CAB | ACR

Canadian Association of Broadcasters

L'Association canadienne des radiodiffuseurs

April 10, 2007

Mr. Claude Majeau
Secretary General
Copyright Board of Canada
56 Sparks Street, Suite 800
Ottawa, Ontario
K1A 0C9

Dear Mr. Majeau:

Re: SOCAN/NRCC Tariff 1.A (Commercial Radio Stations) Rehearing

Please find attached the CAB's statement of case and supporting evidence pursuant to the Order of the Board (revised December 6, 2006) in relation to the above noted proceeding.

Sincerely,

Original signed by

Margot Patterson
Vice President, Legal Affairs

cc. Paul Spurgeon (SOCAN)
George Hynna (SOCAN)
Gilles Daigle (SOCAN)
Sundeep Chauhan (NRCC)
Glenn Bloom (NRCC)

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EXHIBIT CAB-1

COPYRIGHT BOARD CANADA

File: Public Performance of Musical Works 2003-2007

SOCAN–NRCC TARIFF 1.A (COMMERCIAL RADIO STATIONS)

REHEARING

STATEMENT OF CASE
OF
CANADIAN ASSOCIATION OF BROADCASTERS

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I. INTRODUCTION

In its decision dated October 14, 2005, the Copyright Board (the "Board") held that the standard rate previously certified for SOCAN Tariff 1A for Commercial Radio ought to be increased on three accounts: [1]

(a) SOCAN's repertoire had been historically undervalued;[2]

(b) Radio now uses more music than in the past;[3] and

(c) Radio now uses music more efficiently.[4]

The Board also held that the NRCC Tariff for Commercial Radio should be set at a rate that is one half the SOCAN rate and, ultimately, certified a single SOCAN-NRCC Tariff (the "Tariff").[5] Accordingly, any increase by the Board in the previous SOCAN Tariff rate results in an increase to that extent in the overall SOCAN-NRCC Tariff Rate.

By Judgment dated October 19, 2006, the Federal Court of Appeal set aside the Board's decision and remitted back to the Board the issues in respect of which the Board's reasons were found to be inadequate. In particular, the Board is required to re-determine issues relating to Tariff increases relating to the "historical undervaluation" of music and the "more efficient use" of music.[6]

The Board subsequently determined the parameters of its re-determination of the issues provided by the Federal Court of Appeal (discussed below) and scheduled a rehearing for June 2007. This constitutes the CAB's summary of the case it will present at the rehearing.

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[1] Decision of the Board dated October 1, 2005 ("Radio Decision"), p.19

[2] Radio Decision, pp. 19-20

[3] Radio Decision, pp. 20-25

[4] Radio Decision, pp. 25-27

[5] Radio Decision, pp. 30 & 42-43

[6] Judgment of the Federal Court of Appeal dated October 19, 2006 (the "FCA Judgment") and Reasons for Judgment of the Federal Court of Appeal dated October 19, 2006 (the "FCA Reasons")

II. FRAMEWORK FOR REHEARING

The Board has ordered that two issues will be re-determined as a result of the FCA Judgment and that the parties shall address each issue by responding to a series of questions. The issues, and questions, are set out below.

(a) The first issue deals with the amount by which the Tariff rates should be increased to account for the historical undervaluation of music. The Board posed the following questions with respect to this issue:

   (i) How should the Board determine the increase in the Tariff rates on account of the historical undervaluation of music?

   (ii) What should that increase be?

(b) The second issue deals with the amount of the efficiencies achieved through the use of music, the share of these efficiencies that should go to those who hold rights in music and the amounts by which the Tariff rates should be increased as a result. The Board posed the following questions with respect to this issue:

   (i) How should the Board measure the increased efficiency in the use of music?

   (ii) How should the Board determine the share of this increased efficiency that should go to SOCAN and NRCC?

   (iii) How should the Board determine the resulting increase in the Tariff rates?

III. CAB SUBMISSIONS

A. METHODOLOGIES FOR DETERMINING TARIFF INCREASES (QUESTIONS A1 AND B1)

1. Introduction

The three bases on which the Board increased the Tariff are interrelated. The Board's decision reflects this interrelationship:

(a) The Board did not define its concept of "efficiency", which was the third basis it discussed. Nevertheless, the decision makes it clear that increased efficiency included and was evidenced by increased music use, the second basis relied on by the Board. In particular, the Board held that the more efficient use of music was "in part *due to an increased use of music*".[7] The Board then went on to repeatedly refer to increased music use in its discussion of what constitutes increased efficiency: "*Music is now used…. much more* in radio programming than it was in 1987." "The ability to create a music personality format for a station *depends at least in part on the station's ability to use more music*." "*[I]ncreasing the use of the repertoires spawns more efficient uses*". "The Board considers that 5-10% of the annual increase in revenues would adequately compensate the rightsholders for *efficiencies that broadcasters were able to derive, in part due to the increased consumption of music*." [emphasis added][8]

(b) The Board's perception of efficiency increases also relied on factors central to historical undervaluation, the first basis discussed by the Board. In the context of efficiency the Board referenced changes in the regulatory framework that left the industry free to use more music and therefore less spoken word content. The Board had already identified radio's declining emphasis on spoken word in favour of more music in its description of why music was historically undervalued.[9]

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[7] Board Decision, p. 25

[8] Board Decision, pp.25-27

[9] Board Decision, pp.20 & 25

So as not to create artificial categories of analysis that tend to duplicate, undercount or obscure changes in value over time, the CAB has approached these issues by providing a principled economic approach that takes into account *all* factors affecting the value of music, whether identified by the Board or not. The CAB has also provided expert evidence that addresses issues with respect to historical undervaluation and increased efficiency in particular to provide additional insights within the analytical categories used by the Board.

2. Economic Principles

The broad economic approach is provided and explained by Professor Stephen Globerman. He notes that the value of an input (such as music) to a potential buyer of that input (such as radio) in a competitive market is determined by the value of the input's marginal product. In other words, the value of music to radio reflects the net revenues that the buyer anticipates receiving from the sale of output to which the input contributes. In our context, the value of music (the input) to radio reflects the net revenues that radio might anticipate receiving from selling advertising associated with broadcasts containing music (the output). This approach reflects any and all factors that contribute to music's value.

Professor Globerman notes that "value" in this sense represents the maximum amount that a purchaser would be willing to pay for the input (the reservation price). He further notes that a purchaser would not actually be expected to pay that amount in a competitive market; the purchaser would pay a smaller amount to an extent that depends, in part, on the elasticity of supply in the input market.

Professor Globerman did not attempt to determine the reservation price at any given point in time. Instead, given that each of issues A and B suggest a change in value over time, he measured the change in radio's reservation price for music over the period 1996 to 2005. This analysis, in turn, leads to a range of possible adjustments to the Tariff itself.

Just as a purchaser's reservation price at a point in time reflects only the maximum price that might be paid, but not the lower price anticipated from a competitive market, so too a change in reservation price over time would not be expected to flow entirely to the input in question. Instead, depending on the elasticity of supply in the input market, the input would be expected to receive only a portion of any change in the notional value of that input to the purchaser.

As noted above, Professor Globerman's approach addresses changes in the value of music to radio regardless of the basis for the change. Each of the Board's three bases for Tariff increases, plus any other bases not identified by the Board, are accounted for across the time period addressed by Professor Globerman. Accordingly, his approach eliminates the problems associated with attempts to separately attribute increased value to different factors that in fact appear to overlap one another.

3. Factor Specific Analysis

In addition, the CAB has provided expert evidence on the radio industry from Michel Houle ("Houle") and Bohn & Associates ("B&A") that address specific issues relating to historical undervaluation and increased efficiency. Unlike Professor Globerman's broad economic approach, this evidence provides specific information and analysis with respect to each item. As such, these reports provide context to Professor Globerman's report and provide additional analysis to the extent the Board wishes to further consider historical undervaluation and increased efficiency as separate factors.

B. APPLYING THE METHODOLOGIES (QUESTIONS A2 AND B2&3)

1. Professor Globerman's Economic Approach

As noted above, Professor Globerman calculates an increase in the reservation price of music in the amount of 182%.[10] He notes that this calculation overstates the increase as he lacked data on increasing costs of capital. He also points out that the impact of any increase in a purchaser's reservation price on the price increase the purchaser would actually pay in a competitive market depends on the shape (or elasticity) of the supply curve for that product. The input would normally receive only a portion of any increase in the purchaser's reservation price.

Moreover, this increase in "value" or "price" refers to a *dollar* increase as opposed to a *rate* increase. In other words, music's share of any increase in radio's reservation

[10] See Globerman Report, Table 12, Column 4

price represents an increased overall amount of dollars that radio would pay and the input receive. However, the Tariff is expressed not as a price or amount to be paid but rather as a percentage of revenue. Accordingly, any increase in the competitive price for music (i.e. music's share of any increase in the reservation price) must be compared to the increased amounts paid by radio as a function of increased advertising revenues over the period. Even at a constant Tariff rate, increased revenues result in higher payments. Accordingly, increased advertising revenues will themselves provide some or all of any increases in the competitive price to which music may be entitled. The royalty *rate* only needs to be increased to the extent that changes in advertising revenues produce increased royalty payments that lag behind the estimated increases in the competitive price for music.

Professor Globerman does not opine on the share of the increase he measured in radio's reservation price that would accrue to music. However he did calculate the impact of various sharing assumptions. If, for example, music and radio equally shared the average increase in the reservation price over the period, royalty payment increases generated simply by advertising revenue increases would *not* have been sufficient to provide payments equal to the increased competitive price and the Tariff would have to be raised by 7% to compensate.

Other evidence suggests that a 50/50 sharing arrangement likely unduly favours music. An examination of the changes in payments to other radio expense categories, including programming costs, shows that they rose at a much slower rate than a 50/50 sharing rule would imply. It is difficult to explain why music, if priced in a manner analogous to a competitive market, would achieve far higher sharing of increased reservation prices than other related inputs.

The 7% Tariff rate increase that would result from awarding music at 50% of the average increase in radio's reservation price reflects increased value arising for any and all reasons, including those considered by the Board. The Board has already awarded music a 10.6% increase under the rubric of increased use of music. On Professor Globerman's analysis, and assuming 50/50 sharing, each of historical undervaluation and increased efficiency appear to have contributed to the rationale for a Tariff increase. However, that increase has already been awarded (albeit on a narrower basis) and therefore no further increase is justified or required.

2. An Examination of the Board's Specific Factors

The industrial analysis carried out by Houle and by B&A support this conclusion.

a) Houle

Houle corroborates and provides context to Professor Globerman's report and provides additional expert industrial fact evidence that addresses some of the Board's analysis and concerns:

- Historical undervaluation
  - Between 1996 and 2002, the percentage of programming expenses devoted to royalty payments to SOCAN increased from 9.12% to 10.33%, which, using the Board's methodology, amounts to an effective increase of 13% in the value of SOCAN's repertoire. This is higher than the 10% increase awarded by the Board in its original decision.
  - There were other compelling factors that led radio stations to seek permission from the CRTC to convert from AM to FM. These factors include the fact that fewer and fewer listeners were tuning into AM and the fact that there were problems of reception quality that were inherent to the AM band.
  - These same factors were specifically invoked by the CBC/Radio-Canada when it sought permission from the CRTC to convert its talk stations from AM to FM. No reference was made to playing more music upon conversion to FM.
  - Virtually all stations that sought permission to convert from AM to FM retained their pre-conversion format post-conversion, whether it was talk or music.
  - Between 1993 and 2001 only 13 stations made requests to the CRTC to change their spoken word requirements, according to the list that SOCAN

itself provided for the original hearing, and upon which the Board relied in its original decision. This represents 2.5% of the 516 radio stations in operation in 2001. Of these, not all of them requested a *reduction* in their spoken word requirements.

- Increased Efficiency
    - the more efficient use of music by private radio stations played no tangible or measurable role in the $160 million increase in advertising revenues reported by the private commercial radio sector between 1998-2002, given that:
        - The vast majority (83.44%) of the increase in advertising revenues for the radio industry was attributable to the general increase in advertising revenues experienced by all media, not just radio.
        - The remainder (16.56%) is explained by the efficiencies that were achieved through the significant consolidation that took place in the industry during this time period.
        - Stations that were not subject to consolidation actually saw a slight reduction in their per-station revenues.
        - Had industry consolidation not taken place, the evidence suggests that the radio industry would have actually experienced a *loss* in the efficiency with which it attracted advertising dollars.

- The vast majority of radio stations that converted to the personality format (e.g. JACK and BOB) only converted *after* the time period referenced by the Board in its original decision (i.e. 1998-2002).

- There is also no evidence that the relatively small number of stations that have converted to the personality format have had a significant impact in increasing the radio industry's revenues overall.

- An analysis of the BBM ratings for 13 stations that have adopted the personality format shows a positive short-term impact for only a few stations, and a neutral or negative impact for a majority of the stations in the medium-term.

b) B&A

B&A, for their part, provide expert analysis as follows:

- Radio has not enjoyed increased value from recorded music in recent years. On the contrary, broadcasters have struggled to keep up with equipment changes and the rise in other music platforms, which began significantly with in-car music listening and has recently exploded with music online. Stations have increasingly innovated with non-music content to maintain their medium's value and relevance to the audience.

- From 1990 forward, a recurring theme in CRTC radio policy has been to ensure that stations have the flexibility to address shifting market forces, while still meeting statutory objectives. Changes in format and music or spoken word formatting over the years should not be looked at in isolation; these changes are part of an overall trend to ensure that commercial radio has the framework and tools to continue to contribute to the needs of the community and the objectives of the *Broadcasting Act*.

- While a prescribed quantity of spoken word programming has been removed from the CRTC's regulatory requirements, the CRTC has reinforced the need for local programming. For its part, radio has recognized the increasing need for spoken word content, both as an important programming element in its own right, and as a point of differentiation from other media and technologies. Since the 1990s, packaging and promotion have emerged as the determining factors in radio market leadership.

- The Commission's weighting of music as a factor for licensing compared to spoken word, local programming, economic growth and financial viability is secondary. From a potential licensee's perspective as well, music is only one of the various factors involved in developing a proposal to serve a community.

- Since the deregulation of FM foreground and mosaic programming and AM and FM re-branding, News/Talk has been ranked the second highest format in Canada in terms of percentage of hours tuned. Since 1993, the format has grown from 24 stations with 19.5% of tuning to 40 stations with 25.8%. As of Spring 2006, the format is ranked number one. This is a prime example of radio re-inventing itself in recent years with non-music, exclusive programming to distinguish stations from their competition.

- The use of the AM and FM bands, or choice of one over the other, is based on a range of competing factors including consumer usage, relative cost, equipment availability, and signal reach and clarity. A station "flip" from AM to FM may be driven by a number of these factors, of which music may or may not significant.

- The increasing blurring of music genres on radio and the explosion of the availability of music across multiple media and platforms have meant that music format has ceased to be a sufficient means by which music stations can differentiate themselves in the market.

- The methods and means of programming today's music do not reflect increased value to radio. Rather, they are eloquent demonstrations of how it now costs radio more to extract the value that the music formerly produced.

- JACK, BOB, JOE and similar Personality Brands underscore the change in radio programming philosophy that puts personality, lifestyle, positioning and marketing ahead of music to attract an audience.

- In fact, JACK, BOB, and JOE are **brands** that have been applied to different musical genres, such as Country. The value of these brands lies in the **non-musical** elements they contribute in creating the overall personality of a station. It is this persona or character that attracts listeners and enables the station to differentiate itself.

- These brands have been successfully applied in some markets, while in others they have performed with decidedly mixed results.

IV. CONCLUSION

The best method for evaluating changes in the value of music is one that captures all changes, and reasons for change, and avoids the risk of analytical gaps or overlaps.

Professor Globerman's analysis reveals that, even if music is awarded half of any increased value, the Tariff rate should rise by approximately 7%. In fact, for a variety of reasons, this sharing assumption favours SOCAN and, even if the assumption was reasonable, the amount of increase is likely too high.

Accordingly, SOCAN and NRCC have already been fairly compensated by a 10.6% rate increase, when increased payments caused by rising revenues are taken into account.

Therefore no additional Tariff increase is necessary or warranted.

V. EVIDENCE AND DOCUMENTS

A. DOCUMENTS

Documents	**Rehearing Exhibit Numbers**
Professor Steven Globerman, *Determining the Appropriate Increase in SOCAN Tariff Payable for the Public Performance of Musical Works*	CAB-2
Michel Houle, *Analyse de la quantification des majorations de tarifs imposées par la Commission du droit d'auteur du Canada*	CAB-3
Bohn & Associates Media, *Canada's Radio Revolution*	CAB-4
Witness Statement: Commercial Radio Panel	CAB-5

Original Evidence:

Exhibits CAB-1, 1A, 3 (pp. 3-23), 13 (including Appendix B) and 20

Exhibits SOCAN-1, 1A, 2 (excluding appendices) and 3

Exhibits NRCC-1, 1A, 7 and 9 (Tableau 3.2, p.24)

The portions of the original evidence expressly identified in Rehearing Exhibits CAB-2, -3 and -4

B. WITNESSES

1. Professor Steven Globerman (1.5 hours in chief)

2. Michel Houle (1 hour in chief)

3. Bohn & Associates (1 hour in chief)

4. Commercial Radio Panel - Pierre Rodrigue (Vice-présidence développement, Astral Media Radio inc.); Corus Entertainment representative (TBD); and Pierre-Louis Smith (Vice-President, Policy & Regulatory Affairs (Radio), CAB) (1 hour in chief)