Psihoyos Photography
433 Juniper Ave.
Boulder Colorado, 80304
303-443-3409
FAX 303-545-9938
Louielouiep@aol.com

January 29th, 2002

Jerry and Idaz,

N.G.'s expert report response to our expert witness just FYI. 1 of 18 pages.

Louie Psihoyos

Law Offices
Schaden, Katzman, Lampert & McClune
11870 Airport Way
Broomfield, Colorado 80021-2555
Telephone: 303-465-3663
Facsimile: 303-465-3884

Fax

To: Louie Paltenos	**From:** Karen Penland
Fax: 303-545-9938	**Date:**
Phone:	**Pages:** 44
Re: Expert Reports	**CC:**

☐ Urgent ☐ For Review ☐ Please Comment ☐ Please Reply ☐ Please Recycle

•**Comments:**

Expert Witness Report of

Paul Kramer

January 28, 2002

Table of Contents

EXPERT REPORT OF PAUL KRAMER

I. Introduction

In 1997, 1998 and 1999, a number of individuals ("Plaintiffs") filed three separate suits in the United States District Court, Southern District of New York against National Geographic Society ("the Society"), National Geographic Enterprises, Inc. ("Enterprises"), collectively "NGS", Mindscape, Inc. ("Mindscape"), Eastman Kodak Company ("Kodak"), and Dataware Technologies, Inc. ("Dataware")[1], (collectively, "Defendants"). In the complaint the plaintiffs alleged that the defendants, through the development, manufacture and reproduction, sale and distribution of certain CD-ROMs and related products (hereinafter "CNG")[2], containing material that was originally published in the National Geographic Magazine, infringed the copyrights of the plaintiffs.

II. Scope of Engagement

The firm of Weil Gotshal & Manges, LLP retained Paul Kramer, of the firm of Kramer & Love, to:

1. evaluate the plaintiffs' expert reports (Kerry Ruoff) submitted on or about December 7, 2001;
2. calculate the profits relating to CNG of Mindscape and NGS before apportionment to the infringing components;
3. give testimony on my findings, if requested and;
4. give rebuttal testimony, if appropriate.

---

[1] I have been informed that Dataware, now known as LeadingSide, Inc., filed a petition pursuant to Chapter 11 of the Bankruptcy Code on April 5, 2001.

[2] CNG was first sold in September, 1997. The product was titled "The Complete National Geographic: 108 Years of National Geographic Magazine on CD-ROM." NGS continued to update the product each year, creating, from 1998 through 2001, CD-ROM 109, CD-ROM 110, CD-ROM 111and CD-ROM 112. In addition, NGS created and sold DVD iterations of certain products as well as subsets of these products, which included various decades of National Geographic Magazine. A complete list of SKUs (stock-keeping units) pertaining to these products is contained in Exhibit B.

III. Opinions

If the court finds the defendants liable for copyright infringement, based upon the work performed, and addressed in the following sections of this report, I hold the following opinions to a reasonable degree of professional certainty:

- Ruoff's expert reports overstate Mindscape's gross revenues and royalty income that Mindscape paid to NGS.
- Mindscape's CNG profits before apportionment to the infringing component for the period September 1997 to September 2001 is $3,312,334.
- NGS's CNG profits before apportionment among the infringing components for the period from inception of the project (1996) to September 2001 is $1,623,086.

We have not been engaged to calculate the apportionment of overall CNG profits to the infringing components and understand that will be calculated at such time as the court orders.

The following are the bases for my opinions, with my remarks on Ruoff's expert reports addressed separately.

III. Work Performed

I or other individuals working for me and under my direction and supervision read and reviewed various pleadings, deposition testimony and documents provided by Weil, Gotshal & Manges LLP. A complete list of such documents is included in Exhibit B to this report. I have reviewed sections 17 U.S.C. §§501 to 504 of the Copyright Act of 1976 ("The 1976 Act") and sections §§§101b, 104 and 116 of the Copyright Act of 1909 ("The 1909 Act") and a recent case[3] relating to the deduction of overhead expenses in a copyright infringement action.

I have read and reviewed the expert reports of Kerry Ruoff ("Ruoff") submitted on or about December 7, 2001 relating to defendants' revenues from the sale of CNG. I have also read the expert reports of Jane Kinne, Sheldon Czapnik, Henry Dauman, Barbara Zimmerman, and Jonathan Wells concerning license fees for photographs and articles, which allegedly would have been paid the plaintiffs for the use of their works.

I visited NGS and Mindscape, had discussions with accounting personnel and other individuals knowledgeable about CNG and I have viewed a copy of CNG to gain an understanding of the product at issue.

In addition, I have also drawn on my professional knowledge and experience as an outside director of public companies and as a practicing CPA with over 45 years of experience in providing varied financial and accounting services to clients, including those in the publishing and information services industries. Exhibit A is a copy of my curriculum vitae.

I will continue to read and review materials relating to this case, and accordingly, may change, amend or supplement this report at such time that additional probative information comes to my attention.

[3] Hamil America, INC. v. GFI, 193F.3d 92 (2d Cir. 1999)

V. BASES FOR OPINIONS

If the court finds that there has been infringement, two Copyright Acts relating to damages are relevant, the 1976 Act, 17 U.S.C. §§501 to 504 and §101b, and the counterpart provisions of the 1909 Act. The 1909 Act states, "If any person shall infringe the copyright in any work protected under the copyright laws of the United States such person shall be liable: To pay to the copyright proprietor such damages as the copyright proprietor may have suffered due to the infringements, as well as all the profits which the infringer shall have made from such infringement". The provisions of 1976 Act relating to damages provide that a copyright infringer is liable for either the copyright owner's actual damages and any additional profits of the infringer; or statutory damages. The plaintiffs' photographs and articles appeared in issues of the National Geographic Magazine over the period 1937 to 1997.

In each section below, I describe the profits relating to CNG for Mindscape and NGS and how they were calculated. The alleged damage period dates from the development period in 1996 to September 2001 ("damage period"). The following is a summary of CNG profits during that time.

40 million?

CNG Profits

Inception (1996) to September 2001

	Mindscape	NGS
Sales	$ 51,111,059	$ 6,277,734
Cost of Goods Sold	(13,420,348)	(3,664,344)
Gross Profit	37,690,711	2,613,390
Shipping & Handling Income	-	446,313
Co-Promotion Fees - Kodak	657,125	134,125
Royalty Income (Expense) From MS Sales	(12,393,302)	12,393,302
Distribution and Fulfillment Expense	(3,066,664)	(491,609)
Marketing Expense	(8,331,103)	-
CNG Project Expense	-	(1,570,244)
Royalty Expense to Dataware	-	(1,336,124)
License Fees- Photographers and Writers	-	(8,058,667) ?
CNG Inventory Write-Off	-	(497,554)
CNG Content Development and Marketing Expense	-	(1,361,899)
Selling, General and Administrative Expense	(11,244,433)	(647,947)
Profits	$ 3,312,334	$ 1,623,086

Exhibits C and F reflect the CNG profits by year for Mindscape and NGS.

Mindscape

Background

Mindscape is a distributor of CD-ROM and other computer interactive products. The industry and the company had considerable growth in the 1990's. However, starting in late 1999 Mindscape and the entire industry started experiencing a slowdown in sales of its CD-ROM and other computer interactive products. Mindscape's distribution channel customers required continuing changes in Mindscape's marketing and sales approach and investment in order to maintain relationships and outlets.

During the alleged damage period, Mindscape changed ownership several times. It also moved financial personnel and financial books and records from California to Massachusetts and back and changed computer systems. The combination of the above factors have led to incomplete and unavailable financial information prior to 1999 and non-recurring and unusual items in the financial statements, especially in 2000, resulting from moving, downsizing and significant industry and business changes.

historical 1999? Tell the

Based on my forty-five years of professional experience it is not unusual for a company to have misplaced and/or lost historical financial data when there has been a change of ownership and location of company books and records.

I was able to review financial information of Mindscape for the years 1999, 2000, and the six months ended June 30, 2001. Mindscape incurred losses for each of these periods. During 2000, the then owners decided to sell Mindscape and prepared a selling document, which, among other things, analyzed profitability by product brand for 1999.[4] I discussed the methodology employed in the preparation of this information with Mindscape's accounting personnel, who believe the expenses captured are a fair and reasonable representation of what the expenses applicable to NGS CD-ROM products were in 1999. Based on discussions, I also believe the methodology employed captures a fair and reasonable representation of expenses applicable to NGS CD-ROM products in 1999. Accordingly, I used the data produced to determine the appropriate distribution and marketing expenses for CNG products as described in those sections following. There are other NGS CD-ROM products included in addition to the CNG, but CNG represents the majority of the NGS CD-ROM products sold by Mindscape in 1999 and for the other years included in the damage period.

[4] MS 004/006,007 (Plaintiff Exhibit 205)

Profits

In the section below I have calculated the profits of Mindscape relating to the manufacture and reproduction, selling, marketing and distribution of CNG. A summary of those profits is as follows:

Mindscape CNG Profits
September 1997 to September 2001

Net Receipts	$ 51,111,059	Exhibit D
Cost of Goods Sold	(13,420,348)	Exhibit D
Gross Profit	37,690,711	Exhibit D
Co Promotion Fees - Kodak	657,125	
Total Income Before Expenses	38,347,836	
Royalty Expense For CNG Sales to NGS	(12,393,302)	Exhibit D
Distribution Expense	(3,066,664)	
Marketing Expense	(8,331,103)	
Selling, General and Administrative Expense	(11,244,433)	
Total Expenses	(35,035,502)	
Profits	$ 3,312,334	

Net Receipts

The agreement between NGS and Mindscape required Mindscape to send quarterly royalty reports. The alleged damage period includes seventeen quarterly royalty periods, commencing in September 1997[5] through September 2001. We obtained redacted electronic versions of the net receipts quarterly royalty statements from Mindscape[6] for twelve of the seventeen quarterly periods[7]. In addition to reporting current quarterly net receipts and royalties to NGS, the first five quarterly royalty statements also contained cumulative totals for units sold, net receipts and royalties

[5] Mindscape's first quarterly royalty statement is for the month of September 1997.
[6] Mindscape produced the electronic quarterly royalty reports to Weil Gotshal & Manges LLP. We received redacted electronic versions of the quarterly royalty statements.
[7] Over the course of the seventeen quarterly periods Mindscape's format of the royalty statements changed five times due to different ownership and different systems.

earned. Therefore, in calculating Mindscape's profits we used the cumulative totals in the fourth quarter 1997 and third quarter 1998 contained in electronic royalty statements.

For four of the five remaining quarterly royalty periods, where no electronic version of the royalty statements was available from Mindscape (fourth quarter 1998, first quarter 1999, third and fourth quarter 2000), we used Ruoff's electronic data input and added units sold, net receipts and royalties contained in these royalty statements to account for all CNG products.

Ruoff's expert report incorrectly excluded the net receipts and units sold for the second quarter of 2000, and therefore we entered the data from the hard copy royalty statement produced in this litigation.[8]

Mindscape's total net receipts from the sale of CNG for the period covered by the alleged infringement were $51,111,059 (Exhibit D).

Cost of Goods Sold

Under the terms of the Mindscape distribution agreement with NGS, Mindscape was required to deduct the cost of goods[9] in calculating its royalty due NGS for retail sales for net receipts less than $20, consumer and educational sales, and OEM sales. Therefore, the royalty statements contained information relating to cost of goods sold ("COGS") and we relied on the amounts contained in all of the quarterly royalty statements if an amount existed.

[8] NGS-017/0202 to NGS-017/0212

[9] § 1.1.12 MS Distribution Agreement - Cost of goods: "The actual cost to MS of the finished Licensed Product unit, including program media, manuals and other collateral materials, packaging materials and manufacturing costs, but not plant or development costs for teachers' packs if any, and no other costs."

For the first five quarters (September 1997 through September 1998), the royalty reports contained COGS information for all CNG products, even if the COGS was not a factor in the royalty calculation.

Commencing in the fourth quarter of 1998 through the third quarter 2001, since the royalty reports did not contain the COGS for retail sales (when net receipts were greater than $20), we had to obtain COGS information from Mindscape. The standard cost information was not available for the fourth quarter 1998 and 1999. We obtained the 2000 standard cost per unit for CNG from Mindscape and had discussions with Mindscape's accounting personnel and determined that the 2000 standard cost would not be significantly different than the 1998 and 1999 standard cost for CNG. We also reviewed and discussed with Mindscape accounting personnel the standard unit production costs and system related to CNG and reviewed supporting costing information for a sample of such products.

For the quarterly royalty periods commencing in the fourth quarter of 1998 through the third quarter 2001, we calculated the COGS as follows: for retail sales greater than $20 and other sales or returns where there was no COGS amount in the royalty statement, we multiplied the units sold or returned by the 2000 standard cost per unit.

There were a few CNG products sold that did not appear in the 2000 CNG standard cost data. For those sales we obtained the unit cost from a quarterly royalty statement that had the information.

Lastly, for those CNG products that were missing unit cost information, we applied the overall cost percentage of products sold for all periods, 26.4%. Revenues with missing costs were only $69,502 of the total $51,111,059 net revenues.

The standard cost and COGS information contained in the quarterly royalty reports do not include distribution costs, i.e. freight handling and storage. We therefore separately calculated distribution expense as described below.

For the alleged damage period the total COGS for CNG was $13,420,348 (Exhibit D).

Mindscape Royalties Paid to NGS

Mindscape paid NGS royalties for the license of CNG. In order to calculate the royalties that Mindscape paid to NGS, we relied on the royalty information contained in the twelve electronic redacted quarterly royalty statements. For the remaining four quarters where no electronic quarterly royalties statements were available (fourth quarter 1997, first quarter 1998, third and fourth quarter 2000), we followed the same procedures derived for net revenues by using Ruoff's royalty data and added royalties Mindscape paid to NGS.

Amendment 3 to the Mindscape Distribution Agreement resolved the dispute between Mindscape and NGS relating to royalties for the second quarter of 2000 and other claims NGS was asserting. Pursuant to the amendment 3, "no amount shall be owed by either party."

40 million

The total royalties that Mindscape paid NGS during the alleged damage period for the license of CNG were $ 12,393,302 (Exhibit D).

Distribution Expense

Distribution (freight, handling and storage) expenses were captured by product brand in the 1999 product profitability analysis described previously by using per unit standards. The total company 1999 distribution costs for all products were 8% of gross revenues and 11.7% of net revenues. The 1999 distribution costs for NGS products were

$1,092,000, or 4% of gross revenues and 6% of net revenues. Because of the drop in Mindscape sales volume in 2000 and 2001, the percent of distribution expenses to revenues should be higher than in 1999. I have used 6% in applying distribution expenses to $51,111,059 of CNG net revenues for all periods covered in this matter. The resulting total distribution expenses for CNG during the alleged damage period for are $3,066,664.

Marketing expense

Marketing expenses are essential in a distribution company. They are not overhead, but integral and necessary expense components of operating the business. One significant category of Mindscape's marketing expense is comprised of market and development funds, "MDF," which includes co-op advertising, shelf space payments, advertising inserts and circulars, in effect advertising at the customer level. In the 1999 product profitability analysis such expenses amounted to 10.7% of Mindscape's net sales of NGS products.

Marketing expenses also include other advertising, which is the more traditional advertising, not at the customer level, such as print ads. For 1999, such expense amounted to 5.6% of Mindscape's net revenues. The total of these two marketing expense categories is 16.3% for 1999.

Mindscape accounting personnel believe this is a fair percentage for marketing expenses, in line with other similar products and lower than 2000, which as stated previously is unusual because of the factors affecting that years operations. They also believe that 16.3% is appropriate to use for all other periods. Therefore, I have used 16.3% in applying marketing expenses to the $51,111,059 of CNG net revenues for all periods covered by this matter. The resulting total marketing expenses for CNG during the alleged damage period were $8,331,103.

Selling, general and administrative expense

In order to determine if there was a nexus between selling, general and administrative expenses ("SGA") and the CNG product sales, I reviewed Mindscape's financial information describing the nature of the SGA expenses. I reviewed these expenses with Mindscape accounting personnel and also reviewed the financial statements for 1999, 2000 and the six months ended June 30, 2001. Total SGA was approximately 30%, 38% and 31% of net revenues for 1999, 2000 and the six months ended June 30, 2001. The SGA expenses included in the sales department were salaries, benefits, customer support and service, and administration of the department. The general and administrative expenses included salaries, benefits and expenses of the corporate office and the finance, human resources, legal, tax, facilities maintenance departments, and the administration of those units. The SGA expenses and percentages excluded restructuring and other non-recurring items.

However, as described under marketing expenses above, the changes in the business and ownership affected these expenses and percentages of net revenues for 1999, 2000 and six months ended June 30, 2001. Consequently, I discussed with Mindscape what would be a normal target today for such expenses, and what would be normal for all periods, absent the unusual events affecting the company. They believe such expenses should range between 22 percent to 25 percent of net revenues. I selected 22% as a percentage to apply to the total CNG net revenues of $51,111,059 for all periods covered by this matter. The low end of the range was selected to be conservative and provide for smaller unusual items, which may not have been excluded from the SGA totals for 1999, 2000 and six months ended June 30, 2001. The resulting total SGA for CNG during the damage period was $11,244,433.

Inasmuch as these expenses are essential and integral to distributing all Mindscape products, we believe the allocation of SGA between the alleged infringing CNG products and other Mindscape products is a reasonable allocation.

Co-Promotion Fees From Eastman Kodak Company ("Kodak")

Kodak, NGS and Mindscape entered into a Co-Promotion Agreement in 1997 for the promotion of Kodak in connection with CNG. Kodak agreed to pay $600,000 less a 15% agency commission fee of $90,000 payable to Kodak's advertising agent. If no fee was payable to an agency, Kodak agreed to pay the full $600,000 to NGS.[10] Upon receipt of this payment, NGS then would pay Mindscape $485,000. As a result, we included $485,000 as revenue to Mindscape and $115,000 as revenue to NGS.

In 1998, Kodak entered into another Co-Promotion Agreement with Mindscape and NGS. Kodak agreed to pay NGS $191,250, which is net of a 15% commission on the total fee of $225,000.[11] Within the 1998 Co-Promotion Agreement, there is no mention of the possibility that an agent would not be used. Upon receipt of the payment, NGS would pay Mindscape $172,125, representing the $191,250 less a 10% payment to NGS Advertising Division. Revenues include $172,125 and $19,125 for Mindscape and NGS, respectively. The total revenues for the two agreements are $657,125 to Mindscape and $134,125 to NGS.

Conclusion

If the court finds the defendants liable for copyright infringement, the CNG total profits for the alleged damage period attributable to Mindscape is $3,312,334.

[10] KD001-0033-36
[11] KD 001/0172-174

NGS

NGS income after expenses from the sale of CNG are derived from three revenue sources: (1) sale of licensed product from NGS catalog and web site; (2) a co-promotion fee from Eastman Kodak Company; (3) royalties received from Mindscape on sale of CNG products.

In addition, NGS incurred project costs to develop CNG, royalty expense paid to Dataware, and other costs attributable to the sale of CNG. NGS would also be entitled to deduct license fees it would have to have paid to the photographers and writers. A summary of the income after expenses to NGS relating to CNG is as follows:

NGS CNG Income After Expenses
Inception (1996) to September 2001

Sales From the Catalog and Web Site	$ 6,277,734	Exhibit G
Cost of Goods Sold	(3,664,344)	Exhibit H
Gross Profit	2,613,390	Exhibit G
Shipping & Handling Income	446,313	
Co-Promotion Fees - Kodak	134,125	
Royalty Income from CNG MS sales	12,393,302	Exhibit D
Total Income Before Expenses	15,587,130	
Distribution and Fulfillment Expense	(491,609)	Exhibit I
CNG Project Expense	(1,570,244)	Exhibit L
Royalty Expense to Dataware	(1,336,124)	Exhibit M
License Fees - Photographers and Writers	(8,058,667)	
CNG Inventory Write-Off	(497,554)	
CNG Content Development and Marketing Expense	(1,361,899)	Exhibit N
CNG General and Administrative Expense	(647,947)	Exhibit O
Income After Expenses	$ 1,623,086	

Sale of CNG from NGS catalog and web site

Sales

Under the terms of the Mindscape Distribution Agreement, NGS was entitled to purchase finished CNG product from Mindscape and to sell it through its catalog and web site. Total CNG sales for the alleged damage period were $6,277,734[12] and shipping and handling revenue relating to these sales was $446,313[13] (Exhibit G).

Cost of goods sold

We discussed with NGS accounting personnel the standard unit costs related to CNG and reviewed supporting costing information for #783201 (108 Years of NG CD-ROM). To calculate COGS we obtained the unit cost information by year for seventeen of the twenty CNG products sold from a document[14] prepared by NGS. For #783201 we used $101, as this was the actual cost. For the remaining CNG products sold, we obtained the unit cost information for products #N783229[15] and #N775000 from Schedule G[16] (attached to Mindscape Distribution Agreement Amendment 2) and #5P83210 from NGS. We then multiplied net units sold by unit cost, which resulted in COGS relating to CNG for the alleged damage period of $3,664,344 (Exhibit H).

Fulfillment and distribution expense

The sales of the CNG products by NGS are through their catalog and E-Commerce divisions. In order to determine appropriate fulfillment and distribution costs to deduct from gross profit, we obtained the total of such expenses from the Catalog and E-Commerce division Statements of Income and Expense for the years 1999 and 2000 and the ten months ended October 31, 2001 (Exhibit K). We deducted from such total

[12] NGS 041/378A
[13] NGS 041/378A
[14] NGS 052/176
[15] The unit cost document prepared by NGS did not contain 1998 unit cost information.
[16] NGS 012/0026

fulfillment and distribution expenses the shipping and handling revenues charged customers.

We then determined the resulting net fulfillment and distribution costs as a percentage of such net revenues for the same periods (Exhibit I). To obtain the fulfillment and distribution expense, we applied the percentages for each of those periods to the total revenues of the alleged infringing CNG products for the same periods (Exhibit I).

The Catalog and E-Commerce shipping revenue information for 1997 and 1998 was not available. For 1998, we developed a percentage based on the actual 1999 shipping revenues as a percentage of total revenues and, using the actual 1998 fulfillment and distribution costs, determined that such costs were 7.5% of net revenues. We used 7.5% to apply costs to 1998 product sales (Exhibit I). Based on discussions with NGS personnel, for 1997 we assumed that the 1999 cost increases of one percentage point (7.5% to 8.5%) or a 13% increase, would have been the same for 1998 compared to 1997. Accordingly, we assumed a 13% cost increase from 1997 to 1998, resulting in a percentage of 6.6% for 1997 and used that percentage to apply fulfillment and distribution costs to 1997 product sales (Exhibit I). The total fulfillment and distribution expense relating to CNG for the alleged damage period was $491,609 (Exhibit I).

Royalties received from Mindscape on sale of CNG infringing products

As discussed above, NGS received royalty income from Mindscape for the alleged damage period totaling $12,393,302 for the licensing of CNG (Exhibit D).

CNG Project Costs

Dataware developed CNG and invoiced NGS for the project costs. For the years 1997, 1998 and 1999 we reviewed the CNG project expense schedules prepared by NGS, Dataware invoices, journal line detail and the deposition transcript of Mr. Griffin. The majority of project costs were comprised of invoices paid to Dataware. Although three CNG project codes[17] were incorrectly coded for other Dataware project cost invoices, NGS produced additional CNG Dataware invoices to support the CD-ROM-108 project costs amounts for 1997 to 1999, except for $65,000 in 1998. NGS informed us that the Dataware invoices were not available, so we deducted the $65,000 from 1998 EM0013 project costs.

For 2000 and 2001, we reviewed the journal line detail for all project expenses and the supporting invoices for a sample of these items. The total project expenses relating to CNG for the alleged damage period were $1,570,244 (Exhibit L).

Dataware Royalty Expense

By agreement dated August 15, 1996, with Ledge Multimedia, a division of Dataware, Dataware managed the development of the CD-ROM product for NGS. Dataware received a royalty, initially at a rate of 20% of Mindscape's royalty to NGS, which was reduced to 6% when the total Dataware's royalties earned reached $886,000.

We reviewed NGS's quarterly royalty statements to Dataware from December 1997 (this period was from the commencement of Mindscape sales in September 1997) through December 31, 2000[18], except for the second quarter of 1999, as this royalty statement could not be located. For this missing quarter we calculated royalties NGS paid Dataware based on Mindscape's second quarter 1999 royalty statement (Appendix 1, Schedule 5). The total royalty expense NGS paid Dataware for the alleged damage period was $1,336,124 (Exhibit M).

[17] EM 001, EM 0013, and EM10017

[18] Last royalty statement NGS prepared. NGS informed us that did not owe Dataware any royalties after this period.

CNG Inventory Write-Off

gave good away but

Pursuant to the terms of Amendment 3 to the Mindscape Distribution Agreement, in 2000 Mindscape and NGS agreed that NGS's excess inventory, including CNG products, would not be returned to Mindscape. In addition, the inventory could only be distributed on a "not for sale basis (e.g. premiums or donations)." The portion of the 2000 inventory write-off related to CNG was \$497,554. We reviewed the supporting documentation for the write-off.

Content Development and Marketing Expense

Direct expenses related to the CNG products are captured in ng.com[10]-CD-ROM product area in the content development and sales and marketing expense categories. We reviewed CD-ROM's Statement of Income and Expense for the alleged damage period, NGS Department Allocation Stats-Worksheet as of November 19, 1999, Department Budgets-2000, and had discussions with NGS accounting and budgeting personnel to determine which expenses were attributable to CNG and what methodology NGS used to allocate departmental expenses. The majority of the direct expenses (principally salaries and benefits) fall into three departmental categories, Production and Editing, Rights/Asset Clearance and Marketing. In addition we obtained the Department Expense Statement for these three departments as of December 31, 2000 to gain a further understanding of the specific types of expenses that are incurred by these departments.

The next step was to allocate a portion of these direct expenses to CNG. We applied an allocation factor, by year, based on the relationship of CNG project costs to total CD-ROM project costs. For 1997 to September 30, 2001 the allocation percentages were 21.2%, 8.7%, 56.4%, 20.3% and 47.7%, respectively.

[10] Formerly known as NG Interactive.

Finally, to arrive at CNG's direct costs we multiplied the above allocation percentages by the direct departmental expenses resulting in total content development and marketing expense for the alleged damage period of $1,361,899 (Exhibit N).

General and administrative expense

Ng.com incurred general and administrative expenses for CNG products. The nature of these expenses are either specific to the ng.com division or corporate charges for services provided by NGS. In order to determine the expense categories that have a nexus to the CNG product sales, we reviewed ng.com's Statement of Income and Expense for the alleged damage period and had discussions with the accounting and budgeting personnel and concluded that corporate charges, affiliate rental profit, incentive plan, and post retirement expense contained in the "other expenses" line item and administrative expenses at the divisional level relate to CNG product. We have segregated the general and administrative expenses into two categories, as the allocation methodology to apply to CNG products is different due to the nature of the expenses. The first category includes administrative expenses at the divisional level and at the corporate level and the second category are the other expenses described above.

Administrative Expenses

Since the administrative expenses at the divisional level, ng.com, are similar in nature to the corporate administrative allocations from NGS we have combined these amounts for purposes of calculating the percentage attributable to CNG. The administrative expenses at the corporate level are part of a monthly charge from NGS that are included in the line item "corporate charges" in ng.com Statement of Income and Expense. For the alleged damage period the methodology for NGS corporate expense allocations remained the same and the types of expenses at the divisional level are comparable.

Therefore for analyses we selected 2000 and for administrative expenses incurred at the divisional level we obtained ng.com Administration Departmental Expense Statement and ascertained that the majority of expenses were salary and benefit related. The administrative expenses at the corporate level are predominately for NGS overhead allocations (i.e., purchasing, corporate finance and business systems departmental expenses) and also we reviewed NGS overhead allocation calculations.

Because these administrative expenses are allocated to the divisions and not to the various product areas, one of which is CD-ROM[20], we decided to extend the same allocation methodology NGS applied to the other NGS divisions to these product areas. Our computation of administrative expenses allocated to CNG was a three step process. First we combined the corporate and divisional administrative expenses. Next we determined the allocation factor at the CD-ROM product area based on the relationship of CD-ROM total expense to total ng.com expense and then to determine an allocation factor for CNG we applied the same allocation factor as described in the content and development expense section of this report to the total CD-ROM administrative expense. The total CNG administrative expenses for the alleged damage period were $396,792 (Exhibit O).

Other Expenses

Corporate charges are the majority of general and administrative expenses contained in the "other expense" category. They are comprised of the same recurring NGS charges for employee services and information systems during the entire alleged

[20] Over the damage period the product areas that are included in ng.com (formerly NGS Interactive) were Website, CD Publishing, E-commerce (formerly Retail Merchandising) and Business Development.

damage period. We reviewed the budget allocations and other supporting financial documentation for employee services and information systems for 2000. As described above in the previous section our computation for determining the other expense allocation to the CNG products was a three step process. Our first allocation factor (CD-ROM product area) was derived based upon the relationship of CD-ROM head count to the total ng.com head count. We then applied the CD-ROM allocation factor to the other expenses[21] to determine CD-ROM's percentage of other expenses. Finally, as described above we applied the same CNG allocation factor in the content and development expense section of this report to other expenses to arrive at total other expenses allocable to CNG products. For the alleged damage period CNG other expenses totaled $251,155 (Exhibit O).

For the alleged damage period the total general and administrative expense for CNG was $647,947 (Exhibit O).

Co-Promotion Fees from Eastman Kodak Company

For a description see section regarding Mindscape. The total Co-Promotion fees from Eastman Kodak Company for the alleged damage period were $134,125 ($115,000 in 1997 and $19,125 in 1998).

License Fees

I have read Ms. Kinne's and Mr. Czapnik's expert reports and have deducted license fees NGS would have to have paid to the photographers and writers. I have used the approach described by Ms. Kinne and have deducted the fees at a rate of 15% of NGS and Mindscape total product sales of CNG (excluding $3,664,344 of Mindscape's sales

[21] Corporate charges, affiliate rental profit, incentive plan, and post retirement expense.

to NGS for resale by NGS). The total sales were $53,724,449 and the resulting license fees are $8,058,667.

Conclusion

If the court finds the defendants liable for copyright infringement the total profits for the sale of CNG attributable to NGS is $1,623,086.

Apportionment

Ruoff's expert reports eliminated certain revenues in what appears to be an attempt at apportionment. It appears that the elimination was for certain CNG products covering years earlier than the years the plaintiff's work first appeared in original form.

However, these eliminations were incomplete in that they did not consider apportionment for the principal CD-ROM-108 products, the Complete National Geographic 108, which covered the years 1888 to 1996, and which product was updated for later years. Also, there was no attempt at apportionment among other photographic or text contributors to the products, or for features of the products that were not provided by copyrighted works. Upon the advice of counsel, we have made no apportionment allocations. Accordingly, we have used the revenues of all the alleged infringing CNG products to arrive at Mindscape and NGS profits.

Ruoff's expert reports overstate Mindscape revenues and royalty income Mindscape paid to NGS

Ruoff's expert reports incorrectly state that "no cash data was provided" for the second quarter of 1999[22]. Instead, Ruoff used the accrual basis royalty statement. The accrual

[22] MS 8 0000003-0000008 produced to plaintiff counsel November 17, 2001.

basis royalty statement for this quarter overstates net receipts (cash basis) by $428,670 and royalties paid to Mindscape by $70,313.

In addition, Ruoff's reports excluded sales and returns for the second quarter of 2000 on the grounds that no royalty was paid to NGS. The royalty statement reflects net receipts of $2,408,184 and returns of $5,103,848. In calculating Mindscape's gross revenue, it is improper for Ruoff to ignore the net returns of $2,695,664 for this quarter. Therefore, the gross revenue for Mindscape is overstated.

Lastly, Ruoff's data input for one CNG product (#1128748) was entered incorrectly for the third quarter of 1999. Ruoff entered net receipts as a negative number ($230,256) instead of a positive number, resulting in an understatement of gross revenues of $460,512.

Dauman and Zimmerman Expert Reports are illogical and flawed

I have reviewed the expert reports of Henry Dauman, Barbara Zimmerman and Jonathan Wells concerning license fees for photographs and articles, which allegedly would have been paid to the plaintiffs for the use of their works. However, I have not evaluated the accuracy of these reports and have no opinion on their content except for their conclusions.

Their conclusions are illogical and flawed. Mr. Dauman and Ms. Zimmerman expert reports conclude that total estimated license fees, multiplied by six for unauthorized use, results in a combined licensed fee in excess of $372 million that would be paid the plaintiffs for the unauthorized use of their works allegedly infringed upon. This total assumed license fee for the use of plaintiffs works is more than seven times the total revenues derived to date from the sale of the CNG products, before deducting any costs and expenses.

VI Compensation

My total fees will depend upon my hours and those of people working with me on this engagement. My fee for this work is $475 an hour, plus out-of-pocket expenses. Other professionals working with me are charged at lower rates commensurate with their experience. My fee and expenses are not contingent upon the final resolution of this matter.

Paul Kramer

Paul Kramer
January 28, 2002

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.

<u>General Overview</u>

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 those 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.

<u>The assumption that the rates would go up proportionately for each additional right requested.</u> 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.

<u>The assumption that NGS would have gone back to the writer to get permission for each increase in the print run.</u> 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

TOTAL P.01

again your point?

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?

yes it is

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.

<u>Factual Confirmation</u>

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:

<u>John Rutter</u> 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.

<u>Greg Daugherty</u> 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.

<u>Joel Fotinos</u> 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.

<u>Peter Simmons</u> 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.

<u>Judy Spritzer:</u> 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.

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

<u>Lany McDonald</u> 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.

<u>**What Would Have Been Done?**</u>

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

EXPERT REPORT OF JANE S. KINNE

The National Geographic Society ("NGS") has retained me in this case to opine on the amount of the license fees which would have been negotiated for the use of images created by Plaintiffs in the various "Complete National Geographic" CD-ROMs and DVDs ("CNG") published by Mindscape under agreement with NGS.

BACKGROUND AND EXPERIENCE

I have worked in the photographic industry for some 55 years. From 1947 to 1993, that principally involved being an agent for freelance photographers. As such, I was negotiating or supervising the grant of licenses and the accompanying fees for all types of uses, both editorial and commercial, on a daily basis. At times, this activity exceeded 100 different transactions in a single day.

Part of my background included acting as editor or packager on single books or series of titles. All of these publications relied heavily on the image content but also included supporting text.

Throughout my long career, I have been active in the various professional organizations whose membership includes the creators, the users and the agents and vendors of the entire photographic and publishing communities. From the late 1960's to the present day, my involvement in the American Society of Media Photographers (ASMP); the American Society of Pictures Professionals (ASPP); the Picture Agency Council of America (PACA); and the North American Nature Photography Association

(NANPA) has centered on the development of ethical business practices, the creation of standard paperwork, conditions and terms and the education of creators and users on the elements that create value in arriving at fair and reasonable pricing. Toward these ends I was involved in the writing and editing of ASMP's Guide to Business Practice Editions 1 through 5, and the Stock Photographers Handbook Editions 1 and 2. I also served as a consultant and editor for Pricing Photography by Michael Heron and David MacTavish.

In the past four years I have testified, either at deposition or at trial, as an expert in the following cases:

2001: B&B Photo Studio v. New York Post, New York State Supreme Court
Levy v. Levy, New York State Supreme Court
Sinkovec v. Rick Johnson & Co., Inc., New Mexico State Court
Greenberg v. Lens Crafters, U.S. District Court, Southern District of Florida
George Howard v. City of Tucson, Arizona State Court
John Warner v. St. Labre Indian School Education Ass'n, U.S. District Court, District of Montana, Billings Division

2000: Edith Shaw Marcus and Meta Shaw Stevens as Temporary Administrators of the Estate of Sam Shaw v. Martin Bressler, Larry Shaw, Susan Shaw, Bressler & Bressler, Valerie Goodman, 1912 Productions, Inc., Marc Weinstein, Individually and d/b/a Color Group, New York State Supreme Court

1999: Edward Pardee v. Orange Micro, U.S. District Court, Northern District of California
Guthy-Renker v. Gary Bernstein, U.S. District Court, Southern District of California

1998: Jack Leigh v. Warner Bros., U.S. District Court, Southern District of Georgia, Savannah Division
Kim Taylor Reece v. DFS (Duty Free Shops), U.S. District Court, District of Hawaii
Greg Mancuso v. University of California, L.A., California State Court
Focus on Sports v. Ernest Lawrence Group, New York State Supreme Court

Boris Raishevich v. Charles Foster, an Officer of the NY State Police
U.S. District Court, Southern District of New York

I am being compensated for my time and expertise at the rate of $200 per hour. A copy of my curriculum vitae is attached as Exhibit A.

INFORMATION REVIEWED

a) Certain issues of the magazine in which the images that are the subject of this complaint originally appeared;

b) The various CD-ROM and DVD products in which these same images appear;

c) Financial information on the sales figures for the various CD-ROM and DVD products;

d) Letter dated 6 May 1997 from James Pickerell addressed to Former and Present National Geographic shooters;

e) The expert report of Plaintiffs' expert Henri Dauman;

f) The expert report of Plaintiffs' expert Kerry Ruoff;

g) The expert report of Plaintiffs' expert Barbara Zimmerman;

h) The expert report of Plaintiff's expert Jonathan Wells;

i) Industry pricing guides often used in determining price structures, including:

1) Negotiating Stock Photo Prices, by Jim and Cheryl Pickerell, 1993, 1997, 2001 editions;

2) Pricing Photography, by Michael Heron and David MacTavish, 1993, 1997, 2002 editions;

3) The computer software program Foto Quote;

4) ASMP Professional Business Practices in Photography, 6th Edition.

j) Contracts between Plaintiffs and NGS concerning the publication of images and/or texts in National Geographic Magazine;

k) Documents showing amounts paid by NGS for the use of images in CD-ROM products other than "The Complete National Geographic;"

l) Documents showing amounts paid by NGS to stock photographic agencies for the use of images in "The Complete National Geographic;"

m) Minutes of a meeting of the Board of Trustees of the National Geographic Society on June 12, 1997.

Most importantly, I relied on my 55 years of experience in the real world of negotiating licenses and fees and in determining suitable budgets for heavily illustrated products.

ANALYSIS

I have a fundamental difference of opinion with all of Plaintiffs' experts as to the nature of "The Complete National Geographic." By long-standing industry accepted definition, this is an editorial product intended to convey facts and information, as opposed to a commercial product which is intended to promote or advertise goods or services. To use any commercial fee structure, therefore, is simply wrong. KODAK AD

Moreover, I disagree with the basic approach taken by Plaintiffs' experts, whereby they set a base fee for the use and then apply multipliers due to a variety of factors. As an initial matter, I understand based on comments by John Fahey to the NGS

Board of Trustees that NGS expected "The Complete National Geographic" to do no better financially than break even. The parties thus would never have anticipated or accounted for in their negotiations the success that the products actually realized. For this reason, the royalty model that I outline below is a better approach because it accounts for the events that actually occurred. Additionally, because my approach provides for royalties payable on all sales, it takes into account all of the varied factors that caused Plaintiffs to apply multipliers, such as the print run, worldwide distribution, and the like.

Plaintiffs' approach is also flawed because certain of the multipliers are simply inappropriate. For example, Plaintiffs use a multiplier of 100% for the right to publish in all languages, when in fact I understand that the product was only published in the English language. Furthermore, two of the multipliers – for "lack of copyright credit" and for "unauthorized use" – have no place in an analysis that attempts, as Mr. Dauman states, "to determine the prices each party would have agreed to had they been reasonably and voluntarily trying to reach an agreement" before publication of the products at issue. These multipliers are only applicable if the negotiation took place after publication. Finally, even when multiples are used, they are rarely 100%, the amount suggested by Mr. Dauman and Ms. Zimmerman in some instances.

As a result of Plaintiffs' fundamentally flawed approach, the proposed license fees put forth by Plaintiffs' experts are astronomical. In no negotiation of which I am aware did a photographer or writer request or receive such a high fee. The unreasonableness of Plaintiffs' experts' proposed license fees is underscored by comparing them to amounts actually paid by National Geographic Society to third parties for the use of images in various CD-ROM products. On average, NGS paid $137 per image in CD-ROM products other than "The Complete National Geographic." With respect to "The Complete National Geographic," NGS paid an average $161 per-image fee to stock photo agencies.

In trying to determine a fee that might have been the result of an arm's-length negotiation prior to the publication of CNG, the first fact established would have been the classic editorial nature of this reference set, even though it is an electronic product rather than a traditional print set and is widely sold in retail locations, not just in bookstores. With that in mind, it is my opinion that a "budgeting approach" would have been used as a framework for negotiating fees to be paid to photographers and writers. Such an approach would have been analogous to the model long used in the publishing world for heavily illustrated books, popularly called "coffee table" books, wherein the appeal to the consumer emanates from the images displayed more than from the written text.

The model often used by publishers for these "coffee table" books is to set aside a sum equal to a percentage of the "sticker price," or retail price, to pay for all content, both images and text. The percentage can range from 10% to 15%. Historically, the visual content or images commanded two-thirds of this sum, and one-third was reserved for the texts. To be conservative, I have chosen 15%, with 10% going to photographs and 5% going to texts.

These percentages should be applied to revenues received as a result of sales of the product to end users. Therefore, the figure to which the percentages should be applied is the revenue received by Mindscape, less its sales to NGS, plus NGS' sales to end users. I am informed that this figure is $53,724,449. Use of this amount is also conservative because it uses actual sales figures, not the projections which were made before the product was released. I have reviewed John Fahey's statements to the Board of Trustees of National Geographic Society prior to publication of "The Complete National Geographic" that the product was expected to do no better than break even. I have also reviewed certain documents reflecting revenues that the defendants received from the sale of "The Complete National Geographic," as well as the reports of Plaintiffs' financial experts. Based on these documents, I understand that the projections were much lower than the actual sales for "The Complete National Geographic."

Applying the budgeting model, $8,058,667 (15% of $53,724,449) would have been set aside to pay photographers and writers. Two-thirds, or $5,367,072, would have been available to pay photographers. One-third, or $2,683,536, would have been available to pay writers.

This exact model is suggested in the 6 May 1997 letter from James H. Pickerell addressed to "Former and Present National Geographic Shooters," wherein he states:

> A reasonable compromise would be for Geographic to set aside a certain percentage of the gross sales of the product which would be shared by the copyright holders based on their proportional share of the total content on the disc set.
>
> Considering the large numbers of images involved the payment per image is likely to be very low, but for photographers who have done a number of stories over the years the gross still may be significant. For example, let's

say that there were 20,000 pictures that were produced by freelancers entitled to royalties. If, as result of sales, $100,000 goes into the pot to pay the copyright holders each holder would get $5 per picture.

The next step would be to divide these totals for images and text between the creators of the content proportionately according to each individual's contribution.

The images that were potentially protected by copyright in 1997, and thus would have been considered eligible to be included in the content percentage, are those that appeared from 1923 through 1997. I am informed that approximately 123,075 images appeared during those years. This figure was determined by having a NGS staff member count the number of images appearing in one year's worth of magazines every five years after 1978 and every ten years before 1978. These counts were used to calculate the average number of images that appear in National Geographic Magazine during the course of a year, and that average number was multiplied by 75 (the number of years elapsed between January 1, 1923 and December 31, 1997) to arrive at the 123,075 figure.

Dividing the $5,367,072 photographer royalty pool by 123,075 photographs establishes that each individual image would carry a value of $43.60 (nearly 9 times the value of James Pickerell's 1997 example). The per-image figure of $43.60 then only needs to be multiplied by the number of images each creator provided to arrive at his/her share. Thus, in the case of Fred Ward, who I have been told is the creator of 532 images, his share would be 532 times $43.60, or a total of $23,195.20.

The same principle applies to the authors of text pieces. They would share 5%, or $2,683,536, proportionally according to their contribution. I am informed that, based on a counting exercise done in the same way as that conducted for photographs, approximately 5,775 stories have appeared in the Magazine since 1923. Each individual story therefore would carry a value of $464.68. The per-story figure would then be multiplied by the number of stories each creator provided to arrive at his/her share. Mr. Ward, who, I am told, wrote nine stories, would have received $4,182.12.

This report reflects my expert opinion at this time based on all the facts made available to me. Should additional facts become available, I reserve the right to amend my opinion at that time.

Dated: January 28, 2002

Jane S. Kinne