EXPERT REPORT OF SHELDON CZAPNIK

I have been retained in this case by counsel for the National Geographic Society ("NGS") to examine several expert reports provided by the Plaintiffs in the case involving "The Complete National Geographic" CD-ROM products ("CNG") and to provide my own assessment of what NGS would have paid for the rights to reproduce freelance writers' text in that product in an arm's-length negotiation at the outset. As a part of an apportionment of profits analysis, I have also been asked to provide a calculation of how profits from the CNG would be divided, according to the nature of the work -- photographs or texts -- and the number of works involved. I am being paid $300 an hour for this service.

Background

I have been an editorial executive my entire professional life. About 30 years ago I started out as a Managed Book Editor, responsible for acquiring freelance texts, photographs and articles for college textbooks. At Newsweek, where I was Editorial Controller, I was responsible for managing that magazine's worldwide editorial budget for the domestic and international editions, including the acquisition of text and photographs, and licensing of text. For 17 years, until mid-2001, I worked in senior management positions at Time Inc. – managing text and picture acquisition at Sports Illustrated as Assistant Managing Editor there; in my responsibility as assistant to the Editor-in-Chief of Time Inc., developing and administering an electronic-rights policy for the company; and in my role as Director of Editorial Services at Time Inc., managing the company's entire text and picture assets and syndicating images and text. The company's text archive management, its 20-million Picture Collection and Time-Life Syndication all reported to me for the 1994-2001 period.

Since mid-2001, I have been the editor of a new magazine made up entirely of repurposed text and picture content from a large number of major publishers, including Time, Newsweek, Sports Illustrated, Forbes, Fortune, The Wall Street Journal, Golf Digest, Yahoo!, Internet Life, Salon.com, and so on. My job is to select and acquire that content, under contract terms between my company and the publishers of these outside publications.

Material and Information Reviewed

In preparing this report, I reviewed the following:

- Expert Report by Barbara Zimmerman

- Expert Report by Henri Dauman
- Expert Report by Jonathan Wells
- Expert Report by Paul Kramer
- Expert Report by Jane S. Kinne
- A James Pickerell letter dated 6 May 1997 to NG photographers
- The license agreement between NGS and Microsoft for the latter's Encarta CD-ROM product
- The Rate Card provided by the New York Times
- The relevant portions of "New Choices Magazine's" standard freelance agreement.
- "The Complete National Geographic" CD-ROM product.
- Time Inc.'s electronic rights policy

I also conducted the following interviews and examined several rate cards, freelance contracts, and other documents provided by the interviewees:

- Greg Daugherty, Editor-in-Chief of New Choices magazine
- Peter Simmons, NY Times Syndication
- Larry McDonald, former Director of Time Inc. Research Center
- Joel Fotinos, Penguin Books/Putnam Publishing
- John Rutter, National Geographic Society

I am waiting for confirmation of the practices as I understand them to be at McGraw-Hill and John Wiley & Sons from:

- Bill Farley, Legal Department, McGraw-Hill
- Judy Spritzer, Copyright & Permissions, John Wiley & Sons

For purposes of the apportionment of profits analysis, I also conferred with counsel for NGS and was informed by them that profits made as a result of an infringement may be part of a damages award in an infringement action.

__General Overview__

It is my considered opinion that the positions taken by the Plaintiffs' experts are so at variance with the realities of the marketplace, so deeply and fundamentally flawed in their assumptions and conclusions, and so utterly out of step with the practical, daily experience of text (and photo) content licensors *and* licensees that they are all but useless in providing a solution to the problem presented: *If there were a price to be paid by NGS to non-staff writers for licensing text content for the CNG, what would that price have been, and how might it have been determined?* The analysis they present bears no relationship to any reality I, in my entire life in the profession, or the people I interviewed, ever experienced. In my judgment, if business were conducted along the lines they suggest it would be impossible for any product, including one as successful as CNG has been, to ever have been launched. And, in fact, no product launched that I know of followed their model.

The flaws in the Plaintiffs' documents may be summarized as follows:

The assumption that the base rates cited are appropriate. Nothing could be further from the truth – the rates quoted by these experts bear no relationship to reality. For a truly typical base rate, one need look no further than the rates in the Microsoft/NGS contract for the Encarta product: "$300 per text for article for optical disc; $150 per . . . for additional use via on-line systems; $150 per. . .for additional optical discs in all foreign languages." Furthermore – and this is a key point, discussed further below – the fee Microsoft is paying is not just for the article itself, *but for the value of the "National Geographic Society" brand*. There would be no demand for these articles if they were submitted by the individual writers on their own, separate from any mention of their magazine of origin. I understand that the rates charged by McGraw-Hill are similarly in the $100-200 per article range, which will be confirmed with Bill Farley. It is also my understanding that one of Plaintiffs' experts, Barbara Zimmerman, worked on McGraw-Hill's Primus (textbook) custom textbook products in the early 1990s and should therefore be aware of these practices.

The assumption that the industry operates strictly by established, published pricing standards. This, too, is misleading at best. Market demand for individual articles is quite low; in fact, outside the Reader's Digest and the occasional textbook compilation, there is virtually no demand for *unbranded* individual articles. Fees tend to be totally *ad hoc*.

Furthermore, most transactions of any size in this industry, where more than one or two articles are involved, are almost in every case *negotiated*. Writer and photographer associations attempt to suggest rates – and even these are considerably lower than what the Plaintiffs' experts suggest – but publishers offer their own, even lower rates based on what they can afford. Any rate card lasts only as long as the first inquiring phone call. The first question an experienced syndicator will ask when called about a particular article is, "what's your budget?" And successful syndicators honor that figure, *because they want to make a sale*. When considerable quantities are involved, as is the case here, rates for individual articles are generally not considered. The writer (or photographer) or agency are interested in the most they can get, and will reduce their fee for each additional article they can sell to one purchaser. Charging the same unit fee for 10 articles as one article gives the purchaser no incentive to stay with that seller. In short, the base fee suggested by the Plaintiffs' experts is a number pulled out of the air, which is confirmed by the results of my interviews. And, to make matters worse, the effort to multiply that number by the total number of articles is entirely out of sync with market reality and practice, where quantity discounting is very well established.

I should add that the rates are especially excessive in a case like this, where NGS wants to reuse content it has already paid for. Because writers want additional assignments, which are far more lucrative than reprints, they tend not to demand even market rates for reuse by their own publishers.

The assumption that the rates would go up proportionately for each additional right requested. It is here that the Plaintiffs' experts depart most significantly from any practice I know of in the industry. And, in fact, their analysis fails a basic test of economic logic: It assumes that all rights are worth the same amount. They are not. For example, one expert takes the base text fee for English rights and doubles it for all languages. But the rights for English-language sales overseas are not worth a doubling of the fee; the market for the product just is not robust outside the US. I understand that only 11% of the product's sale were overseas. The overseas reproduction fee paid, *if any,* would not have been a multiple of the base fee, but a small fraction of it. Further, the product was only published in English. There would, therefore, have been no necessity to make any additional payment for use in other languages. Had a freelancer attempted to negotiate a higher fee for rights in all languages, NGS would have simply refused, knowing full-well that rights to publish in all languages were worthless because NGS knew it would only be publishing in English.

A similar point can be made about the 50% increase suggested for electronic uses. For example, with respect to the core Time Inc. titles, which include Time, Sports Illustrated, People, Fortune, Money, Life and Entertainment Weekly, the increase in fee for electronic use – a use for which magazines usually required writers to agree, or the writer wasn't used – was small at best.

When all of the Plaintiffs' expert fees are totaled, the cited fee comes to over $200,000 per article without any of the penalties imposed (which take the per article fee to over $1.3 million). This fee is without any counterpart in the real world. Even if the National Geographic had known at the outset of the project how well it would succeed, even a fraction of this fee would have made the project a non-starter – multiplying the stated fee by the number of articles in the compilation, and then adding in the photo fees specified, would have quickly exceeded the entire revenue for the project, let alone the profit.

And in fact this would not have been the fee negotiated. At the time of the project, there was enormous interest in the industry in this potential new revenue stream – writers and photographers wanted to participate in it and *were willing to share the risk with publishers.* (James Pickerell's letter is a good representation of what writer and photographer spokesmen were saying at the time.) The dominant model proposed was a revenue-sharing model. If the negotiation were taking place at the time, NGS would have either offered writers a standard flat fee for reprinting each article – in the hundreds of dollars at the most – or would have offered a smaller, minimum payment plus a share of the royalties. And this is the key point: *The writers would have taken it*, because the interest in participating in this new digital world, and in a new revenue-stream model, was extremely high.

The assumption that NGS would have gone back to the writer to get permission for each increase in the print run. Again, let's try to imagine this working as the Plaintiffs' experts suggest in the real world. The product sales exceed 100,000, and it's time to go back for another print run. The product has been created at enormous expense, with writers and photographers painstakingly tracked down when the product was first again your point 3

launched. (This is in some ways the most time-consuming part of a project like this.) Sales are greater than expected, the CD-ROM plant is working overtime, and now NGS must stop the presses, try to track everyone down again, and renegotiate? And if some writers or photographers, knowing the sales are on the line, choose to hold up NGS for an exorbitant fee? And NGS must put a hold on the manufacture of the successful product, and then frantically remove stories or photos when they can't reach an agreement with the writer or photographer, so the product contains gaps everywhere and is no longer complete or the same?

No. That's not how it works. The people who put this product together have to know up front what their cost and exposure would be, or else the product never gets green-lighted. An up-front fee would have been negotiated. If an agreement had been reached to share some of the upside potential with the content provider, then it would have been agreed to at the beginning (or, as in the case of book publishers for photography, understood by long-standing practice) – not a proportional increase in the fee (i.e., no doubling for a doubling of the run), but a percent of the original fee, or some royalty sharing arrangement

__The assumption that the CD-ROM is a commercial – i.e., non-editorial – product, and that therefore higher rates should apply.__ Regular magazines are sold for profit in many of the same venues as CD-ROMs. And after all, "National Geographic Magazine" is the "National Geographic Magazine," with the regular First Amendment and other press protections. Whether it is in paper, microfilm, on-line, or CD-ROM form, it is editorial.

No

__The assumption that these stories have significant independent value outside their "National Geographic" context.__ The publicity and value given the articles comes from much more than their intrinsic quality; it also, and perhaps mainly, comes from their branding as "National Geographic" stories. There is a market for National Geographic Magazine content in its compilation form -- NGS can sign many good agreements with electronic and other content aggregators like Lexis/Nexis. But there is not much of a market for these articles as individual pieces. *And whatever value exists declines precipitously for material that is over 1-2 years old; it is considered out-of-date.* In the magazine I run, for example, the value of the content to the reader and hotel distributor comes largely from the brand names on the cover, my company would not even get in the door if all I offered were precisely the same articles, unbranded. (And older articles wouldn't get a phone call answered. They would be dismissed as unreliable and out of date by the reader.) While I cannot *prove* that the writers have benefited from having their articles appear in National Geographic Magazine, I would not be surprised if they have done so – and would be quite confident that they've lost no sales because of their participation in the CNG.

There are other flaws in the Plaintiffs' expert reports. For example, one expert takes the fees that were paid in the 1970's and 1980's and increases them for inflation to 2001. In fact, the rates did not increase in that manner; writers and photographers complain constantly that their fees have not kept pace. In reality, the fees are not that much higher now than they were back then.

Factual Confirmation

To confirm the above analysis, I held a number of conversations, as listed earlier, and am awaiting confirmation from two additional sources. Here is a summary of what I found:

John Rutter makes his living by actually trying to make money for writers when he sells material previously published in National Geographic Magazine, but reports that there is generally not a large market for texts. The fees he gets for the majority of licensed content average about $300. While fees can be lower, they have also been considerably higher. Higher fees are generally charged when the potential license is for a unusually high initial print run—for example, Reader's Digest has requested a 10 million copy initial print run in all languages—or when an author or an individual article is particularly well-known—such as Peter Bentley's article on Great White Sharks. However, out of hundreds of licenses, I am informed that such license fees have been garnered less than a dozen times. For higher-priced articles, however, there is a significant quantity discount if more than one article is licensed simultaneously (as would have been done with the CNG). He pointed to the Encarta arrangement as an example.

John also suggested that what would have most likely happened in a negotiation at the outset of the CNG project was that the writers would have been offered a flat fee for all their work, rather than a per-article, per-use arrangement.

Greg Daugherty shared New Choices Magazines' standard freelance contract with me, and it shows that re-use by his company of an article in electronic form entitles the writer to an additional 10% of the original fee. He stated that the electronic fees range between $200-300. He also said there's no well-developed market – that is, demand – for freelance text.

Jodi Fotinos states that Penguin buys previously published text on an *ad hoc* basis. The editors pay between $50-$300, depending on the *initial* print run and geographic right sought. He has turned down deals where the seller wanted another fee for a print run over 10,000 copies – he needs to know in advance what his out-of-pocket will be. And he doesn't go back to the copyright holder even if the *first* print run is later increased, or for asking for other rights. ("I don't want to be held hostage," he said.) He considers the presence of the article in his product as free advertising for the writer.

Peter Simmons reports that The Times' published rate card is a starting point for negotiation; actual fees received are usually lower, particularly if the article sought is part of a compilation instead of a stand-alone. He also says the Times is able to command a market premium because of the value of the brand.

Judy Switzer: I will confirm my understanding with Judy that Wiley has established a single fee structure; one fee obtains print and e-book or CD-ROM rights. Further, I will confirm that Wiley's fees are world English, with no limit on the print run, and that the fee for reprinting a journal article is $14 a page for anything written in the last five years, and $7 a page for older material.

Bill Farley: I will confirm that McGraw-Hill usually pays one-time fees in the $100-200 range.

Lany McDonald reports that she spoke to many publishers, and all say the market for freelance text is poor and *ad hoc*. Anticipated sales and profit margins have not been high enough to justify set, high prices. She also spoke to major electronic content aggregators: Dan Jones at Newsbank, Ken Tillman from Proquest, Tim Collins of Ebsco, and Elizabeth Mackey at Franklin Electronic Publishers. None could cite a single example where they bought an individual item. All make deals directly with publishers for branded material. She also stated "there would have been no smorgasbord of payments for additional rights." There would have been a small fee to the writer or some kind of royalty arrangement. Ms. McDonald also spoke to Fortune magazine about text sales, and that publication reported that buyers are interested strictly in the brand and in fact no one would know about the article unless they had seen it in the magazine. "It's the brand that creates the value," said Ms. McDonald.

And unless you're John Updike, that's the way it is.

What Would Have Been Done?

The logical approach is fairly obvious: NGS would have either paid what would in fact have been a reasonable fee at the time for the rights actually used by NGS – i.e., world English – in which case the fee *per* article would have been somewhere between $50 and $200, particularly if several articles by a single author were involved, or would have let the writers benefit from the potential success of the product by negotiating a royalty arrangement.

If a royalty arrangement were negotiated, royalties would probably have been calculated as follows: Take the revenues for the product, which I am informed are $53,724,449, and assume that half can be attributed to the value of the logo – an understatement, but not out of line with practice. (For example, when we licensed a LIFE calendar at Time Inc., that is what we did – attributed half the receipts to the brand, and the rest to the content providers.) That leaves half the revenues, or $26,862,225 to be allocated in some fashion. Licensing royalties typically go from 6% to 10%, tops, but I will use a more generous figure of 15% on the assumption that NGS would have wanted quick agreement from all its content providers. Apply the 15% to the 50% of the revenues remaining, which is $4,029,333.80, and that's the pool from which writers and photographers are to be paid.

How much to attribute to each group is a thorny issue. At Newsweek, to the best of my recollection, the revenue from article resale was apportioned according to the physical percentage of the article that was taken up by each form. (The actual square inches were estimated.) If the text took up two-thirds, the writer got two-thirds. In the case of NGS, this could be done through statistical sampling – or by simply acknowledging the importance of photography in National Geographic Magazine, and assigning one-third of the royalty to the writers, two-thirds to the photographers. According to this model, one-third, or $1,341,768.10, would be allocated to writers. It is my understanding that 5,775 articles were published in the Magazine from January 1, 1923 (I understand that all works published before that date are in the public domain) through 1997 (the year negotiations would have taken place). Therefore, the $1,341,768.10 allocated as the writer's share would be divided by 5,775, which comes out to $232.34 per article.

__Apportionment of Profits.__

I was informed by counsel that, if an infringement is established, plaintiffs may be entitled to that portion of the infringer's profits attributable to the inclusion of their work in the infringing work. I was then asked to calculate, based on the license analysis performed above, to opine on how profits would be allocated were an infringement to be found here. As indicated above, I believe that 50% of the profit on the sale of the CNG would be attributable to brand image, or the fact that it is the "National Geographic Magazine" being reproduced on CD-ROM. If called upon to opine on the percentage of the remaining 50% that is attributable to one image or one article, I would assign 2/3 to photos and 1/3 to text and simply divide by the number of images and articles to arrive at the amount of the remaining profit attributable to each contribution.

If this calculation were performed with regard to the texts, the total profits, which I am informed were $15,484,566, would be divided by half for the brand image, leaving $7,742,283. One third of this, or $2,554,943.40 would then be allocated to the texts. This number would then be divided by the number of texts not in the public domain, or 5,775, which comes out to $442.41 per article.

If this calculation were performed with regard to photographs, two-thirds of the $7,742,283 (profits after brand-image calculation), or $5,109,906.80 would be divided by the number of photographs not in the public domain, which I am informed is 123,075. This equals $41.52 per image.

__Reservation of Rights to Supplement This Report.__

I reserve the right to supplement this report to the extent that additional information becomes available.

Dated January 28, 2002
New York, New York

Sheldon Czapnik