyright management information through electronic watermarks or comparable means; and 3) provision of royalty reporting through electronic means. Each condition warrants a 5% discount, for a total available discount of 15%.

rather than retail. The Tribunal, in setting the rate at 8.5% PPD, found that the recording industry had "thrived" internationally during the sixty-year period that the previous rate had been in place and that it should not disturb the existing position unless there was good cause,[12] and therefore set a rate that was only a slight increase over the PPD equivalent of the previous rate. Following the Copyright Tribunal's decision, the parties separately agreed that in cases where there is no PPD, the rate would be 6.5% of retail price.

There are no minimum mechanical royalties imposed on physical products in the U.K. The Copyright Tribunal in 1991 stated that including a minimum royalty would result in special treatment for composers at the expense of record companies, for which there was no commercial justification.[13] The Tribunal also noted that imposing a minimum royalty would make it difficult or impossible for record companies to sell older works at the discounted prices necessary to attract sales.

Finally, the U.K. Copyright Tribunal decided that there should be no limit on the number of promotional copies that record companies can provide royalty-free.[14] It determined that because there is a sufficiently common interest between record companies and composers in their desire to maximize profits from record sales, it was not necessary to establish a limit on

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[12] *See* Copyright Tribunal Decision in The Matter Between The British Phonographic Industry Ltd. and Mechanical-Copyright Protection Society Ltd. and Composers' Joint Council, Nov. 1, 1991, at 45. Attached as RIAA Ex. D-105-DP.

[13] *Id.* at 19.

[14] All "bona fide" promotional copies are royalty free in the U.K. if certain reporting requirements are satisfied, but BPI and MCPS have agreed as an alternative that 1,500 promotional copies (3000 singles) will be allowed with less detailed reporting/evidential requirements.

promotional exemptions.[15] The Tribunal noted that record companies lose just as much money as composers if too many promotional copies are given away, and left it to the commercial judgment of the record companies to determine the proper amount.

C. U.K. Mechanical Royalties for Online Formats

As mentioned above, the royalty rates for online music in the U.K. have recently been the subject of a U.K. Copyright Tribunal reference. In September 2006, the BPI, certain music service providers and mobile network operators entered into a settlement with the MCPS and PRS in respect of the majority of issues that were before the Copyright Tribunal (iTunes and a number of mobile network operators are continuing to pursue a number of specific issues before the Copyright Tribunal). The original reference to the Copyright Tribunal was initiated by BPI and music service providers to challenge the royalty rate scheme instituted by "MCPS-PRS Alliance" (the "Alliance"), a collaboration between the UK mechanical rights and performing rights collection societies. The royalty system that the Alliance sought to impose was a joint royalty rate scheme, which combined royalties owed for both mechanical and performance rights for a range of services. The parties, however, were able to reach a settlement on the royalty rates and terms just as the proceeding was set to begin. That settlement applies retroactively for royalties due beginning July 1, 2006, and will continue until June 30, 2009. The agreed terms apply specifically to the parties to it but the firm expectation is that when the remaining issues before the Copyright Tribunal are resolved early next year, that the MCPS and PRS will issue an online scheme which, in all but the issues still before the Tribunal, mirrors the settlement.

[15] Copyright Tribunal Decision in The Matter Between The British Phonographic Industry Ltd. and Mechanical-Copyright Protection Society Ltd. and Composers' Joint Council, Nov. 1, 1991, at 16. Attached as RIAA Ex. D-105-DP.

In the U.K., the Alliance has insisted on licensing only music service providers and has refused to license record companies where they are not the last link in the transmission of music to the user. Therefore, it is the music service providers that have generally obtained mechanical and performance right licenses and paid the relevant royalties. I understand that in the U.S., record companies, rather than music service providers, generally obtain mechanical licenses and pay mechanical royalties for downloads.

The rate structure under the agreement is divided by online service types. For permanent downloads, the rate is set at eight percent of the retail price, less VAT. The royalty rate is also eight percent of the retail price, less VAT, for limited downloads and on-demand streaming services, as well as for special webcasting. Limited downloads are when users are able to download recordings of their choosing but retain them only for a limited time (e.g., the duration of a subscription), and with on-demand services, users can stream specific recordings on-demand, but cannot retain the recordings for subsequent listening. Special webcasting services are defined as those where more than 50% of the songs played are by a single artist or band. Finally, for premium and interactive webcasting, as well as pure webcasting, the joint royalty rate is set at 6.5%, less VAT. Services are categorized as premium or interactive webcasting when they do not fit into any of the other categories and no permanent or temporary copy of a work is retained by the user. Pure webcasting services are those in which, among other criteria, there is no interactive functionality, personalizing of the service, or advance notice of tracks to be played. The agreement also grants a license to reproduce musical works on servers for the purpose of transmitting those recordings to users.

In addition to the base royalty rates, there are also various minimum royalties applicable for each type of service. U.K. record companies did not wish to agree minimum royalties, but

accepted them as part of the give and take in reaching an overall settlement. Their inclusion allowed BPI to reach agreement on other features that were very important to BPI members, and we accepted the agreed upon minimums because they are flexible, detailed, and part of a larger package deal with rates that we could accept. For permanent downloads, the agreement provides for reduced minima on bundles of multiple tracks. Details on the agreed mechanical royalty rates and minima for online formats are provided in the chart below:[16]

| Service | Rate | Minimum Royalties |
|---|---|---|
| Permanent Downloads | 8% gross revenue (less VAT) | £0.04 for single track downloads (or bundles of 7 tracks or less) (approx. 8¢ U.S.)<br>£0.035 for each track in bundles of 8-12 tracks<br>£0.03 for each track in bundles of 13-17 tracks<br>£0.025 for each track in bundles of 18-29 tracks<br>£0.02 for each track in bundles of 30+ tracks<br>£0.03 per track if track was originally released 2+ years previously and is sold for a price of 49 pence or less (same rate for bundles of 13+ tracks when entire bundle or all tracks in bundle were originally released 2+ years ago) |
| Limited Download/On-demand Service | 8% gross revenue (less VAT) | £0.60 per subscriber/mo. for portable subscription services (approx. $1.13 U.S.)<br>£0.40 per subscriber/mo. for PC subscription services (approx. $0.75 U.S.)<br>£0.20 per subscriber/mo. for limited subscription services (approx. $0.38 U.S.)<br>£0.0022 per musical work played for all other LD/ODS services (approx. $0.004 U.S.) |
| Special Webcasting | 8% gross revenue (less VAT) | £0.0022 per musical work communicated per user, unless service is subscription service, in which case parties shall negotiate a minimum (approx. $0.004 U.S.) |
| Premium & Interactive Webcasting | 6.5% gross revenue (less VAT) | £0.22 per subscriber/mo. for webcasting subscription services (approx. $0.41 U.S.) |

[16] *See* U.K. Settlement Agreement, dated September 28, 2006, at Schedule 2. Attached as RIAA Ex. D-106-DP.

| | | |
|---|---|---|
| | | £0.00085 per musical work communicated per user (approx. $0.0016 U.S.) |
| Pure Webcasting | 6.5% gross revenue (less VAT) | £0.22 per subscriber/mo. for webcasting subscription services (approx. $0.41 U.S.)<br>£0.0006 per musical work communicated per user (approx. $0.0011 U.S.) |

Although the agreement provides for minimum royalties, it is expected that the percentage rate will be the operative rate in most situations. As an example, the price of a permanent download from iTunes U.K. is £0.79, which, after excluding the 17.5% VAT, amounts to £0.672. The 8% mechanical royalty due on this download would be £0.0537, rather than the minimum of £0.04.

Additionally, the agreement also contains various promotional exemptions, under which the minimum royalties will not apply. For instance, services are permitted to use clips of up to 30 seconds to promote a song without the payment of a minimum royalty, so long as the clip is used solely for promotional purposes. There are also provisions for royalty-free introductory trial periods for webcasting subscribers, as well as a limited number of special royalty-free downloads for non-subscription services. Additionally, only one royalty is payable for "dual downloads," so that even if a song is downloaded to both a mobile device and a computer, only one royalty is due.

The agreement also includes provisions for certain important discounts. For example, gross revenue obtained in the form of advertising or sponsorship will be reduced by five percent to reflect the costs in obtaining it. There is also a 15% discount for all audio-visual material until the "date of convergence" (which is defined as when unit sales of permanent video downloads become the same or greater than the unit sales of audio-only permanent downloads). Finally, there is also a 15% discount for mobile permanent downloads and a 7.5% discount for other mobile music services (which also will only apply until a certain date of convergence).

D. Comparing Mechanical Royalty Rates in the U.K. and Japan to those in the U.S.

Due to the similarities between the U.S., U.K., and Japanese music industries, the rate structures in the U.K. and Japan are appropriate considerations when determining the U.S. mechanical royalty rate. However, there are a number of factors that must be taken into account when comparing the rates. Based on my experience with international mechanical royalty rates, I would expect these factors to result in the U.S. having a lower royalty rate than the U.K. and Japan.

The first difference is that the online royalty rates in the U.K. and Japan are joint mechanical and performance right royalties. To translate the rate to something that could be applied in the U.S., one must deduct the value of the performance royalty from the joint royalty rate. Based on my knowledge of how the collecting societies divide the joint royalties between mechanical and performance rights, they apportion the mechanical royalty and performance royalties 3:1 in favor of mechanical royalties for downloads (75% mechanicals, 25% communication to public right).[17] This suggests that the "value" of the mechanical right for permanent downloads in the U.K. is 6% (75% of 8%) of retail price. Therefore, the mechanical royalty rate in the U.S. should be lower than the joint rate of the U.K. and Japan to account for the fact that performance rights in the U.S. are not being addressed in this proceeding.

Also, the mechanical royalty rate in the United States should take into account the high level of international marketing that U.S. record companies undertake. Although the U.K. is second in the world for music exports, the gap between it and the U.S. is still significant. The U.S. is responsible for 34% of the global value of music, whereas the U.K. produces 10% of the

[17] *See* http://www.mcps-prs-alliance.co.uk/.

global value.[18] Because U.S. record companies invest in creating the world's most successful international repertoire, music publishers and songwriters in the U.S. receive a greater benefit from U.S. record companies than do publishers and songwriters in other countries, including the U.K. and Japan, from their record companies. Therefore, it would be appropriate for the royalty rates in the United States would be lower than those in the U.K. and Japan.

## IV. Factors Contributing to The Different Mechanical Royalty Rates in Other Countries.

When comparing the mechanical royalty rates in different countries, it is very important to understand the various legal and industry factors that influenced the setting of the rate. Over the years I have worked at IFPI, assisting various countries with mechanical royalty rate issues, I have observed how these various aspects impact the rate of mechanical royalties. I believe that examining some of these factors clarifies why the mechanical royalty rates are higher in a number of countries, most notably continental European countries, than the rates are in the U.K. and Japan, and the rates should be in the U.S.

First, most countries do not have independent bodies that determine royalty rates or to which disputes regarding the reasonableness of rates can be brought. Without such independent bodies, such as the Copyright Royalty Judges and the U.K. Copyright Tribunal, the rates in many countries have been unilaterally promulgated by the collecting societies, often despite the objections of licensees.

The nature of the recording industry in the country also has a significant impact on the mechanical royalty rates. The substantial investment made by record companies in the U.S., U.K., and Japan provides music publishers and writers with a great deal more benefit than they

[18] *See* IFPI 2006 Global Recording Industry in Numbers, at pp. 26, 67, RIAA Ex. D-103-DP.

obtain in other countries. For instance, because U.S. and U.K. record companies are international in focus, writers and publishers receive mechanical and performance royalty payments around the world from recordings produced in the U.S. and U.K. They also profit in increased sales from the large sums invested by record companies in A&R and promotion.[19] Also, record companies in continental Europe typically spend less on recording albums and pay lower advances to artists than do companies in the U.K. and U.S.

Furthermore, record companies in many other countries have reduced risk because the majority of internationally successful repertoire originates in the U.S. and U.K. The songs that do not succeed in the U.S. and U.K. are weeded out before being released in other countries, with the losses sitting with the U.S. or U.K. record company concerned. On the other hand, the songs that are proven hits in the U.S. or U.K. can then be released in other countries without additional production cost. For licensees of the major record companies, the records are available free of advances and recording and video expenses, and with considerable market research already completed. As a result, the risk profile of U.S. and U.K. record companies is much higher than that of record companies in most territories. Because record companies in other countries have less investment and risk than record companies in the U.S. and U.K., and because they provide less benefit to music publishers and writers, it is logical that their mechanical royalty rates should be higher than those in the U.S. and U.K.

Finally, the mechanical royalty rates in continental Europe appear higher at face value than they actually are because a number of discounts are applied to the set rate. For example, the

[19] These points were noted in the U.K. Copyright Tribunal's 1991 decision as reasons that the mechanical royalty rate in the U.K. should be lower than the BIEM/IFPI rate that applied to most of continental Europe. *See* Copyright Tribunal Decision in The Matter Between The British Phonographic Industry Ltd. and Mechanical-Copyright Protection Society Ltd. and Composers' Joint Council, Nov. 1, 1991, at 35-37, RIAA Ex. D-105-DP.

official rate for physical formats under BIEM/IFPI contract, which set the mechanical royalty rate across continental Europe and has now expired but is still followed by many countries today, is 11% PPD. But after discounts are applied, the net rate is only 9.009% PPD. My understanding is that this rate may be further reduced by central licensing rebates and other considerations.

All of these considerations explain why many countries, continental European countries in particular, are not suitable comparables to the U.S. as are the U.K. and Japan when looking at mechanical royalty rates.

## V. The U.S. Mechanical Rates Are Among the Highest in the World.

The United States has one of the highest mechanical royalty rates in the world for physical music formats, and its rate for online formats is higher than other countries with independently set or agreed rates. The fact that the rates in the U.S. are higher, despite the numerous reasons discussed above why the U.S. should have one of the lowest mechanical royalty rates in the world, shows that the current U.S. rates are higher than they should be.

### A. Comparison of Rates for Physical Formats.

Over the past 25 years, the United States has gone from having among the lowest mechanical royalty rates in the world for physical music formats to having among the highest rates today. The chart below shows the mechanical royalty rates in place in various countries in 1981, after the statutory rate in the U.S. was increased by the Copyright Royalty Tribunal, and the rates for physical products in the same countries in 2005.

| Country | 1981 | 2005 |
|---|---|---|
| United States | 4¢ - approximately equivalent to 5% retail or 8.6% wholesale | 9.1¢ - approximately equivalent to 12.93% wholesale (14.15% in 2006) |
| Austria | 8% retail | Net rate of 9.009% PPD (11% PPD before deductions) |

| | | |
|---|---|---|
| France | 8% retail | Net rate of 9.009% PPD (11% PPD before deductions) |
| Italy | 8% retail | 9.009% PPD for physical formats |
| Japan | 5.4% retail (and 4.8% for singles) | Net rate of 4.53% retail (6% before deductions) |
| Netherlands | 8% retail | Net rate of 9.009% PPD (11% PPD before deductions) |
| U.K. | 6.25% retail | 8.5% PPD or 6.5% retail |

As this chart indicates, after the U.S. Copyright Royalty Tribunal adjusted the mechanical royalty rate in 1981, the rate was four cents per song, which translates to approximately 5% of retail price or approximately 8.6% of wholesale price at the time. At that rate, the United States had one of the lower royalty rates in the world. In 2006, however, with a rate of 9.1 cents per song, which is equivalent to approximately 14.15% of wholesale prices, the United States now has one of the highest mechanical royalty rates in the world.

As explained above, in light of various recording industry and legal factors, it appears appropriate that the United States should have a lower mechanical royalty rate than other countries, in particular the continental European countries. The fact that the U.S. instead has one of the highest rates for physical formats in the world today demonstrates that automatic increases to the U.S. mechanical royalty rate have taken it far out of line with rates in other countries.

B. Comparison of Rates for Online Formats.

The mechanical royalty rates currently applied in most countries to online music formats have been unilaterally set by collecting societies and have not been either agreed to by music service providers and record companies or found reasonable by an independent tribunal. Therefore, comparing the rates in those countries to the rates in the U.S. is not useful. Comparing the rates in the U.S. with those countries in which the online rates set by collecting

societies were challenged and resulted in rates independently found reasonable or mutually agreed to, however, supports the proposition that the rates in the U.S. are comparatively high. Those countries with agreed upon online rates – the U.K. and Japan – are also the other countries with the most developed music markets, and as discussed above, I would therefore expect the U.S. to have mechanical royalty rates in line with or lower than those countries. However, when the current U.S. rate of 9.1 cents is applied to a download with a retail price of $.99 and a wholesale price of $.70, it represents 13% of the wholesale price or 9.2% of the retail price. When the current U.S. rate is applied to a download of a 13-track album with a retail price of $9.99 and a wholesale price of $7.00, it represents 16.9% of the wholesale price or 11.8% of the retail price. This is higher than the 8% of retail rate in the U.K. for a permanent download, and considerably higher than the rates in Japan after the discounts are applied. Therefore, even in the emerging area of online music, the U.S. currently has mechanical royalty rates that are higher than the rates for both mechanical and performance rights in other countries where rates have been agreed upon.

## CONCLUSION

As my testimony has explained, the United States is one of the only countries in the world that does not have a percentage-based mechanical royalty rate structure, and therefore the U.S. lacks the important flexibility that other countries' mechanical royalty rate systems have in responding to various formats and new markets. A fixed cents rate in the U.S. is likely to undermine the ability of U.S. record companies to price back catalog recordings at the most efficient level to maximize sales. Even in continental Europe, where there are minimum royalties on physical sales, these are reduced minimum royalties for budget releases to ensure that sales of back catalogs are maximized. The United States has gone from having one of the

lowest mechanical royalty rates in the world to having one of the highest, despite the numerous reasons why the U.S. should have a lower mechanical royalty rate than other countries.

As I also explained, there are numerous reasons that the mechanical royalty structures in the U.K. and Japan are sound comparables for the United States. Those reasons include that all three countries have internationally prominent and leading recording industries, and all face similar issues with declining retail sales of physical products and an emerging online marketplace that is currently undermined by internet piracy. Although the markets are similar in important respects, it is necessary to bear in mind that the online royalty rates in the U.K. and Japan are for both mechanical and performance rights, and that the record market in the U.S. is more prominent internationally than that in the U.K. and Japan. For these reasons, and other reasons discussed above, it is my opinion that the mechanical royalty rate should be lower in the U.S. than in the U.K. and Japan.

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

Geoffrey Michael Taylor

Date: 21/11/06

## Exhibits Sponsored by Geoffrey Michael Taylor (Public)

| Exhibit Number | Description |
|---|---|
| D-101-DP | "Quick Reference Tariff Table Relating to Downloads and On-demand Streaming" |
| D-102-DP | BPI Statistical Handbook 2006 |
| D-103-DP | IFPI 2006 Global Recording Industry in Numbers |
| D-104-DP | BPI Press Release, "Record industry reinvests 17% of turnover in new music," April 19, 2006 |
| D-105-DP | Copyright Tribunal Decision in The Matter Between The British Phonographic Industry Ltd. and Mechanical-Copyright Protection Society Ltd. and Composers' Joint Council, Nov. 1, 1991 |
| D-106-DP | U.K. Settlement Agreement dated September 28, 2006 |