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

In the Matter of: Digital Performance Right in Sound Recordings and Ephemeral Recordings	Docket No. 2009-1 CRB Webcasting III

TESTIMONY OF

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for Sony Music Entertainment

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QUALIFICATIONS

My name is Dennis Kooker. I am currently Executive Vice President, Operations, and General Manager, Global Digital Business and U.S. Sales, for Sony Music Entertainment ("Sony"), a position I have held since October 2008. In this capacity, I am responsible for overseeing all aspects of the day-to-day operations of the Global Digital Business Group and the U.S. Sales Group. The Global Digital Business Group handles digital distribution and sales initiatives on behalf of each of Sony's various label groups worldwide including the United States, and the U.S. Sales Group handles distribution and sales and marketing initiatives on behalf of each of Sony's various label groups in the United States. The areas within the organization that report directly to me include Finance, Sales Reporting, Research, U.S. Supply Chain, and distributed labels such as IODA and RED. In addition, I have general oversight with respect to our artist website group and our direct to consumer sales group.

Before assuming my current role at Sony, I was Executive Vice President, Operations, Global Digital Business and U.S. Sales for Sony, where I oversaw physical sales and channel marketing as well as all aspects of finance for the division. In that role, I oversaw new product development and customer relationship management activities in relation to Sony's artist websites, as well as developed and implemented key commercial strategies and policies for the physical and digital distribution of our repertoire. During this period of my career, the Finance, Sales Reporting, Research, and U.S. Supply Chain areas reported directly to me, while I had general oversight with respect to the artist website and direct to consumer sales groups.

From 2004 to 2007 I was Senior Vice President and Controller for SONY BMG MUSIC ENTERTAINMENT (Sony's corporate predecessor). Prior to that, I was Senior Vice President for Finance at BMG Entertainment. From 2003 to 2004 I was Senior Vice President of BMG North America, and for the four years before that I worked in BMG's United Kingdom and Ireland operations.

I hold a Bachelor of Science in Business Administration from Shippensburg University and an MBA from St. Joseph's University.

DISCUSSION

I. Sony's Position in the Music Industry

Sony is a global recorded music company with a roster of current artists that includes a broad array of both local talent and international superstars. Sony's vast catalog of recorded music comprises some of the most important recordings in history. It is home to premier record labels representing music from every genre, including American Recordings, Arista Nashville, Arista Records, Aware, Battery Records, Beach Street Records, Black Seal, BNA Records, Cinematic, Columbia Nashville, Columbia Records, Epic Records, Essential Records, Flicker Records, Fo-Yo Soul, GospoCentric, Hitz Committee Entertainment, J Records, Jive Records, LaFace Records, Legacy Recordings, Masterworks, Polo Grounds, RCA Records, RCA Nashville, RCA Red Seal, RCA Victor, Reunion Records, Slightly Dangerous, Sony Classical, Sony Music Latin, Star Time International, Verity Records, and Volcano Entertainment.

Sony is a wholly owned subsidiary of Sony Corporation of America and is currently the second largest record company in the United States. In August 2004, Sony Corporation of America and Bertelsmann AG formed a global recorded music joint venture where each contributed its existing recorded music business — Sony Music Entertainment in the case of Sony Corporation of America, and BMG Music, in the case of Bertelsmann AG — to the venture. In October 2008, Sony Corporation of America purchased Bertelsmann AG's fifty percent share of the joint venture. The combined company is called Sony Music Entertainment.

Sony's year to date market share for CD albums in the U.S. is approximately [[redacted]] (including both owned and distributed repertoire), and its year to date digital marketshare for digital albums is approximately [[redacted]] (including both owned and distributed repertoire).

II. Sony's Substantial Investment in the Creation, Marketing and Distribution of Music

Each year, Sony makes substantial investments in the creation, production, marketing, promotion and distribution of recorded music. These investments are and continue to be the life blood that the music industry — in the broadest possible sense, which extends well beyond just record companies — relies upon to find and develop musical talent and transform musical talent into important brands. Once established, the power of these brands goes far beyond just the sale and other exploitation of recorded music. The sale and other exploitation of recorded music alone is a vital function, for without that investment, it would not be possible to bring to the marketplace the new recordings, new artists and heritage recordings that the public clearly enjoys and continues to expect. But the power of these brands also drives other industries, such as webcasting and other digital services, live events and touring, the sale of branded or sponsored merchandise, endorsement opportunities, film and TV careers and music publishing, just to name a few. Each of these industries creates jobs, revenue and growth for a plethora of interested parties and advisors, including the artists. However, it all starts with the substantial investment we make because the careers of these musical artists that eventually become brands begin with the initial financing we provide to record, market and promote the recorded works.

For Sony, the investment activity starts with the discovery of talent. Although talent discovery can occur in several different ways, the primary methodology is for members of our Artists and Repertoire (A&R) department to go to nightclubs and music festivals throughout the country, and spend countless hours listening to demonstration tapes. Out of the hundreds or even thousands of potential artists that our A&R department scouts, only a small handful of new artists get signed. In addition, Sony also invests in third parties who scout for talent under a range of different business arrangements such as so-called "P & D" deals, so-called "label deals", joint ventures and distribution deals. To say the least, this time consuming and laborious "research and development" process involves the skills of an array of highly trained personnel who have a talent for finding that "needle in the haystack" that might become tomorrow's superstar.

Once an artist is signed, we then spend considerable amounts of time and money in developing the repertoire to be recorded, recording the music and working closely with the artist on the branding and imaging that will be used by the artist for his or career generally, including the sale and exploitation of the resulting sound recordings. One of the most significant talent-related expenses are the recording costs and other artist advances, which enable the artist to make the best recordings possible and cover the artist's living expenses during the recording process. We typically advance millions of dollars per year for these purposes. Over the long term, there is much of this investment that Sony often is unable to recover, and many advances simply have to be written off. These recording costs include the cost of backup musicians, sound engineers, producers, and all of the other creative talent required to make a commercial sound recording. All told, our total expenditures for talent and recording in the most recent fiscal year, ending in March 2009, were roughly [[redacted]].[1] (This figure reflects only our out of pocket expenses on these activities. It does not include the salaries and other overhead costs that are required to locate and sign talent and to oversee the process of making a record, such as the A & R staff discussed above, which accounts for many millions of dollars more.)

Of course, making a sound recording is only the beginning. Once a recording is made, it has to be distributed and marketed, which includes manufacturing costs for physical products, marketing costs, promotion costs, and distribution costs (which is substantial even for digital distribution). We invest extraordinary amounts in all of these activities. In 2008, for example, we invested over [[redacted]] on the manufacturing of records and over [[redacted]] on distribution. Our marketing costs are even higher — in the most recent fiscal year alone, we invested over [[redacted]] to sell and market our records, including our out of pocket marketing expenses and our selling and marketing overhead. In the year before that, those same activities required a combined investment of over [[redacted]]. Even with these substantial investments that would seemingly guarantee success, the vast majority of new releases are not profitable for the company.

[1] When we were co-owned by Bertelsmann AG, we reported on a calendar year. Now that we are again wholly owned by Sony Corporation of America, we have returned to our previous practice of reporting on a March year-end. Thus, our fiscal years 2005 through 2007 are equivalent to calendar years, but the next fiscal year (which we refer to in our records as "fiscal 2009") is actually the year running from March 2008 to March 2009. For the sake of clarity, I will simply use "2008" in this statement to refer to that latter year.

III. The Recording Industry's Transformation from Physical Products to Digital Distribution and Its Challenges

The recording industry is currently in a state of extraordinary flux and transformation. Historically, Sony's revenues have been principally derived from the sale and distribution of pre-manufactured physical products, such as vinyl records, cassette tapes, VHS tapes and most recently CDs, DVDs and Blu-Ray discs. Unlike music publishers who have long enjoyed a public performance right and associated revenues every time their songs get played on the radio or TV, the recorded music industry has been almost entirely dependent on the revenues generated by the sale of these packaged goods.

Today, sales of these physical products have fallen precipitously year-over-year, and to satisfy the evolving needs of our consumers and the expectations of the marketplace, we have focused our energies and resources on the digital distribution of music. The challenges associated with this migration from physical to digital distribution are significant, as it significantly "changes the game" from a financial perspective.

The first challenge associated with this migration from physical to digital distribution is that for many consumers, digital formats — including streaming over the Internet — have replaced the consumption of physical products. As a result of this substitution of digital for physical, revenues from digital exploitations of our repertoire — including those attributable to statutory and other forms of licensing activities — are now viewed as a primary source of revenues (rather than "ancillary") that must be maximized in order for the recorded music business to survive, and for Sony to keep making the various investments I have already discussed. Further, I believe that digital revenues will become even more critical as the sale of packaged media continues to decline in the future.

Digital revenues have grown steadily at Sony — both in absolute terms and also as a percentage of Sony's revenues. This is no accident, as Sony has invested heavily in the infrastructure necessary to operate this component of its business. In 2007, for example, digital revenues were [[redacted]] — about [[redacted]] percent of total revenues. In 2008 (i.e., the year ending March 2009), digital revenues were [[redacted]] — about [[redacted]] of total revenues in that year. We expect that digital will make up an even higher proportion of our revenues in the future.

The second challenge associated with this migration from physical to digital distribution is that the marketplace is slowly migrating from a model based on "ownership" of digital music to "access" to digital music. While much of Sony's digital revenue currently comes from a la carte and subscription sales of permanent digital downloads (such as iTunes or other similar online and over-the-air download services) which consumers purchase and own, we are seeing an increasing trend towards streaming services which enable users to "rent" or "access" music from their PC or mobile device without actually "owning" the music. For example, our online subscription revenue from various interactive streaming services such as Napster, Zune and Rhapsody has increased approximately [[redacted]] from [[redacted]] in 2005, to approximately [[redacted]] in 2008.

The third challenge associated with this migration from physical to digital distribution is that consumers only have a finite amount of time to consume music in a day, and the types of interactive services previously mentioned — which generally speaking yield Sony more revenue on both a per user and per play basis — compete head-to-head with the services that operate under the statutory licenses covered by Sections 112 and 114 of the Copyright Act. Our performance revenues from those statutory licenses likewise have risen steadily, from about [[redacted]] in each of 2005 and 2006 to [[redacted]] in 2008.

Thus, in a very real sense, Sony has come to depend on digital revenues from all sources, including the performance royalty income from statutory license. Accordingly, digital revenue is a "core" (not "incidental") source of revenues that is increasingly vital in order to make the continued investment necessary to record, produce and market the recording stars of tomorrow.

IV. The Continuing Decline of Physical Sales and the Failure of Digital Distribution to Close the Gap Is Making It Harder for Record Companies to Recoup on Their Investments.

In light of the challenges I have discussed in section III, it has not been easy to recoup Sony's substantial investments in the creation, production, marketing, promotion and distribution of recorded music. As the Judges well know by now, these challenges have thrust the recorded music industry into a 10-year downward spiral, and we do not believe that we have reached the bottom yet.

The retail sales figures collected and distributed by the RIAA bear that out. Those figures show that the total retail value of all music shipped in the United States in 2008 was $8.5 billion — down 18.2 % from 2007, and down a full 42% from 1999. Breaking out that figure to see the trends in physical versus digital sales is instructive. In 1999, U.S. manufacturers distributed 938.9 million CDs for a total retail value of $12.8 billion. When other forms of distribution are taken into account, such as albums, singles and cassettes, the retail value of all shipments in that year was $14.5 billion. By 2007, CD shipments had fallen to 511.1 million units with a total retail value of $7.5 billion, and things have only continued to get worse: in 2008, the retail value of CD shipments was down to $5.5 billion — a 26.6 % drop from 2007, and about 38% of the 1999 figures.

While sales of traditional physical products have plummeted, Sony's digital revenues have failed to close the gap. While some may have predicted that growth in digital sales would make up for the loss in physical sales by now, I want to stress that this has not yet happened. And the revenue trends I have observed based on the industry in general and Sony's business in particular do not suggest that it will happen any time soon.

In 2008, the total retail value of digital music goods and services was $2.7 billion — which is well short of what would have been needed to offset the decline in traditional physical sales. Our experience at Sony is entirely consistent with these nationwide trends. Sony's U.S. sales of physical product has fallen from [[redacted]] in 2005 to [[redacted]] in 2007, and [[redacted]] 2008 (i.e., the year ended March 2009). Over the same period, revenues attributable to digital products rose from [[redacted]] in 2005 to [[redacted]] in 2007, and only to [[redacted]] in 2008 — not nearly enough to make up for the loss in physical revenues.

Generally speaking, while our digital revenue is growing (though not nearly at the pace we would like to see), as the revenues from our physical records continue to decline, we are becoming increasingly reliant on our digital revenues in order to survive; make the substantial investments in creating, producing, marketing, promoting and distributing recorded music; and bring the public the stars and hits of tomorrow. Without a significant contribution from every conceivable source of those digital revenues — including performance royalties under the Sections 112 and 114 statutory licenses — these goals will not be attainable.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 9/25/09

Dennis Kooker