THE ARBITRATION BOARD
at the German Patent
and Trademarks Office,
Established under the Act
Governing the Administration of
Copyright and Related Rights

Munich, April 12, 2005
REF: Sch-Urh 28/00

In the Proceedings Relating to the

Association Agreement (in German “Gesamtvertrag”)

as instituted by the German National Group of the International Federation of the Phonographic Industry ("IFPI"), an association registered in Germany and represented by its Managing Director, Mr Peter Zombik, at Oranienburger Strasse 67/68, 10117 Berlin

— hereinafter referred to as the "Petitioner" —,

Attorneys of Record: Lawyers Boehmert & Boehmert, at Meineckenstrasse 26, 10719 Berlin,

versus

Gesellschaft fuer musikalische Auffuehrungs- und mechanische Vervielfaeltigungsrechte [the {German} Society for Musical Performing and Mechanical Reproduction Rights] ("GEMA"), represented by its Executive Board, Messrs. Professor Dr. Reinhold Kreile (the Chairman of the Executive Board), Professor Dr. Juergen Becker, and Rainer Hilpert, at Rosenheimer Strasse 11, 81667 Munich

— hereinafter referred to as the "Respondent" —,

Attorneys of Record: Lawyers Becker Buettner Held, at Untere Weidenstrasse 5, 81543 Munich,

the Arbitration Board at the German Patent and Trademarks Office, established pursuant to the Act Governing the Administration of Copyright and Related Rights and represented by Presiding Judge Portmann as well as Associate Judges Lochbuehler and Akintche, hereby issues, on the basis of hearings held on July 28, 2004, and December 9, 2004, the following

Proposal for a Settlement:

I. A proposal for the following Association Agreement is hereby submitted to the Parties hereto:

ASSOCIATION AGREEMENT

For the period of July 1, 2000, up to and including December 31, 2005, the following Agreement shall be concluded, pursuant to § 12 of the German Copyright Administration Act, for the members of IFPI between:

the German National Group of the International Federation of the Phonographic Industry ("IFPI"), an association registered in Germany and represented by its Managing Director, Mr Peter Zombik, at Oranienburger Strasse 67/68, 10117 Berlin

and

Gesellschaft fuer musikalische Auffuehrungs- und mechanische Vervielfaeltigungsrechte [the Society for Musical Performing and Mechanical Reproduction Rights] ("GEMA"), represented by its Executive Board, Messrs. Professor Dr. Reinhold Kreile (the Chairman of the Executive Board), Professor Dr. Juergen Becker, and Rainer Hilpert, at Rosenheimer Strasse 11, 81667 Munich.

1. The previous Association Agreement concluded on October 25/November 12, 1990, in respect of traditional audio carriers and audio compact discs (excluding customised products manufactured on behalf, and for the account, of third parties) whose term has been stipulated, by virtue of a decision by the Higher Regional Court of Munich of June 12, 2003, for the period up to and including June 30, 2000, in conjunction with the supplementary and extension agreements dated May 24/June 6, 1991; February 6/February 18, 1992; May 4, 1993; May 25, 1993; December 7, 1993; May 4, 1994; September 29, 1993; August 3, 1995, as well as the undated agreement concluded for the period from January 1, 1996, to December 31, 1996, which includes Amendment No. 7 to the Standard Contract for the Phonographic Industry as signed on June 30, 1998, between BIEM (Bureau International des Sociétés Gérant les Droits d'Enregistrement et de Reproduction Méchanique) and IFPI (the International Federation of the Phonographic Industry) as well as provisions as to the Adjustment of Minimum Royalties pursuant to the Schedule prepared by GEMA

and enclosed herewith as Annex 1 to this Agreement, shall be extended to cover the period up to and including December 31, 2005.

2. From January 1, 2004, onwards, the provisions mentioned in the preceding Clause 1. shall apply subject to the proviso that the number of copies exempt from royalty as per Article V (24), Clauses 3 and 4, of the Interim Standard Contract of 1997 for the Phonographic Industry (Audio Carriers) shall be increased to 1,200 units.

3. This Association Agreement shall serve as a basis for the standard contracts to be agreed between GEMA and the members of IFPI.

II. The official charges incurred for these Proceedings shall be defrayed by Petitioner. Respondent's necessary extra-official charges shall be borne at 25% by Petitioner. In other respects, each of the Parties hereto shall bear its own costs as incurred by it.

I.

Petitioner is the German National Group of the International Federation of the Phonographic Industry. It unites nearly all producers of audio carriers in the Federal Republic of Germany. By virtue of its statutes, Petitioner safeguards all similar interests of its members, particularly in the economic and legal spheres.

Respondent is a collecting society for musical performing and mechanical reproduction rights existing in the Federal Republic of Germany, administering the rights in copyright-protected light and dance music on the basis of deeds of assignment with the composers, lyricists, and music publishers affiliated to Respondent, as well as on the basis of reciprocal representation agreements with foreign collecting societies. Respondent is a member of BIEM (Bureau International des Sociétés Gérant les Droits d'Enregistrement et de Reproduction Méchanique).

On October 25/November 12, 1990, the Parties to these Proceedings concluded a Association Agreement, pursuant to § 12 of the German Copyright Administration Act, for the manufacture and distribution of audio carriers and audio compact discs (except for customised products manufactured on behalf, and for the account, of third parties). That Association Agreement was based on the standard agreements negotiated between BIEM and IFPI (the International Federation of the Phonographic Industry, London) and, with several extension agreements included, was in force until December 31, 1996.

For the period from January 1997 up to and including June 30, 2000, there was also a Association Agreement in existence between the Parties to these Proceedings, the final version of which was created only through a final and binding decision dated June 12, 2003, by the Higher Regional Court of Munich (reference: ZUM-RD 2003, pp. 464 ff.). The complaint against denial of leave to appeal as lodged against that decision was dismissed by the Federal Court of Justice by way of a ruling dated January 29, 2004 (Ref.: I ZR 153 C 03). Just as the proceedings before the Arbitration Board (Ref.: Sch-Urh 37/97) that preceded the action in the Higher Regional Court of Munich, the latter dealt primarily with the payment and settlement of royalties for media-advertised audio carriers. After the decision by the Higher Regional Court of Munich had become final and binding, the previous Association Agreement concluded on October 25/November 12, 1990, which had been in force until December 31, 1996, in respect of traditional audio carriers and audio compact discs (excluding customised products manufactured on behalf, and for the account, of third parties), in conjunction with the supplementary and extension agreements dated May 24/June 6, 1991; February 6/February 18, 1992; May 4, 1993; May 25, 1993; December 7, 1993; May 4, 1994; September 29, 1993; August 3, 1995, as well as the undated agreement concluded for the period from January 1, 1996, to December 31, 1996, was extended to cover the period up to and including June 30, 2000, with the foregoing applicable as from July 1, 1997, to June 30, 2000, including Amendment No. 7 to the Standard Contract for the Phonographic Industry as signed on June 30, 1998, between BIEM (Bureau International des Sociétés Gérant les Droits d'Enregistrement et de Reproduction Méchanique) and IFPI (the International Federation of the Phonographic Industry) as well as provisions as to the Adjustment of Minimum Royalties pursuant to the Statement by GEMA enclosed as Annex 1 to this Agreement, subject to the proviso that Article V (par. 18*ter*) of the Association Agreement should read as follows:

> "(18*ter*) As regards new releases of audio carriers advertised on radio, on television and/or at the cinema — i.e., any audio carrier released under a new catalogue number and, as such, listed in the producer's publications and advertised on radio, on television and/or at the cinema —, royalties under this Agreement shall be paid subject to the following terms and conditions:
>
> The producer shall be authorised — as per the end of each accounting period within a period of 12 months from the commencement of the accounting period for the first delivery — to account for 50% of the outgoings determined in operation of the foregoing paragraphs (16) and (17) subject to the proviso that the royalties for the outgoings during the accounting period for the first delivery will be due for payment only in the

> following accounting period. At the end of the accounting period that coincides with the expiration of a period of 18 months from the commencement of the accounting period for the first delivery, the producer will account for the balance of the remaining 50%, taking into account such returns as shall not have been deducted yet."

For further details, reference is hereby made to the contents of the decision by the Higher Regional Court of Munich.

The present application for the initiation of arbitration proceedings relating to the submission of a Association Agreement, which was received by the Arbitration Board on December 21, 2000, was originally intended by Petitioner only to ensure observance of the time limit. Petitioner refrained from giving a more detailed statement of reasons because initially, negotiations were being conducted between the parties involved. In its petition brief, Petitioner *inter alia* stated the following:

> "In case the Arbitration Board holds that a more detailed statement of reasons is required even at this point in time, we hereby ask for information to that effect, stating that Petitioner will file with the Higher Regional Court of Munich an action for the conclusion of a Association Agreement for the period from January 1, 1997, to June 30, 2000."

In its response to the petition, Respondent stated that negotiations between BIEM and IFPI International were not being deemed a failure yet. Furthermore, Respondent submitted as follows:

> "Consequently, an opinion on Petitioner's petition, which in other respects is unfounded and inadmissible, will not be required either."

Negotiations between BIEM and IFPI International as well as between the Parties to these Proceedings continued through the years 2001, 2002, and 2003. In a letter dated December 23, 2003, which was received by the Arbitration Board on January 7, 2004, Petitioner advised that negotiations for the conclusion of a Association Agreement had failed. Furthermore, Petitioner submitted a Draft Association Agreement between the Parties to these Proceedings for the "manufacture of sound recordings of works of the GEMA repertoire, their reproduction on audio carriers, and their distribution for sale to the Association-public for private use".

According to that Draft Association Agreement, Article IV, Paragraph 2.1, Clause 1, provides that a royalty at the rate of 6.6% of the 'Published Price to Dealers' ("PPD") shall be paid in respect of the recording of those works onto audio carriers, as well as in respect of their reproduction and distribution.

The PPD is equivalent to the producer's listed selling price, exclusive of value-added tax. Since the year 1985, the royalties to be paid by Petitioner's members to Respondent have been calculated on the basis of the PPD. The previous method of calculation, which was based on the fixed or suggested retail price or consumer price recommended by the producer, and is usually paid by the general public (German abbreviation, "EVP"), was abandoned by mutual agreement because after the elimination in the eighties of retail-price maintenance for audio carriers, it was no longer possible for such EVPs to be determined in a reliable fashion. Nevertheless, both parties were unanimously proceeding on the assumption that the participation of rights holders at a rate of 8% of the EVP, which regime had been applied since the year 1947, was to be deemed equitable. Owing to the difficulties of determining a reliable figure for the EVP, the parties calculated such equitable remuneration, since the year 1985, on the basis of the PPD, and then applied an 'up-lift' to the average PPD determined so as to obtain an amount equivalent to 8% of the EVP. Arithmetically, the up-lift is hence equivalent to the difference between EVP and PPD. The proposal for a calculation practice based on the so-called Actual Realised Price ("ARP"), which had been submitted by Petitioner in the course of arbitration proceedings, was put aside by mutual agreement.

The up-lift by which the PPD was increased had been mutually agreed to be 37.5% since the year 1985, which resulted in a gross remuneration in favour of Respondent at a rate of 11% of the PPD (37.5% of 8% = 3%; 8% plus 3% = 11%).

To the figure thus determined, amounting to 11% of the PPD, a 10% deduction was applied, by mutual agreement as well, in respect of packaging and a 9% deduction in respect of the discounts granted by Petitioner or its members to their purchasers, which ultimately resulted in a remuneration at a rate of 9.009% of the PPD. The Parties also agreed that the up-lift at a rate of 37.5%, the packaging discount at 10%, and the discount that finally amounted to 9%, represent fictitious figures so that it would be possible to arrive at the intended result of negotiations, a rate of 9.009%.

The Draft Association Agreement submitted by Petitioner provides for the following:

1. the up-lift rate shall be only 9.2%, rather than 37.5%;
2. the 10% deduction for packaging shall be maintained; and
3. an allowance for discounts, at a rate of 16.5% rather than 9%, shall be taken into account.

Arithmetically, these figures from the Draft Association Agreement will result in a royalty rate of 6.57% of the PPD instead of 9.009% of the PPD as previously.

The Arbitration Board assumes that the figure mentioned in Article IV, Paragraph 2.1, Clause 1, of the Draft Association Agreement submitted by Petitioner — i.e., a rate of 6.6% — was obtained through rounding up. Since the year 1992, discounts have been taken into account, by mutual agreement, from an initial 4% via 6% up to, finally, 9% in the year 1997. Petitioner distinguishes between dealer discounts, product discounts, and other discounts/contributions to promotional expenses. Dealer discounts are granted to individual dealers, and are thus not related to individual products or orders. A dealer may be granted product discounts on certain products as part of individual orders if he orders major quantities of a product, or a wide range of products. Dealer and product discounts may overlap, and can therefore not be clearly separated. Other discounts are rebates for which a dealer reciprocates such as, for instance, the placing of an advertisement. Contributions to promotional expenses represent a producer's participation in the promotional expenses incurred by dealers.

In Article IV, Paragraph 2.1, Clause 2, of the Draft Association Agreement, Petitioner furthermore seeks a 12% deduction from the 6.6% remuneration stipulated pursuant to Article IV, Paragraph 2.1, Clause 1, in calculating royalties for media-advertised audio carriers.

Article IV, Paragraph 2.1, Clause 3, of the Draft Association Agreement provides that both parties pay an amount at the rate of 1% of the PPD towards the establishment of a fund for combating piracy and taking copy-protection measures. That fund is to be managed and administered by both parties on an equal footing. The royalty to be paid pursuant to Article IV, Paragraph 2.1, Clause 1, of the Draft Association Agreement was to be reduced thereby to 5.6% of the PPD.

Furthermore, Article V, Paragraph 2.1, of the Draft Association Agreement provides that within the initial 12 months following the first release of the respective audio carrier, a producer should account towards Respondent for only 60% of the outgoings, rather than 80% or, respectively, 90% as before, and pay the sum resulting from that calculation. After an accounting period described more fully in that Article, settlement is to be effected so that the returns accrued until then may be deducted from the remaining outgoings that have not been accounted for yet. Contrary to the regime previously applied, crediting in favour of Petitioner should be possible as well. Furthermore, Article V, Paragraph 2.2, of the Draft Association Agreement provides that a producer, instead of making provision for returns, may also effect a lump-sum deduction in terms of volume. Such deduction, which in practice is regularly preferred by smaller producers of audio carriers, is to be raised from a previous 6%-10% to 15%.

Furthermore, Petitioner's Draft Association Agreement does not include the provisions on minimum royalties that have been in force until now. And neither does the Draft Association Agreement contain any provisions on the limitation of work numbers and playing times.

Finally, the Draft Association Agreement, unlike the Association Agreement in force until June 30, 2000, does not provide for a limitation on the number of free copies required for advertising and promotional purposes. In addition, a distinction should no longer be made between products customary in the trade and other products intended for advertising and promotional purposes. At any rate, Petitioner seeks to raise the limit for free copies to at least 4,000 units or, by way of alternative, to have a lump-sum deduction of 1,000 units per release/configuration.

In a letter dated February 24, 2005, Petitioner presented the results of a survey it had commissioned its members to conduct with regard to the amount of technical costs incurred in the manufacture of an audio carrier, broken down into costs of manufacture, packaging, booklet, artwork, and "miscellaneous costs" (cf. Annex, ASt 25), to whose contents reference is made herein. According to that survey, the current average share of technical costs per audio carrier is 11.83% of the PPD.

Petitioner claims that the up-lift — i.e., the difference between EVP and PPD — has been reduced considerably in recent years. Within the BIEM contractual territory, it was only 14.1% still. A *GfK*[1] study of October 11, 2004, which was submitted with a letter dated October 18, 2004 (cf. Annex, ASt 13), and to whose contents reference is herein made, had revealed that the up-lift in Germany was 9.6% in the year 2003. This was in line with the result of a previous survey by the *GfK,* according to which an up-lift of 9.2% had been determined for the year 1995. Petitioner had accepted the 9.009% royalty rate valid until June 30, 2000, only because the Standard Contract between BIEM and IFPI International had been extended for yet another period. As the Universal Music company was now pursuing a complaints procedure against BIEM before the EU Commission, Petitioner was also in a position to bring proceedings against Respondent before the Arbitration Board without being required to consider the international agreements. In addition, it was only then that Petitioner was able to seek to establish a new method of calculation in respect of royalties based on, for instance, the ARP.[2] The reduction in up-lift from 37.5% to 9.2% could be explained by a marked reduction in trade margin along with a continuous PPD increase, with retail prices having remained relatively steady. Pursuant to the

[1] A consumer-research institution.
[2] The so-called Actual Realised Price.

table submitted with the letter of October 18, 2004 (cf. Annex, ASt 14), the average PPD in the high-price CD segment has, according to Petitioner's submission, developed as follows:

1991	EUR 11.31
1992	EUR 11.38
1993	EUR 11.48
1994	EUR 11.58
1995	EUR 11.69
1996	EUR 11.69
1997	EUR 11.76
1998	EUR 12.15
1999	EUR 12.41
2000	EUR 12.53
2001	EUR 12.77
2002	EUR 12.72
2003	EUR 12.59

According to Petitioner, the drop in sales in the market for audio carriers represents a material change in the actual situation so that an essential reduction in the royalty rate would be required. In addition, concentration in the audio-carrier industry as well as the "PHONONET" electronic ordering system had left only a few major vendors or discount retailers so that wholesale trading in audio carriers had become insignificant. Approximately 70% of the retailers were purchasing audio carriers directly via "PHONONET", which was tantamount to the elimination of one marketing level. Concentration on the demand side and the abolition of one marketing level had been the reasons why the EVP had remained relatively stable whereas there had been an increase in the PPD.

Petitioner is of the opinion that the present royalty rate and the provisions on minimum royalties as well as the limitations on work numbers and playing times, as provided for by the previous Association Agreement, constitute a contravention of Articles 81 and 82 of the EC Treaty. For further explanation, Petitioner relies on the complaint of May 31, 2002, addressed by the Universal Music company to the EU Commission, as well as on the so-called ORDOVER Report, whose contents are herein referred to. For that reason, the previous arrangements under the Association Agreement should not be used as a guideline in the present Arbitration Proceedings.

Furthermore, Petitioner claims that the average discount granted by producers to dealers amounts to 16.5%. Petitioner is of the opinion that in the present case, that discount should be taken into account in full. At a rate of 16.5%, the actual difference between EVP and PPD was being reduced. For further explanation, Petitioner, in a letter dated October 18, 2004 (cf. Annex, ASt 16), submitted an overview which reveals the amounts of discounts granted by its members, broken down into dealer and product discounts, miscellaneous discounts, as well as contributions to promotional expenses. Reference is herein made to the contents of that statement.

In addition, Petitioner is of the opinion that a 12% deduction from the remuneration in respect of media-advertised audio carriers, as stipulated in Article IV, Paragraph 2.1, Clause 2, of the Draft Association Agreement, would be reasonable. The Higher Regional Court of Munich, in its decision dated June 12, 2003, had failed to take into account that the promotional expenditure borne by producers alone, which had been considerably increased in recent years, had become reflected in a rise in sales figures and, hence, in increased royalties. In addition, the dismissal of the "principle of reference markets" by the Higher Regional Court of Munich was legally mistaken. The fact that authors were profiting from sales increased on account of promotional expenses would have to lead to a reasonable participation in the defrayal of advertising costs.

Furthermore, Petitioner is of the opinion that the returns regime as provided for in Article V, Paragraphs 2.1 and 2.2, of the Draft Association Agreement is necessary. The existing returns regime was leading to a situation where, to a drastically increasing degree, royalties had to be paid to Respondent in respect of which Petitioner had been unable to generate sales because the audio carriers would be returned by dealers. Petitioner's members were being compelled to create a strong presence of their products in the market; in addition, Petitioner's members were being required to grant their purchasers unconditional return privileges. That development did not include media-advertised audio carriers only but was covering all new releases. The decision by the Higher Regional Court of Munich, which had not given an adequate evaluation of that situation, was legally mistaken. Any organisational and financial burden on Respondent should not lead to a situation where royalties would have to be paid even if no sales were being generated on the audio carriers.

In addition, there had been a striking increase in the number of returns since the year 2000. These had also been spread over longer periods of time so that any set-off against outgoings was impossible. For further explanation, Petitioner, with its brief dated July 12, 2004 (Annex, ASt 11), submitted a chart to which reference is made herein. According to Petitioner, it should be noted further in this context that returns were not spread evenly over all types of audio carriers but were rather related regularly to individual products with large numbers of returns for which set-off against subsequent outgoings was on principle impossible.

Petitioner furthermore is of the opinion that minimum royalties represent an unreasonable impairment of their members' freedom of economic action. A producer would not be able to offer two-track or Pock-it CDs, each of which contains only two recordings, at a low price of, for instance, EUR 2.00 because a minimum royalty would rule out any economic gain. In addition, any publishing of works by unknown authors would be prevented because for potential purchasers, price would be the overriding concern in respect of such products. Furthermore, a minimum-royalty regime would be against anti-trust law because it would be an encroachment upon a producer's right of free pricing. In addition, a minimum-royalty regime would impose unreasonable restraints on Petitioner's members compared with rival firms abroad because in England, for instance, minimum royalties do not exist, and a large number of producers of audio carriers would prefer to obtain licences in such countries. The same would apply *mutatis mutandis* to any provisions on the limitation of work numbers and playing times. Such provisions, too, would represent an unreasonable encroachment upon the freedom of economic action on the part of Petitioner's members because economically attractive products such as, for instance, compilation albums could then be offered at excessive licensing costs only.

The decision by the EU Commission as to the complaint filed by the Universal Music company would have a direct impact on the contents of the Arbitration Board's proposal for a settlement. A decision by the EU Commission would have to be implemented by the Arbitration Board so that suspension of the present Arbitration Proceedings was required.

At any rate, the Arbitration Board should cause the Federal Cartel Office to inform the EU Commission of the present Arbitration Proceedings.

Petitioner is of the opinion that the application for the submission of a Association Agreement as received by the Arbitration Board on December 21, 2000, is sufficiently specific. The fact that it had been only since the year 2004 that Petitioner had deposited that part of the royalties which is in dispute did not indicate that the existence until December 31, 2003, of a "factual Association Agreement" would need to be assumed because a right of deposit would be created only upon the failure of negotiations. In view of the application for the conclusion of a Association Agreement as received by the Arbitration Board on December 21, 2000, Respondent would not have been in a position to assume that it could let the provisions of the Association Agreement valid until June 30, 2000, continue to apply. The fact that Respondent conducted distributions from July 1, 2000, onwards subject to the general proviso that subsequent adjustments might be made by way of debiting or crediting was suggesting that even from Respondent's point of view, the level of the royalty rate, of 9.009%, was to be called into question. By way of precaution, Petitioner hereby seeks restitution to the previous condition because Petitioner's brief of December 23, 2003, which contained specific submissions and detailed statements of reasons, was received by the Arbitration Board only on January 7, 2004, and not — as should have been expected for customary message-delivery times — by December 31, 2003.

With a letter dated October 18, 2004, Petitioner declared settled that part of its proposal for a settlement which relates to the establishment of a joint fund for combating piracy and taking copy-protection measures (Article IV, Paragraph 2.1, Clause 3, of the Draft Association Agreement).

Petitioner claims that Respondent, prior to the initiation of these Arbitration Proceedings and prior to the drafting of the brief dated December 23, 2003, had always conveyed towards Petitioner the impression that Respondent was ready to conduct negotiations in respect of the point that had been declared settled.

Respondent does not subscribe to the declaration of partial settlement. According to Respondent, the fund planned by Petitioner for combating piracy and taking copy-protection measures cannot be the subject matter of an Association Agreement. Petitioner was not entitled to dictate to Respondent how to use Respondent's royalties.

In a letter dated December 23, 2003, and received by the Arbitration Board on January 7, 2004, Petitioner initially put into concrete terms an application which was in its original form received by the Arbitration Board on December 21, 2000, which called for:

> the submission of a proposal for a settlement in respect of the conclusion, upon equitable terms and conditions, of a Association Agreement on the granting of rights of utilisation or the granting of consents with regard to the manufacture and distribution of traditional audio carriers and audio compact discs (excluding customised products manufactured on behalf, and for the account, of third parties) for the period commencing upon July 1, 2000, and for imposing the cost of the proceedings, including Petitioner's necessary outlays, on Respondent pursuant to § 14, 1, of the Rules of Procedure for the Arbitration Board for Copyright Cases;

and finally turned the foregoing into a formal petition:

1. That a proposal for a settlement in respect of the conclusion of a Association Agreement based on Petitioner's draft (cf. Annex, ASt 1), for the pe-

riod from July 1, 2000, to December 31, 2005, be submitted to the Parties hereto.

2. That proceedings with regard to the part that has been settled be dismissed free of charge, in accordance with § 13, Clause 4, Sentence 1, of the Rules of Procedure for the Arbitration Board for Copyright Cases, and that, to the extent that costs may have been incurred on the part of Respondent, such costs be imposed on Respondent.

3. That the present proceedings concerning a Association Agreement be suspended pending the decision by the EU Commission as to the complaint filed by the Universal Music company on May 22, 2000 (Ref., COMP/C2/38.440, UNIVERSAL vs. BIEM), in accordance with § 148 of the *ZPO* [i.e., the German Code of Civil Procedure].

   3.1 That, alternatively in respect of the Petition under 3):

   The Federal Cartel Office be caused to submit these Proceedings, in accordance with § 50, III, of the *GWB* [i.e., the German Anti-Trust Act], to the EU Commission, and to obtain an opinion on the issues being the subject matter of the aforementioned complaint brought by the UNIVERSAL company.

   3.2 That, strictly by way of alternative as regards the Petition under 3):

   Prior to a decision by the EU Commission, no proposal for a settlement be submitted which may contain provisions different from Petitioner's ideas relating to the provisions of the BIEM/IFPI Standard Agreement, which are the subject matter of the aforementioned complaint proceedings.

4. That, by way of precaution, there be restitution to the previous condition because the concretised petition for the issuance of a Association Agreement was not received by the Arbitration Board by December 31, 2003.

5. That the costs of these Arbitration Proceedings be imposed on Respondent.

Respondent requests that:

1. Petitioner's applications be dismissed with costs.

2. a) It be declared that the submission of a proposal for a settlement for the period from July 1, 2000, to December 31, 2003, is not necessary because Petitioner's members and Respondent have actually (i.e., factually) reached agreement on the conditions of utilisation being the subject matter of these Proceedings;

2. b) For the period from January 1, 2004, to December 31, 2005, a proposal for a settlement be submitted for the extension of the Association Agreement of October 25/November 12, 1990, for traditional audio carriers and audio compact discs (excluding customised products manufactured on behalf, and for the account, of third parties) as determined by court to be valid until June 30, 2000, and applied until December 31, 2003, by the Parties to these Proceedings, in conjunction with the supplementary and extension agreements dated May 24/June 6, 1991; February 6/February 18, 1992; May 4, 1993; May 25, 1993; December 7, 1993; May 4, 1994; September 29, 1993; August 3, 1995, as well as the undated agreement concluded for the period from January 1, 1996, to December 31, 1996, including Article V (par. 18*ter*) in accordance with the final and binding decision of June 12, 2003, by the Higher Regional Court of Munich (Ref.: 6 WG 4/00), stipulating that there shall be no falling below the existing royalty rate of 9.009%;

Alternatively,

2. c) A proposal for a settlement be submitted for the extension of the Association Agreement based on the application under 2) above, for the period from July 1, 2000, until December 31, 2005.

3. That the costs of these Proceedings be imposed on Petitioner.

Respondent is of the opinion that Petitioner represents only part of its membership. Therefore, according to Respondent's view, Petitioner is not entitled to apply for a Association Agreement. In addition, the precondition for the grant of a 20% discount under a Association Agreement was no longer being met. The number of Petitioner's members supporting the Draft Association Agreement on hand was insufficient for warranting certain facilities which would justify a discount under a Association Agreement.

In addition, the application for a reduction of remuneration represented an abuse of law because it was in this way that the so-called major companies intended to re-organise their financial recovery at the expense of authors. The marked reduction of royalty rates, as applied for, would be tantamount to a complete invalidation of copyright. The fact that Respondent and the Association of Independent Producers of Audio Carriers (German abbreviation, "VUT"), which is one of Petitioner's members, had on November 15, 2004, concluded a Association Agreement, whose contents are comparable in terms of the royalty rate applied for by Respondent in the present Proceedings as well as in terms of the additional provisions applied for, was speaking in favour of the reasonableness of Respondent's request.

Respondent furthermore claims that since the passing of June 30, 2000, there had been no material change in the standards to which the existing Association Agreement had been geared. Those provisions, which had been freely negotiated at the time, might be seen as indicative of those of a Association Agreement to follow thereupon. The market decline, which had actually occurred for the side of Petitioner, was not going to change anything about the principle of pro-rata participation because such market decline was posing the same burden to authors and audio-carrier producers alike. The agreement on a percentage-based tariff would be authoritative as long as guiding standards had not changed. Since such a change had not occurred, the 9.009% royalty rate valid until June 30, 2000, had remained reasonable.

Petitioner is of the opinion that the 37.5-percent up-lift should be maintained in the new Association Agreement as well. Upon the conclusion of the Standard Agreement in the year 1987 between BIEM and IFPI International, the Parties to these Proceedings had agreed that any factual changes in the up-lift percentage of 37.5 would not be applicable to the royalty rate.

Raising the discount share to 16.5% would not be justified. The granting of discounts was a managerial measure which came under the sphere of risks to be incurred by Petitioner, or its members, alone. In addition, the discounts granted by producers to dealers were already included in Petitioner's calculation model so that to that extent, a double deduction would apply. The Parties to these Proceedings, upon the conclusion of the last Association Agreement, had agreed that seemingly higher discounts would have no influence on the 9.009% royalty rate. The lump-sum discount deduction as granted in the last Association Agreement had been intended deliberately to represent only a partial participation, at the expense of authors, in the discounting practice of audio-carrier producers.

The deduction sought in addition by Petitioner, at a rate of 12% for media-advertised audio carriers, would not be reasonable because media advertising was exclusively subject to managerial decisions by each producer of audio carriers and, accordingly, would come solely under such producers ' sphere of risks. Authors' lack of influence on the type and scope of advertising would exclude any financial participation. In other respects, Respondent refers to the decision of 12 June, 2003, by the Higher Regional Court of Munich with regard to the Parties to these Proceedings.

According to Respondent, the provisions applied for by Petitioner in accordance with Article V, Paragraph 2.1, of the Draft Association Agreement are not legitimate either. The reason speaking in favour of an adjustment of the returns regime in the case of media-advertised audio carriers were applicable only to that category but not to all new releases. If one took into account the short production times for audio carriers as well as the purchasing practice of dealers, the actual number of returns was low. Furthermore, the crediting regime as provided for in Article V, Paragraph 2.1, of the Draft Association Agreement would lead to unreasonably high administrative expenditure incurred by Respondent. In addition, Respondent would under that crediting regime be able to distribute royalties only after producers had effected final settlement in respect of each type of audio carrier. Timely distribution would be impossible under such a regime. Any distribution that could be carried out two years after manufacture and distribution at the earliest would be unreasonable. This was true particularly if one considered that even upon reproduction and offering to the general public, reasonable remuneration was due to authors. Moreover, the returns regime as applied for would lead to a legally inadmissible participation by authors in the economic risk incurred by producers or dealers. Provisions governing returns, as agreed between audio-carrier producers and dealers, would come under their sphere of operations and risk. Therefore, an increase to 15% in lump-sum deduction in terms of volume, pursuant to Article V, Paragraph 2.2., of the Draft Association Agreement, could not be deemed reasonable either.

A minimum-royalty regime was required for protecting authors from gradual invalidation of their rights. The lack of authors' influence on the market behaviour of Petitioner, or its members, was necessitating such minimum royalties.

A limitation of work numbers and playing times was also necessary because a producer of audio carriers is able to press onto a CD more, or longer, musical works while maintaining the same price. Therefore, it was in this instance, too, that any gradual invalidation of copyright would need to be prevented. The existing regulation was customary, and had proved worthwhile in practice.

An increase to 1,200 at most in the number of copies exempt from royalties might be considered reasonable, while at any rate a limit of 50% of the circulation of each audio carrier should not be exceeded.

Respondent furthermore claims that in the meantime, the actual presentation costs incurred for a booklet had become so low that a 10% packaging discount was not justified. The actual packaging discount amounted to an average rate of 0.5% as a maximum, compared with a 'Published Price to Dealer' ("PPD") of EUR 12.00 on average. The packaging discount was not intended to cover any particular technical expenditure incurred in the production or presentation of audio carriers but was rather related exclusively to the graphic design of the booklet enclosed with an audio carrier. Respondent claims that for at least 65% of the audio carriers manufactured in Germany, producers would be able to make use of existing booklet designs, and to that extent would therefore not have to bear any costs.

The application for suspension should be dismissed because the aforementioned EU proceedings represented a dispute relating to an individual case of utilisation, and would therefore have no legal effect on the present Proceedings. The same would apply *mutatis mutandis* to the alternative petition that the Federal Cartel Office should inform the EU Commission of the present Arbitration Proceedings, as well as to the alternative petition that the present Proceedings should be suspended until a decision had been made by the EU Commission.

The petition submitted on December 21, 2000, to the Arbitration Board was not specific enough, and would therefore have no legal effect on proceedings relating to a Association Agreement. The petition had stated neither the subject matter nor the cause of the claim asserted so that it was impossible for the matter in dispute to be specified. In addition, the fact that Respondent had for the first time taken cognisance of the concretised petition delivered to the Arbitration Board on January 7, 2004, and the demand therein that the royalty rate be reduced to 5.6%, as well as the fact that up to that point in time, royalty had been paid without objection at a rate of 9.009%, had led to the *de facto* conclusion of an agreement.

Hearings were held before the Arbitration Board on July 28, 2004, and December 9, 2004. Reference is hereby made to the contents of the minutes of those hearings, as well as to the briefs, including annexes, as submitted by the Parties hereto.

II.

According to § 14, Clause 1, No. 1 B), of the *UrhWahrnG* [the Copyright Administration Act, "CAA"], submission to the Arbitration Board is admissible because the dispute pertains to the conclusion or amendment of a Association Agreement, and a collecting society is involved. Submission to the Arbitration Board has also been made in due form (cf. § 14, Clause 4, of the CAA, in conjunction with § 1, Clause 1, of the *UrhSchiedsV* [i.e., the Rules of Procedure for the Arbitration Board for Copyright Cases].

1. The Term of the Association Agreement

Proceedings relating to a Association Agreement are admissible retroactively for the period from July 1, 2000, to December 31, 2005.

For the period from July 1, 2000, to December 31, 2003, however, the subject matter of the dispute and, hence, the Arbitration Board's proposal for a settlement is limited to amendments to be made to the Association Agreement valid until June 30, 2000, with regard to provisions on returns and the 12-percent deduction from royalties for media-advertised audio carriers (Article IV, Paragraph 2.1, Clause 2; as well as Article V, Paragraphs 2.1 and 2.2, of the Draft Association Agreement). To the extent that Petitioner, in its brief received by the Arbitration Board on January 7, 2004, seeks to have further amendments compared with the provisions in the last Association Agreement, an additional matter in dispute is being brought into the proceedings pending since the year 2000, or the existing subject matter of the dispute is being expanded. In accordance with § 14 c, Clause 1, Sentence 2, of the CAA, any expansion of the matter in dispute is admissible only with effect as per January 1, 2004. Respondent has not objected to the extension of the Petition (with Paragraphs 263, 267 of the Code of Civil Procedure to be applied *mutatis mutandis*) so that the initiation of any additional proceedings was not required.

The petition for the submission of a proposal for a settlement towards the conclusion of a Association Agreement, as received by the Arbitration Board on December 21, 2000, is, in terms of its contents described above, to be deemed sufficiently specific. In view of the nature of arbitration-board proceedings as conciliatory proceedings, it is to be presumed that the Arbitration Board has a freedom of arrangement so that requirements as to the definiteness of petitions relating to proceedings on Association Agreements should not be set too stringently (cf. Dreier/Schulze, *Kommentar zum Urheberrechtsgesetz 2004*[3], § 14,

[3] A Commentary on the Copyright Act of 2004.

Marginal Note 19). Petitioner sought a Association Agreement "upon equitable terms and conditions". The Petition as submitted did not reveal what such equitable terms and conditions should actually look like. A petition like that, however, can be subject to interpretation. In accordance with § 133 of the *BGB* [i.e., the German Civil Code], the actual intent is to be investigated in the interpretation of procedural statements, and the literal sense of an expression should not be adhered to (cf. Zoeller, *Zivilprozessordnung*[4], 24th Edition, Marginal Note 25 preceding § 128; *BGH* [i.e., the Federal Court of Justice]; Ref., NJW RR 1994, p. 568). Since the Petition is an act requiring communication, that manifestation of intent is to be interpreted in the way it should have been understood by its recipient taking common usage into account (cf. *BGH,* NJW 1990, p. 1446 — consistent court practice; Palandt, *Kommentar zum BGB 63*[5], 63rd Edition, § 133, Marginal Note 9, including further references). Consideration may be given only to facts that were known to the recipient upon delivery of the manifestation of intent. The objective explanatory power of Petitioner's behaviour is to be determined through normative interpretation (cf. Palandt, op. Cit.).

In its interpretation along these lines, the Arbitration Board arrives at the result that from the point of view of the recipient of the manifestation of intent — i.e., from the points of view of both the Arbitration Board and Respondent alike —, the matter in dispute in the arbitration proceedings initiated on December 21, 2000, was related to the 12% deduction sought by Petitioner even for the period from January 1, 1997, to June 30, 2000, from royalties in respect of media-advertised audio carriers, which deduction had been in dispute even then, as well as the amendments with regard to the returns regime as sought then by Petitioner. In its brief dated December 7, 2000, Petitioner had lodged objection to the Arbitration Board's proposal of November 6, 2000, in respect of a Association Agreement for the period from January 1, 1997, until June 30, 2000. It thus became apparent that Petitioner was going to bring an action, which then happened by way of brief addressed on December 28, 2000, to the Higher Regional Court of Munich. The legal issues in dispute between the parties were thus to be resolved by the Higher Regional Court of Munich. These legal issues, however, did not include the amount of remuneration, did not include the provisions as to the limitation of playing time and work numbers, did not include the elimination of the requirement as to a minimum number of units, and neither the establishment of a fund for combating piracy and taking copy-protection measures. Neither Respondent nor the Arbitration Board were able to recognise that Petitioner was seeking such a marked change in the existing long-standing arrangements, beyond the points that had been in dispute earlier on.

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[4] The [German] Code of Civil Procedure.
[5] A Commentary on the 63rd Edition of the German Civil Code.

This view is supported by another consideration. At the time the present Arbitration Proceedings were being initiated, on December 21, 2000, no Association Agreement existed between the Parties hereto. For Petitioner, this is disadvantageous in that there is then no reason for a discount under a Association Agreement. Because of the provision of § 14 c, Clause 1, Sentence 2, of the Copyright Administration Act, it was thus necessary for a petition for the submission of a Association Agreement to be submitted to the Arbitration Board in the year 2000 still. The fact that Petitioner had not worded more concretely the petition received by the Arbitration Board on December 21, 2000, was bound to mean, from the recipients' point of view, that the concrete details of the points at issue then were initially intended to be left open because those issues were negotiable, a course of action that is quite customary. Within the framework of negotiations for the last Association Agreement, Respondent in fact declared specifically towards Petitioner that it would not invoke potential lack of definiteness. In addition, it was possible for the expected decision by the Higher Regional Court of Munich to have an influence on the details of the Association Agreement sought for the period beginning on July 1, 2000. Any other result would be contrary to the principle of limited retroactivity as contained in the provision of § 14 c, Clause 1, Sentence 2, of the Copyright Administration Act, under which a Association Agreement may be submitted only with effect from January 1 of the year in which a petition to that effect was submitted to the Arbitration Board. It is therefore true that the petition received by the Arbitration Board on December 21, 2000, is admissible because from the recipient's point of view, it lends itself sufficiently to objective interpretation. That interpretation, however, leads to the qualifying result described above. The Arbitration Board may submit a Association Agreement with the extended scope as applied for on January 7, 2004, only with effect from January 1, 2004, to December 31, 2005.

To the extent that Petitioner submits that despite its request, the Arbitration Board had not given it any indication to that effect, no different legal assessment will follow from this. The petition received by the Arbitration Board on December 21, 2000, was, from the recipients' point of view — as stated above —, limited from the very beginning to amendments of the provisions of the Association Agreement valid until June 30, 2000, with regard to returns and the 12% deduction from royalties in the case of media-advertised audio carriers. Consequently, there was no reason for providing Petitioner with any indication to that effect.

2. <u>The Returns Regime, and the 12% Reduction in Royalties for Media-Advertised Audio Carriers</u>

The Arbitration Board deems reasonable the returns regime limited to media-advertised audio carriers, as determined by the Higher Regional Court of Munich in the most recent Association Agreement, as well as the dismissal of a petition for the 12% reduction in royalties for media-advertised audio carriers. In its decision dated June 12, 2003 (Ref., ZUM-RD 2003, pp. 464, 474 ff.), the Higher Regional Court of Munich, giving a detailed statement of reasons that was indeed easy to comprehend, dismissed Petitioner's then current application for changes in the reduction of royalties for media-advertised audio carriers, and modified the returns regime applicable to media-advertised audio carriers. In its decision, the Higher Regional Court of Munich stated as follows:

> *"The statement of reasons for the determination of the Association Agreement — limited to the contractual stipulations in dispute between the Parties pursuant to Article V (par 18*ter*) as amended on August 3, 1995, in accordance with Exhibit B 7 — shall be as follows:*
>
> *On the basis of the facts to be assessed in the present case which follow from the facts and arguments submitted by the Parties, the 12% reduction in the current remuneration amounting to 9.009% of the Published Price to Dealer (PPD) as sought generally by Plaintiff, to 7.9279% in future would lead to a situation where a reasonable participation by authors affiliated to Defendant in the economic benefit of their works would not be ensured (any more). A large number of considerations have led to this result, of which only an approximate account can be given herein.*
>
> *At first, it should be assumed together with the Parties hereto that the correct vantage point for such a regime is to be seen in Article V (25) of Amendment No. 6 of December 12, 1992 (Annex 1 to Exhibit K2), under which in respect of television-advertised phonograph records, tapes, and cassettes, particular terms and conditions 'may' apply which are to be stipulated by mutual agreement between the society and the national group of IFPI. For the standard agreement, as a model agreement, should be worded so that it may become effective as a single-user contract without a stop-gap function, without prejudice to the admission of arrangements otherwise agreed in exactly defined points.*
>
> *By agreeing on the special returns regime for new releases of the audio carriers being the subject matter in dispute, in Article V (par. 18*ter*), the Parties hereto have made use of such admission as already described in detail. The other countries of the European Community, however, have also made use of*

such admission, and have done so in extremely different forms, as can be seen particularly from Exhibit B 5.

In this context, special attention had to be paid to Plaintiff's line of reasoning, according to which Plaintiff's members were being disadvantaged particularly in competition on a European scale because virtually all national collecting societies in Europe had concluded agreements with their respective contracting parties pursuant to Association Agreements, under which deductions were effected from the royalty rate in respect of the audio carriers being the subject matter hereof, while this was not the case in the Federal Republic of Germany alone.

In that context, it should be stated that the change in the competitive situations in the domestic market for audio carriers, which has occurred on account of the decision of January 20, 1981, by the European Court of Justice (GRUR Int. 1981, 229 — Difference in Charges, II), is of particular significance. For according to that decision, the domestic holder of a copyright in a Member State of the European Union may not invoke an exclusive exploitation right conferred upon him by virtue of copyright so as to prevent or limit the importation of audio carriers which have been marketed regularly by the right holder itself, or with such right holder's consent, in the market of another Member State. Consequently, audio carriers manufactured domestically will on principle compete with audio carriers from the Member States of the European Union, without any protection from competitive disadvantages which may arise from the fact that there are different levels of royalties for copyright holders. The fact that royalty rates applicable abroad are to be considered in determining reasonable remuneration, however, does not mean that domestic remuneration needs to be equivalent to remuneration levels in other Member States. For according to submissions by the Parties, it may not be assumed that audio carriers manufactured domestically are in fact exposed to comprehensive competition from audio carriers from European Member States because the Parties accept as a non-contentious point that there are virtually no parallel imports. This is also in line with what the EU Commission ascertained in the Seagram/Polygram proceedings of September 21, 1998 (Case No. IV/M, 1219), published in the Official Journal of the EC Commission on September 21, 1998; C 268), as well as in the Time Warner/EMI proceedings of June 14, 2000 (Case No. COMP/M, 1852, published in the Official Journal of the EC Commission on June 28, 2000, C 180), according to which parallel imports were currently without significance, or there was hardly any cross-border wholesale or retail trade in audio carriers between the Member States. The peculiarities of the free movement of goods have also been taken into account by interna-

tional contracting parties by way of differentiated export rules in Article V (items 7 to 23) of Amendment No. 7 of June 30, 1998 (cf. Exhibit K 6).

In the foregoing context, Defendant pointed out that market structures are extremely different in each European Member State, and that the admission of different special arrangements at national level for the audio carriers being the subject matter hereof, in accordance with Article V (25) of Amendment No. 6 of December 12, 1992, was precisely intended to take this fact into account. Indeed, provisions being extremely different in nature have been enacted at national level, which follows in particular from Exhibit B 5, and do not allow for a statement to the effect that there are considerable differences in royalty levels. For an overview of the different provisions enacted in Europe reveals that those provisions may not without difficulty be compared with one another and, consequently, cannot be applied directly — let alone partly — from one country to another. It is only by way of example that to that extent, it may be stated that for those European countries where royalty deductions have been granted in respect of the audio carriers being the subject matter hereof, both the regime as to free copies exempt from royalties and the returns regimes applicable in each case are by far less favourable for audio-carrier producers compared with the provisions for the parties in this country. Furthermore, it should be stated in particular that the said royalty reductions are regularly subject to terms and conditions according to which the advertising costs per audio carrier must demonstrably exceed a certain basic amount, and/or a minimum number has been set for advertising placements on television or radio, and/or royalty reductions are limited either to a number of audio carriers expressed in an amount, or in terms of duration. All this applies especially to the Belgian regime as well, which Plaintiff intends to use, albeit only partially — i.e., as regards the extent of the reduction provided for there —, as a standard of comparison. In the circumstances obtaining in the present case, the latter will by no means lead to reasonable results, even if one did not consider the fact that the different European provisions do not lend themselves to overall comparison, and take account of the national market situation which is different in each case. Now as far as the stipulation of delimitation as to scope, duration, and/or cost is concerned, which relates to the media advertising per audio carrier that might cause any reduction, the Division has finally refrained from making use of its pertinent considerations, on the basis of the reasoning by the Parties hereto. For on the one hand, Defendant was right in pointing out that in the interests of the authors affiliated to it, the stipulation of certain minimum requirements as to the implementation of any royalty reductions will be indispensable and, on the other hand, it is undisputed be-

tween the Parties hereto that it is particularly the stipulation of such minimum requirements, especially the stipulation of a minimum expenditure, in terms of amount, on advertising that would put at a disadvantage the so-called minor producers of audio carriers for the purposes of § 20, Clause 1, of the GWB [i.e., the German Anti-Trust Act]. In this context, special attention was also to be paid to the fact that the latter applies quite independently of the remarkable reasoning by the Federal Cartel Office in its opinion of October 25, 1999, as incorporated into the Arbitration Board's settlement proposal of November 6, 2000 (Exhibit K 5). For the avoidance of repetition, reference is hereby made to the said opinion given by the Federal Cartel Office. To the objections raised by Plaintiff to that extent, it should be stated that the Federal Cartel Office was, according to its reply to an inquiry of August 2, 1999, by the Arbitration Board (Exhibit K 14), in possession of copies of the Arbitration Board's procedural files, and that from the Division's point of view, there is no indication of any 'non-objective' wording of the said inquiry.

Irrespective of the question as to whether there are, as regards the advertising of their audio carriers, groups of 'major' producers who do advertise their products in the media, and 'smaller' producers who do not; or whether there are only different categories of products by all producers, it may be stated on the basis of Plaintiff's submission that of the 350 members of Plaintiff, 336 are small and medium-sized audio-carrier producers whose advertising budget will, to the best of one's judgement, be endowed by far more modestly than will be the case, e.g., for the five so-called major enterprises, whose market share alone, according to the data ascertained by Plaintiff, amounts to 76%. It is in view of this extremely differentiated structure, too, that the stipulation of one single amount of minimum advertising expenditure would appear to be inappropriate.

But it is also Plaintiff's submission that 20% of its associate members do advertise audio carriers that raises doubts, for that figure is based on a survey conducted by Plaintiff among its 325 associate members, to which 106 companies responded, of which 21 companies stated that they were advertising their audio carriers. In this context, attention had to be paid as well to the fact that, for instance, each of the major companies Warner Music Germany and EMI Electrola advertised 9.5% or 5,5%, respectively, of all their new releases in the year 2000 in the media belonging to the subject matter hereof. After all, the ideas of each of the Parties hereto — as to which costs accruing within the framework of the advertising of audio carriers should be part of any minimum advertising budget and whether, for instance, the costs accruing within the framework of special arrangements (co-operation ar-

rangements) with broadcasting institutions should be counted as well, or not at all — differ radically from each other.

In these circumstances, any structural deviation from the provisions applicable as between the Parties hereto, as regards this point, did not appear appropriate to the Division for safeguarding a reasonable balance between performance and counter-performance of the Parties.

But it is neither on the grounds of the actual change in the situation on the market for audio carriers that any such deviation, which would at least correspond in part to Plaintiff's application, from the set of rules existing between the Parties under a Association Agreement would seem appropriate.

Plaintiff's line of reasoning, according to which performance and counter-performance are inequitably disproportionate because there was no counter-performance by authors in respect of the sales rise in the audio carriers being the matter in dispute, which rise had been 'bought' by audio-carrier producers with significantly increased employment of funds for marketing and promotion, can in the present form not be accepted by the Division. The figures to that extent submitted by Plaintiff, particularly those from Exhibits K 27 and K 37, reveal that the sales share of the so-called media-advertised audio carriers in the total sales generated in the market for audio carriers was 16% in 1994, 17% in 1995, 19% in 1996, 18.5% in 1997, and 16% in 1998 (cf. Exhibit K 27), while the sales generated for the audio carriers being the matter in dispute rose from 1994 to 1996, and from 1997 to 2000 declined continuously to a level below that of 1994 (Exhibits K 37, K 41, and B 16). Likewise, the amounts of advertising expenditure on the audio carriers being the matter in dispute increased continuously from 1994 to 2000, for reasons that may still be in dispute when it comes to discussing details (cf. Exhibit K 37). From Exhibit K 37, it also follows that sales of the audio carriers being the matter in dispute rose from 1994 to 1996, and from 1997 to 2000 declined continuously to a level below that of 1994. During the same period, the sales of audio carriers that were not media-advertised was rising continuously, as Exhibit K 37 reveals as well.

That result is also in line with Plaintiff's submission according to which the use of media advertising, on the one hand, 'frequently' leads to a considerable increase in audio-carrier sales while, on the other hand, it is particularly in the segment of the audio carriers being the matter in dispute where the producers of audio carriers are exposed to a significantly increased marketing and 'flop' risk of up to 40% of new releases. Accordingly, audio-carrier royalties collected by Defendant in the year 2000 fell below the level of 1998. In these circumstances, any statement to the effect that Defendant's *members would profit directly and without any deduction from the sales rise 'bought' by producers using significantly increased marketing and promotional expenditure would in fact appear inappropriate. For Defendant's members of course participate in the significantly increased marketing risk, in the same fashion. If one furthermore considers that the pecuniary advantage relevant to the basis of computation is determined by sales and not by the exploiting party's profit, and that the Published Price to Dealer of the audio carriers being the matter in dispute is generally not higher than that of audio carriers advertised in a traditional manner even if the advertising expenditure incurred by audio-carrier producers is included in costing, compliance with Plaintiff's request would lead to unreasonable results.*

In this context, attention was also to be paid to the fact that answering the question whether — and if, to what extent — media advertising for a certain type of audio carrier makes sense or is required under aspects of business management is a producer's very own decision which comes under its sphere of risk alone, particularly because authors are not in a position to have any influence whatsoever on this. Neither does Plaintiff's pertinent submission offer any indication that media advertising might be a necessity 'dictated' by the market. In the circumstances obtaining in the present case, there is no scope for the subsidising by authors of the advertising expenditure of audio-carrier producers as demanded by Plaintiff.

No different conclusions may be drawn either from the — increasing — market-structure problems described by Plaintiff which are a consequence of Internet piracy, and the emergence of product reproduction with the help of CD burners, for those problems are by no means limited to the category of audio carriers being the matter in dispute, and ultimately affect both Parties hereto in the same way.

Neither is Plaintiff's request justified on the grounds of the dramatic changes in the programming structures of broadcasting stations since the beginning of the nineties. Even if there may have been a decline in the advertising of audio carriers in the course of regular programming with regard to new releases of audio carriers, which is free of charge to the audio-carrier industry, it should be stated on the other hand that as a consequence of the increase in the number of broadcasters on offer, because of the admission of commercial broadcasters in the early nineties, the bottom line is that by far more programming slots and channels for the utilisation of music titles are now available.

In this context, it should also be pointed out that as a matter of course, it is not only Defendant's members but also Plaintiff's members as well that participate in the receipts of broadcasting stations.

Neither should there be consent to Plaintiff's opinion that in the market in question in the present case — i.e., the market for the exploitation of copyright-protected works on audio carriers —, deductions from authors' licenses which are caused by users' marketing costs are customary. This, in particular, does not follow from the decisions by the Federal Court of Justice of April 5, 2001 (I ZR 32/99 and I ZR 132/98; BGH WRP 01, 1345 ff.), to which Defendant has already made correct reference. For that case was about the basis of computation in the area of broadcasting — i.e., the advertising revenue of each broadcasting station, and about the question whether the commissions of sales representatives and the withholding of so-called 'combined radio rates', as marketing costs incurred by broadcast operators, may be deducted therefrom, or not. With regard to that subject, the Federal Court of Justice essentially stated that while it may have become customary for such costs to be deducted in determining advertising revenue, there are many factors speaking in favour of limitation or implementing a flat-rate scheme so that the basis for computing royalties may not be diminished merely through organisational measures taken by broadcast operators. There were no indications, however, of any conclusions drawn by Plaintiff in that respect.

*Now as regards the returns regime in respect of the audio carriers being the matter in dispute in accordance with Article V (25) of Amendment No. 6 of December 12, 1992 (Annex 1 to Exhibit K 2), in conjunction with the version, as last amended, of Article V (par. 18*ter*) of August 3, 1995 (Exhibit B 7), the opinion of the Division — which deviates from the Arbitration Board's proposal for a settlement — is that a modification for the purposes of Plaintiff's request, namely in the direction of a settlement method that accounts more precisely for numbers of units sold, would be reasonable and appropriate for sufficiently considering producers' efforts to promote sales of the audio carriers in question through such advertising expenditure as may not be insignificant. These preconditions, however, will not be met by the absolutely precise accounting for units sold, as sought by Plaintiff, through the crediting regime suggested by Plaintiff, which will be further discussed below.*

In this context, Defendant is right to assume that even reproduction is subject to royalties and that, in addition, intervention in authors' distribution rights is regularly and at an early stage effected in that audio carriers are offered to the Associationpublic — cf. §§ 16, Clause 1, and 17, Clause 1, of *the Copyright Act —, which frequently happens long before the audio carriers leave a producer's central warehouse. Accordingly, it is merely for reasons of expediency that in accordance with Article V (16) of the Association Agreement, the due date for remuneration in respect of works utilisation through reproduction and distribution is linked to a point in time that can be applied consistently, i.e., the point in time at which an audio carrier leaves the producer's central warehouse. It is at the point in time of such delivery at the latest that from a producer's point of view, an audio carrier has been sold and is hence subject to royalty, which is absolutely in accordance with the law.*

Plaintiff's opinion that in view of the significantly increased risk of returns for the audio carriers being the subject matter in dispute in the present case, remuneration in respect of audio carriers actually unsold would — illegitimately — accrue to Defendant, so that only absolutely precise accounting for numbers of units circulated could be deemed appropriate, is thus inaccurate for several reasons. For firstly, as has been mentioned above, even the reproduction of works through the manufacture of audio carriers, and the offering of the same to the Association public, will on principle be subject to royalties; secondly, audio carriers, when delivered by a producer to dealers, have been sold and, thirdly, the foregoing applies absolutely independently of any agreements between producers and retailers with regard to returns of such audio carriers that cannot be resold by dealers.

Accordingly, the existing provisions of the Association Agreement between the Parties hereto, under which royalties will be due only upon delivery by producers to dealers, rather imply that the authors affiliated to Defendant will 'participate' in the significantly increased marketing risk for the audio carriers being the matter in dispute, as has also been submitted by Plaintiff, namely with regard to such audio carriers that cannot be sold even by producers to dealers, and for which no remuneration will thus be paid.

*On the other hand, it can be stated that on the basis of the provisions under the Association Agreement as available to the Division, returns reductions in respect of defective, damaged, and/or non-marketable audio carriers have for decades been customary on principle for all types of audio carriers. Furthermore, it should be taken into account that with regard to the peculiarities of the audio carriers being in question in the present case, the Parties hereto agreed even by way of the special arrangements made between them on October 25/November 12, 1990, as annexed to the Association Agreement of October 25/November 12, 1990 (Annex 2 to Exhibit K 1), to create special provisions, in the form of Article V (par. 18*ter*), for the so-called media-advertised audio carriers. Until the most recent pertinent arrangements* *of August 3, 1995 (Exhibit B 7), these special provisions have been amended several times in favour of producers, as described in detail under Clause II, 2.1.1, of the statement of reasons. It is undisputed that these amendments towards more precise accounting, in terms of units sold, have been effected so that it was possible for producers' advertising expenses and changes in the market situation to be considered. Accordingly, it is in the present litigation, too, that Defendant has not on principle opposed further modifications in favour of the producers of audio carriers, as may be inferred from its conciliatory suggestions with regard to this matter (cf. brief dated April 25, 2002, page 4, sheet 122, of the application).*

Against this background and with regard to the fact that the Parties hereto agree that returned audio carriers that are delivered again and have not been licensed yet or are no longer licensed, and are required to be licensed, the Division has decided to stipulate a returns regime for the audio carriers being the matter in dispute in the present case, which is to come as close as possible to precise accounting in terms of units sold.

In this process, the Division at first assumed that the significantly increased risk of returns, as submitted by Plaintiff, for so-called media-advertised audio carriers is at any rate to be attributed also to the fact that delivery of the major part of inventories for covering expected dealer demand is carried out concurrently with the advertising campaign during the first accounting quarter, whereas in the subsequent quarters only a few units will be delivered, which will then be juxtaposed by large numbers of returns that cannot be set off. Furthermore, the Division assumed that returns will be completed approximately 9 months after the commencement of delivery, and that according to information from Plaintiff, a carry-forward of any excess returns to the following accounting periods, which is as such possible under Article V (17) of the Association Agreement, will frequently fail to materialise because the audio carrier will then be out of stock.

Accordingly, the Division has — going beyond Defendant's suggestion submitted by way of settlement — raised the reserves quota to 50% subject to the proviso that accounting will commence only during the second accounting period following first delivery, and that reserves shall be dissolved after 18 months only.

In doing so, the Division has also taken into account that it is indisputable that as a consequence of concentration in the audio-carrier trade, there are essentially five major purchasers left that dominate the market so that Plaintiff will probably not be able without difficulty to opt out of the returns arrangements with dealers that have been customary to date as well.

At the same time, however, and with regard to the organisational and financial burden on Defendant which would be associated with the creation of reserves for the purpose of granting credits, as has been submitted by Defendant in an absolutely comprehensible way, the Division does not deem reasonable the kind of precise accounting in terms of units sold, through crediting on the part of Defendant, as demanded by Plaintiff. Apart from the fact that Defendant would no longer be able to meet its obligation to perform the distribution of royalties to authors in a timely manner because it would be impossible to calculate the amounts of any reserves required, a completely new accounting system would need to be installed. Such a set of rules would also be contrary to the system because it follows from Article V (17) of Amendment No. 5 of December 31, 1989 (Annex 1 to Exhibit K 1) that while a carry-forward of excess returns to subsequent accounting periods has been provided for in principle, this does not apply to a crediting system. There has been no change to date in international agreements with regard to this set of rules."

The Arbitration Board subscribes in full to these statements. The returns regime stipulated by the Higher Regional Court of Munich is reasonable only for media-advertised audio carriers because there is a considerable risk of returns because of the greater demand to be expected — but not invariably met — for media-advertised audio carriers, and the resulting requirement that a strong market presence be created. For consumers, it would hardly be understandable if they were unable to find that a media-advertised audio carrier is out of stock at a relevant business establishment.

For audio carriers that are not media-advertised, the existence of such an increased risk of returns cannot be stated. For these audio carriers, a particularly strong market presence is not required. To the extent that Petitioner claims that for all audio carriers, the number of returns had increased dramatically since the year 2000, and would cover a longer period of time, no different result would be justified. This claim, which is challenged by Respondent, has not been substantiated as submitted, and is inconsistent with the figures submitted by Petitioner itself. According to the overview submitted with the letter dated June 12, 2004 (Annex ASt 11), the numbers of returns in the years 2000 and 2001 have actually declined, compared with figures from previous years. For the year 2002, only a slight increase is to be noted, which continued, edging slightly upwards as well, until the year 2003. It is thus not possible to register any remarkable change up to and including the year 2003.

It is only singles for which a considerable increase in the number of returns can be stated for the first quarter of the year 2004, which, however, does not apply to long-play records and compilations which are more significant economically. Even if one assumes that these figures are accurate and representative, the considerations by the Higher Regional Court of Munich as quoted above, in particular,

- the legal opinion as to the origination of copyright royalties at the time of the manufacture of audio carriers, or at the time when there is an offer to the Association public;
- the legal opinion as to a reasonable spreading of risks in the selling of audio carriers;
- the fact that the advertising of audio carriers comes under Petitioner's members' very own sphere of risk;
- the great administrative expenditure that would otherwise be created for Respondent, associated with a marked delay in the distribution of royalties to rights holders,

will lead to limiting the returns regime stipulated in the decision of July 12, 2003, by the Higher Regional Court of Munich to media-advertised audio carriers for the period from July 1, 2000, to December 31, 2005, as well, and will lead to deeming inappropriate the request for a 12% reduction in royalties for media-advertised audio carriers. For the same reasons, Petitioner's request for absolutely precise accounting in terms of units sold should be dismissed.

3. <u>The Level of the Royalty Rate</u>

The Arbitration Board holds that the royalty rate of 9.009% as stipulated in the most recent Association Agreement continues to be reasonable.

According to § 13, Clause 3, Sentence 1, of the Copyright Administration Act, the pecuniary advantages of users should as a rule be the basis for computing reasonable remuneration. Authors shall equitably participate in the economic benefit of their work (cf. *BGH*[6], GRUR 1986, p. 376 — film music; *BGH,* GRUR 1982, p. 102 — master tapes; *BGH,* GRUR 1985, p. 131 — display of magazines at hairdressing salons; *OLG*[7] Munich, GRUR 1983; p. 578 — utilisation of music on video cassettes). The benchmark for that economic benefit will be the user's financial performance to the extent that such performance is directly related to the utilisation of the copyright-protected works. It is not a user's profit that will be crucial because that profit will be dependent on numerous factors not related to a work, but rather the sales generated by a user from the work

[6] *BGH* = Federal Court of Justice.
[7] *OLG* = Higher Regional Court.

(cf. Schricker/Reinbothe, *Kommentar zum Urheberrecht*[8], 2nd Edition, § 13 of the Copyright Administration Act, Marginal Note 7; consistent arbitration-award practice by the Arbitration Board, e.g., ZUM 1989, p. 533). An author shall not be made to participate in a user's economic risk. It should be noted, however, that an author's equitable participation in economic utilisation may not go so far as to create a situation where the remuneration to which an author is entitled is disproportionate to the user's expenses (cf. *BGH,* GRUR 1988, p. 373 — importation of phonograph records, III; *OLG* Munich, ZUM-RD 2003, p. 464).

The Arbitration Board has explored the possibility of determining the amount of equitable remuneration so that the individual ratios leading to the royalty rate of 9.009% of the PPD (i.e., up-lift, discount, and packaging discount) would be re-calculated. That course of action, however, is in fact not a feasible possibility because one of those ratios, the so-called up-lift — i.e., the difference between the average recommended retail price generally paid by the public at large, the EVP, and producers' average listed selling price charged to dealers, the PPD, can be determined neither through legal considerations nor through any taking of evidence such as, for instance, surveys or expert opinions. Since the mid-eighties, such a recommended retail price generally paid by the public at large has no longer existed. Consequently, it is impossible to determine, for the period relevant to the decision, the difference between such a figure and the average PPD; i.e., the up-lift.

To the extent that Petitioner computes, on the basis of surveys conducted by the *GfK*[9], an up-lift of 9.2% for the year 1995 and of 9.6% for the year 2003, this will not lead to any different legal assessment. The *GfK* compared average retail prices with the average listed selling prices. In the present case, however, the Parties hereto agree that the price that should matter is not the "average retail price", which has been easy to determine from the mid-eighties onwards. The crucial price was, and still is, the so-called average "recommended retail price" which must not be confused with the average actual retail price. Petitioner submits — and is ultimately right to submit — that the actual retail price is a figure that is not fit for the purpose because it is exposed to considerable fluctuation, and thus cannot serve as a dependable basis for determining equitable remuneration. To that extent, Respondent agrees to Petitioner's considerations and intends — just as Petitioner — to determine reasonable remuneration on the basis of the "recommended retail price". Since that recommended retail price has been out of existence for decades, a re-calculation of the up-lift is impossible even for factual reasons.

[8] A Commentary on Copyright Law.
[9] A consumer-research institution.

The Arbitration Board holds that the actual average retail price is not suitable for determining equitable remuneration, for the additional reason that this price includes discount allowances. Experience shows that at least part of the undisputed discounts granted will be passed on to ultimate purchasers. To that extent, discounts would be taken into account twofold at the expense of Respondent because Petitioner, in its calculation model, has already considered elsewhere the discounts granted on average, in their full amounts (16.5%).

Consequently, equitable remuneration must be determined using another method. For that purpose, the provisions under the Association Agreement, which have to date been deemed reasonable, and thus agreed, by the Parties hereto, appear to provide the obvious solution. According to consistent arbitration-award practice by the Arbitration Board, the provisions under an Association Agreement, which have been deemed reasonable, and thus agreed, by the parties to a case, will be a substantial help in determining an Association Agreement. In that process, any modification or non-modification of guiding standards which may have occurred since early stipulations were put in place by the parties should be considered (cf., *inter alia, OLG* Munich, decision dated June 12, 2003, ZUM-RD 2003, pp. 464, 472). It is therefore relevant to the decision whether since July 1, 2000 — i.e., since the expiration of the last Association Agreement that had been concluded with the consent of both parties —, any material change has occurred in the factual circumstances that led to the royalty rate of 9.009% that was being considered equitable at the time.

The Arbitration Board has been unable to detect any such material change in those factual circumstances so that the assumption that the royalty rate amounting to 9.009% of the PPD should continue to be valid.

Contrary to Petitioner's claim, no material increase in the PPD can be recognised. To the extent that Petitioner claims that the PPD has risen continuously, Petitioner fails to recognise that only changes in the PPD amount since July 1, 2000, are relevant to the present decision. Until June 30, 2000, the Parties agreed in considering the figure of 9.009% of the PPD (which should be equivalent to the figure of 8% of the EVP) to be an equitable rate of remuneration.

To the extent that Petitioner submits that it was compelled by virtue of international agreements to consider equitable the royalty rate valid until June 30, 2000, at a rate of 9.009% of the PPD, this is legally insignificant. While a change in motivation may be of significance for Petitioner, it does not lead to any change in the guiding standards put to use at the time. And even the objective that from July 1, 2000, onwards, a different method of calculation — based, for instance, on the ARP — should be agreed does not represent any change in the guiding standard on which previous provisions under Association Agreements were modelled.

By concluding the Association Agreement valid until June 30, 2000, Petitioner indicated that the royalty rate valid until June 30, 2000, at a rate of 9.009%, was deemed reasonable. It was neither in the Association Agreement nor in other contractual arrangements with Respondent that such reasonableness was linked to international obligations or changes in accounting modalities expected for the future. Consequently, only changes in the PPD from July 1, 2000, onwards may be deemed material changes in the guiding standard. No such change could be identified by the Arbitration Board. Even if one assumes that the information submitted by Petitioner with a letter of October 18, 2004 (cf. Annex ASt 14), is correct and representative, the PPD remained almost constant between the years 2000 and 2003. It is true that there is a lack of specific figures for the years 2004 and 2005; there are, however, no indications or facts submitted that might lead to a recognition of any material change.

Nothing different applies to the discounts granted by Petitioner or its members. Even according to Petitioner's submission relating to the period relevant to this case, the period from July 1, 2000, no material change in the amounts of discounts can be identified. In this context, only the so-called dealer and product discounts are relevant to the Arbitration Board. The "miscellaneous discounts" granted by Petitioner or its members is, according to Petitioner's submission, juxtaposed by a counter-performance which may be utilised independently by the producer so that any discounts granted insofar will nit imply any direct sales disadvantage. In the opinion of the Arbitration Board, the granted contributions to promotional expenses are not to be taken into account either because the implementation of advertising measures is to be attributed clearly to product sales, and consequently affects the users' sphere of risks alone. To that extent, reference may be made to the statements by the Higher Regional Court of Munich as quoted above, on the dismissal of the request for a 12% deduction for media-advertised audio carriers.

According to the overviews submitted by Petitioner, dealer and product discounts have increased from 15.7% in the year 2000 to 17.8% up to the year 2003. Such a slight increase, of 13.4% in percentage terms, does not represent a material change in the guiding standard. Between the Parties to these Proceedings, only a participation in discounts, at the expense of Respondent, had been agreed until June 30, 2000. Because of the fact that the discounts granted by Petitioner will directly affect the extent of economic utilisation, the Arbitration Board, too, deems in principle reasonable — as has been agreed mutually for many years — a participation by rights holders in those discounts. In the opinion of the Arbitration Board, Respondent's maximum participation, in the discounting practice used to date, should be 50% of the average discounts granted by Petitioner or its members. This would mean that, for an average discount at a rate of 16.5% as alleged by Petitioner, a participation by Respondent at a rate of 8.25% should be deemed equitable. The participation by Respondent in discounts, at 9%, as agreed in the calculation model provided for in the most recent valid Association Agreement, thus comes quite close to that figure. Even if one assumes in favour of Petitioner that the rate of the average discounts granted is 16.5%, no adjustment of the guiding standard thus created, to a change in discounts, would be required.

That the Arbitration Board deems equitable Respondent's participation at a maximum of 50% in discounts granted on average is based on the following reasoning. Respondent is right to point out that the discounts represent individual managerial decisions relating to the sphere of sales alone, and hence coming under users' sphere of risk. Attention must be paid in favour of Petitioner, however, to the principle that an author's reasonable participation in economic utilisation may not go as far as to be excessive at the expense of a user (cf. *BGH,* GRUR 1988, p. 373 — importation of phonograph records, III; *OLG* Munich, ZUM-RD 2003, pp. 464 ff.). The Arbitration Board does not ignore the fact that dealer and product discounts may reduce sales and, hence, the economic benefit. The Arbitration Board is also aware that Petitioner, or its members, are in many cases almost compelled to grant discounts — for instance, to bulk purchasers. Purchasers with a strong market position will quite seriously consider refraining from selling audio carriers if they are not granted hefty discounts by producers. Such refraining would have a direct effect on authors' remuneration because then sales of audio carriers would be reduced in number. A compulsion to grant discounts, however, is not limited only to the trade in audio carriers. In many areas where producers face bulk purchasers, such dealer and product discounts are customary. It is in line with managerial common sense to include such discounts — at least partly — in one's pricing when listed prices, i.e. PPDs, are being determined. In addition, such discounts are juxtaposed by advantages on the part of producers as well because bulk purchasers will frequently order large numbers of units, or even whole product ranges. If such large numbers of units have automatic effects in favour of authors, too, then this will be only logical because of the good marketability of the works in question.

In the opinion of the Arbitration Board, a participation by rights holders at a maximum of 50% in discounts granted on average represents a reasonable balance between the factors that need to be considered. On the one hand, the discounts granted are, as mentioned above, completely removed from Respondent's sphere of influence. On the other hand, Respondent, too, does not ignore the fact that, as described above, companies with a strong market position will actually compel producers of audio carriers to grant discounts. Respondent's participation in that discounting practice is reasonable in particular because the discounts granted may reduce producers' pecuniary advantages as actually achieved. In view of this, participation by Petitioner in the discounts granted will be reasonable because otherwise there may be a threat of protected rights becoming invalidated. To the extent that Petitioner is granted a 50% participation in discounts, any gradual invalidation of copyrights is not to be expected. In the event of a 50% participation, the economic consequences of that discounting practice will be an equal burden on both Petitioner and Respondent alike. The Arbitration Board deems equitable such a split of discounts.

Contrary to Petitioner's view, then, it would not be justified to pass the disadvantages resulting from discounts on to the authors in a one-sided way. The amounts of discounts will depend solely on producers' negotiating skills, on which rights holders have no influence, and pertains exclusively to sales of audio carriers; i.e., they will come under producers' very own sphere. To that extent, Petitioner is right to submit that it needs to oppose any gradual invalidation of copyrights. Should the non-granting of discounts lead to a decline in sales and, hence, to a decline in royalty revenue, this may be a negative development from Petitioner's point of view. From Respondent's point of view, it may be possible to deliberately tolerate such a fact so as to counteract any selling of copyright at dumping prices.

In view of the figures submitted by Petitioner in Annex ASt 16 to the brief dated October 18, 2004, Respondent's 9% participation until June 30, 2000, as mutually agreed, is approximately equivalent to a 50% participation in dealer and product discounts. To the extent that one assumes the figures given in Annex ASt 16 to be accurate and representative, dealer and product discounts were 15.7% in the year 2000; 16.0% in the year 2001; 17.3% in the year 2002; and 17.8% in the year 2003. Thus, any taking of evidence for determining the rate of discounts granted on average is not required.

In addition, there has not been any material change since July 1, 2000, in the circumstances that have led to an acknowledgement of the packaging discount at a rate of 10%. To that extent, Petitioner fails to recognise — and Respondent is right to point this out — that the packaging discount is not intended to settle all costs accruing in connection with the manufacture of an audio carrier. According to the Association Agreement in force to date, that packaging discount was applicable for individually designed presentation. This expression refers to the cover — i.e., packaging as such —, as well as to the booklet; i.e., the table of contents, the textbook, or the relevant pictorial designs. Even if one considers the survey conducted among Petitioner's members with regard to "technical costs" as submitted with a letter of February 24, 2005 (ASt 25), assuming that the figures contained therein are accurate and representative, the "technical share" deemed crucial by Petitioner will be calculated at 11.83%. It is not possible to ascertain any material change in the guiding standard compared with the figure of 10% as agreed to date.

Consequently, all guiding standards actually in use which lead to the rate of 9.009% of the PPD have since July 1, 2000, not changed in such manner that any adjustment of the royalty rate would be required. This result has not been reached through interpreting figures but on account of the fact that there has been no material change in guiding standards since the expiration of the most recent Association Agreement.

It is not least the fact that on November 14, 2004, the VUT concluded an Association Agreement with Respondent, the contents of which are comparable to those of the Association Agreement stipulated in the present Proceedings, that speaks in favour of the reasonableness of the provisions stipulated in the present Proceedings.

4. Minimum Royalties, as well as the Limitation of Work Numbers and Playing Times

The provisions stipulated in the existing Association Agreement, with regard to minimum royalties as well as to the limitation of work numbers and playing times, should continue to be deemed reasonable. To the extent that Petitioner seeks complete deletion of those provisions, it will be impossible to comply with such request. Provisions on minimum royalties are necessary to protect authors from any potential invalidation of their rights (cf. *BGH,* GRUR, 1988, pp. 373, 376 — importation of phonograph records, III). It is only in rare exceptional cases that the Arbitration Board will deem minimum royalties inappropriate. It is only in cases where from a commercial point of view there is no possibility other than utilising audio carriers at extremely low prices that minimum royalties may be deemed inappropriate. In the present Draft Association Agreement, however, Petitioner does not seek such exceptional regulation. Rather, Petitioner, under its freedom of economic activity, would like to be allowed to carry out unrestricted pricing. To Petitioner, the modifications discussed at the two hearings, which would have been part of the provisions of the existing Association Agreement, were insufficient; as before, Petitioner seeks a complete elimination of minimum royalties as well as a complete elimination of limitations relating to work numbers and playing times. Against the background of a potential invalidation of copyrights, this is not appropriate. For the same reasons, the complete elimination of limitations relating to work numbers and playing times is not justified either. The principle that authors shall participate equitably in the economic benefit of their works (cf. *BGHZ* 97, 37, 43 — film music) is not violated disproportionately, at the expense of users, by the existing provisions of the Association Agreement which relate to minimum royalties as well as to limitations of work numbers and playing times.

5. Exempt Copies

The complete elimination of the limit on the number of exempt copies is deemed inappropriate because otherwise, there would be a threat of copyrights becoming invalidated as well. An increase to a maximum of 1,200 in the number of copies exempt from royalties, as suggested by Respondent, represents an equitable reconciliation of interests. The Arbitration Board, however, does not see any reason for linking such an increase in the number of copies to the proviso that at any rate, a percentage of 50% of the respective audio carrier's circulation shall not be exceeded. If audio-carrier circulation is low, then the number of exempt copies required should be low, too, so that any restriction going beyond the upper limit would be unnecessary. In addition, any such linkage has not been agreed as customary in the existing Association Agreements of the parties involved.

6. Establishing a Fund for Combating Piracy and Taking Copy-Protection Measures

In a brief dated October 18, 2004, Petitioner declared its application settled to that extent. Respondent has not consented to that declaration of partial settlement.

Partial settlement of the dispute has not occurred. To that extent, Petitioner's application was unfounded from the beginning. It is true that Petitioner and Respondent may at any time conclude agreements relating to the establishment of a fund for anti-piracy and copy-protection measures. Formally, this may also be done within the framework of an Association Agreement. Such provisions, however, are not part of an Association Agreement to be submitted in proceedings before the Arbitration Board. This is not a tariff issue that may be proposed or stipulated by the Arbitration Board or a court as a content of an Association Agreement. Within the limits of the Copyright Administration Act, Respondent may decide independently on how to apply the funds to which it is entitled. To that extent, Respondent is only subject to the agreements with its members and to governmental regulation under the Copyright Administration Act. To that extent, neither Petitioner nor the Arbitration Board or courts will be in a position to stipulate certain obligations against Respondent's will within proceedings relating to an Association Agreement.

7. The Alternative Petitions

The application for the suspension of proceedings had to be dismissed. Suspension may be considered, at most, in accordance with the provision of § 148 of the Code of Civil Procedure. As Respondent is right to submit, however, the action brought by the Universal Music company before the EU Commission represents proceedings in a case of individual utilisation. There is no prejudicial effect on the Arbitration Proceedings.

To the extent that Petitioner alternatively petitions that the Federal Cartel Office be caused to submit these Proceedings to the EU Commission pursuant to § 50, Clause 3, of the *GWB,* that request cannot be complied with for legal reasons. The Arbitration Board has informed the Federal Cartel Office of the present Proceedings, and sent the briefs exchanged, as well as the minutes of hearings, to the Federal Cartel Office. To that extent, the Federal Cartel Office will decide on its sole responsibility as to the further course of action it may take. There is no possibility for the Arbitration Board of exerting legal influence to cause the Federal Cartel Office to take any particular measures.

The application made strictly by way of alternative, in Clause 3.2, is also to be dismissed. As explained above, the complaints proceedings initiated by Universal Music have no prejudicial effect on the present decision. Consequently, considering the contents of any decision by the EU Commission will not be mandatory.

8. Restitution to the Previous Condition

Pursuant to the provision of § 233 of the German Code of Civil Procedure, which is by analogy applied to the present case, restitution to the previous condition may be considered only if Petitioner has failed to comply with a deadline. In the present case, however, no such failure applies. At most, Petitioner may have missed an opportunity of concluding an Association Agreement having the contents applied for by Petitioner even for the year 2003. § 14 c, Clause 1, Sentence 2, of the Copyright Administration Act provides that the conclusion of an Association Agreement may be suggested only with retroactive effect as per January 1 of the year in which an application was made. As explained above, the Arbitration Board deems effective such petition for the issuance of a proposal for a settlement as will go beyond a returns regime and a 12% reduction for media-advertised audio carriers only from January 1, 2004, onwards on the grounds of the extension of application as filed on January 7, 2004. This opinion follows from legal considerations, without any non-compliance with deadlines being ascertainable.

III.

The official charges incurred for these Proceedings shall be defrayed by Petitioner. This is in line with the outcome of these Proceedings.

The order that a share of 25% of the necessary extra-official charges incurred by Respondent be imposed on Petitioner is in accordance with the principle of equitableness (§ 14, Clause 1, Sentence 2, of the Rules of Procedure for the Arbitration Board for Copyright Cases). It is true that the Arbitration Board's policy is that parties to arbitration proceedings shall as a rule defray for themselves the necessary costs incurred by them. In the present case, however, a different allocation of costs is required. From the very beginning, Petitioner's request with regard to the establishment of a fund for combating piracy and taking copy-protection measures was obviously without any prospect of success. It would have been possible for Petitioner without difficulty to reach agreement with Respondent, prior to arbitration proceedings, on whether the establishment of such a fund is intended by both Parties. The mere fact that Respondent has discussed the establishment of such a fund is not equivalent to an agreement thereon. In addition — as has been mentioned above —, provisions to that effect may not be presented, by way of a proposal for a settlement, by the Arbitration Board as part of the contents of an Association Agreement. The fact that any such regulation would not come under tariff issues should have been known to Petitioner, which was represented by an attorney of record.

The Arbitration Board assumes that this request is equivalent to 25% of the entire matter in dispute. The total royalty revenue which Respondent is entitled to receive from Petitioner is estimated at an average of EUR 90 million per year for the period from July 1, 2000, to December 31, 2005. The provisions applied for with regard to returns, the 12% reduction for media-advertised audio carriers, the limitations on work numbers/playing times, and the cancellation of free copies represent a volume of an estimated EUR 6 million annually. Petitioner's request for a reduction from 9.009% of the PPD to 5.6% of the PPD, i.e., a reduction by approx. 38%, is roughly equivalent to an amount of EUR 34 million per year. The share that was to be apportioned to the fund amounts to approx. EUR 10 million per year. Thus, the total royalty volume in dispute, in the amount of roughly EUR 40 million per year, includes a request for approx. EUR 10 million which was obviously without any prospect of success from the very beginning. It is in line with the principle of equitableness that to that extent, the necessary extra-official charges incurred by Respondent should be imposed on Petitioner.

The change in procedure as regards free copies as stipulated by the Arbitration Board with effect from January 1, 2004, is irrelevant under the law concerning legal costs because of its insignificance in proportion to the entire matter in dispute.

IV.

The Parties hereto shall be entitled to lodge objection <u>within one month</u> to this Proposal for a Settlement.

The time limit for filing such objection shall be calculated as from the date of service. Objection shall be addressed to:

Schiedsstelle
nach dem Gesetz ueber die Wahrnehmung
von Urheberrechten und verwandten Schutzrechten
beim Deutschen Marken- und Patentamt[10]*,*
80297 Muenchen [Munich].

In the event of no objection being lodged, this Proposal for a Settlement shall be deemed accepted.

V.

The decision as to costs may be challenged by way of appeal to a court of law even if this Proposal for a Settlement is otherwise accepted.

Such appeal shall be addressed to the Higher Regional Court of Munich, 80097 Munich.

[Signed, Portmann, Lochbuehler, Akintche]

[10] The Arbitration Board at the German Patent and Trademarks Office, established under the Act Governing the Administration of Copyright and Related Rights.

Arbitration Award:

The value of the matter in dispute is hereby determined at EUR 40 million.

Statement of Reasons:

Pursuant to § 13, Clause 3, of the Rules of Procedure for the Arbitration Board for Copyright Cases and in conjunction with § 3 of the German Code of Civil Procedure, the value of a matter in dispute shall be determined by arbitrators in accordance with their reasonably exercised discretion. In that process, the parties' interest in bringing to an end a situation where no contract exists between them, through stipulating reasonable terms and conditions under a Association Agreement, shall be of paramount importance.

In the present case, the estimated royalty volume in dispute, for the period from July 1, 2000, to December 31, 2005 (with a volume of EUR 40 million per year in royalties in dispute), is approximately EUR 180 million. Approx. EUR 153 million thereof comes under the request in dispute, for reducing remuneration from 9.009% of the PPD to 5.6% of the PPD, and EUR 27 million comes under the provisions applied for in addition with regard to returns, the 12% reduction for media-advertised audio carriers, the limitations of work numbers and playing times, and the cancellation of free copies.

It is true that the Arbitration Board has proceeded on the assumption that the matter in dispute has been extended only from January 1, 2004. Petitioner's request, however, pertains to the said period from July 1, 2000, to December 31, 2005, so that it is this period that needs to be considered in determining the value of the matter in dispute.

The maximum limit for the matter in dispute is undoubtedly the total volume of royalty revenue being in dispute. Another indication in that respect is given by the Higher Regional Court of Munich of June 12, 2003 (Ref.: 6 WG 1/03), in which an amount in controversy of DM 4 million was determined with regard to a returns regime for media-advertised audio carriers as well as to the 12% reduction for media-advertised audio carriers.

In determining the value of the matter in dispute, the Arbitration Board uses as a reference the volume of royalty revenue in dispute, for one calendar year. It is in line with the principle of reasonably exercised discretion when in determining the value of the matter in dispute, the amount of the sum being in dispute between the parties is at least included in considerations without, however, the entire amount in dispute being taken over completely. This course of action is also supported by the fact that from the year 2004 onwards, Petitioner's market-dominating members have made use of the option of deposition in accordance with § 11, Clause 2, of the Copyright Administration Act. The Arbitration Board is aware that, in terms of proportion, this value of the matter in dispute is markedly higher than the amount in controversy determined by the Higher Regional Court of Munich, in its ruling of June 12, 2003, as cited above. As regards this point, however, the legal opinions of the Parties hereto, with regard to the contents of an Association Agreement being disputed, are by far wider apart from each other. In the opinion of the Arbitration Board, any extrapolation that would be merely mathematical in nature, of the amount in controversy determined by the Higher Regional Court of Munich, to the present case would not be in line with the requirement that the principle of reasonably exercised discretion be applied.

[Signed, Portmann, Lochbuehler, Akintche]