

Before the  
COPYRIGHT ROYALTY BOARD  
LIBRARY OF CONGRESS  
Washington, D.C.

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In the matter of:

The Digital Performance  
Right in Sound Recordings | Docket No.

and Ephemeral Recordings | 2005-1 CRB DTRA  
(Webcasting Rate  
Adjustment Proceeding)

|-----+  
Volume 9

Room LM-414  
Library of Congress  
First and Independence Ave., S.E.  
Washington, D.C. 20540

Monday,  
May 15, 2006

The above-entitled matter came on for  
hearing, pursuant to notice, at 9:30 a.m.

BEFORE:

THE HONORABLE JAMES SLEDGE, Chief Judge  
THE HONORABLE WILLIAM J. ROBERTS, JR., Judge  
THE HONORABLE STAN WISNIEWSKI, Judge

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## I-N-D-E-X

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2 (9:37 a.m.)

3 CHIEF JUDGE SLEDGE: We'll come to  
4 order.

5 Mr. Handzo.

6 MR. HANDZO: Good morning, Your  
7 Honor.

8 SoundExchange is going to resume  
9 its case with Dr. Michael Pelcovits. We have  
10 our usual notebooks.

11 Whereupon,

12 W. MICHAEL PELCOVITS  
13 was called as a witness by counsel for  
14 SoundExchange, and after having been first  
15 duly sworn, was examined and testified as  
16 follows:

17 DIRECT EXAMINATION BY COUNSEL FOR  
18 SOUNDEXCHANGE

19 BY MR. HANDZO:

20 Q For the record, would you tell us  
21 your name?

22 A Yes, my name is Michael Pelcovits.

1 Q Dr. Pelcovits, what is your  
2 business or profession?

3 A I'm a consultant with the  
4 consulting firm of Micra, microeconomic  
5 consulting and research associates. I've been  
6 with Micra for three years.

7 Q What is your educational  
8 background?

9 A I received my bachelor's degree in  
10 economics from the University of Rochester in  
11 1972, and I attended MIT, Massachusetts  
12 Institute of Technology where I received my  
13 Ph.D. in economics in 1976.

14 Q Where are you currently employed?

15 A As I mentioned, I'm employed at  
16 Micra consulting firm in Washington, D.C.

17 Q Can you just tell us a little bit  
18 more about what the business is Micra is?

19 A Sure, Micra is a firm entirely of  
20 economists. We work in a variety of applied  
21 microeconomic fields. We are engaged in  
22 analyzing industries, rate setting, costing

1 issues, a whole variety of applying  
2 microeconomics to different primarily  
3 litigated cases, in the anti-trust, in the  
4 regulatory arena, and then quite a lot of  
5 other forms as well.

6 Q Dr. Pelcovits, how long have you  
7 been with Micra?

8 A Three and a half years.

9 Q Prior to joining Micro where were  
10 you employed?

11 A I was employed for 14 years at  
12 MIC, which at one point was acquired by  
13 WorldCom. I like to remember it as MCI. I  
14 was employed there for that entire position.

15 Q What was your position with MCI?

16 A I started out as a senior staff  
17 economist, and I moved up through the ranks  
18 and eventually became the chief economist and  
19 a vice president.

20 Q Did any of your work at MCI  
21 involved rate-setting proceedings?

22 A Quite a lot. Rate setting is

1 essential, a key part of telecommunications  
2 industries. Rates are set for a variety of  
3 telecommunication services by state regulatory  
4 commissions, by the FCC, and in foreign  
5 countries by their respective regulatory  
6 bodies.

7 And it was essential to MCI's  
8 business to be involved very heavily in how  
9 those rates were set, either for itself and  
10 also quite extensively as an intervenor in  
11 those cases.

12 Q Can you give us an example of a  
13 rate-setting proceeding with MCI?

14 A Sure, I think probably among the  
15 most significant and monumental efforts that  
16 the entire industry was engaged in for many  
17 years was the setting of rates and terms under  
18 which competitors in the local telephone  
19 markets were able to interconnect and use the  
20 networks of the incumbents.

21 This was an issue that was a  
22 consequence of the 1996 Telecommunications

1 Act, which permitted entry into the local  
2 telephone market.

3 And as a result for several years  
4 I was really in charge of MCI's efforts at  
5 being involved at the FCC and in the states at  
6 trying to get the methodologies and the rates  
7 that would be favorable to the business.

8 Q Did your work at MCI involve any  
9 work on Internet issues?

10 A Yes, they did.

11 Q Can you describe that for us?

12 A Sure. The Internet was a very  
13 major part of MCI's business. MCI was a  
14 leader, in fact the first major provider of  
15 the Internet backbone, and always remained the  
16 largest Internet backbone in the country.

17 MCI dealt, and I had to deal,  
18 working with MCI colleagues, with economic  
19 issues relating to the Internet as they  
20 pertained to a number of issues that were  
21 brought up in the context of either merger  
22 approvals, in the context of reviewing of the

1 policies dealing with peering, Internet  
2 networks.

3 So I would say that it was a  
4 substantial part of my attention, particularly  
5 the last several years at MCI.

6 Q Did those issues involve broadband  
7 access as well?

8 A There were issues also relating to  
9 broadband access to the Internet. It was  
10 almost a separate class of issues, because at  
11 the same time that we were trying to foster  
12 competition in the local telephone market in  
13 terms of the regular, pick up the phone and  
14 dial a phone and make a call, it was also the  
15 time when competition was blossoming, and  
16 there were quite a lot of developments in the  
17 broadband access to the home by cable modems  
18 and also, and an area that was very important  
19 to MCI, through the DSL products that were  
20 being introduced by both the Bell companies  
21 and also several competitors, including MCI.

22 And there was quite a lot of

1 issues involved in terms of access, pricing,  
2 regulation of the broadband access to the  
3 home.

4 Q What were the pricing issues for  
5 broadband?

6 A Well, there were pricing issues in  
7 terms of access to the underlying network  
8 element that was needed by a competitor to  
9 compete in the market. There were issues  
10 relating to whether broadband prices and  
11 access would itself be regulated by the FCC.

12 And there was a lot of issues  
13 dealing with to what extent would broadband or  
14 for example voice-over-Internet protocol used  
15 over broadband would become a substitute for  
16 conventional telephone service.

17 Q Have you written at all on the  
18 subject of the Internet?

19 A I have. I was asked to write a  
20 chapter of a book on the economics of the  
21 Internet. I co-authored with Dr. Vincent  
22 Cerf, who is indeed one of the fathers of the

1 Internet.

2 Q Prior to your employment with MCI,  
3 Dr. Pelcovits, where were you employed?

4 A I had a number of different  
5 employments. I worked for about seven years  
6 in a consulting firm that I co-founded. The  
7 name of the consulting, Cornell, Pelcovits and  
8 Brenner. We were also refugees from the FCC,  
9 and we consulted on quite a lot of  
10 telecommunications and other applied economic  
11 issues in a number of other industries.

12 Q Can you give us an example?

13 A Well, I did a lot of work  
14 testifying on rate-setting issues. Primarily  
15 at that time they involved in terms of access  
16 to the network by long-distance companies, and  
17 the pricing of access in the state regulatory  
18 commissions.

19 We also worked on one of our first  
20 cases that sort of got us started as a firm.

21 We worked for Sony following the famous  
22 Betamax case at the Supreme Court where there

1 was pending and proposed legislation to impose  
2 various taxes on video recording, and we  
3 worked for Sony to develop some of their  
4 material for Capitol Hill on those issues.

5 Q And just quickly, prior to  
6 Cornell, Pelcovits and Brenner, where did you  
7 work?

8 A I worked at the place where I was  
9 eventually a refugee from, the FCC. I was on  
10 the office ; I was in what was called the  
11 Office of Plans and Policy. It was really  
12 where the economists were housed along with  
13 some engineers.

14 I worked for a year at the Civil  
15 Aeronautics Board, and for a couple of years  
16 after graduate school I was an assistant  
17 professor at the University of Maryland,  
18 College Park.

19 Q Professor of economics?

20 A Yes, in the economics department.

21 Q Dr. Pelcovits, have you testified  
22 as an expert in microeconomic issues before?

1           A        I have. I've lost count, but I've  
2 testified I'd say probably 40 times in state  
3 regulatory proceedings on rate setting and  
4 other economic and policy types of issues.

5           Q        That may have anticipated my next  
6 question, but how many of those times that you  
7 testified involved rate-setting proceedings?

8           A        I would say at least half,  
9 probably more. There are a lot of issues  
10 relating to costing, pricing, that have sort  
11 of been at the key of the industry for the  
12 entire time that I've been active, I'd say  
13 since I was at the FCC in 1979, from then on.

14                   MR. HANDZO: I would offer Dr.  
15 Pelcovits as an expert in applied  
16 microeconomics.

17                   CHIEF JUDGE SLEDGE: Any objection  
18 to the offer?

19                   MR. STEINTHAL: Your Honor, if we  
20 can reserve for voir dire on cross.

21                   MR. JOSEPH: Likewise, Your Honor.

22                   CHIEF JUDGE SLEDGE: Without

1 objection, the offer is accepted.

2 BY MR. HANDZO:

3 Q Dr. Pelcovits, when were you  
4 retained by SoundExchange in this case?

5 A I was retained in August of last  
6 year.

7 Q What were you asked to do for  
8 them?

9 A I was asked to essentially analyze  
10 the issues relating to setting a rate for use  
11 of sound recordings according to the statute  
12 for noninteractive webcasts.

13 I was asked to develop a  
14 recommended rate and present the economic  
15 reasoning and analysis in a testimony.

16 Q Can you give us an overview of  
17 what you did when you first began this  
18 engagement?

19 A I think the starting point for me  
20 was really reading the previous CARP decision  
21 and to get a good understanding of the legal  
22 framework behind the case. Primarily I would

1 say I didn't try to play lawyer, I read the  
2 CARP decision and read filings from the  
3 previous decision | from the previous  
4 proceeding. I read significant amounts about  
5 the industry and also about some of the  
6 economic issues that had been researched and  
7 written in the literature about the industry.

8 And I discussed with the attorneys  
9 at Jenner & Block about obtaining certain  
10 types of information, particularly information  
11 on the contracts that had been entered into  
12 between the webcasters and the record  
13 companies for what I felt would be a good  
14 benchmark service.

15 I would say | add one other thing  
16 to the list, which is, I also got quite  
17 familiar with the nature of the services that  
18 were being provided by the webcasters, a  
19 combination of having research assistants try  
20 to dig up and collect as much information as  
21 they could, and even as mundane a task as  
22 trying a lot of them out myself.

1           Q       Based on your review of the CARP  
2 decision, what did you understand the legal  
3 standard that you were going to be applying  
4 here to be?

5           A       The legal standard is referred to  
6 as the willing buyer-willing seller standard.

7           Q       And what did you understand the  
8 hypothetical market for our willing buyers and  
9 willing sellers to be?

10          A       Well, the market, or the  
11 hypothetical market would be for the licensing  
12 of the copyrighted works of the copyright  
13 holders to whatever broadcaster would observe  
14 the statutory requirements, primarily no  
15 webcasting, but essentially any use that  
16 follow the constraints in the statute.

17          Q       And just to be clear, who did you  
18 understanding the willing sellers in this  
19 market to be?

20          A       The willing sellers are those that  
21 own the copyrights, which is principally the  
22 record companies.

1 Q And who did you understand the  
2 willing buyers to be?

3 A Willing buyers are whoever is in  
4 the market and wishes to obtain a license in  
5 order to provide a noninteractive webcast.

6 Q And finally, what did you  
7 understand the willing sellers to be selling  
8 to the willing buyers?

9 A I understood them to be selling a  
10 blanket license for all of the copyrighted  
11 music that they had the copyright to.

12 Q What approach did you adopt, Dr.  
13 Pelcovits, to come up with a rate proposal in  
14 this case?

15 A The approach I adopted is termed a  
16 benchmark approach. And benchmark approach  
17 simple means looking for evidence from  
18 comparable markets, and examining that  
19 evidence to try to get a sense of what willing  
20 buyers and willing sellers are doing in the  
21 marketplace.

22 Q What are the advantages of using a

1 benchmark approach?

2 A Well, the advantages, I would say  
3 fundamentally, first of all you're dealing  
4 with evidence that is there in the market.  
5 There is actual data. The first thing an  
6 economist looks for is data. So you have data  
7 in the market. You have the advantage of  
8 actually seeing the result of the marketplace  
9 forces from both the demand side and the  
10 supply side. So you're seeing market  
11 equilibria, and you are able to observe the  
12 outcome of all the different forces that are  
13 influencing the buyers and the sellers.

14 Q In your view, Dr. Pelcovits, what  
15 are the characteristics of a good benchmark?

16 A Well, the characteristics of a  
17 good benchmark are, obviously it has to be a  
18 reasonably similar market with similar  
19 characteristics, and in this case I would say  
20 in general, you don't always have this  
21 opportunity, you have the same buyers and the  
22 same sellers.

1           You have in the same copyrighted  
2 works being provided, and you have the  
3 copyrighted material being used in a manner  
4 that it's provided to customers in a very  
5 similar way.

6           Q       You have described the  
7 similarities of your benchmark, but I guess we  
8 should first identify what market you chose as  
9 your benchmark.

10                   What market did you choose as the  
11 benchmark?

12           A       The market I chose was the market  
13 for interactive or alternatively let's call it  
14 on-demand webcasts.

15                   If I could give an example, it  
16 would simply be a service where a customer  
17 subscribes, pays a monthly fee, for example,  
18 to Rhapsody, and is able to listen to  
19 relatively high quality streaming audio of his  
20 or her own selection by choosing artists, by  
21 choosing albums, by choosing songs.

22           Q       I think you've already touched on

1 it, but what were the similarities you  
2 perceived between the benchmark market ; and  
3 if we can refer to the market that we're a  
4 rate for here as the target market, does that  
5 make sense?

6 A To have a common terminology,  
7 right.

8 Q So the question was, what were the  
9 similarities that you perceived between the  
10 benchmark market and this target market?

11 A The similarities I'd say start  
12 with similar buyers and similar sellers, and  
13 by its very nature, then, very similar  
14 products being exchanged between the buyer and  
15 the seller, the same music, the same ability  
16 to use the music for commercial purposes of  
17 various sorts.

18 And then also the ability to look  
19 at how that service, that music, is then as an  
20 input used in the downstream markets by  
21 consumers in various ways.

22 So that makes a good benchmark.

1 It has another attribute which I think is  
2 really | well, there are a couple of other  
3 attributes.

4 One is, and this is very  
5 important, they are similar, but they are I  
6 believe sufficiently different that the  
7 current rate set by the CART in the  
8 noneconomic market does not have an  
9 overwhelming influence on the rate in the  
10 benchmark market.

11 In other words if the benchmark  
12 were too close to the target market, you could  
13 not use that information because the benchmark  
14 would be strong affected by the gravitational  
15 pull of the preexisting rate in the target  
16 market which was not set by the market, but  
17 set by the CART.

18 So it has to be sufficiently  
19 different, and the other thing is that it has  
20 to be amenable to analysis, to be able to look  
21 at the difference between the characteristics  
22 of the target and of the benchmark market and

1 measuring the importance of that  
2 characteristic, and adjusting the rates in the  
3 benchmark market for those characteristics in  
4 order to come up with the recommended rate for  
5 the target market.

6 Q Now in terms of your ability to  
7 make adjustments, does that depend in part on  
8 having sufficient data about the benchmark  
9 market?

10 A It does.

11 Q And did you have sufficient data  
12 about the benchmark market in your view?

13 A Yes, I would say I need data not  
14 just for adjustments, but for just simply pure  
15 analysis purposes, it's pretty hard to try to  
16 apply, let's say, one or two pieces of data,  
17 so the fact that there were a significant  
18 number of contracts for the interactive  
19 services, and the contracts were pretty  
20 straightforward to see what the prices were.

21 Sometimes if you're doing an  
22 analysis of certain markets, prices are not so

1       apparent.  There's a lot of dimensions to  
2       price, so it's important to be able to zero in  
3       and identify the price that you're looking  
4       for, so it had that characteristic.

5               And I've probably not answered  
6       your question entirely.

7               Q       That's fine.

8               Do you recall how many contracts  
9       for the interactive market you saw?

10              A       I recall that for the interactive  
11       market I saw, I believe it was 29 contracts.

12              Q       Where did you get those from?

13              A       I got them from counsel, from  
14       Jenner & Block.

15              Q       In your analysis of the benchmark  
16       market, did you exclude any of those contracts  
17       from consideration?

18              A       I won't say I excluded them from  
19       consideration, but I eventually sort of zeroed  
20       in on 17 of those contracts.  There were  
21       several cases where contracts, earlier  
22       contracts, were superseded by later contracts,

1 so in that case I looked, and I used for  
2 analytical purposes the more up to date  
3 contracts.

4 And there was one other contract  
5 that I excluded from the actual measurements  
6 that I conducted, which was a contract that  
7 essentially was a real outlier, used a  
8 mechanism for calculating the payment that was  
9 totally different than any of the other  
10 contracts. It was called a slotting  
11 allowance, and essentially when something is  
12 so far off the general pool of data you have  
13 it's conventional to take it out of the data  
14 set and work with the data set you have.

15 Q So I'm sorry, in the end you would  
16 up with 17 contracts?

17 A I ended up analyzinig and working  
18 with 17.

19 Q Okay.

20 Let me ask you first of all about  
21 the rate structure of the contracts in the  
22 internactive markets.

1                   What did you find with respect to  
2                   that rate structure?

3                   A           I found that almost all the  
4                   contracts had a three-part rater of structure.  
5                   Namely, the rate or the possible rate was  
6                   calculated three different ways, and the  
7                   amount paid by the webcaster was the greater  
8                   | it's called greater, it really should be  
9                   greatest | the greatest of the three different  
10                  rate calculations.

11                  The three calculations were first,  
12                  a per play rate, which is | am I allowed to  
13                  give the number here? Are we giving numbers?

14                  Q           Let's hold off on the numbers.  
15                  We'll get to that later.

16                  A           Well, there was a per play rate,  
17                  where a per play rate means a rate per every  
18                  time a song is played to a individual  
19                  listener. So if I'm sitting at home, and I  
20                  click, and I'm on Rhapsody, and I want to  
21                  listen to a particular song, and that song  
22                  plays, there is a | essentially the meter goes

1 by one click.

2 The second was a per subscriber  
3 fee. It's called a pro rate per subscriber  
4 fee where the fee would be essentially based  
5 on the number of subscribers to the service.  
6 So if there are a million subscribers, and the  
7 fee is ten dollars, the base of the fee is ten  
8 million dollars.

9 Now that fee is then paid to the  
10 individual record label according to its  
11 contract, and the fee is based on the pro rata  
12 share of plays on the webcaster that are using  
13 the copyrighted material of that record label.

14 So if you are BMG Music and 25  
15 percent of the plays on Rhapsody are of your  
16 music, then you multiply 25 percent times that  
17 \$10 million I just gave, and that's the second  
18 element.

19 The third element is a percentage  
20 of revenue, which we've talked about is in the  
21 range of about 40 to 50 percent, and once  
22 again that is of ; there are a variety of

1 different definitions and adjustments taken,  
2 but it's essentially the revenue that the  
3 webcaster collects directly or indirectly from  
4 the service, and again, the pro rata mechanism  
5 is used to determine the amount due to the  
6 particular record label under its contract.

7 Q Going back to the per subscribed  
8 rate, is that set as an amount per subscriber  
9 per month?

10 A Correct, it is per subscriber per  
11 month.

12 Q Do you have an understanding, Dr.  
13 Pelcovits, of what that rate structure exists  
14 in this market?

15 A Yes.

16 MR. STEINTHAL: Objection, Your  
17 Honor, lack of foundation.

18 CHIEF JUDGE SLEDGE: Repeat your  
19 question.

20 MR. HANDZO: The question was  
21 whether Dr. Pelcovits has an understanding of  
22 what that rate structure exists.

1 CHIEF JUDGE SLEDGE: Overruled

2 WITNESS: I do. I have an  
3 understanding that there are various  
4 mechanisms to try to garner a share of  
5 revenues, depending on how the music is used.

6 They're obviously working within a  
7 context of uncertainty. If everyone knew  
8 exactly what was going to happen when you  
9 signed the contract, you wouldn't need a  
10 greater than type of structure, because you  
11 could essentially predict ahead of time which  
12 was going to be the one that would essentially  
13 be the greatest, and negotiate on that one, or  
14 just negotiate on whatever you needed to if  
15 you had perfect information.

16 So given that there is imperfect  
17 information there, and sort of a | there are  
18 a lot of dynamic changes in the market, there  
19 is concern by the record companies to be able  
20 to collect revenue based on how the music is  
21 used in the different services.

22 If it's played a lot more than

1 might have been expected, the per play rate  
2 might come into force. If revenue is let's  
3 say collected through a bundled service where  
4 it's hard to attribute revenue for a  
5 particular music service, because it's bundled  
6 along with other things, the per subscriber  
7 amount might become the key one.

8           If you're using the music and not  
9 collecting a lot of music | sorry, a lot of  
10 money from the subscriber, but rather from  
11 advertisers or other ancillary services, then  
12 the revenue percentage might come into play.

13           Q       Based on your review of the  
14 contracts for the interactive market, did you  
15 reach any conclusion about what the rate  
16 structure should be for this case, for the  
17 target market?

18           A       I recommend that the same rate  
19 structure apply. Once again we're dealing  
20 with trying to look at the market and see what  
21 willing buyers and willing sellers do.

22                   Willing buyers and willing sellers

1       agreed on a three-part rate structure. It was  
2       their way, quite frankly, of handling the  
3       uncertainty of what was going on in the  
4       market, and there is, within any negotiation,  
5       a give and take. And this resulted in the  
6       three-part rate structure, in the benchmark  
7       market, and I believe that it's very important  
8       to import that same rate structure into our  
9       target market in order to take sort of account  
10      of all those different factors that were  
11      important in the other market, and also to  
12      sort of capture what's behind the incentives  
13      of the willing buyer and the willing seller.

14           Q       Now in your report, Dr. Pelcovits,  
15      in the end you recommend a set of rates.  
16      Would there be any adjustments that should be  
17      made to those rates if we did not use this  
18      three-part structure?

19           A       Yes, I believe that if you were to  
20      sort of take my approach and import the rate  
21      level from one of the pieces of this structure  
22      but not the entire structure, you would be

1 sort of undervaluing the use of the music in  
2 the target markets.

3 And the reason is that when you're  
4 setting up a three-part structure, you are  
5 getting something out of each one of them.

6 And if you say I'm not going to | or I as the  
7 seller am not going to get the benefit of two  
8 parts of the rate structure, whatever those  
9 benefits are, but obviously they're benefits  
10 that affected their negotiations in the  
11 benchmark market, if I'm going to give up some  
12 benefits, then I can't simply take the rate  
13 derived from the three-part structure without  
14 making some adjustments to offset those lost  
15 benefits of the rate structure itself.

16 MR. HANDZO: If I can just take a  
17 break here for a second, I'm about to get into  
18 restricted information with Dr. Pelcovits, and  
19 restricted information involves the particular  
20 prices that have been negotiated in the  
21 benchmark market, and that is competitively  
22 sensitive information. The record companies

1 don't share it with each other, certainly not  
2 with the parties they're negotiating with.

3 So at this point I would request  
4 that the court put us into executive session,  
5 and designate this as restricted.

6 I actually don't see anyone in the  
7 courtroom who would have to leave.

8 CHIEF JUDGE SLEDGE: This is to  
9 review the rates that are part of contracts  
10 that were in his benchmark?

11 MR. HANDZO: That's correct.

12 CHIEF JUDGE SLEDGE: Any objection  
13 to the motion to apply the protective order on  
14 questions and answers relating to the rates of  
15 contracts used in the benchmark?

16 No objection. The motion is  
17 granted.

18 MR. HANDZO: Thank you.

19 (Whereupon at 10:10 a.m. the  
20 hearing in the above-entitled matter went into  
21 closed session.)  
22

1 CHIEF JUDGE SLEDGE: We are ahead  
2 of our normal recess. Does anyone want to  
3 start on cross-examination with this time  
4 frame?

5 MR. STEINTHAL: I will start, Your  
6 Honor.

7 CROSS-EXAMINATION BY COUNSEL FOR DIGITAL  
8 MEDIA, ET AL.

9 BY MR. STEINTHAL:

10 Q Good morning, Dr. Pelcovits.

11 A Good morning, Mr. Steintal,  
12 correct?

13 Q My name is Ken Steintal. We  
14 haven't met.

15 A Yes, your reputation precedes you.

16 Q As does yours.

17 A Thank you.

18 Q Dr. Pelcovits, it's correct, is it  
19 not, that prior to this engagement you had no  
20 experience in the online music industry?

21 A As an economist no.

22 Q Other than your own use as a

1 consumer of online music, it's fair to say you  
2 had no prior experience in the online music  
3 industry?

4 A That's correct.

5 Q And that includes the webcasting  
6 industry, does it not?

7 A That is correct.

8 Q What about the sound recording  
9 business more generally? You had no prior  
10 experience before this engagement in the sound  
11 recording industry; correct?

12 A That's correct.

13 Q Indeed in connection with looking  
14 at copyrighted content more generally, other  
15 than dealing with software issues in  
16 connection with telecommunication switches at  
17 MCI, you had no experience dealing with  
18 copyrighted content prior to this engagement,  
19 correct?

20 A I mentioned also I had worked on  
21 the Betamax issues, so that was the other  
22 involvement I had in those issues.

1           Q       Other than that limited Betamax  
2 issue you testified about, you had no  
3 experience dealing with evaluation of  
4 copyrighted content other than software in  
5 connection with telecommunication switches;  
6 correct?

7           A       And as you correctly mentioned,  
8 that is an area in which I was involved, the  
9 valuation of the copyrights contained within  
10 telecommunications equipment, what are called  
11 right-to-use fees, in that part of the  
12 industry.

13          Q       But in connection with valuation  
14 of music or audio-visual copyrighted content,  
15 you have no prior experience before this  
16 current?

17          A       As I mentioned, the Betamax  
18 experience, but other than that, no.

19          Q       The Betamax experience didn't get  
20 you involved in evaluating or assessing the  
21 value of music, did it, in any respect?

22          A       It was not music; it was video.

1 That's correct.

2 Q Now it's also correct is it not  
3 that you never interviewed or spoke with  
4 anyone in the webcasting industry before  
5 submitting your written report?

6 A That's correct.

7 Q And by definition then you talked  
8 to nobody involved in webcasting under a  
9 statutory license before submitting your  
10 report; correct?

11 A That's correct.

12 Q And no one involved in the  
13 delivery of on-demand streaming services, your  
14 target ; I'm sorry, your benchmark market,  
15 correct?

16 A That's correct.

17 Q Let me ask you some questions  
18 about the research you did before writing your  
19 written report.

20 Now I believe you said this  
21 morning and in your written statement that you  
22 reviewed material about the industry; correct?

1           A        Yes.

2           Q        Meaning the music industry  
3 generally and the webcasting industry  
4 generally?

5           A        I guess as opposed to what? I  
6 reviewed quite a lot of things about the music  
7 industry, about copyright valuation, about  
8 webcasting. So quite a big research project.

9           Q        Well, putting aside the contract  
10 you reviewed between individual labels and  
11 licensees in the target and benchmark markets,  
12 what specifically did you review?

13          A        I reviewed and approached this  
14 just like I would any other economic analysis  
15 where I read as much as I can about the  
16 industry, about the nature of the services,  
17 about the market structure, the prices,  
18 consumption patterns, relevant legal  
19 decisions, and quite a lot of economics  
20 literature that deals with both retail pricing  
21 and valuation of intellectual property.

22          Q        And that was all done by reading

1 materials that were publicly available to you?

2 A That's correct.

3 Q And all the materials you reviewed  
4 you've identified in your report, correct?

5 A Well, the report doesn't list  
6 every single thing I reviewed. I obviously  
7 talked in general about what I reviewed. I  
8 think we provided material on discovery.

9 Q But apart from that publicly  
10 available material that you reviewed, it's  
11 correct, is it not, that you reviewed no data  
12 about the webcasting business?

13 A I reviewed whatever data was  
14 available in public sources.

15 Q You got no data from any  
16 webcasters, correct?

17 A That is correct.

18 Q And the data from public sources,  
19 can you tell me what specific kinds of data  
20 you rely on in your report from public sources  
21 about webcasting?

22 A I would have to go back and look.

1 I think there is a lot about webcasting that  
2 is written in publications about the industry,  
3 whether it's recent books, articles, annual  
4 reports of the webcasters themselves, Security  
5 & Exchange Commission reports of various  
6 webcasters; their websites themselves where  
7 they are describing at length their services  
8 where they are trying to attract customers or  
9 even attract users of their service.

10 So that's | that is what I did.

11 Q So all your information about why  
12 webcasters price certain services one way or  
13 another way was derived for example from  
14 websites or other publicly available  
15 information; correct?

16 A I told you I didn't go into an  
17 analysis of the whys; I looked at the market  
18 evidence. So that in my mind is the hard  
19 data that's available as opposed to what I  
20 would think would be far less informative,  
21 which would be to try to get some  
22 impressionistic idea of why they are pricing

1 where they are.

2 Q But for example, when you do your  
3 charts that are in your report, we'll come  
4 back to that, you look at prices that are  
5 listed for various products without any data  
6 whatsoever about how many people are actually  
7 paying those prices; right?

8 A From the public sources  
9 themselves, I've seen data since then, but  
10 from the public sources themselves, there is  
11 limited data on the number of customers, and  
12 it's also difficult to get the breakdown of  
13 customers by the type of service they  
14 subscribe to.

15 These are in the market. They're  
16 actively promoted and sold. There was some I  
17 believe it was AccuStream that had some data.  
18 But in terms of the actual number of  
19 subscribers on each service, that was not  
20 publicly available; correct.

21 Q And I gather the information that  
22 you just mentioned that you relied upon for

1 webcasters was the same whether it be  
2 statutory licensed webcasters or on-demand  
3 streaming and conditional download services?

4 A The services might be different  
5 depending whether the companies were  
6 different, but the types of research material  
7 was similar.

8 Q Now, in addition to your review of  
9 these materials, before you did your written  
10 report you had two or three conference calls  
11 with people in the sound recording industry,  
12 correct?

13 A Yes.

14 Q And that was in the early stages  
15 of your research, was it not?

16 A Yes, it was.

17 Q And do you remember who those  
18 people were?

19 A I do not.

20 Q And the subject was largely about  
21 the hold back issue, is that right?

22 A That was the primary reason for

1 the calls. I was trying to make sure I  
2 understood the contracts, and I was  
3 interpreting evidence properly. I was also  
4 hoping to try to quantify the effects of the  
5 hold backs, which can affect the value of the  
6 music in the interactive contracts.

7 So that was really an area that I  
8 was trying to see whether there was data or  
9 other ways of making an adjustment in the  
10 model for the hold backs, and that was the  
11 nature of the research at that time.

12 Q But just so I understand it then,  
13 you generated this report based on two or  
14 three conference calls of that nature with  
15 people you can't remember, and your review of  
16 a series of contracts that you got from the  
17 label representatives, or actually from  
18 Jenner, and from the publicly available  
19 information you gleaned about the industry;  
20 correct?

21 A That's correct, I approached it  
22 the way I would approach research that I've

1 undertaken in the past in other industries,  
2 and the | certainly a lot of effort into  
3 getting a lot of material from the public  
4 sources.

5 Q So you would agree with me that if  
6 you had the same universe of data to tackle a  
7 telecommunications problem before you  
8 undertook this assignment, you'd have a heck  
9 of a lot more experience and expertise to draw  
10 on to reach conclusions about the project than  
11 you did in taking on a subject like webcasting  
12 in which you had no prior experience; isn't  
13 that right?

14 A It depends a lot on what the  
15 project was. There are projects I've done in  
16 telecommunications, particularly newer markets  
17 in telecommunications, where the | you're  
18 dealing with something which from an  
19 analytical standpoint is very much sort of a  
20 fresh look. That might be true of many things  
21 related to the Internet. It would be true of  
22 things related to, let's say, voice over IP;

1 I've done research and looked at that issue,  
2 and wasn't a lot to discuss. It was trying to  
3 understand the quantitative nature of things  
4 going on, the prices, and the effect of price  
5 bundling and other topics.

6 So it depends. It depends on the  
7 project as to what is the appropriate research  
8 step and tools to use.

9 Q Now you said you reviewed  
10 contracts that were entered into between music  
11 services and the copyright holders; correct?

12 A That's correct.

13 Q Those copyright holders were the  
14 major labels; correct?

15 A That's correct.

16 Q Meaning the big four, are you  
17 familiar now that there are four major record  
18 companies?

19 A Very familiar.

20 Q And you didn't review any  
21 contracts between other copyright holders and  
22 music services, did you?

1           A       I did not.

2           Q       You know that SoundExchange  
3 represents a great multitude of copyright  
4 owners other than the majors?

5           A       I do ; I am aware of that.

6           Q       Did you seek any information about  
7 contracts between other copyright holders than  
8 the major four record companies from Jenner &  
9 Block or the SoundExchange representative?

10          A       I ; for the interactive web  
11 servers you're talking here, because those  
12 would be where you get the contracts, but I  
13 did inquire as to whether I could get them in  
14 time to do my analysis, and they were not  
15 available to me.

16          Q       You said it was for the  
17 interactive services in your last answer.

18          A       Right.

19          Q       Are you familiar with the fact  
20 that there were contracts entered into by both  
21 major record labels and independent record  
22 labels with certain webcasters?

1           A           I did in fact address in my  
2 testimony the contracts for the wider range of  
3 webcasting services which use the term,  
4 customized radio, to refer to those who can  
5 add certain features that either are, or  
6 arguably are, make them ineligible for the  
7 statutory license.

8                   CHIEF JUDGE SLEDGE: Judge  
9 Wisniewski has just reminded me that Mr.  
10 Handzo never concluded his portion of  
11 questioning that was subject to the protective  
12 order.

13                   We are no removed from application  
14 of the protective order.

15                   MR. STEINTHAL: From the beginning  
16 of my cross, yes, Your Honor, absolutely.

17                   BY MR. STEINTHAL:

18           Q           So basically in terms of the  
19 contracts you reviewed, you reviewed what  
20 Jenner & Block gave you and nothing else;  
21 correct?

22           A           That's correct.

1           Q       By the way was the benchmark on  
2 demand service market that you chose to rely  
3 on something that you yourself thought of, or  
4 was it suggested to you by someone else?

5           A       I frankly don't recall. I know  
6 early in the engagement I was presented, or  
7 discussed, a number of different options. And  
8 certainly interactive was raised, as were some  
9 of the others that I mentioned in my  
10 testimony.

11                   So I did consider a number of  
12 other benchmarks. And I will say that very  
13 early on, it was my judgment, which I stand by  
14 to this day, that those are by far the best  
15 evidence in the market to serve as a  
16 benchmark. It's very compelling, very  
17 powerful, very useful evidence.

18           Q       Sir, you would agree, would you  
19 not, that a service seeking to offer  
20 subscribers on demand access to specific music  
21 recordings effectively must have a license  
22 from each of the big four major record

1 companies; correct?

2 A Effectively it turns out to be  
3 that way in the market. I don't know whether  
4 it would be possible to have a more limited  
5 tailored music service.

6 Q Well, we're talking about on  
7 demand streaming conditional download services  
8 that form your benchmark market, all of those  
9 services tell consumers that they're offering  
10 essentially the world's music on demand, don't  
11 they?

12 A I don't know if I'd put it that  
13 way. As I said, some of the | particularly  
14 the larger ones are advertising that they are  
15 offering a wide range of music. They mostly  
16 make that point by genre. They say, we have  
17 a variety of different types of music that  
18 we're offering.

19 They obviously can't represent  
20 they have everything, because they don't have  
21 everything.

22 Q Let's talk about that for a

1 second. You had mentioned that there are  
2 times when certain tracks aren't available.

3 Is it your testimony, sir, that  
4 the reason those tracks aren't available is  
5 because of hold back rights associated with  
6 the labels, and only that issue?

7 A As far as I'm aware, they are held  
8 back or one way or another not released or  
9 provided by the copyright holder, and that if  
10 the music service wanted to ; obviously if the  
11 music service wants to use a piece of music,  
12 it has to get the approval of the copyright  
13 holder.

14 Q And that copyright holder is more  
15 than the sound recording owner, right?

16 A It can, yes.

17 Q The publisher as well?

18 A It appears the publisher as well.

19 Q And as a matter of fact, sir, are  
20 you familiar with the fact that there are many  
21 tracks that the services that are in your  
22 benchmark market have the sound recording

1 rights to but have been unable to clear the  
2 publishing rights to?

3 A I don't recall if I was aware of  
4 that, but I can see that that would be  
5 possible, and that would reduce the value of  
6 those services to the consumers and ultimately  
7 the value and how much they'd be willing to  
8 pay to the sound recording companies for the  
9 right to use their sound recordings. It  
10 doesn't pay to get the sound recording if you  
11 can't get the musical work with it. So it  
12 doesn't matter why you can't get it; it  
13 affects how much you're going to pay for it.

14 Q Well, you did your analysis based  
15 on your assessment of what was available and  
16 what wasn't available through these services,  
17 right?

18 A I did my analysis, and essentially  
19 the entire testimony I gave this morning did  
20 not try to measure the effects of hold backs  
21 on either a copyright standpoint or the  
22 effects on consumer pricing.

1           So I can say that I didn't  
2 quantify it. I did not try to quantify it.  
3 Had I, I would have needed to do a lot more  
4 research to get a complete understanding of  
5 the hold-back principles.

6           But since my analysis doesn't  
7 measure in anyway the hold-back aspect, it is  
8 conservative; it doesn't matter why it's being  
9 held back.

10           Q       But to the extent you gave the  
11 impression that the reason why tracks aren't  
12 available was because record companies prefer  
13 to hold back tracks, the fact is that you're  
14 not, as you're sit here today, aware as to  
15 whether given tracks are held back because of  
16 problems clearing sound recording rights as  
17 distinguished from publishing rights; isn't  
18 that right?

19           A       I am not aware of how much fo the  
20 hold back is from which source, but I stand by  
21 what I said that my estimate is conservatives  
22 because of hold backs, regardless of the cause

1 of the hold back, In one case it might affect  
2 the contracts here, but it obviously is  
3 affecting the music that is being made  
4 available that is of value to the webcasters,  
5 and is ultimately of value to the customers.

6 MR. STEINTHAL: Your Honor, I'd  
7 move to strike. I'm just trying to get a yes  
8 or no answer as to whether his prior answer  
9 gave a certain impression or not. It was an  
10 invitation to go into everything he went into.

11 CHIEF JUDGE SLEDGE: I am going to  
12 deny that motion. I'm not clear that it's  
13 that much addition.

14 MR. STEINTHAL: Just trying to move  
15 it along, Your Honor.

16 CHIEF JUDGE SLEDGE: Well, in that  
17 case |

18 (Laughter.)

19 BY MR. STEINTHAL:

20 Q Now on this issue, one more thing,  
21 you testified either in your written statement  
22 or in your deposition that an example of this

1 difficulty of clearing sound recording rights  
2 was, you personally noticed, did you not, that  
3 certain albums you could some but not all of  
4 the tracks on an album; remember that?

5 A Yes.

6 Q Wouldn't that be an indication,  
7 given that the sound recording rights on the  
8 album are likely hold by one sound recording  
9 owner, that the reason you couldn't get  
10 certain tracks would be because of the  
11 publishing rights associated with certain  
12 tracks within that album?

13 A Not necessarily. It could well be  
14 that the ; particularly a newly released  
15 album, the sound recording copyright holder  
16 might want to generate interest in the album,  
17 and offer essentially the ability for  
18 customers to sample it through an on-demand  
19 service, but not satisfy their entire taste  
20 for the album through the on demand service.

21 Q Let's stick with hold backs here  
22 for a minute.

1           Is your understanding the reason  
2           that the labels request hold backs | by the  
3           way this is usually a 90-day or temporary hold  
4           back provision, right?

5           A           In some case it is; in some cases  
6           it is not.

7           Q           But the general hold back feature  
8           that you were referring to was a hold-back  
9           feature, was it not, that would enable record  
10          companies to sell in the physical market or  
11          the permanent download market for a certain  
12          period of time before tracks would be released  
13          to on demand streaming and limited download  
14          services; isn't that right?

15          A           No.

16          Q           Well, is it your understanding  
17          that that is one of the reasons why labels  
18          have hold back rights?

19          A           Yes.

20          Q           And is that particular reason one  
21          to try to enable them to window if you will  
22          the release of their new releases so that they

1 can try to sell with the high margin product  
2 in the permanent download and physical CD  
3 market?

4 A Either to sell or to avoid piracy  
5 or for whatever reason.

6 Q One of the reasons is to try to  
7 have that initial window where they can  
8 capture the largest margin in the sale of  
9 permanent downloads or physical CDs, correct?

10 A Yes.

11 Q And that's in part because they  
12 view these on demand streaming conditional  
13 download services | your benchmark market | as  
14 substitutional to some degree of sales of  
15 permanent downloads and physical CDs, correct?

16 A On some albums and some  
17 circumstances, they probably do.

18 Q Now going back to the benchmark  
19 market, it's true, is it not, that your  
20 benchmark market's services are all on demand  
21 streaming conditional download services which  
22 do advertise themselves as offering a very

1 comprehensive universe of sound recordings  
2 that can be accessed on demand; correct?

3 A That's true of most of them. But  
4 there are some that are much more tailored, or  
5 niche providers of service, a couple of which  
6 I included in my regression analysis, and  
7 tried to address that part of the market.

8 Q I'm talking about the 17 companies  
9 that you used as your benchmark services.  
10 Those are all services that offer to the  
11 public and advertise that they offer a  
12 comprehensive catalog of a million plus tracks  
13 for consumers to access on demand; correct?

14 A I think I answered this before,  
15 and I think I said, other than the word  
16 "comprehensive," which I don't know whether  
17 that appears in their public | their web pages  
18 | they do certainly advertise the number of  
19 tracks. The numbers for many of them are a  
20 million or more, and they do represent that  
21 they're covering a wide range of music; I  
22 agree with that.

1 Q And would you agree, then, that  
2 for those services in particular, they in  
3 order to offer a product that can be  
4 competitive with the other 16 of your 17  
5 companies, effectively have to have a license  
6 from each of the big four major labels?

7 A I would say to that that appears  
8 to be the business model they've chosen,  
9 correct.

10 Q And in fact I was mentioning  
11 before the 17 agreements in your benchmark  
12 market that you rely upon, those are actually  
13 17 agreements entered into by just five  
14 different companies, aren't they?

15 A I was going to include that  
16 correction in my answer, but I decided to hold  
17 back.

18 Q So it's a fairly tight market that  
19 you have analyzed for purposes of your  
20 benchmark market, isn't it?

21 A It's a | well, indeed it is a  
22 tight market in the sense of there are a small

1 number of large companies that are webcasters,  
2 and a small number of companies that are the  
3 owners of the copyrights.

4 Q Let's talk about how large these  
5 companies are for a minute. How large is  
6 Napster LLC?

7 A I don't know.

8 Q Do you know what their  
9 capitalization is?

10 A Not at Napster, no.

11 Q Do you know the name of the  
12 company that owns the stock or the principal  
13 stockholdings in Napster LLC?

14 A No, but I do know of others, and I  
15 do know how large they are.

16 Q Stick with me first on that.

17 A Sure.

18 Q You don't know how large Napster  
19 LLC is, right?

20 A No, I don't.

21 Q What about Music Net? Do you know  
22 who owns Music Net?

1           A           I do not know. I get confused,  
2 quite frankly, of the MusicNet, MusicMatch and  
3 so forth, which one is under which music  
4 service umbrella now, so I don't know  
5 specifically from MusicNet.

6           Q           Well, it's good, maybe I can  
7 refresh your recollection.

8           A           Okay.

9           Q           Napster LLC is the successor to a  
10 company called Pressplay, is it not?

11          A           I do not ; did not recall that.  
12 I'll take that.

13          Q           Well, in all your reading about  
14 this industry which you told us about, can you  
15 tell us who the first two companies were that  
16 got into the on demand streaming conditional  
17 download service business, your benchmark  
18 markets?

19          A           I cannot.

20          Q           Isn't it true, sir, or do you just  
21 not know, that the first two entrants into  
22 this market were companies owned either

1 entirely or substantially by the major record  
2 labels?

3 A I do know that the record company  
4 labels were involved in some initial efforts  
5 in this market. I don't know the order in  
6 which and the percentage of ownership of which  
7 the particular record labels had in the  
8 particular music services. I don't recall  
9 those facts.

10 Q Are you familiar with the fact  
11 that all of the licenses you've observed for  
12 purposes of your benchmark market are  
13 derivative of agreements entered into between  
14 companies that were owned by the labels,  
15 entering into agreements with their  
16 shareholder owners?

17 A I would not accept the terminology  
18 of saying they are derivative of previous  
19 contracts. These are contracts between  
20 independent webcasters, and independent web  
21 companies. They are negotiated freshly by the  
22 two parties to the negotiation.

1                   So the fact that there might be  
2 certain precedents does not in my mind make it  
3 a derivative.

4           Q        You would agree with me that the  
5 50 percent rev share that is common among all  
6 these agreements has been in place since the  
7 very first of these on demand streaming  
8 limited download services came into the market  
9 in 2001; isn't that right? Or do you just not  
10 know?

11           A        I don't recall what is before any  
12 of the contracts that I saw, and as I said, I  
13 focused on the market and its most recent  
14 information of the contracts that had been  
15 entered into frankly the last two years or so.  
16 That's in my mind the most relevant  
17 information.

18           Q        Well, I'm still going to stick  
19 with probing all this stuff you read about  
20 this market.

21           A        Sure.

22           Q        So are you familiar, yes or no,

1 with the fact that the first two entities to  
2 offer these kinds of on demand streaming  
3 conditional download services were companies  
4 called Pressplan, which was owned by Sony and  
5 Universal, and MusicNet, which was owned by  
6 the then-other three major labels, BMG, EMI  
7 and Warner, along with Real Networks; does  
8 that ring a bell?

9 A I think it rings a bell because  
10 you asked about it a couple of minutes ago.  
11 And as I said I don't recall the specifics of  
12 the early stages of the business and the  
13 nature of the ownership.

14 I undoubtedly read about it, but I  
15 did not recall specifics of that nature.

16 Q And you never considered or  
17 factored into your analysis, I gather, the  
18 relationship between the major record  
19 companies at the outset of this market with  
20 the only two entities that existed in the  
21 market at the beginning of its growth;  
22 correct?

1           A           I did not then, and I would not  
2 now based on what you've just told me.

3           Q           Okay, those are two of the  
4 companies.

5                        The other three companies, who are  
6 the co-parties to these agreements upon which  
7 you relied, who are they?

8           A           From when ;

9           Q           From the list of 17?

10          A           From the list of 17 there was Real  
11 Networks, which provides Rhapsody. There was  
12 Yahoo. And also there's a service that Yahoo  
13 offers, I believe, MusicMatch. There is AOL  
14 which also has a trade name, I forget whether  
15 it's MusicNet or Music something. And there  
16 is Virgin Music Service.

17          Q           Let's go back.

18                        The 17 agreements that are your  
19 benchmark model, don't include anything from  
20 Yahoo other than the MusicMatch agreement,  
21 right?

22          A           Well, that is how Yahoo gets the

1 music.

2 Q Now it does, but MusicMatch  
3 entered into that agreement when it was  
4 MusicMatch before it was acquired by Yahoo,  
5 correct?

6 A I believe there have been some  
7 more recent agreements with Yahoo.

8 Q Now I'm looking down the list, AOL  
9 is not on the list. Are you referring to  
10 MusicNet at AOL?

11 A Well, that's what I just said,  
12 yes, Music ; I wasn't sure of the name, but I  
13 believe it was MusicNet, yes.

14 Q Is MusicNet a service that is  
15 available to the public directly?

16 A Directly to anyone who wants to  
17 subscribe to AOL?

18 Q No, I mean directly from MusicNet?

19 A No.

20 Q Do you know whether the service  
21 that is offered by AOL is any different than  
22 the service that was offered by Real Networks

1 prior to the launch of the Rhapsody service?

2 A Prior to the launch of the  
3 Rhapsody, not as we're talking about right  
4 now. I don't know. I know what it is  
5 compared to Real Networks now.

6 Q Well, are you familiar with the  
7 fact that the MusicNet's service is what's  
8 called the white label service that is  
9 distributed by any number of companies?

10 A Yes, I do know about white label  
11 servicing.

12 Q Well, which os the benchmark  
13 companies or benchmark agreements that you are  
14 offering are white labeled by MusicNet through  
15 third parties?

16 A White labeled and then sold to  
17 third parties? I don't recall sitting here  
18 which | how many are of which nature.

19 Q And MusicNow, what's MusicNow?

20 A I don't recall.

21 Q The contract date on your  
22 attachment A, to your report, says that the

1 MusicNow agreement was dated in 2003.

2 How big was MusicNow in 2003, any  
3 idea?

4 A I do not know.

5 Q Any idea who the owners were?

6 A I don't recall.

7 Q And the MusicMatch deals that you  
8 have on your list | and by the way, as I go  
9 through the list, I think there is one |  
10 there's a | two, three MusicNow agreements,  
11 one from 2002, one from 2003, and one from  
12 2005.

13 But you rely on all three of those  
14 during that time period, correct?

15 A I think as I testified I'm relying  
16 on all of them, that are in this list. But I  
17 did observe that if you take the most recent  
18 agreements you are generally going to get  
19 higher prices.

20 Q On portable ones, not necessarily  
21 on non-portable; isn't that right?

22 A Well, I think particularly if you

1 look at the pro rata subscription fees, the  
2 prices that are above 2.50 for the non-  
3 portable, with the exception of one entered  
4 into in 2004, there's 2005 and there are 2004  
5 and 2005 and | 2004 and 2005, those are the  
6 later contracts.

7 Q let me go back to your testimony  
8 about how big all these companies were on the  
9 buyer's side. We talked about MusicNet, we  
10 talked about Napster, and we talked about  
11 MusicNow.

12 How big was MusicMatch before it  
13 was acquired by Yahoo?

14 A I don't recall. I have seen what  
15 the price paid for it was, but I do not recall  
16 how large it was at the time of entering into  
17 any contracts.

18 Q And then the other company on the  
19 list is Real Networks.

20 A Yes.

21 Q Do you know how large that company  
22 is?

1           A           I have reviewed their 10-K  
2           recently, and I offhand do not recall the size  
3           of the company. It's growing. It features a  
4           number of different services. It's from my  
5           standpoint an active major participant in the  
6           market.

7           Q           The biggest of all the five that  
8           we've been talking about?

9           A           I think Yahoo is the biggest in  
10          the market. Yahoo is the biggest by far of ;  
11          I would say in the Internet space, there's  
12          maybe AOL and Google, Yahoo is an extremely  
13          large company with a market capitalization of  
14          over \$40 billion.

15          Q           Again, sticking with attachment A,  
16          the word, Yahoo, doesn't show up on it, does  
17          it?

18          A           No. Again, Yahoo is now the party  
19          that is providing these services in the  
20          market, and they are using it under contracts  
21          that are entered into here.

22                        So it indicates their use of the

1 copyrighted music.

2 Q Well, sir, who negotiated the  
3 MusicNet deal ; strike that.

4 You are familiar with the fact  
5 that Yahoo Music Unlimited is actually powered  
6 by MusicNet, right? Yahoo has nothing to do  
7 whatsoever with the negotiation of the sound  
8 recording rights underlying that service;  
9 isn't that right?

10 A I believe it's MusicMatch.

11 Q No, I'm talking about Yahoo Music  
12 Unlimited. Is it your testimony that Yahoo  
13 Music Unlimited is powered by MusicMatch?

14 A No, it's not my testimony. If you  
15 could ask me questions about which music  
16 service sitting here right now can I remember  
17 which ones powers which service, I can't tell  
18 you. I've said that.

19 What I can say, and rather than  
20 trying to pass a memory test, is that there  
21 are major ; these are the contracts in the  
22 market. This is how the music is being bought

1 and sold into the market today. These are the  
2 willing buyers and sellers. These are the  
3 same willing buyers and willing sellers in the  
4 benchmark target and the target market.

5 Q Sir, let's talk about Yahoo Music  
6 Unlimited. It's in your regression analysis;  
7 it's on all your charts, right?

8 A Right.

9 Q I'm asking you specifically as you  
10 sit there today, do you know whether Yahoo had  
11 anything to do with the negotiation of the  
12 sound recording licenses that underlie the on  
13 demand streaming and conditional download  
14 service that is offered by Yahoo Music  
15 Unlimited?

16 A I do not know whether it was  
17 before or after they acquired the white label,  
18 or whatever you want to call the company that  
19 has the rights. They are using those rights  
20 today.

21 Q Sir, if you would please answer  
22 the question.

1 Do you know whether Yahoo had any  
2 role in negotiating the sound recording rights  
3 underlying the service that is known as Yahoo  
4 Music Unlimited?

5 A I do not know.

6 Q Is it your testimony that it's  
7 offered, it's a service that was negotiated by  
8 MusicMatch?

9 A There is a MusicMatch negotiation.  
10 I think I already answered and said I don't  
11 recall the specific ownerships as I sit here  
12 today of which music copyright is now being  
13 used or negotiated by any of the particular  
14 services.

15 I'm looking at the market, and  
16 what is used in the market to provide these  
17 services.

18 Q And is it irrelevant to you who  
19 the entity is that negotiates with the sound  
20 recording copyright owners to get the rights  
21 underlying the agreements that are on your  
22 attachment A to your report?

1           A           That's what's in the market, and  
2           that's in the benchmark market, and that's  
3           what would be in the noninteractive market; it  
4           doesn't matter. That's the market evidence.

5           Q           Let me ask you this: would you  
6           agree that in respect of the sales of licenses  
7           to their respective catalogs to on demand  
8           services that comprise your benchmark market,  
9           the big four record labels don't really  
10          compete against one another?

11          A           I missed the first part of the  
12          question. Could you give it back to me, sir?

13          Q           I'm asking you whether you would  
14          agree with the proposition that when it comes  
15          to the sales of licenses to their respective  
16          catalogs to on demand services in your  
17          benchmark models, the big four record  
18          companies compete against one another or not?

19          A           They | I would say that for the  
20          most part they can't | they only compete to  
21          the extent that they are offering  
22          differentiated products in the same market.

1 They cannot compete for the sale of the same  
2 copyrighted material. There is only one owner  
3 of the copyright.

4 Q So hypothetically if you accept  
5 that these benchmark services effectively must  
6 get a license from all four of the major four  
7 record companies, then you'd agree in that  
8 hypothetical that the big four record  
9 companies don't compete against each other in  
10 the licensing of their repertoires to those  
11 services, correct?

12 A Well, I would not agree with that.

13 Q Well, that's not a competition  
14 between two or more sellers of the exact same  
15 copyrighted works, right?

16 A There is not that type of  
17 competition. There is, I would say it's not  
18 very | from marketplace evidence | that  
19 customers value particular sound recordings,  
20 and don't see one record of a particular  
21 artist as a substitute for another artist's  
22 record. There is not that type of intense

1 competition.

2           There is more than one set of  
3 recordings available on the market. They do  
4 provide some degree of competition. Does that  
5 very intense in the sense of selling very  
6 similar products? No.

7           Q       It's true, is it not, that there  
8 is really no price competition as between each  
9 of the four major record companies in that  
10 hypothetical, isn't it, because the universe  
11 of what they're offering as you say is totally  
12 differentiated one from the other?

13           A       I wouldn't ; I'm trying not to  
14 argue here, but I'm just trying to state sort  
15 of what I think are the economic conditions  
16 here, which is, there is a degree of com  
17 petition which economists would refer to as  
18 competition between differentiated products,  
19 so even though things are not the same, it  
20 does have an impact on the price of the other  
21 differentiated product.

22           So does it have no effect on the

1 price? No, I cannot agree with that. Does it  
2 have a major effect on price? Do we see a lot  
3 of intense price competition anywhere in the  
4 market among these highly differentiated  
5 products? No, we don't.

6 Q So in this hypothetical market, if  
7 a music service wants to offer a particular  
8 song sung by a particular artist to which  
9 there is a particular unique copyright, the  
10 buyer must buy that from a single copyright  
11 holder; correct?

12 A Yes.

13 Q In essence conveying monopoly  
14 power to the licensor of the sound recordings,  
15 where a licensee is seeking to offer on demand  
16 access to a comprehensive catalog?

17 A Correct.

18 Yes, with | let me just explain if  
19 you don't mind. I'll give a firm yes, there  
20 is monopoly due to the ownership of the  
21 copyright, which is the nature of copyright  
22 law.

1           Q       Now you're aware, are you not,  
2       that in the CARP decision and the librarian  
3       decision that you've cited several times in  
4       your testimony, the CARP and the librarian in  
5       the first proceeding stated that the  
6       hypothetical market to be replicated by this  
7       board is a hypothetical competitive market;  
8       correct?

9           A       I think you'll have to show that  
10      to me. I don't recall putting it that way.

11          Q       Okay.

12                 MR. STEINTHAL: Your honor, since  
13      we are approaching the break, and I'm going to  
14      get these exhibits, I think that maybe we can  
15      take a break now. I'll get the exhibits  
16      ready, and we'll go right into it after the  
17      lunch break, if that is okay with you.

18                 CHIEF JUDGE SLEDGE: Mr. Handzo?

19                 MR. JOSEPH: Your Honor, before we  
20      recess I just have one housekeeping matter.

21                 CHIEF JUDGE SLEDGE: Yes, sir.

22                 MR. JOSEPH: We have learned that

1 one of the artist witnesses has refused,  
2 knowing of the court's two orders to produce  
3 tax returns, has refused to produce tax  
4 returns. That's MS. Fink, who will be  
5 testifying on Wednesday.

6 We will be | actually have filed  
7 this morning | a motion to strike the  
8 financial portions of her testimony, and a  
9 motion to limit her testimony to nonfinancial  
10 matters.

11 I'm not suggesting that we get  
12 into an argument on that motion now. We have  
13 informed SoundExchange, we actually spoke with  
14 them, and we did confirm this morning, and I  
15 just wanted to know if I could have leave to  
16 hand up copies of those motions before I file  
17 today so that they can be considered on an  
18 expedited basis. And obviously SoundExchange  
19 will have an opportunity to respond as well.

20 CHIEF JUDGE SLEDGE: Certainly you  
21 may give us courtesy copies of what you have  
22 filed.

1 MR. HANDZO: Since Mr. Joseph is  
2 doing housekeeping, I wanted to as well.

3 Obviously we will respond in  
4 writing. MS. Fink, I believe, did produce tax  
5 returns, but not personal returns; she  
6 produced her business returns. In any event,  
7 we will certainly respond in writing on that.

8 One other housekeeping matter that  
9 I wanted to raise, and that relates to the  
10 schedule on Thursday.

11 We had intended to bring Dr.  
12 Brynjolfsson back hopefully to complete his  
13 testimony that day. You will recall that Mr.  
14 Smith was handling that examination. He is  
15 actually not available on Thursday to complete  
16 it.

17 So with the court's permission, I  
18 believe we were going to draft Mr. Pirelli to  
19 impersonate Mr. Smith. And I just wanted to  
20 alert the court to that, in case anyone was  
21 concerned about that.

22 CHIEF JUDGE SLEDGE: We'll address

1 that when it arises.

2 I don't know if that causes  
3 problems or not.

4 MR. SMITH: Your Honor, I have  
5 compelling reasons why I need to be out of  
6 town that day, and I would hate to have the  
7 redirect opportunity lost by not being here  
8 that day. If we can get some kind of guidance  
9 from the board about whether we'd be able to  
10 accommodate them, I'd appreciate it in  
11 advance.

12 CHIEF JUDGE SLEDGE: Can't do that.  
13 I don't have enough information to do that.

14 MR. SMITH: Is there some other  
15 information that you need, Your Honor?

16 CHIEF JUDGE SLEDGE: I don't know  
17 if Mr. Pirelli has been present during all the  
18 evidence. I don't know if anybody has any  
19 objection to switching in the middle of a  
20 witness. That's not an easy matter to  
21 resolve.

22 MR. HANDZO: Perhaps, Your Honor,

1 we'll confer with counsel and we can provide  
2 that information to the court.

3 CHIEF JUDGE SLEDGE: All right.  
4 Well recess until 2:00 o'clock.

5 (Whereupon at 12:29 p.m.  
6 the proceedings in the  
7 above-entitled matter  
8 went off the record to  
9 return on the record at  
10 2:03 p.m.)

11 MR. HANDZO: Before we begin, if I  
12 could just address the issue that we left off  
13 with, I promised that I would canvass the  
14 present counsel with respect to Mr. Pirelli  
15 substituting for Mr. Smith.

16 I believe there is no objection  
17 from counsel, and I can represent to the court  
18 that Mr. Pirelli was here for virtually all of  
19 Dr. Brynjolfsson | the part that he hasn't  
20 been here for, he's read the transcript. So  
21 he will be fully prepared.

22 So with that information I would

1 ask the court to permit us to allow Mr.  
2 Pirelli to complete the redirect so that Mr.  
3 Smith can attend to his family obligations.

4 CHIEF JUDGE SLEDGE: And to what  
5 extent of redirect are you anticipating? Let  
6 me ask Mr. Smith then.

7 MR. SMITH: Your Honor, I think we  
8 were looking at something in the range of half  
9 an hour, or 45 minutes, something like that.  
10 That'd be my best estimate.

11 CHIEF JUDGE SLEDGE: That's a  
12 difficult call to make.

13 All right, we'll grant that  
14 request.

15 MR. HANDZO: Thank you very much.

16 MR. STEINTHAL: Thank you, Your  
17 Honor.

18 CONTINUED CROSS-EXAMINATION

19 BY MR. STEINTHAL:

20 Q Before the break. Dr. Pelcovits, I  
21 asked you about the hypothetical market  
22 standard set forth in the librarian decision.

1 And I'm going to show you what I was referring  
2 to.

3 MR. STEINTHAL: I'd mark as  
4 Services Exhibit No. 54 a copy of the  
5 librarian's decision in the first part.

6 (The aforementioned  
7 document was marked for  
8 identification as  
9 Services Exhibit No. 54)

10 BY MR. STEINTHAL:

11 Q I'd ask you to take a look, if you  
12 would at page 245, 244, the numbers are in the  
13 upper left-hand corner, there's a paragraph  
14 where the librarian states: In this  
15 configuration of the marketplace, the willing  
16 buyers of the services which may operate under  
17 the webcasting license. The MCA compliance  
18 services, the willing sellers are record  
19 companies, and the product consists of a  
20 blanket license from each record company which  
21 allows us of that company's complete  
22 repertoire of sound recordings.

Because of the diversity among the

1 buyers and the sellers, the CARP noted that  
2 one would expect a range of negotiated rates,  
3 and so interpreted the statutory standard as  
4 the rates to which absent special  
5 circumstances most willing buyers and willing  
6 sellers would agree in a competitive  
7 marketplace.

8 Do you see that?

9 A I do.

10 Q Does that refresh your  
11 recollection that the CARP and the librarian,  
12 as part of their interpretation of the willing  
13 buyer-willing seller standard focused on a  
14 hypothetical competitive marketplace?

15 A I don't read it that way, and  
16 that's not how I read the CARP. This is  
17 quoting the CARP, and the CARP decision adopts  
18 willing buyer-willing seller as the existing  
19 buyers and sellers, and it says in fact that  
20 an alternative view where there would be  
21 multiple providers of the same copyright would  
22 not be consistent with a competitive market.

1           Q       So that your testimony, sir, that  
2       the willing buyer-willing seller standard does  
3       not require this panel to establish the rates  
4       that have been established in a hypothetical  
5       competitive market?

6           A       Well, when you say, hypothetical  
7       competitive, that, first of all I think the  
8       term hypothetical refers to the fact that  
9       there would be a marketplace absent the  
10      statutory license, so that part, hypothetical,  
11      in my mind, refers to a hypothetical market in  
12      that sense.

13                   The term of whether it's a  
14      competitive market, the CARP accepted,  
15      adopted, the market as it stood with  
16      essentially the same players that are there  
17      today.

18          Q       Sir is it your testimony that the  
19      CARP adopted the market as it stood and simply  
20      replicated rates that were found in the  
21      market?

22          A       It adopted, and interpreted the

1 willing buyers and the willing sellers as the  
2 willing buyers that we talked about are the  
3 webcasters and others users of the license.  
4 And from the standpoint of looking at any  
5 issue of market power among the record  
6 companies, it accepted that the record  
7 companies, as they were, were the willing  
8 sellers.

9 Q You are familiar with the fact,  
10 are you not, that the CARP rejected 25 of the  
11 26 benchmark agreements proffered by the RAA?  
12 You're familiar with the fact that one of the  
13 reasons those agreements were rejected was  
14 because of the lack of comparable bargaining  
15 power or market power as between the entities  
16 in the subject negotiations?

17 A In many cases, that was the RIAA  
18 negotiating, and that was a single seller.

19 Q But you would agree with me, would  
20 you not, that the reason that the panel  
21 rejected those agreements was because they  
22 found that the market as it was reflected a

1 market in which there was not equal bargaining  
2 power?

3 A I don't know if that was the exact  
4 words they used. They did reject those, and  
5 rely on and interpret the entire structure of  
6 this issue of the market as the existing  
7 buyers and existing sellers.

8 Q Let me be precise here, because I  
9 don't really understand what you said.

10 Is it your view that the  
11 hypothetical market to be replicated by this  
12 panel is a hypothetical competitive market or  
13 not?

14 A It's a hypothetical market. There  
15 is | it does not | I don't believe in any way  
16 this | these judges have to try to construct  
17 a hypothetical version of the market with some  
18 competition above and beyond what's in the  
19 marketplace today.

20 And the competition that is there  
21 is among the four major record companies and  
22 several others. It is a competitive market,

1 and has been found to be such.

2 And I see no reason to create a  
3 hypothetical different than what's there  
4 today.

5 Q Are you testifying, after what you  
6 said this morning, before lunch, that the  
7 market in which an on demand streaming service  
8 finds itself in negotiating with the four  
9 major labels is a competitive market?

10 A It is a bargaining and a  
11 negotiation between a willing buyer and a  
12 willing seller where the structure of the  
13 seller's industry is workable competitive ;

14 Q No ; I'm sorry.

15 A Let me finish please. And where  
16 the notion of applying some textbook  
17 competitive standard to that cannot really  
18 work because you have individual copyrights  
19 held by individual companies.

20 Q So your testimony is that the  
21 panel is obligated to set the rates that we  
22 would find on a hypothetical workably

1 competitive market?

2 A No, my ; I would state it very  
3 simply. My belief is that the court can use  
4 the same standard that the CARP adopted in its  
5 previous decision, which was to interpret the  
6 willing sellers as the companies that  
7 currently own these copyrights.

8 That market can be characterized I  
9 believe in general these companies are in a  
10 workably competitive industry. That does not  
11 mean that in particular negotiations there are  
12 not different weights of bargaining power.

13 Bargaining power does not ; if the  
14 presence of bargaining power does not mean  
15 that a market is not workably competitive.

16 Q Well, you would agree, then, that  
17 the four major labels in their individual  
18 negotiations with on demand streaming and  
19 conditional download services have far more  
20 market power and bargaining power in that  
21 negotiation than does any particular service,  
22 correct?

1           A           I'm sorry, I missed the end of  
2           that.

3           Q           You would agree, would you not,  
4           that the individual labels in their  
5           negotiations with an individual on demand  
6           streaming and conditional download service  
7           have far greater bargaining power than the  
8           individual service does, right?

9           A           If you use the term bargaining  
10          power, I would agree with you, that in most  
11          cases that will be true, yes.

12          Q           Now going back to the quote I read  
13          you from the librarian's decision, do you just  
14          disagree with what the librarian said at the  
15          end, the words, in a competitive marketplace?

16          A           I don't disagree, because the  
17          entire report of the CARP and as accepted by  
18          the Librarian of Congress, accepted the market  
19          as it was back when the decision was rendered  
20          with essentially the same sellers and the same  
21          buyers.

22                        So it seems to me inconceivable

1 that they could have something in mind in a  
2 particular quote of a hypothetical situation  
3 that's something different than the way the  
4 market functions and the way the market works.

5 Q Well, if the CARP and the  
6 librarian were content to take the market as  
7 it was, then why in the world did they reject  
8 25 of the 26 agreements, which were all based  
9 on the market as it was?

10 A That was RIAA negotiating, and the  
11 market as it is does not now, and in a context  
12 of a nonstatutory license, would not allow  
13 RIAA to negotiate as a collective for all of  
14 the copyright holders.

15 Q You are familiar with the tack  
16 that it was the RIAA that urged the agreements  
17 between the RIAA and all those 26 webcasters  
18 as the benchmark agreements; right?

19 A I don't recall. But I do recall  
20 that they had those agreements, and they were  
21 presented, and they were rejected.

22 But the market willing buyer and

1 willing seller as I described it is what the  
2 CARP adopted.

3 Q The last CARP relied on one of  
4 those agreements between RIAA and a purported  
5 willing buyer; correct?

6 A It relied on one of those, and it  
7 also stated a standard. And the standard is  
8 very clear.

9 Q Is it your testimony that it  
10 stated a standard that it then rejected?

11 A No.

12 Q Now if the CARP and the librarian  
13 were content on taking the market as it was,  
14 do you view that as therefore | strike that.

15 Is it your testimony, sir, that  
16 this panel should take the market as it is, to  
17 use your words, and not make any adjustments  
18 that might exist between differences in  
19 bargaining power that would exist as between  
20 the willing buyers and statutory license  
21 webcast negotiations versus the willing buyers  
22 in your benchmark market?

1           A           That's a long question. Let me  
2           make sure I understand it.

3           Q           Let me rephrase it. I'll cast it  
4           as a hypothetical, and then you can tell me  
5           what you think.

6                        Hypothetically, assuming that the  
7           buyers in your benchmark market have less  
8           bargaining power because of the nature of the  
9           service they offer, compared to buyers in a  
10          statutory webcasting market, is it your  
11          testimony that no adjustment would need to be  
12          made for the differences in bargaining power  
13          between your benchmark market and your target  
14          market?

15          A           I honestly can't answer that as a  
16          hypothetical. I believe the markets are  
17          essentially the same. Same willing buyers,  
18          same willing sellers, same copyrighted  
19          material.

20                        I think Dr. Brynjolffson addresses  
21          the issue of bargaining, and that is not the  
22          way I used to analyze the market.

1           The market is there. There is  
2 market evidence, and there are transactions  
3 between willing buyers and willing sellers.

4           Q       I understand. But you posit this  
5 theory based on your benchmark market, and  
6 you've asserted just now that the bargaining  
7 power in your judgment is the same, is that  
8 your word, the same or essentially the same?

9           A       Essentially the same.

10          Q       Okay, I'll come back to that.

11                 I'm asking you as an economist to  
12 hypothesize a situation where the benchmark  
13 market is such that the buyers have greater  
14 bargaining power than the buyers in the target  
15 market.

16                 Wouldn't you have to make an  
17 adjustment in your model to accommodate the  
18 difference in bargaining power between the  
19 benchmark market buyers and the target market  
20 buyers?

21           A       I can only answer that as a  
22 hypothetical. There is not enough there for

1 me to say exactly what that means.

2 Again, bargaining power is a very  
3 loose term, and I did not look at this as  
4 trying to weigh a bargaining model of the  
5 markets. I believe that the market is  
6 primarily valuing this as unique pieces of  
7 intellectual property that are being made  
8 available and provided through these  
9 agreements.

10 Q Sir, turn to page 10 of your  
11 written statement, okay?

12 Is it correct that in this first  
13 full paragraph on page 10, where you talk  
14 about the use of benchmark rates, you say, a  
15 market brings together buyers and sellers and  
16 solves the equations that specify the  
17 willingness of these parties to engage in a  
18 transaction at a particular price.

19 You go on to say the buyers  
20 equation consists of the sum of the  
21 willingness to pay of all the existing and  
22 potential customers of a service. Their

1 willingness to pay is dependent among other  
2 things on the characteristics of the service;  
3 the income of the customers; and the prices of  
4 substitutes, and complements to the service.

5 That's all correct in your mind,  
6 right?

7 A Yes.

8 Q Then you go on to say the  
9 willingness of a seller to offer a service at  
10 a particular price is in large measure a  
11 function of its costs; the effective sales of  
12 one service on sales of other services sold by  
13 the same company; and the intensity of  
14 competition in the marketplace, both in the  
15 short and in the long run.

16 You said that, and it was accurate  
17 when you said it, right?

18 A Yes.

19 Q I'm asking you to posit a  
20 situation where your willing buyers, in the  
21 benchmark market, have different bargaining  
22 leverage than the willing buyers in your

1 target market, either to use your language  
2 because of the price of substitutes is greater  
3 for them, or for example competition in the  
4 marketplace is less for them.

5 A And the question is, sir?

6 Q Wouldn't you have to make an  
7 adjustment in your model, based on your own  
8 testimony, if those factors reflected  
9 different supply and demand characteristics as  
10 between the buyers in the benchmark market  
11 and the buyers in the target market?

12 A And my answer is, not in the way  
13 that I built my model. My model is not a  
14 bargaining model. It is valuation from the  
15 consumer side. And it accepts the rates as  
16 the result of an interaction between willing  
17 buyers and willing sellers.

18 Q Is it your testimony that if the  
19 supply and demand characteristics affecting  
20 the buyers in your benchmark market are  
21 different than the supply and demand  
22 characteristics affecting the buyers in your

1 target market, you don't care?

2 A I didn't say that.

3 Q Well, then, let's assume it that  
4 way. Let's assume that the supply and demand  
5 characteristics, in the benchmark market, for  
6 the buyers, are different than the supply and  
7 demand characteristics for the buyers in the  
8 target market.

9 Wouldn't you need to make an  
10 adjustment for those differences?

11 A If the demand characteristics are  
12 different, you would need to make an  
13 adjustments, and I've made adjustments based  
14 on demand characteristics.

15 Q In what respect have you made  
16 demand characteristic adjustments?

17 A In the entire treatment of the  
18 issue of interactivity.

19 Q So you're saying that apart from  
20 the issue of the difference in characteristics  
21 | and let me be really specific here. You say  
22 here in this very paragraph the willingness to

1 pay is dependent among other things on the  
2 characteristics of the service; the income of  
3 the customers; the prices of substitutes ;  
4 those are all separate things, right?

5 A Yes.

6 Q Okay.

7 Now I gather that the  
8 interactivity of the service is a subset of  
9 the characteristics of the service; right?

10 A That's correct.

11 Q Okay. Now, again, putting aside  
12 differences in the characteristics of the  
13 service, I'm asking you to assume that the  
14 supply and demand characteristics of the  
15 market in which the buyers find themselves in  
16 the target market is different than the supply  
17 and demand characteristics in the benchmark  
18 market.

19 Is it your testimony that you  
20 don't have to make an adjustment for that?

21 A My testimony is that, I state it  
22 right here, you are looking at, as best you

1 can, at the demand and supply characteristics  
2 of the market. And as I said, there are a lot  
3 of things that influence that. And if you can  
4 capture them, and if you can model them  
5 properly, you try to take account of them.

6 I cannot say how a hypothetical  
7 change in one part of one particular feature  
8 or aspect of the service would translate into  
9 a different adjustment.

10 And I did not model the bargaining  
11 process, nor do I believe that the need for or  
12 the demand for one record label's services  
13 rather than another is going to have a very  
14 big effect on price.

15 Q Well, what about if we look at the  
16 record company, if we look at the buyers as I  
17 was positing, what if the buyers in the target  
18 market had more substitutes, or cheaper  
19 substitutes, than the buyers in your benchmark  
20 market? You would imagine all other things  
21 being equal, the price of goods to a buyer  
22 that has more substitutes or cheaper

1 substitutes, would be less, than in a market  
2 where they have less of those substitutes,  
3 correct?

4 A Yes, and I think it would be  
5 reflective, and I agree with you, that it  
6 would be reflected essentially in the demand  
7 elasticity for the services; absolutely.

8 Q But you would want to make an  
9 adjustment for that difference in the demand  
10 equation if your analysis found in fact that  
11 there was such a difference; would you not?

12 A If I had the data, if there was a  
13 way to fit it into a model, if I could  
14 compute, perfectly compute, elasticities, I  
15 would do it, given the data available and the  
16 extent of the market at this point in time, I  
17 adjusted what I felt was necessary.

18 Q Wait a minute, now I'm very  
19 concerned.

20 Are you saying that even if you  
21 discern evidence of a difference, in the  
22 demand characteristics of target market and

1 benchmark market, if you don't have sufficient  
2 data to calculate or measure the difference,  
3 you're not going to do that?

4 A Well, if I cannot take account of  
5 anything. No analytical technique can handle  
6 every real world complication. If you could,  
7 the art and science of economics would be  
8 entirely different. You have to work with  
9 observable data. You have to work with  
10 measurable things, which is why, for example,  
11 I included a simulation to deal with the  
12 substitution issue.

13 Overall I would say that my  
14 judgment not to be focused very much on the  
15 nature of the competition among the record  
16 companies is because the competition among  
17 record companies is primarily not about price.  
18 They don't lower and raise their prices  
19 primarily in reaction to each other's prices,  
20 because they're selling different goods.

21 Q You'd agree with me, would you  
22 not, that the buyers in a target market and a

1 benchmark market may have different levels of  
2 substitutability, and therefore, different  
3 demand curves?

4 A The buyers might have different  
5 demand curves, I agree with you. And I cannot  
6 capture, there is not sufficient data to  
7 estimate the demand curves reliably.

8 I did make an assumption and a  
9 calculation based on similar elasticities. If  
10 there are significantly different substitutes  
11 available in the two markets, they are not in  
12 a | if they are in very different markets  
13 facing very different conditions, then you  
14 would have to make an adjustment of  
15 elasticities, and that would carry through in  
16 the recommended rates.

17 Q And that would carry through |

18 A That would carry through to a  
19 difference in the recommended rates.

20 Q Okay. Now as you said before, you  
21 assumed that the demand characteristics of the  
22 buyers in your benchmark market and the buyers

1 in your target market were essentially the  
2 same; I think those were the words you used.

3 A Generally, yes.

4 Q Are you familiar with the fact  
5 that in the deposition testimony of one of the  
6 record company executives, Mr. Larry Kenswil,  
7 testimony was given that addressed the  
8 difference in the demand characteristics  
9 between your very benchmark market and the  
10 target market?

11 Are you familiar with that?

12 A I'm familiar with the ; I'm  
13 familiar that there was a deposition. I don't  
14 recall that specific point.

15 Q Well, let's take a look at Mr.  
16 Kenswil's deposition.

17 It has already been marked as  
18 Services Exhibit No. 22. And I'd like you to  
19 take a look at pages ; start on page 71. Hold  
20 on one second if you don't mind.

21 Okay, take a look at 71, line 7.

22 The question is, is it your view that on

1 demand streaming and conditional download  
2 services have to get licenses from all the  
3 major labels in order to offer consumers a  
4 desirable subscription on demand streaming  
5 conditional download service?

6 Answer: I think in order to  
7 compete they need to have the competitive  
8 catalog. Whether some of the smaller majors  
9 are necessary, I don't know, but I think they  
10 need a competitive catalog. It would be hard  
11 for them to compete with holes in their  
12 catalog,

13 Question: When you say compete,  
14 you mean compete with other on demand  
15 conditional streaming download services?

16 Answer: Correct, that's correct.

17 Then skipping down | sorry.

18 Okay, at the bottom of 74, sorry,  
19 bottom of 73, top of 74, then the question is:  
20 Let me go back to ask you this question with  
21 respect to non-on demand Internet radio  
22 services.

1 Bottom of 73, actually 74. It's  
2 hard to see the numbers here, because they are  
3 very tiny. But the bottom of page 74, line  
4 22, question: Let me go back to ask you this  
5 question with respect to non-on-demand  
6 Internet radio services.

7 Is it your view that non-on-demand  
8 Internet radio services have to have a license  
9 from all the major labels in order to offer a  
10 desirable product?

11 Answer: No.

12 Question: Why is that?

13 Answer: Because radio doesn't play  
14 everything, and you could program very good  
15 radio stations from a much smaller supply of  
16 music than the entire universe of music and  
17 have a very satisfying program service.

18 Now, did you consider in  
19 connection with your testimony the fact that  
20 Mr. Kenswil of Universal had made the  
21 distinction that he made in his deposition  
22 testimony between | excuse me | the supply and

1 demand characteristics of your benchmark  
2 market, and your target market?

3 A When I prepared my testimony, this  
4 was obviously not taken. I've seen a lot of  
5 this discussion here from Yahoo witnesses,  
6 where they essentially say they need the music  
7 for whether it's on demand or the statutory  
8 services.

9 And I believe that there is not a  
10 major difference in the ability of the music  
11 service to substitute one record label's plays  
12 for another.

13 And furthermore, and I would add  
14 this, and I think it's a crucial point, you  
15 don't see a lot of competition on price. And  
16 I think that's explained one page earlier by  
17 Mr. Kenswil, which I can read and say, since  
18 people don't pay different amounts for access  
19 to the different licensed catalogs, we are not  
20 competing on the price to consumer.

21 That's not the way in which  
22 competition takes place; it's not on price.

1 Q Dr. Pelcovits, are you familiar  
2 with the fact that the Launchcast Internet  
3 radio service operated for more than a year  
4 without music from the Universal Music Group  
5 catalog?

6 A I do not recall that.

7 Q Would that affect your judgment as  
8 to whether in fact a radio service operating  
9 under the statutory license has an equal or  
10 essentially the same demand curve with respect  
11 to its situation operating under a statutory  
12 license, and that of a buyer in your benchmark  
13 market?

14 A In order to try to take account of  
15 that, I would have to see how successful that  
16 service was, and whether ; and again, if this  
17 is a statutory service, I don't understand why  
18 they didn't have something available to them.

19 Q Are you familiar with the fact  
20 that Universal sued Yahoo, claiming that its  
21 Internet radio service crossed the line  
22 between non-interactivity and interactivity?

1           A           I am familiar that there is  
2 litigation over that, but that does not say  
3 that they did not provide a service which  
4 satisfied the statutory requirements, and had  
5 the entire library of music.

6           Q           Let's go back to the hypothetical.  
7 Strike that.

8                        In any event, in doing your model,  
9 you made no adjustment for any differences in  
10 the demand curve that would affect buyers in  
11 the target market versus buyers in the  
12 benchmark market; correct?

13          A           Except with respect to  
14 interactivity, that's correct.

15          Q           Take a look while you have the  
16 librarians' decision in front of you, take a  
17 look at page 45 to 48.

18          A           I have it.

19          Q           The upper left-hand corner, the  
20 first paragraph says, in choosing this  
21 approach the panel did not accept the 26  
22 voluntary agreements at face value. It

1 evaluated the relative bargaining power of the  
2 buyers and sellers; scrutinized the  
3 negotiating strategy of the parties;  
4 considered the timing of the agreements;  
5 discounted any agreement that was not  
6 implemented; eliminated those where the  
7 service paid little or no royalties; where the  
8 service went out of business; and evaluated  
9 the effect of a service's immediate need for  
10 the license on the negotiated rate.

11           Ultimately it gave little weight  
12 to 25 of the 26 agreements for these reasons,  
13 and because the record demonstrated that the  
14 rates in these license reflect above-  
15 marketplace rates, due to the superior  
16 bargaining position of the RIAA or the  
17 licensees' immediate need for a license due to  
18 unique circumstances.

19           Does that in any way reflect your  
20 recollection that the librarian was concerned  
21 about relative bargaining power between  
22 licensees and licensors in the hypothetical

1 market to be created?

2 MR. HANDZO: Let me object. This  
3 has been asked and answered. We've already  
4 been over those agreements with this witness.

5 CHIEF JUDGE SLEDGE: Mr. Steinthal?

6 MR. STEINTHAL: I'm just asking him  
7 whether that refreshes his recollection about  
8 what the librarian said. He said he went  
9 through the court report and the librarian  
10 report quite a bit.

11 CHIEF JUDGE SLEDGE: Sustained.

12 BY MR. STEINTHAL:

13 Q Wouldn't you agree, sir, that  
14 anything that affects the demand and supply in  
15 the market should be considered in comparing  
16 the benchmark and target markets?

17 A Yes.

18 Q And that those factors should be  
19 considered in evaluating the comparability of  
20 the asserted benchmark and target markets?

21 A Yes.

22 Q And you'd want, as you said, to

1 measure and to adjust for any differences  
2 between the supply and demand characteristics  
3 of the benchmark and target markets?

4 A If you can.

5 Q Now, you acknowledge the  
6 possibility, do you not, that the hypothetical  
7 market to be replicated in these proceedings  
8 is one populated by a large number of record  
9 companies each selling a small percentage of  
10 the total available universe of sound  
11 recordings; isn't that right?

12 A It could be done that way; that's  
13 certainly a possibility.

14 Q But you didn't do it that way?

15 A I did not.

16 Q Dr. Pelcovits, I gather not every  
17 market is a legitimate candidate for a  
18 benchmark market; correct?

19 A I'd agree with that.

20 Q There comes a point where another  
21 market just doesn't serve as a legitimate  
22 benchmark; correct?

1           A       Correct.

2           Q       For example where differences in  
3 the markets are too difficult to capture and  
4 measure; correct?

5           A       Too | I would say too difficult to  
6 capture or measure, or based on judgment, they  
7 are considered to be important and difficult  
8 to measure.

9           Q       I'm not sure I understood that.

10                    Is it correct that you would find  
11 inappropriate a benchmark market where the  
12 differences between the benchmark and the  
13 target markets are too difficult to measure?

14           A       I would not agree that that is  
15 necessarily the case.

16           Q       Would that be one consideration in  
17 determining whether a benchmark market is  
18 inappropriate?

19           A       Well, I think it would be a  
20 consideration I would be concerned about if I  
21 first passed a threshold of a judgment that  
22 this was a significant factor.

1 I think you can always come up  
2 with things you can't measure, You are never  
3 going to have a benchmark if you say, gee, we  
4 can't measure something. So there is a degree  
5 of judgment, of trying to find something  
6 that's satisfies certain criteria, and allows  
7 measurement of things that your judgment says  
8 are the most important things.

9 Q But at some point, if the  
10 difficulty in measuring differences between  
11 the market, benchmark market and target  
12 market, becomes a substantial issue, then  
13 you'd agree that that is a consideration in  
14 determining whether to accept or reject a  
15 benchmark market?

16 A In terms of difficulties of  
17 measuring, or just difficulties of assessing?

18 Q Both.

19 A I think it's extremely hard to  
20 answer in the abstract. You can posit almost  
21 | and say things are different about anything.  
22 So yes, there are times in which a market is

1 not a good benchmark because you don't have a  
2 good enough hold on the things that are  
3 important.

4 Q Now, I'll press this one more  
5 time. If you have a handle on differences  
6 that you identify between the target market  
7 and the benchmark market, and by differences,  
8 I mean material differences, but you are  
9 unable to measure those differences, wouldn't  
10 that be a consideration in determining the  
11 appropriateness of a benchmark market?

12 A I'm almost in agreement with that,  
13 so let me just put a little bit of a | amend  
14 that a little bit. If you said you had a  
15 handle that there were differences, and you  
16 had a sense they were important, and you could  
17 not measure them, then you would not want to  
18 use it as a benchmark.

19 And I'll add, it always comes down  
20 to compared to what? There is always a need  
21 to do something.

22 Q Now, did you consider in your

1 analysis what the limits are of a benchmark  
2 market in terms of its potential applicability  
3 to this case?

4 A Implicitly, yes.

5 Q Did you consider the prior CARP  
6 and librarian decision in evaluating the  
7 limits of an appropriate benchmark market?

8 A I did, although I have to say, the  
9 market was very different then; the type of  
10 agreements were very different. So it's hard  
11 for me to get a sort of lot of guidance on  
12 that.

13 Q You say the type fo agreements  
14 were very different. Are you familiar with  
15 the fact that the RIAA, apart from its 26  
16 agreements it had negotiated with webcasters  
17 operating under the statutory license, also  
18 put into evidence 115 agreements between  
19 individual labels and entities not operating  
20 under the statutory license?

21 A I am aware of that.

22 Q Are you familiar with the fact

1 that there were three agreements put on that  
2 were agreements with subscription webcasters  
3 of the same nature as you've relied upon in  
4 your benchmark market?

5 A Yes, and those were put in but not  
6 analyzed.

7 Q Your testimony is that the CARP  
8 didn't analyze the evidence?

9 A I'm saying the RIAA did not  
10 present an analysis, as far as I know, of the  
11 nature of those agreements, and how to make  
12 any adjustments to the benchmark.

13 So I think, I would say, if you're  
14 going to put in a benchmark, it has to be  
15 analyzed, and should be analyzed by the party  
16 that submits it.

17 Q Does it comport with your  
18 recollection that the RIAA put in those  
19 agreements, including three agreements from a  
20 subscription webcasting market, to corroborate  
21 its position that the benchmark agreements it  
22 was relying upon, between the RIAA and certain

1 webcasters, were correct?

2 A As I said, I believe they did put  
3 in those agreements. I don't recall exactly  
4 how they presented their case, but I do know,  
5 they did not present an analytical treatment  
6 of the benchmark, or of those agreements as a  
7 benchmark.

8 Q Let me ask you to take a look at  
9 what we've marked as Services Exhibit 56 and  
10 57.

11 (Whereupon the  
12 aforementioned documents  
13 were marked for  
14 identification as  
15 Services Exhibits Nos.  
16 56 and 57)

17 MR. STEINTHAL: We're a little bit  
18 out of order simply because we're trying to  
19 premark things, Your Honor. We can mark these  
20 55 and 56 if you like, but I just assume for  
21 speed purposes, the panel is okay with marking  
22 these as 56 and 57.

1 CHIEF JUDGE SLEDGE: As long as  
2 they're marked.

3 MR. STEINTHAL: Okay.

4 BY MR. STEINTHAL:

5 Q Exhibit 56 is an excerpt from the  
6 proposed findings of fact and conclusions of  
7 law that the Recording Industry Association of  
8 America in the first CARP, and Exhibit 57 is  
9 one of the subscription services agreements  
10 referred to in those proposed findings.

11 MR. STEINTHAL: Your Honor, this  
12 exhibit was marked as restricted in a prior  
13 CARP, so I think you ought to consider these  
14 exhibits under seal, unless the RNA wishes to  
15 change its designations.

16 MR. HANDZO: Before Mr. Steintal  
17 proceeds, if I can just raise an objection.

18 As Mr. Steintal points out, these  
19 were designated as restricted by the RIAA in  
20 the last hearing. We at Jenner & Block do not  
21 have access to restricted materials from the  
22 last proceeding. The protective order from

1 the last proceeding recited that the materials  
2 from that proceeding could be used only for  
3 that proceeding, and were supposed to be  
4 destroyed by the parties after that  
5 proceeding, except I believe counsel was  
6 allowed to keep one | or a couple of copies  
7 for the record.

8 But number one, the protective  
9 under that CARP precluded the use of materials  
10 in that CARP for any other proceeding; that's  
11 the first problem.

12 The second problem is at the  
13 outset of this case, on behalf of Jenner &  
14 Block, I requested from the parties to the  
15 prior CARP access to restricted materials from  
16 the CARP, and I was refused access to those  
17 materials.

18 So these are materials that have  
19 never been supplied to Jenner & Block as the  
20 counsel for SoundExchange; indeed, opposing  
21 counsel has refused to allow it.

22 Given the provisions of the

1 protective order, and the fact that we have  
2 not been allowed to have access to them, I  
3 would submit that it's inappropriate to use  
4 those materials here.

5 CHIEF JUDGE SLEDGE: Mr. Steinthal?

6 CHIEF JUDGE SLEDGE: Your Honor, I  
7 am unaware of the request or response. I  
8 don't doubt it for a moment if Mr. Handzo is  
9 representing that that occurred, though I was  
10 certainly not the one to give the response.

11 I can probably navigate around  
12 this without use of the actual exhibit from  
13 the prior CARP, and just using the public  
14 record version of the RIAA proposed findings.

15 So I think that in light of Mr.  
16 Handzo's representation, I certainly would  
17 like to work around that, and I'll withdraw  
18 these exhibits and work off of a public  
19 version of the proposed findings.

20 Is that all right with you?

21 MR. HANDZO: That's fine.

22 MR. STEINTHAL: And in that respect

1 the ; if you don't mind I will question the  
2 witness only off the proposed findings and the  
3 public versions thereof.

4 MR. HANDZO: Well, I will just  
5 note, I don't have a copy of the public  
6 version of those findings.

7 MR. STEINTHAL: You'll see, I'm not  
8 going to go into any restricted material.

9 MR. HANDZO: I'm just looking at  
10 this document. The entire document is marked  
11 restricted. I don't see any part of it that  
12 appears to be unrestricted.

13 MR. STEINTHAL: Well, the table of  
14 contents is not restricted.

15 MR. HANDZO: Well, all I can say  
16 is, I'm looking at it and it says restricted  
17 at the top.

18 MR. STEINTHAL: We will replace  
19 this with a version of the excerpt that is a  
20 public record version.

21 MR. HANDZO: I understand Mr.  
22 Steinthal's point. I think my response is, I

1 think if they're going to ask the witness  
2 questions, they ought to have the public  
3 version to give him, not a restricted version.  
4 I have no way to know what was restricted and  
5 what wasn't. All I can see is that the entire  
6 document that I have now been handed says  
7 restricted on it.

8 MR. STEINTHAL: Well, certainly I'm  
9 in a position to waive whatever objection was  
10 made previously so that you can look at the  
11 restricted of this excerpt of the RIAA's own  
12 post-trial findings.

13 CHIEF JUDGE SLEDGE: It's a little  
14 late for that.

15 These exhibits have been withdraw.  
16 I don't know what the issue is.

17 BY MR. STEINTHAL:

18 Q Dr. Pelcovits, are you aware |

19 CHIEF JUDGE SLEDGE: Are you going  
20 to refer to these exhibits?

21 MR. STEINTHAL: No, not if they're  
22 not | not if I don't have a public record

1 version of it right this second.

2 CHIEF JUDGE SLEDGE: Thank you.  
3 Please proceed.

4 BY MR. STEINTHAL:

5 Q Is it consistent with your  
6 recollection in reviewing the proceedings of  
7 the prior CARP that the RIAA in fact relied  
8 upon among other things agreements between  
9 MusicNet and recording industry members as  
10 corroborative evidence of its case in the first  
11 CARP?

12 MR. HANDZO: I just want to be  
13 clear. Is Mr. Steintal representing that  
14 that material was unrestricted in the prior  
15 CARP? If it wasn't, there's certainly no way  
16 the witness could have seen it, and it's  
17 unfair to ask about it.

18 MR. STEINTHAL: I think the  
19 references are in the public version of the  
20 CARP decision that these agreements were  
21 relied upon, not the exact rates, but the fact  
22 that subscription webcasting services were

1       relied upon is a matter of public record.

2               MR. HANDZO: I have no objection to  
3       the extent that Mr. Steinthal wants to examine  
4       about what's in the CARP decision and what it  
5       says about those agreements

6               WITNESS: If I understand the  
7       question now, is, am I aware there were  
8       agreements from the on demand markets  
9       submitted by RIAA as part of their case; the  
10      answer is yes.

11              BY MR. STEINTHAL:

12              Q       Did you take into consideration in  
13      propounding your model here that subscription  
14      services agreements of the same nature as  
15      those you are relying on here were offered and  
16      rejected by the prior CARP?

17              A       I don't regard it at all to be the  
18      same thing, but I have not just submitted  
19      agreements. I have used the agreements to  
20      perform an economic analysis.

21              My reading of the CARP decision is  
22      that they did not reject an analysis based on

1 those agreements.

2 Q Let's go back to the librarian  
3 decision for a minute, if you would go to page  
4 45, 257, upper right-hand corner, the second  
5 full sentence, the librarian says, it,  
6 referring to the CARP, rejected the agreements  
7 between RIAA and non-DMCA-compliant services  
8 because the rates in those agreements were for  
9 rates beyond those granted under the statutory  
10 license.

11 Did you give any consideration to  
12 the fact that both the CARP and the librarian  
13 rejected the non-DMCA-compliant webcaster  
14 agreements with individual labels because they  
15 involved different rights?

16 A Yes, they rejected taking a rate  
17 without performing any analysis to apply the  
18 benchmark. And it's not a benchmark. From  
19 what I understand, this is saying you can't  
20 use another rate and just bring that into this  
21 and adopt it for the statutory service, and I  
22 agree with that.

1 Q Did you make any ; strike that.

2 How if at all did you take into  
3 account the panel's and the librarian's  
4 rejection of the subscription webcasting  
5 agreements in the prior CARP in connection  
6 with your analysis?

7 A I took it upon myself to not say  
8 that the court should adopt the rates in the  
9 interactive market without just on their own,  
10 without undertaking or without making an  
11 adjustment. And a lot of my testimony deals  
12 with the adjustment. It says, don't take  
13 these rates; use this as a benchmark. And  
14 there is a vast difference between saying,  
15 adopt rates from a different market without  
16 any adjustments, and then taking those rates  
17 as a benchmark and performing an analysis in  
18 order to use the benchmark. It's totally  
19 different.

20 Q Well, are you familiar with the  
21 fact that certain actual proposed percentage  
22 of revenue rates that were reviewed by the

1 first CARP, were rejected as above market  
2 rates?

3 A I don't recall that specifically.

4 Q Take a look at the librarian's  
5 decision again.

6 A Okay.

7 Q Go back to 45-258. I'm not going  
8 to read the whole thing again, but at the end  
9 of the passage that I read to you before, the  
10 librarian refers to the CARP having given  
11 little weight to 25 of the 26 agreements for  
12 these reasons, and because the record  
13 demonstrated that the rates in these licenses  
14 reflect above market place rates.

15 Does that refresh your  
16 recollection that in fact various rates had  
17 been presented that were rejected as above  
18 marketplace rates?

19 A Can you point where in the  
20 document this is? You gave me the page.

21 Q 45-248, upper left-hand corner,  
22 probably about 20 lines into it.

1           A           I agree, they rejected these rates  
2 because they said they were above market  
3 rates.

4           Q           And again, on page 45-245, in the  
5 middle column, in the paragraph starting in  
6 essence, right in the middle, do you see the  
7 reference to the sentence, in fact the panel  
8 found that when RIAA negotiated with less  
9 sophisticated buyers who could not wait for  
10 the outcome of this proceeding, the rates were  
11 above market value and therefore not  
12 considered by this CARP.

13                       Is that another reference to above  
14 market value?

15           A           That's what it says; I agree.

16           Q           Now are you familiar with the fact  
17 that the actual percentage of revenue rates  
18 that were rejected as above market were  
19 agreements that were at 15 percent of revenue  
20 and 11 percent of revenue?

21           A           I don't recollect that exactly,  
22 but I do not try to interpret the discussion

1 of above market rates as involving an analysis  
2 of the percentages applied. It's simply  
3 saying, these are not rates, and these are not  
4 contracts we're going to use as a benchmark,  
5 because they didn't like the way the  
6 agreements were arrived at; not because they  
7 felt the percentages were wrong.

8 Q Well, is it your testimony that  
9 you would ignore a prior CARP determination  
10 that an 11 percent of revenue rate and a 15  
11 percent of revenue rate are above market in  
12 doing your analysis of what a willing buyer-  
13 willing seller rate should be in the same  
14 marketplace?

15 A If I wanted to go back and review  
16 the entire record of the previous proceeding,  
17 I would try to analyze exactly what was the  
18 nature of the contracts that were presented to  
19 the CARP at that time. Just saying  
20 percentages without looking at the contracts,  
21 at the services, and accounting for the market  
22 developments over the last several years, I

1 can't say what that means.

2 Q You don't think it's worth at  
3 least a gut level check on what your model  
4 generated to look at what the actual  
5 percentage rates that were rejected in the  
6 last CARP as above market rates?

7 MR. HANDZO: Objection; asked and  
8 answered. We're just arguing here.

9 CHIEF JUDGE SLEDGE: Sustained. I  
10 might add that that's not part of his model,  
11 going from the last rate set, and therefore  
12 not part of his direct testimony.

13 MR. STEINTHAL: Your Honor, I think  
14 it goes to the credibility of his model, if he  
15 did or didn't consider certain matters that  
16 the RIAA certainly was aware of.

17 CHIEF JUDGE SLEDGE: That was part  
18 of the last model we had, not part of this  
19 model.

20 BY MR. STEINTHAL:

21 Q I counted at least a half a dozen  
22 times when you refer to the CARP panel

1 decision in your report and in your testimony.

2 You referred to it quite a bit,  
3 did you not?

4 A I did.

5 Q But I gather you didn't refer to  
6 those parts of it that rejected the 25 of the  
7 26 agreements?

8 MR. HANDZO: Objection; it's been  
9 asked and answered.

10 CHIEF JUDGE SLEDGE: Sustained.

11 BY MR. STEINTHAL:

12 Q Now you sought to rely on  
13 agreements, in your benchmark market, that are  
14 currently in force, correct, to the best !

15 A To the best of my knowledge, yes.  
16 It's a changing process, and things are  
17 updated all the time. But I tried to get a  
18 fair snapshot.

19 Q I gather you also wouldn't want to  
20 rely on agreements if you had evidence that  
21 they were part of an effort on the label  
22 licensor's part to artificially raise market

1 prices, correct?

2 A I am sorry, I don't understand the  
3 question.

4 Q Well, if you were presented with  
5 evidence that the very agreements upon which  
6 you're relying were part of an effort on the  
7 part of the licensor to set an artificially  
8 high price, you wouldn't want to rely on those  
9 agreements, would you?

10 A Again, that doesn't have any  
11 meaning to me, because I don't know what you  
12 mean by an artificially high price. A willing  
13 seller is going to try to get as much as he  
14 can, and there is nothing artificial about it.

15 Q What about if you had evidence  
16 that the agreements were the products of  
17 activities alleged to be in violation of the  
18 anti-trust laws?

19 A There are | if you simply say it's  
20 an allegation, I would have to say I can't  
21 answer that without knowing the specifics, and  
22 since I'm not going to conduct an anti-trust

1 investigation on my own I would generally  
2 expect to rely on the decisions of an anti-  
3 trust agency rather than simply an  
4 investigation.

5 Q Are you aware of evidence that the  
6 very agreements upon which you rely have been  
7 the subject of two Department of Justice  
8 investigations, one that terminated in  
9 December, 2003, and another that's ongoing?

10 A I know there is ; I've read in the  
11 newspapers that there are anti-trust  
12 investigations going on, and there are anti-  
13 trust investigations going on all the time of  
14 all sorts of industries. And I did not try to  
15 second-guess what the result of those  
16 investigations will be. An investigation is  
17 not a finding.

18 Q Are you aware of a decision from  
19 Chief Judge Patel in the Northern District of  
20 California several weeks ago finding that two  
21 fo the major four labels deliberately misled  
22 the government in the prior investigation

1 ending in 2003 concerning the very agreements  
2 about which you are relying on?

3 A I'm not aware of that decision.

4 MR. STEINTHAL: Can we mark this?

5 (The aforementioned  
6 document was marked for  
7 identification as  
8 Services Exhibit No. 58)

9 BY MR. STEINTHAL:

10 Q I'd have you look at what's been  
11 marked as Services Exhibit No. 58.

12 Have you read in the press or been  
13 made aware of the actual decision of Judge  
14 Patel, which resulted in an order requiring  
15 certain labels to reproduce materials from the  
16 original Department of Justice investigation?

17 MR. HANDZO: Objection, asked and  
18 answered. He's already testified that he's  
19 not aware of the decision.

20 CHIEF JUDGE SLEDGE: I don't  
21 believe he said that; overruled

22 WITNESS: I am not aware of the

1 decision.

2 BY MR. STEINTHAL:

3 Q Were you to become aware that  
4 there was evidence that the labels had sought  
5 to collude to raise prices and fix prices in  
6 the online distribution market, would that  
7 affect your willingness to rely on the  
8 benchmark agreements that you've relied on?

9 A If these are allegations, and  
10 evidence presented by one party at one time,  
11 no. As I said, there are allegations and  
12 investigations all the time.

13 I would take it into account if  
14 there was a decision that clearly presented  
15 that and clearly made that finding, but I  
16 don't know of any decision that says that.

17 Q Are you familiar with the fact  
18 that many of the agreements upon which you  
19 rely have most-favored-nations provisions in  
20 those agreements?

21 A I am.

22 Q Are you aware of allegations that

1 those most-favored-nations provisions resulted  
2 in the setting of prices in violation of the  
3 anti-trust laws by the big four labels?

4 A I am aware of that general claim.

5 Q Would it concern you if you came  
6 if you became aware that the very agreements  
7 on which you rely contained MFN provisions  
8 that enabled the major labels to set prices in  
9 violation of the anti-trust laws?

10 A If they had provisions the court  
11 found to be in violation of the anti-trust  
12 laws, it would concern me. The MFN provisions  
13 in these contracts that I have reviewed and  
14 considered, the competition consequences I  
15 believe are not a competitive problem, and are  
16 not anti-competitive or collusive.

17 Q Take a look at page seven of Judge  
18 Patel's decision.

19 In the first full paragraph, she  
20 says, it is not the presence of MFNs in  
21 particular agreements which undermines the  
22 truth of the disparate licensing

1 representations, but rather, the consistent  
2 practice of including MFNs in all license  
3 agreements.

4 This practice, which UMG does not  
5 deny, is fundamentally incompatible with UMG's  
6 assertion that the licenses granted by the  
7 labels show a wide dispersion of terms.

8 Did you do any kind of an analysis  
9 of the MFNs in the benchmark market agreements  
10 upon which you relied to determine whether  
11 they were used in a manner incompatible with  
12 an assertion that the licenses showed any kind  
13 of price dispersion?

14 A No, I did not try to analyze or  
15 assess what the term, wide dispersion, even  
16 means. I think what I did, and I repeat what  
17 I said, I did look at the major of these MFN  
18 provisions, and they are not | I'll  
19 underscore, not | the type of MFN provisions  
20 that are typically a problem for anti-trust  
21 considerations.

22 Q But you didn't take your analysis

1 any further than that?

2 A I'm not exactly sure what you mean  
3 by that.

4 Q You didn't take your anti-trust  
5 analysis any further than your conclusion upon  
6 reviewing the MFNs in this agreement that they  
7 didn't appear to be a problem?

8 A In general, I did not, no.

9 Q Going back to page three, in the  
10 first full paragraph Judge Patel refers to  
11 MusicNet and Pressplan as two joint ventures  
12 involving the major labels.

13 Does looking at that refresh your  
14 recollection at all as to the original entries  
15 into the on-demand streaming and conditional  
16 download markets?

17 A I think you have already refreshed  
18 my memory this morning.

19 Q Now are you familiar with the fact  
20 that there's been a number of class action  
21 lawsuits filed in the last six months against  
22 the four major labels contending that the very

1 agreements upon which you're relying in your  
2 benchmark market are part of a conspiracy in  
3 violation of the anti-trust laws?

4 A Well, I can say that I'm aware  
5 there are a number of class action lawsuits.  
6 My recollection, and this is based on press  
7 reports, is that these primarily deal with  
8 downloads, although I can't say for sure they  
9 don't include these type of agreements as  
10 well.

11 MR. STEINTHAL: Your Honor, can we  
12 mark this?

13 (Whereupon the  
14 aforementioned document was marked for  
15 identification as  
16 Services Exhibit No. 59)

17 BY MR. STEINTHAL:

18 Q I'd ask you to take a look at what  
19 we've marked as Services Exhibit No. 59.

20 MR. HANDZO: If I can just  
21 interject, I would just object to this line of  
22 cross-examination. I think we all learned in

1 first year in law school that complaints are  
2 not evidence, they're allegations. Complaints  
3 from a class action lawyer, I don't see how  
4 that has any probative value here to the  
5 cross-examination.

6 CHIEF JUDGE SLEDGE: Counsel?

7 MR. STEINTHAL: Your Honor, I think  
8 it's relevant to determine whether he has  
9 evaluated aspects of the market relating to  
10 the varying agreements upon which he is  
11 relying that have been the subject of anti-  
12 trust challenge.

13 CHIEF JUDGE SLEDGE: But hasn't  
14 that been covered? What will another  
15 allegation add to that cross-examination?

16 MR. STEINTHAL: Well, the witness  
17 just said in response to my last question that  
18 he thought it related to download markets, and  
19 not the markets for on demand streaming  
20 conditional download.

21 I just wanted to point out that a  
22 passage in this particular complaint that it

1 appears to direct some of his allegations  
2 against the very agreements entered into by  
3 MusicNet and Napster, previously known as  
4 Pressplay.

5 CHIEF JUDGE SLEDGE: I'll overrule  
6 the objection for that limited answer. BY MR.  
7 STEINTHAL:

8 Q Take a look if you would at  
9 paragraph 33 of Exhibit 59.

10 Do you see where there are  
11 references to MusicNet and Pressplay?

12 A I do.

13 Q As part of the market for online  
14 music that is referred to in the complaint?

15 A I do.

16 Q Let's move on to a different topic  
17 if you would.

18 Now, I believe you'd agree with  
19 the proposition that price is essentially the  
20 result of everything that goes into the demand  
21 and supply curves, is it not?

22 A Yes.

1           Q       Now you had no facts about how the  
2 separate components of the benchmark on demand  
3 subscription services were broken down by the  
4 buyers or the sellers as among those  
5 components; correct?

6           A       Well, I did, and that's the nature  
7 of the hedonic regression. It's not looking  
8 at demand and supply in a | forgive me | a  
9 general equilibrium sense, but it is looking  
10 at the prices, and attributing portions of the  
11 prices to different characteristics.

12          Q       As a factual matter, before you  
13 embarked on your regression analysis, it's  
14 correct, is it not, that you had no facts  
15 about how the actual buyers and the actual  
16 sellers valued the individual components of  
17 what was being offered in your benchmark  
18 market; correct?

19          A       I would say that the factors would  
20 be either | have to come from looking at the  
21 prices as I did, and working backward in a  
22 sense; and the other would be to look at

1 surveys of any sort which are not really good  
2 at capturing measurements of value.

3 I have seen a number of surveys of  
4 the online music industry done by Arbitron.  
5 I did not rely on those surveys to try to come  
6 up with measurements.

7 Q Arbitron being?

8 A Arbitron being the company,  
9 Arbitron, that conducts media research and  
10 publishes data into the public and to  
11 subscribers.

12 Q Did you rely on some of the  
13 Arbitron reports that you were able to  
14 research?

15 A I relied on them not to try to get  
16 a measure of value; I did rely on them to get  
17 a sense of the developments in the industry,  
18 the usage patterns, things like that. But I  
19 did not try to turn them into a sort of  
20 analytical tool.

21 Q Going back to my question, isn't  
22 it true, sir, that what you had in terms of

1 data was as you testified earlier the amounts  
2 that the services in your benchmark market  
3 said they were charging to consumers, but not  
4 breakout of what that total amount being paid  
5 was for as between the individual components  
6 of the services being offered?

7 A I think that's what the prices are  
8 telling you, that you have prices of various  
9 different services that are public information  
10 available. Certainly they want you to buy the  
11 services. I really don't know much more to  
12 say other than you look on the website for  
13 Rhapsody, and it presents you the type of  
14 services they offer, and gives you the  
15 characteristics of the services.

16 Q And that's all you have in the way  
17 of information about what the price was being  
18 charged for, correct?

19 A That's all I could have, and all I  
20 could wish to have. I wish I could get that  
21 kind of data in other cases.

22 Q And I believe you said that after

1 gathering that data, you looked at the nature  
2 of the services, and you looked at who the  
3 buyers and the sellers were, and that's  
4 basically what you did in advance of  
5 conducting your regression analysis; correct?

6 A Yes.

7 Q And I gather it's a fair statement  
8 that you sought to pick a benchmark market  
9 which was as close as you could find to the  
10 hypothetical market that the board is charged  
11 with setting a rate for, correct?

12 A That's not what I said.

13 Q Well, why wouldn't you want to  
14 find a benchmark market that's as close as  
15 possible to the market that you're trying to  
16 set rates for?

17 A I think, I explained this morning,  
18 I'd be happy to repeat it, which is, if you  
19 get too close then you're not getting an  
20 independent market price; you're getting a  
21 price that is strongly influenced by the  
22 existing statutory rate for the music

1 licenses.

2 Q Well, hypothetically, if you  
3 weren't looking at services | well, strike  
4 that.

5 Is it your testimony that the  
6 prior CARP rate was set too low?

7 A Yes.

8 Q Isn't it true, sir, that at least  
9 as of the time of your deposition you had  
10 never studied the issue of whether the initial  
11 CARP rate was set too low?

12 A I think my testimony is saying the  
13 CARP rate is too low. So I don't know what  
14 you mean about having studied that. Sure.

15 MR. HANDZO: I wonder if I could  
16 just ask Mr. Steinthal to clarify his question  
17 because I think it might speed things along.

18 Is the question whether the CARP  
19 rate was too low at the time it was set in  
20 2002, or is it too low today?

21 MR. STEINTHAL: Well, it was set in  
22 2002.

1                   WITNESS: If there was a question  
2 pending, I was going to volunteer, but I  
3 didn't want to not be responding to the  
4 questions, but I think it's too low. I've  
5 looked at the market now. I've not tried to  
6 recreate history. But my opinion is, the rate  
7 should be raised.

8                   BY MR. STEINTHAL:

9                   Q       Several fold, obviously.

10                  A       Yes, about threefold.

11                  Q       It's true, is it not, that to  
12 assess whether the CARP rate was set too low,  
13 at least back in 2002, you believe would  
14 require a lot of thought and a lot of care in  
15 constructing and testing hypotheses; is that  
16 right?

17                  A       I have to be honest, I haven't  
18 thought about trying to go back and make a  
19 decision based on knowledge available in 2002.  
20 The market has changed dramatically. I look  
21 at the market as it is today. I realize we're  
22 setting rates for now and into the future. So

1 can I say what I would have recommended had I  
2 been here in 2002? I can't say.

3 Q And what specific facts do you  
4 rely upon in concluding that you're not in a  
5 position to say the rate was set too low in  
6 2002 but you're very comfortable testifying  
7 that the very same rate should be increased by  
8 both the framework into a greater formulation,  
9 and in terms of individual components, by some  
10 two to three times?

11 A I think, as I've said, I don't  
12 know what the facts were as stated knowledge  
13 existed in 2002. I mean I can make some  
14 surmises, but in terms of trying to sort of  
15 construct a hypothetical testimony that I  
16 would have given in 2002, I just can't say  
17 sitting here what I would do and what I would  
18 have done.

19 I can tell you, the market's  
20 changed quite a lot. There's a lot of  
21 evidence in the market that there was not in  
22 2002. And so I'm basically saying, you're

1 asking me what I would have done had things  
2 been different, and what facts I would know  
3 that I needed in order to figure that out, I  
4 can't say that sitting here. It's a different  
5 problem than the one I've been asked to  
6 address here.

7 Q The one you've been asked to  
8 address by the labels?

9 A By my clients, yes.

10 Q Well, hypothetically, if you knew  
11 that the prior CARP rate was in fact the  
12 quintessential hypothetical willing buyer-  
13 willing seller rate for entities operating  
14 under the Section 114 statutory license,  
15 couldn't you try to measure whatever  
16 differences are appropriate up or down from  
17 that benchmark in order to get to an  
18 appropriate willing buyer-willing seller rate  
19 in this case?

20 A I think that is basically Dr.  
21 Brynjolfsson's | part of his testimony. So he  
22 did that; I didn't.

1 MR. HANDZO: Your Honor, I wonder  
2 if I could inquire, we're almost at 3:30. I  
3 wonder if it might be a good time to take a  
4 break. It would be for me, I'll say that.

5 CHIEF JUDGE SLEDGE: It will depend  
6 on Mr. Steinthal to make that suggestion.

7 MR. STEINTHAL: That's fine, Your  
8 Honor.

9 CHIEF JUDGE SLEDGE: Depends on how  
10 kind he is.

11 MR. STEINTHAL: That will be fine.

12 CHIEF JUDGE SLEDGE: We'll recess  
13 10 minutes.

14 MR. HANDZO: Thank you.

15 (Whereupon at 3:29 p.m.  
16 the hearing in the  
17 above-entitled matter  
18 went off the record to  
19 return on the record at  
20 3:43 p.m.)

21 CHIEF JUDGE SLEDGE: Thank you.  
22 We'll come to order.

1 BY MR. STEINTHAL:

2 Q Dr. Pelcovits, you're familiar  
3 with the provisions in the statute that  
4 provide that the copyright royalty board may  
5 consider the rates and terms for comparable  
6 types of digital audio transmission services  
7 and comparable circumstances under voluntary  
8 license agreements negotiated?

9 A Yes.

10 Q Let me ask you some questions  
11 about the comparable for a minute.

12 One of the characteristics that  
13 you considered in conducting your  
14 comparability analysis was the extent that the  
15 libraries of music available on the benchmark  
16 services were the same as the libraries of  
17 music on the target services, correct?

18 A Yes.

19 Q And you concluded that there was  
20 actually a difference between the two insofar  
21 as | because of the hold back aspects of  
22 voluntary licenses between labels and your

1 benchmark market services, they actually had  
2 access to a smaller catalog, at least for  
3 certain time periods; correct?

4 A Yes.

5 Q Now, I believe you testified that  
6 these hold back rights in the voluntary  
7 agreements were actually requested and desired  
8 by the label; correct?

9 A Yes.

10 Q Is it your testimony that the  
11 major labels would also insist on hold backs  
12 in the licensing of statutory license services  
13 were it not for the compulsive licenses?

14 A I can't say. In the sense of,  
15 would they try to set a contract for  
16 noninteractive music which included hold back  
17 provisions in the absence of the statutes? Or  
18 would they not try to do hold backs? I can't  
19 say exactly. I think that holding back music  
20 can affect prices. Where they'd end up in  
21 terms of negotiated rates, I can't say  
22 exactly.

1           Q       Well, if the markets were very  
2 comparable, as between your benchmark market  
3 and the target market, wouldn't you expect  
4 that the labels would seek hold backs in the  
5 target market?

6           A       I'm not sure exactly how they  
7 would assess it. I don't know. I've looked  
8 at the issue of hold backs from the standpoint  
9 of what that says about rates in the benchmark  
10 market. And obviously it's different, and  
11 you're selling less.

12                   And I would say, everything else  
13 being equal, reducing the breadth of the music  
14 available reduces the price people would be  
15 willing to pay for it.

16                   Other than that I can't say what  
17 would happen as the result of a full  
18 marketplace functioning in place of the  
19 statute.

20           Q       Well, wouldn't you agree that if  
21 labels voluntarily chose to have hold back  
22 rights in your benchmark market, but didn't

1 wish to have hold back rights in the target  
2 markets, that that would be indicative of  
3 differences in the two markets?

4 A It would reflect something. It  
5 would reflect some difference in the  
6 underlying markets. I can't say for a  
7 hypothetical situation what motivates it.

8 Q Well, let's do less hypothetical.  
9 Are you familiar with the fact  
10 that there has been voluntary agreements  
11 entered into between Yahoo on the one hand and  
12 Sony Music and Universal Music Group in two  
13 separate transactions, which include grants of  
14 rights that cover the Lankest service that you  
15 place in your target market?

16 A They include Lankest and various  
17 customized types of features, yes.

18 Q And are you familiar with the fact  
19 that the agreements between Yahoo and Sony on  
20 the one hand, and Yahoo and Universal on the  
21 other, don't have hold back provisions of the  
22 nature that you testified are typical of your

1 benchmark market?

2 A I didn't recall that specifically.  
3 It doesn't surprise me, and I'll tell you why.  
4 These are services that are very close to  
5 statutory services, but not the same as, and  
6 I would think that the statute and the terms  
7 of the statute have a very large effect on  
8 these near substitutes.

9 Q Sir, are you suggesting that if  
10 Universal or Sony didn't want to have hold  
11 back rights in its deal for the Lankest and  
12 Lankest plus service with Yahoo, it wouldn't  
13 have requested hold back rights?

14 A I don't know what they requested.  
15 I don't know what tradeoffs or evaluations  
16 were made at the time of the negotiations. So  
17 I can't say, you know, whether they didn't  
18 want it or they didn't want to take a lower  
19 price that might have been required to do some  
20 hold backs.

21 Q In any event, you didn't seek to  
22 make any kind of adjustment for the fact that

1 voluntary agreements between Universal Music  
2 Group and Sony with Yahoo for the Lankest  
3 service did not have any hold back provisions,  
4 whereas your benchmark market typically does  
5 have hold back provisions; correct?

6 A That's correct, overall, if I  
7 could just expand for a second. As I said, I  
8 think I've said very much -- very clearly  
9 this morning I did say hold backs are a  
10 difference, not just between those Yahoo  
11 agreements and the benchmark market, but  
12 between the statutory rate of the benchmark  
13 market. And that is a difference.

14 I said that. I said it has a  
15 particular effect of making my estimate  
16 conservative.

17 Q But it may also be indicative of  
18 differences in the market that you didn't  
19 adjust for otherwise; correct?

20 A There might | there are certainly  
21 differences in these markets. I have used the  
22 analytical techniques that I've described to

1 try to make the adjustments that I thought  
2 were the most significant, most important and  
3 measurable.

4 Q But you didn't try to measure the  
5 significance for noninteractive radio services  
6 of Universal and Sony wanted to have their  
7 product on those webcasting services as of  
8 street date instead of 90 days later after a  
9 hold back in the physical market; correct?  
10 You didn't try to assess that one way or the  
11 other?

12 MR. HANDZO: I would object. That  
13 assumes facts not in evidence.

14 CHIEF JUDGE SLEDGE: Mr. Steinthal.

15 MR. STEINTHAL: I'm asking whether  
16 he assessed that. Either he did or he didn't.

17 CHIEF JUDGE SLEDGE: Sustained.

18 BY MR. STEINTHAL:

19 Q Now it's correct that the  
20 satellite services under their voluntary  
21 agreement with SoundExchange also had no hold  
22 back rights affecting the grant of the

1 plaintiff license by SoundExchange to them;  
2 isn't that right?

3 A I believe that's correct, and I  
4 think that would be true under the governing  
5 statute.

6 Q Same is true of the preexisting  
7 services, MusicChoice, the digital cable radio  
8 services?

9 A Again, under the statute as I  
10 understand it, there are no hold backs.

11 Q So in terms of the library of  
12 music available to the licensee, and the  
13 timing with which that music is made  
14 available, it's correct that the statutory  
15 license services before the board here are  
16 closer in character to the satellite services  
17 and the digital cable radio services than your  
18 benchmark market services; correct?

19 A The statute requires them to be  
20 blanket licenses, so they are similar in that  
21 respect, which is not true of the interactive,  
22 as I described and discussed before.

1           Q       Is it true, sir, that you don't  
2 think that the satellite radio and digital  
3 cable radio services are as substitutional as  
4 your on demand benchmark market services?

5           A       I don't think I said that  
6 anywhere.

7           Q       Do you have a basis of saying so  
8 one way or the other?

9           A       Now you're asking me do I think  
10 one way or the other?

11          Q       Have you done any assessment?

12          A       Oh, okay, that's a different  
13 question.

14                   I have not looked at that.

15          Q       You do acknowledge at page 49 of  
16 your report, however, that statutory license  
17 webcast services are not likely to be as  
18 substitutional as satellite radio; correct?

19          A       I don't think that's what I said.

20          Q       Well, that's the purpose of your  
21 citation to the Wall Street analysts?

22          A       It wasn't to deal just with

1 substitution. This was to talk in general  
2 about the notion that there is an important  
3 substitutional effect of any service that  
4 provides a high quality stream of  
5 noncommercial music to customers.

6 I don't think I judge one being  
7 more than the other.

8 Q Now in your comparative analysis  
9 of the nature of the services involved, as  
10 between your benchmark market services and the  
11 statutory license webcasters, you don't  
12 consider the conditional download component of  
13 the benchmark services as conveying any more  
14 value than the on demand streaming, do you?

15 A I don't try to measure it  
16 separately, since it's a feature of the  
17 service. It's captured in the consumer price,  
18 so it is picked up.

19 Q Well, would you agree that there  
20 are consumer benefits and values associated  
21 with the ability to obtain conditional  
22 downloads in addition to on demand streaming?

1           A           I expect it has some value to  
2 consumers and some value to the webcasters.

3           Q           And did you ; I'm not sure what  
4 you meant on the last trailer there. And some  
5 value to the webcasters?

6           A           Yes.

7           Q           Do the webcasters under the  
8 statutory license have the right to make  
9 deliveries of conditional downloads?

10          A           We weren't talking about the  
11 statutory service; we were talking about  
12 conditional downloads of the interactive  
13 services.

14                       And what I said, to make sure it's  
15 clear, I said yes, I think that has some value  
16 to consumers. I didn't try to measure that  
17 increment separately. I said also for looking  
18 at that aspect of the service in the market,  
19 I think it's valuable to the webcasters  
20 because it can save them bandwidth costs, if  
21 a customer downloads it conditionally and then  
22 listens to it from his or her own computer, it

1 saves them from having to stream the song the  
2 next time the customer demands it.

3 Q But you would agree with the  
4 proposition that there is an additional  
5 benefit to consumers associated with a service  
6 that offers not just on demand streaming but  
7 the ability to obtain conditional downloads,  
8 correct?

9 A Yes.

10 Q And part of that benefit,  
11 especially if it's a portable service, is the  
12 ability to make conditional downloads of songs  
13 that you acquired on an on demand basis, and  
14 port them at various portable devices that are  
15 capable of recognizing that digital rights  
16 management system associated with those  
17 conditional downloads; correct?

18 A Absolutely, and that's recognized  
19 | that aspect, I think that is much more  
20 significant than the conditional download to  
21 the computer itself. The conditional download  
22 to the portable device is very important, and

1 is recognized in the market as having  
2 significant value, and I picked up that effect  
3 in my regression.

4 Q Now within the universe of  
5 nonportable services, it's correct that you  
6 didn't try to ascribe any separate value to  
7 the conditional download component of what  
8 they offered; correct?

9 A That's correct.

10 Q Also in connection with the nature  
11 of the services, as between the target market  
12 and the benchmark market, you'd agree, would  
13 you not, that generally speaking the benchmark  
14 market on demand services deliver higher  
15 quality music than the statutory license  
16 webcasters?

17 A Do you mean by higher quality  
18 better bit rate or something else?

19 Q Start with higher bit rates.

20 A I don't know if that's true. In  
21 fact, the subscription services that I looked  
22 at all tended to have pretty high quality bit

1 rates that some of them claimed to be CD  
2 quality. Whether they are or not, I don't  
3 know, but they are certainly at a relatively  
4 high bit rate, and intended to take advantage  
5 of the broadband connections that customers  
6 have.

7 Q By subscription services in that  
8 answer, you meant the subscription statutory  
9 webcasters, correct?

10 A I did; thank you.

11 Q And those comprise less than 10  
12 percent of the current marketplace of  
13 statutory license webcasters, is that right,  
14 according to your understanding?

15 A It depends on how you measure it,  
16 whether you measure it by customer streams or  
17 value to the total amount of money being  
18 collected.

19 Q Well, as measured by the number of  
20 unique listeners, do you know what the number  
21 is?

22 A I've only seen it | I've not seen

1 a full data set. I have seen partial  
2 datasets, either from Accustream. I've seen  
3 it for specific services like with Yahoo, and  
4 there are | yes, I would say in the range of  
5 90 percent of the customers, unique customers  
6 are using nonsubscription services.

7 Q As measured in terms of the amount  
8 of streaming hours, are you familiar with  
9 whether it's 90 percent, 10 percent, or as you  
10 sit here you don't know the figures one way or  
11 the other?

12 A Well, the only place I've seen  
13 apples to apples figures on that are from  
14 Yahoo. And I don't know, this is proprietary.  
15 So I do know the relationship there. And it's  
16 | well, I won't give the numbers |

17 Q Well, why don't you give the  
18 number as part of this one answer, and we  
19 won't clear the courtroom, because there is  
20 nobody here that we really need to clear it  
21 with.

22 A Okay, so as I recall the ratio of

1 the listening hours or plays is about I think  
2 it's about three to one, three being the ad  
3 supported nonsubscription services, one being  
4 the subscription services.

5 So there is a lot more play per  
6 customer from the subscription services.

7 Q And you haven't looked at any data  
8 on an industry wide basis?

9 A I haven't seen any. There is ;  
10 there is, as I said, some data from the  
11 Accustream, and it doesn't break it down that  
12 way. And I'd also say, it gets complicated,  
13 because I don't know where you fit into that  
14 bifurcation a service like AOL, or XM Online,  
15 which are part of a bundle of services, so  
16 they are neither nonsubscription, nor are they  
17 services that you can identify directly the  
18 purchase price of the music service.

19 Q To the extent Dr. Brynjolfsson's  
20 model ascribed 90 percent of the aggregate  
21 tuning hours in 2005 to nonsubscription  
22 webcasting, and 10 percent to subscription

1 webcasting, do you have any basis to dispute  
2 that?

3 A I frankly don't recall how he got  
4 that. I was looking at this recently based on  
5 the latest discovery for | and that's what I  
6 saw.

7 Q And your comments on the quality  
8 of the streaming and the bit rates, you gave  
9 the answer as to subscription services.

10 It's generally true, is it not,  
11 that the nonsubscription services provide  
12 lower quality, lower bit rate streams?

13 A Quite a few of them do, yes.

14 Q And I gather you didn't try to  
15 make any adjustments in your model as between  
16 the quality of the streaming for your  
17 benchmark services and the target market  
18 services?

19 A I proposed a rate based on an  
20 adjustment for interactivity. I did not make  
21 an adjustment for the sound quality that  
22 particular services choose now or might choose

1 in the future for their streaming services.

2 Q Now you also testified that one of  
3 the characteristics you wanted to look at is  
4 comparability of the buyers in a benchmark  
5 market and a target market; correct?

6 A Generally speaking, yes.

7 Q And you stated this morning I  
8 think that the buyers were essentially the  
9 same; is that a correct statement?

10 A I don't recall my exact words, but  
11 there is a significant number of buyers that  
12 are the same in both markets, and the major  
13 buyers and the parties on the contracts are  
14 primarily services that offer statutory and  
15 nonstatutory services.

16 Q Let's go back to that list of 17  
17 agreements that forms your benchmark markets  
18 and the five companies who are the licensees  
19 under that.

20 Isn't it true, sir, that other  
21 than MusicMatch, which is now owned by Yahoo,  
22 all of the entities that actually did the

1 negotiating with the labels underlying your  
2 benchmark model are not buyers of  
3 noninteractive radio products?

4 A I know that the services that have  
5 those rights, and as I said earlier I'm not  
6 sure of the timing of any acquisition of  
7 services, or rights by particular services.  
8 But a number of those services do offer both  
9 types fo webcasting; for example, Rhapsody.  
10 I mentioned Yahoo. However they've gotten the  
11 license. AOL offers both kinds. So there are  
12 a variety of | a number that have activities  
13 in both markets.

14 Q Again, AOL didn't negotiate any of  
15 the agreements that are part of your list of  
16 17; did they?

17 A We covered that. To the best of  
18 my recollection | I think I said I don't know,  
19 essentially, whether it was AOL or a white  
20 label or something that they had used their  
21 licenses.

22 Q And that was my point, that you

1 don't know as you sit here today how many of  
2 the entities on your list of 17 as willing  
3 buyers in those transactions were entities  
4 that also, at the time they negotiated those  
5 agreements, operated statutory licensed  
6 webcasting; correct?

7 MR. HANDZO: Objection, it's asked  
8 and answered. I think we covered this pretty  
9 thoroughly earlier today.

10 CHIEF JUDGE SLEDGE: Sustained.

11 BY MR. STEINTHAL:

12 Q And I gather you'd agree, would  
13 you not, that the mere fact that a parent  
14 company operates two different businesses  
15 doesn't make them the same for purposes of  
16 your willing buyer-willing seller analysis?

17 A It doesn't necessarily make them  
18 the same. But from the standpoint of the  
19 analysis, I think that there are | as I said,  
20 many of the same companies in those  
21 businesses, and I would add, and I think this  
22 is important, that the ultimate consumers of

1 these music services I think as a very  
2 important part of this, are the same, or  
3 essentially drawn from the same pool of  
4 customers.

5 It strikes me as very important  
6 that you have a statutory and a nonstatutory  
7 service offered by Yahoo or Rhapsody at the  
8 same time to the same group of customers.

9 Is that exactly the same as who  
10 did the negotiations on the date at which they  
11 took place? No.

12 Q And I believe you said before that  
13 the only difference between the target market  
14 and the benchmark market that you ultimately  
15 sought to adjust for was the interactivity  
16 difference; correct?

17 A That's correct.

18 Q Now |

19 A Could I have just a second? I  
20 adjusted for interactivity, but to the extent  
21 that I think we went over this, to the extent  
22 that interactive services offer conditional

1 downloads that is picked up as part of the  
2 interactivity adjustment.

3 Q Okay. Now from a pure  
4 comparability standpoint, you would agree,  
5 would you not, that customized Internet radio  
6 services are much closer statutory licensed  
7 webcasters than your benchmark market  
8 services; correct?

9 A Yeah, I prefer the word  
10 substitutability. They are much closer  
11 substitutes, yes.

12 Q And would you agree as well that  
13 the satellite services and the digital cable  
14 radio services are closer substitutes?

15 A I don't know if I could say that.  
16 Satellite experience right now is primarily  
17 being driven by use of the satellite radio in  
18 automobiles, so it's ; to that extent it's a  
19 very different use of the music.

20 And the preexisting services and  
21 what went on in them, those are ; I consider  
22 to be very old examples of what was in the

1 market then.

2 I think I saw that two of them are  
3 still around, but they are not a major force  
4 in the market.

5 Q But in terms of the programming  
6 that's made available to consumers, wouldn't  
7 you agree that the satellite services and the  
8 preexisting digital cable radio services offer  
9 programming more comparable than your  
10 benchmark model services offer?

11 A I would ; there are  
12 characteristics, and among them, the fact they  
13 are streams of preprogrammed music make them  
14 more similar; that part is more similar.  
15 Other parts are not.

16 Q Now you've said a couple of times  
17 today that you have difficulty with making  
18 reference to negotiations that are too close  
19 to the statutory license; right?

20 A Yes. Too close.

21 Q I believe you claimed in your  
22 written testimony that webcasters use the

1 presence of the statutory license and the  
2 threat not to offer a somewhat interactive  
3 radio service against the labels in order to  
4 get bargaining leverage; is that your  
5 testimony?

6 A I don't know if those are the  
7 exact words, but it's pretty much the theme of  
8 what I said.

9 Q Well, let me see if I can parse  
10 that through. First of all, hypothetically,  
11 if you assume that the statutory license was  
12 not set too low, and contemporaneously there  
13 is a service that wishes to offer an Internet  
14 radio service with some degree of  
15 interactivity that takes across the line from  
16 noninteractive to interactive, as an  
17 economist, would you have a problem with using  
18 the statutory license as a starting point and  
19 just measuring the difference between the not-  
20 too-low statutory license rate and the  
21 measurable differences between noninteractive  
22 and interactive services?

1           A       Well, if my goal is to determine a  
2       statutory rate, and I felt the statutory rate  
3       was not too low, sort of was just right, I'd  
4       just look at the statutory rate, not getting  
5       any additional information by looking at the  
6       merely substitutable services.

7           Q       Well, wouldn't you want to measure  
8       whatever difference there is between you  
9       benchmark market and the target market in that  
10      situation?

11          A       No, because my basis then for  
12      saying the benchmark market is a good market  
13      is that the target market is where it should  
14      be. So why do I need to look at the benchmark  
15      market to tell me what I've already assumed.

16          Q       Well, are you assuming, then, that  
17      there shouldn't be any difference in fees for  
18      modest changes in functionality that take you  
19      from a statutory license service to a service  
20      that doesn't fall under the statutory license?

21          A       No, if my goal was to try to  
22      estimate the factors that caused there to be

1 some difference between the price in the  
2 statutory market, and in the substitute |  
3 closely substitutable market, then I would  
4 look at that difference in price and try to  
5 examine it. In terms of then, that doesn't  
6 make that a better benchmark market, because  
7 the justification for it being a good  
8 benchmark market is that the statutory rights  
9 was correct.

10 So I've accomplished nothing by  
11 looking at the so-called benchmark of the  
12 negotiated rates for the customized radio.

13 Q Well, hypothetically, if we knew  
14 that the statutory rate for satellite services  
15 that currently exist was | strike that.

16 Hypothetically, if we knew that  
17 the rate for satellite services as established  
18 under the | under the parties' agreements was  
19 scientifically the right rate |

20 A I'm sorry, which ones?

21 Q Satellite services. Let's assume  
22 that we've got a rate that we know to be the

1 quintessential willing buyer-willing seller  
2 rate.

3 Is there any reason as an  
4 economist we couldn't use that as a starting  
5 point and then just adjust for differences  
6 between the statutory webcasters on the one  
7 hand and the satellite services on the other?

8 A I think I agree; I just want to  
9 make sure what I'm agreeing to. I'm agreeing  
10 to the assumption that we take the satellite  
11 rates as the omniscient perfect rate. That is  
12 a rate that satisfies willing buyer and  
13 willing seller. It might not satisfy the  
14 statutory standard for satellites, but let's  
15 say it satisfies willing buyer-willing seller.

16 Well, then we might want to use  
17 that rate, which we were commanded is the  
18 correct rate for willing buyer-willing seller,  
19 and use that and try to adjust that to the  
20 webcaster.

21 Q There is no reason you couldn't do  
22 that with any benchmark rate that you were

1 comfortable reflected a willing buyer-willing  
2 seller outcome as long as you could measure  
3 the differences, right?

4 A If you start with something that  
5 again, it comes | where did that number come  
6 from? If the number was given to you by the  
7 omniscient authority, and you are told that  
8 that is the realization of willing buyer-  
9 willing seller, I'd say that's a good  
10 candidate, assuming you can then make the  
11 adjustments.

12 Q Okay.

13 Going back to your claim that  
14 services use the existence of a statutory  
15 license as leverage against labels, in  
16 voluntary negotiations over the customized  
17 radio, let me ask you this: Suppose in advance  
18 of launching a digital radio service, an  
19 Internet radio service, let's call it Service  
20 A, label U sent a letter that indicated in  
21 substance, I hear you're about to launch your  
22 service, but it has features that we believe

1 take you outside of the statutory license. So  
2 you must get a license from us if you want the  
3 label to use music.

4 Are you with me so far?

5 A I'm with you so far.

6 Q Is it your testimony that the  
7 ensuing discussion is one in which a service  
8 has more leverage than a label?

9 A I said, I didn't base my testimony  
10 off the hypothetical presence of a letter. So  
11 if I can refer to the testimony itself, I  
12 first cited the litigation which obviously has  
13 some relationship to contract disputes.

14 JUDGE ROBERTS: What page are you  
15 reading from

16 WITNESS: Oh, I'm sorry, Your  
17 Honor. It starts on the bottom of page 19,  
18 and continues to the top of page 20.

19 JUDGE ROBERTS: Thank you

20 WITNESS: You're welcome.

21 So I said to the extent litigation  
22 is pending that creates uncertainty. So any

1 negotiation is under the cloud of litigation.

2 And then I said, even if the legal  
3 status of the custom radio services were  
4 perfectly clear, the fact they are a close  
5 substitute means their prices will be strongly  
6 influenced by the compulsory fees.

7 So this is just saying, this is a  
8 very powerful influence on the price, because  
9 it influences in some sense the fall back for  
10 the ; for both the radios ; the webcasters,  
11 and essentially for the music service.

12 In the absence of this service  
13 being provided, the webcaster could provide a  
14 statutory service. It doesn't have to  
15 threaten it; it's simply a fact.

16 BY MR. STEINTHAL:

17 Q Let me get this right. In the  
18 circumstance that I posited to you, the  
19 service would have one of four choices,  
20 wouldn't it, either not to go into the  
21 business at all of customized radio; go into  
22 business with a different product than the one

1 they've developed, meaning the statutory  
2 licensed service; pay the rate that label U  
3 wants; or rely on the statutory license and  
4 risk infringement litigation.

5 It's one of those four choices,  
6 right?

7 A I got three. Number one was go  
8 into the statutory ;

9 Q Not go into the business of  
10 customized radio at all because they can't get  
11 the rights voluntarily.

12 A Okay.

13 Q Second is, go into business with a  
14 different product than the one they've  
15 developed, meaning statutory licensing; pay  
16 the label whatever the label wants; or rely on  
17 the statutory license and risk infringement  
18 litigation.

19 Isn't that a fair characterization  
20 of the four options it has?

21 A One very important fifth one,  
22 which is to negotiate with the label. And if

1 the label says I want a million dollars for  
2 this, you say, no, I'm not going to pay your  
3 million dollars, I'll pay you 10 percent more  
4 than the statutory license, take it or leave  
5 it.

6 And the record label might then  
7 come back and say, we'll take it. It might  
8 come back and say, we want 15 percent above  
9 it. But I'm just saying, the existence of the  
10 statutory rate puts a natural sort of focal  
11 point of any negotiations, because to the  
12 extent that the rate deviates significantly  
13 from that, there is the availability of the  
14 substitute in the market, which limits how  
15 much anyone is going to pay for it.

16 Q And, sir, if the label says, I  
17 want an advance of a million dollars, and 1-  
18 1/2 or three times the statutory rate, the  
19 bottom line is, the service has limited  
20 choices which include either not going into  
21 business or going into a different business  
22 than the one that it had planned to go into or

1       risking an infringement lawsuit?

2               A           And I would say the record label  
3       also has limited choices. There are only so  
4       many choices. Its choices can be to provide  
5       the music at a price, not as much as it'd  
6       like, but more than it would get if it were a  
7       statutory webcaster; it can not provide it,  
8       and not be willing to negotiate.

9               Again, these are two parties whose  
10       alternative to trying to provide this music  
11       and the limit to what they can get for this  
12       music is influenced by the presence of the  
13       statutory license which is going to affect  
14       what services are in the market, and what  
15       consumers | this is ultimately driven by what  
16       consumers will pay.

17               So you can demand all you want.  
18       The record company can demand what it wants.  
19       The webcaster can say, we're going to do this  
20       or that or this.

21               But ultimately, unless there is a  
22       significant difference between this service

1 and the statutory service, the consumers would  
2 pay a lot more for it, it's not going to exist  
3 in the marketplace.

4 Q It's not going to exist in the  
5 marketplace?

6 A Absolutely. It will not exist at  
7 a price that is very far away from the price  
8 of services that provide webcasting under the  
9 statutory license.

10 Q And by the way, as I said before,  
11 if we hypothetically knew that the CARP rate  
12 at the time this negotiation occurred was  
13 scientifically the right willing buyer-willing  
14 seller rate, you'd have no problem with having  
15 that in the market, would you?

16 A Having what in the market?

17 Q The existence of a CARP rate, as  
18 long as we knew it was scientifically the  
19 right rate for statutory webcasts?

20 A I'm not sure I understand your  
21 question.

22 Q Well, if we know scientifically

1 that the existing CARP rate reflects the true  
2 willing buyer-willing seller rate, for  
3 statutory licensing, then it's not going to  
4 affect either too much or too little what the  
5 ultimate outcome of that negotiation between  
6 the label and the webcaster would be in your  
7 mind, correct?

8 A I think I understand what you're  
9 saying.

10 If we knew the statutory rate was  
11 the right rate, then would the customized  
12 radio rates be close to the right rates; is  
13 that |

14 Q Yes.

15 A And the answer is yes. If we knew  
16 what is right, then the thing that's very  
17 close to it would also be close to being  
18 right.

19 Q Now let's change the circumstance  
20 one little bit. The webcaster says, I don't  
21 want to pay your premium, because you claim  
22 that my services is interactive. I'm going to

1       rely on the statutory license.

2                   And then label U sues, claiming  
3       \$150,000 per work infringement damages for  
4       thousands of tracks available on my radio  
5       service.

6                   How would you characterize the  
7       difference if any in the negotiations that  
8       would occur between the label after having  
9       sued for infringement seeking damages of  
10      \$150,000 per track being used by the server?

11           A       Let me just try to take this  
12      hypothetical step by step.

13                   One part of I think what you're  
14      asking is, would a lawsuit affect negotiations  
15      over a contract that would sort of replace or  
16      | I don't know what the right word is |  
17      effectively work retroactively and eliminate  
18      the lawsuit.

19                   And to that extent, yes, I think  
20      the presence of a lawsuit affects how people  
21      value something. They are essentially betting  
22      on the outcome of the lawsuit. It happens all

1 the time in settlements. The result fo a  
2 settlement is bargaining over expectations,  
3 based on expectations of the result of a  
4 lawsuit.

5 So to that extent, yes, the  
6 lawsuit affects negotiation over retroactive  
7 prices.

8 Now as far as prospective prices,  
9 I would think the | that's more driven by  
10 assuming it's sort of a pure negotiation just  
11 on prospective prices, that's more driven by  
12 the marketplace forces. And the marketplace  
13 forces here themselves, are highly determined  
14 by the existence of the statutory rate on the  
15 statutory webcast services, which lead to  
16 particular prices in the marketplace, and  
17 limit how high the price is going to be for  
18 the near substitutes.

19 Q Well, you'd agree, wouldn't you,  
20 that if the plaintiff in a lawsuit says, I  
21 will only settle this lawsuit if you pay on a  
22 going forward basis a royalty of X, that there

1 is an opportunity for that plaintiff to use  
2 the pendency of the lawsuit to influence the  
3 price of the license; correct?

4 A If it becomes part of the  
5 settlement negotiations, absolutely.

6 Q Did you consider, in giving your  
7 testimony about how customized services can  
8 use the statutory license to their benefit in  
9 negotiations with the labels, the prior CARP  
10 decision at all?

11 A No, sir, I thought you were asking  
12 a different question, so you'll have to re-ask  
13 it. My mind went.

14 Q My question is, whether in giving  
15 the testimony you gave about how customized  
16 radio services are able to use the existence  
17 of the statutory rate to their advantage in  
18 negotiations with labels, did you consider  
19 what the prior CARP decision said in any  
20 respect?

21 A I have a hard time connecting A  
22 and B here, but let me start with A, which is,

1 I didn't say that the statutory rate is used  
2 by the web services to their advantage. I  
3 described this as a market which is very  
4 similar to the statutory market, and  
5 therefore, is highly affected by it; it  
6 affects the bargaining. But fundamentally,  
7 you can look at it from the demand side, the  
8 supply side, whatever, the price in the market  
9 is strongly affected by the price of the close  
10 substitute.

11 I can quote my testimony if you  
12 want.

13 Q Well, just one second.

14 (Pause)

15 Well, you did testify, did you  
16 not, that services could use the ability to  
17 threaten not to take a customized service  
18 license to try to get a favorable rate by  
19 threatening to operate under the statutory  
20 license, right?

21 A Where did I say that?

22 Q Isn't that the gist of what you

1 said in your written testimony?

2 A No. I'll read the exact sentence.

3 Q Okay.

4 A Which is, and we're on page 20,  
5 the two sentences. I say: Even if the legal  
6 status of the custom radio services were  
7 perfectly clear, the fact that they are close  
8 substitutes for the noninteractive services  
9 means that their prices will be strongly  
10 influenced by the compulsory fees. If the  
11 copyright holders try to set a much higher  
12 price for a nonstatutory customized service,  
13 the music services will simply not offer these  
14 services but instead limit their offerings to  
15 ones that can be provided under the compulsory  
16 license.

17 I don't regard that as a threat; I  
18 regard that simply as a marketplace fact. And  
19 in fact, even if they decided they were not  
20 going to be in the business at all, the issue  
21 is, for the record companies, do I get from  
22 this webcaster or another webcaster, the

1 revenues coming from customers who subscribe  
2 to webcasts that observe the statutory  
3 requirements, or maybe I can get a little more  
4 if I charge a somewhat higher price for my  
5 music, and that goes and flows through to the  
6 market in a somewhat higher cost to the  
7 customers.

8           There's a limit to what the  
9 copyright holder can charge for the music, as  
10 used in the customized web services,  
11 customized radio services, is ultimately  
12 constrained by what customers are willing to  
13 pay for those services. It's not some  
14 abstract concept of bargaining that's more  
15 powerful or more fundamental than what  
16 customers are willing to pay for it.

17           Q       Well, isn't that true of every  
18 market, that the price is limited by what  
19 people are willing to pay?

20           A       Yes.

21           Q       Now that we've at least agreed on  
22 that, isn't it true that in the hypothetical

1 that you're talking about, either the service  
2 is going to be willing to pay what the label  
3 asks for a voluntary license for this  
4 customized radio service or it has no choice  
5 other than to operate a service under the  
6 statutory license?

7 MR. HANDZO: Your Honor, I'm just  
8 going to object. I think this has been asked  
9 and answered now many times. I think Dr.  
10 Pelcovits has made his views perfectly clear  
11 on the bargaining with respect to custom  
12 radio.

13 CHIEF JUDGE SLEDGE: Mr. Steinthal.

14 MR. STEINTHAL: I'm not sure I got  
15 an answer to that question, Your Honor. I've  
16 been trying.

17 CHIEF JUDGE SLEDGE: Objection  
18 sustained.

19 BY MR. STEINTHAL:

20 Q Let me ask you this, sir. I did  
21 ask you this question and didn't get an  
22 answer.

1           Did you consider anything in the  
2    CARP decision on the subject, for example, of  
3    agreements entered into after a lawsuit was  
4    brought by labels challenging a service for  
5    operating outside of a statutory license, in  
6    connection with the testimony you gave with  
7    respect to this precise issue?

8           A       I don't recall anything about this  
9    affecting my analysis.

10          Q       Well, do you recall in fact that  
11   the CARP ruled that agreements entered into  
12   under circumstances where labels threaten to  
13   sue, or did in fact sue, services for  
14   operating outside of the compulsory license,  
15   needed to be rejected because of the  
16   difference in bargaining power created by  
17   virtue of the label's threats or lawsuits?

18          A       I don't recall that specific part  
19   of the CARP decision. I'd be happy to look at  
20   it now. I'd also mention that my testimony  
21   says that one of the reasons I rejected the  
22   custom radio services is because of the cloud

1 of litigation.

2 Q And is it your testimony the cloud  
3 of litigation tends to depress the price that  
4 would be paid by a licensee?

5 A The cloud of litigation affects  
6 the nature of what is being agreed to. What  
7 is being agreed to is not a sort of free  
8 market rate, but it is for the two parties  
9 expectations of what they expect will be the  
10 outcome of the litigation.

11 Q So you wouldn't want to rely on  
12 agreements that are entered into under the  
13 cloud of litigation?

14 A I would say ; as I said, that's  
15 the reason I didn't use the customized radio  
16 agreements.

17 Is any litigation, is any cloud of  
18 litigation a reason not to use an agreement?  
19 I'd have to know the specifics, and what the  
20 nature of the litigation is.

21 But I think I was pretty clear  
22 that uncertainty over whether a customized

1 radio service are inside or outside the  
2 statute is manifest also in the litigation,  
3 affects what those prices are telling you.

4 Q And is it ever the case that the  
5 defendant somehow ends up with more leverage  
6 against the plaintiff in a negotiation that  
7 occurs after a lawsuit is brought?

8 A It depends on what the lawsuit is  
9 relative to what we're talking about.

10 Q That's your testimony?

11 A Yes, that's my testimony.

12 Q Okay.

13 I believe you testified that | and  
14 this is a variation on the not too low | we're  
15 going with the not too high part of the CARP  
16 ruling | I believe part of your testimony was  
17 that you believe that the prior CARP rate was  
18 not too high, or else you would have expected  
19 to observe some deals under the statutory  
20 rate; correct?

21 A Yes.

22 Q Are you aware that Yahoo has

1 entered into some direct deals with  
2 independent labels including the Orchard?

3 A Yes. I don't know specifically  
4 about the Orchard. I don't remember

5 Q Ever heard of the Orchard?

6 A I've seen the label. I don't know  
7 much about it.

8 Q Did you take into consideration in  
9 connection with any of your testimony the  
10 phenomenon or the terms of Yahoo's deals with  
11 independent labels?

12 A I didn't.

13 Q Wouldn't you want to take into  
14 consideration in assessing the marketplace  
15 what voluntary arrangements had been entered  
16 into between willing sellers that are members  
17 of SoundExchange and Yahoo?

18 A If it's for the statutory service,  
19 then I would say it's once again strongly  
20 influenced by the existing statutory rate.  
21 That's the rate absent the negotiated outcome,  
22 so that has a powerful influence on the rate.

1 Q Let me get this right.

2 So in the willing seller-willing  
3 buyer market we're supposed to replicate, you  
4 don't want to look at deals that are entered  
5 into between one of the willing sellers that's  
6 a member of SoundExchange, and one of the  
7 willing buyers that's operating under the  
8 statutory license?

9 A Not at this point in time, given  
10 that there is a rate already there in the  
11 market.

12 Q Not at this point in time given  
13 that there are already rates in the market?

14 A There's already a statutory rate  
15 set in the market, so if you want to try to  
16 look at a market where there is a government-  
17 determined price, and you see that there is  
18 some negotiation off of the government-  
19 determined price, that's got to be strongly  
20 influenced by what that government-determined  
21 price was.

22 Q So even if several record labels

1 and several services got together and came  
2 before this panel and said, we've entered into  
3 a series of deals in the market, you would  
4 ignore them in favor of your hypothetical  
5 market because you believe they would be  
6 affected by the existing statutory rate?

7 A I'd have to know the details of  
8 what you are talking about, because it sounds  
9 to me you've almost talked about a settlement  
10 of the case. In other words, if a number of  
11 the parties got together and came in front of  
12 the CARP and said, we will agree to a  
13 particular rate, that becomes essentially a  
14 settlement of the case.

15 Q Is that not a willing buyer-  
16 willing seller resolution?

17 A At that point I frankly don't know  
18 how I would regard that. I think that is a  
19 legal question I don't think I could answer.

20 Q But as an economist you would  
21 prefer to do your model based on these  
22 interactive benchmark services and making the

1 assumptions and adjustments you do, you would  
2 prefer having a rate set based on that than  
3 these actual voluntary agreements between  
4 people who are within or who are members of  
5 SoundExchange, and members of DiMA who are  
6 operating under the statutory license;  
7 correct?

8 A Because these are a very small  
9 part of the market, because if these contracts  
10 include uses of the music for something other  
11 than statutory service, it adds complexity to  
12 this; because it is not the music of 80  
13 percent of the industry; I would not prefer to  
14 use that, and I did not use it.

15 Q Now your model just assumes that  
16 the same considerations apply to  
17 nonsubscription statutory license services as  
18 subscription statutory license services;  
19 correct?

20 A I don't think I used the term,  
21 same considerations. I said I'd recommend  
22 that the rate be based on the analysis I did,

1 which stemmed from the examination of the  
2 subscription services.

3 Q You make no effort to measure the  
4 difference in the value proposition to  
5 consumers of nonsubscription statutory license  
6 webcasting versus subscription statutory  
7 license webcasting; correct?

8 A Because I don't think that's the  
9 right basis for setting the rate.

10 Q Well, and that's because, if I  
11 wrote it down correctly, you feel that the  
12 sellers should have the ability to capture the  
13 rates that the value consumers would be  
14 willing to pay; is that it, roughly?

15 A They should be able to capture the  
16 value that consumers place on the music and  
17 are willing to pay for the music, rather than  
18 have it cannibalized by a different service  
19 where, let's say, advertisers | and again,  
20 this is at present, advertisers are paying  
21 less than consumers do directly.

22 Q Well, let me do it bit by bit if I

1 can.

2 You do concede, do you not, that  
3 you sought to identify the value to the  
4 consumer in the market for statutory license  
5 webcast services; correct?

6 A For the subscription services.

7 Q Just for the subscription  
8 services?

9 A I used that as the basis of  
10 recommending a rate, and I believe that should  
11 be applied across the board.

12 Q And isn't the reason you chose to  
13 rely entirely on data from the subscription  
14 statutory license webcasters, is that the  
15 evidence you wanted to look at to identify the  
16 value to the consumer of the statutory license  
17 webcast services is the observed price paid by  
18 consumers?

19 A I think I agree with that. I need  
20 to get the exact wording again, if you don't  
21 mind. I'm sorry, it's late.

22 (Question read back.

1                   WITNESS: I would say no, it's not  
2 the evidence I want to look at. That is the  
3 evidence in the market of what consumers value  
4 the noninteractive webcast.

5                   BY MR. STEINTHAL:

6                   Q       Well, the only observed prices you  
7 had were subscription prices; right?

8                   A       That's the only direct observation  
9 of what | how consumers value those types of  
10 webcasts; correct.

11                  Q       So using Dr. Brynjolfsson's 2005  
12 statistics of 90 percent of the webcast  
13 activities under the statutory license being  
14 nonsubscription, and 10 percent being  
15 subscription, it's correct, is it not, that  
16 you relied on the observations from the 10  
17 percent slice of the market in order to  
18 generate your conclusions for the entirety of  
19 the market?

20                  A       Let me first say that 10 percent  
21 as subscribers is not 10 percent of the demand  
22 for the service. I did rely on it, as we've

1 just said. We | that is where customers value  
2 it directly.

3 We don't know what the percentages  
4 are going to be over time as far as the  
5 relationship between subscription and ad-  
6 supported. There is a lot of expectation in  
7 the market, including those from Yahoo and  
8 other music services that ad-supported is  
9 becoming much more popular and a much greater  
10 revenue source.

11 I did not try to come up with a  
12 separate estimate of how much could be raised  
13 from the ad-supported market.

14 And there are, as I said earlier,  
15 also services that get the value through a  
16 bundled approach. So the answer is, I looked  
17 where I saw the data, where I saw a  
18 measurement, and I applied that across the  
19 board, because that is what I believe the  
20 willing seller would do in a free market.

21 Q But again, you went on for some  
22 time, the bottom line is, the only prices you

1 observed were the subscription prices, and you  
2 then used those subscription prices and  
3 extended them across the whole universe of  
4 statutory licensed webcasting for your model;  
5 correct?

6 A I used those prices. I didn't  
7 extend the prices; I extended the rates I got  
8 from the prices, either on a per subscriber  
9 basis; on a revenue percentage; and on a per  
10 play basis, under the assumption of a  
11 tremendous number of plays typical of the high  
12 end of the subscription services.

13 Q So there is no question in your  
14 mind right now that the vast multitude of  
15 streaming activity for statutory license  
16 webcasters is through nonsubscription  
17 services; correct?

18 A I wouldn't agree with that  
19 characterization.

20 Q On what do you base any different  
21 conclusion?

22 A Well, as I've said, I've looked at

1 the Yahoo numbers. Yahoo is a major service,  
2 and I would say possibly the most powerful  
3 service in the market, and they have a  
4 streaming ratio, as we said earlier, I hate to  
5 repeat it, it's confidential, but that's far  
6 from being |

7 Q I think |

8 A -- let me complete this | far from  
9 being a vast majority.

10 And the other thing, it's where  
11 the money is. If you look at the revenue you  
12 get from, let's say, 100 subscribers to the  
13 service rather than, at present, what you get  
14 from 300 ad supported customers, you're  
15 getting much more from the subscription  
16 customers, and I don't see why a copyright  
17 holder would want to see the profitable part  
18 of the market cannibalized.

19 Q Who's talking about the profitable  
20 part of the market being cannibalized here?

21 A I think that's what is the  
22 eventual result if you set a rate for the

1 market based off of the part of the market  
2 where the payment is much less than it is in  
3 the subscription market.

4 Q By the way, your ratio for Yahoo  
5 it three to one, right?

6 A Yes.

7 Q Seventy five percent of the  
8 streaming activity in the way you prefer to  
9 look at it is nonsubscription?

10 A Yes, I think that's three to one,  
11 75 percent. But if you take the money you get  
12 from it, it's more from the 25 percent than  
13 you get from the 75 percent.

14 Q Do you have any specific  
15 information on which you base that?

16 A Yes.

17 Q That's the Yahoo-produced  
18 information?

19 A That's the Yahoo-produced  
20 information.

21 Q We'll get a chance to look at  
22 that, okay.

1                   But let me ask you this. On page  
2 55 if you would turn to page 55, do you see  
3 where you state on this page that in a free  
4 market the owner of the intellectual property,  
5 eg. the record companies, could set a fee  
6 based on the highest value use of its  
7 property, rather than sell at a lower price to  
8 an alternative delivery mechanism that would  
9 undermine the sales of the higher priced  
10 service option.

11                   Do you see that?

12           A        Yes.

13           Q        Is this in part why you believe it  
14 is warranted to look at just what consumers  
15 are paying for the subscription part of  
16 statutory licensed webcasting and not look at  
17 nonsubscription webcasting?

18           A        This is part of the reason, yes.

19           Q        And I gather the highest value use  
20 of property you're talking about is the  
21 subscription market; correct?

22           A        Correct.

1           Q       Compared to the nonsubscription  
2 market?

3           A       That's correct.

4           Q       Let me give you this hypothetical,  
5 which is going to become familiar. It's the  
6 soda-on-the-beach hypothetical.

7                    If you're selling sodas on the  
8 beach in 90 degree weather, and you'd have to  
9 walk a mile into town to get an alternative  
10 source of supply for soda, you'd agree, would  
11 you not, that the seller in that transaction  
12 is able to extract a higher price for the soda  
13 than would be the case if we were in the  
14 middle of town, right?

15          A       The seller could?

16          Q       Yes.

17          A       It could extract a higher price  
18 based on the transport cost to the beach.

19          Q       Or based on the buyer's unique  
20 circumstances and desire in 90 degree weather  
21 on the beach to pay five or even ten times the  
22 normal price for that can of soda, right?

1           A           Not if the ability to provide soda  
2           on the beach is | can be | is in the hands of  
3           many different parties or entrants.

4                        In other words, you might be the  
5           person trying to sell the soda at \$5 a can to  
6           me on the beach, and I'd be willing to pay \$10  
7           for it. But if somebody else is willing to  
8           lug the soda there, and cans of soda there,  
9           and charge less, then that's going to start  
10          driving the price down.

11          Q           But in the hypothetical where  
12          there is one seller, multiple buyers, 90  
13          degrees, and a mile to walk, you'd agree that  
14          the price you would expect for that can of  
15          soda is going to be a heck of a lot higher  
16          than it would be if you were buying that same  
17          can of soda in town, right?

18          A           If you set up a monopoly right,  
19          and you have a greater demand, you're going to  
20          see a higher price, I agree.

21          Q           Would you agree with me that in  
22          looking at a fair market value for soda, you

1 would not want to look at just the sliver of  
2 the market that would be represented by unique  
3 circumstances like a single seller in the soda  
4 on the each example that I gave you?

5 A If that was what I was tasked with  
6 doing is looking at the soda market. Also,  
7 you used the term, a fair price.

8 Q Fair market value.

9 A Well, fair market value, then, the  
10 question is, a fair market value for what? If  
11 it's for soda on the beach, then you'd use the  
12 price that was in that market. If it was soda  
13 in general and you wanted to know what the  
14 average price of soda sold in the market was,  
15 then you would not use that, because that is  
16 not the average price of soda sold in the  
17 market.

18 Q Now let's go back to the sliver of  
19 the market you're looking at in subscription  
20 services as opposed to nonsubscription.

21 You view the subscription services  
22 as representing the highest value use of the

1 sound records as compared to the use of the  
2 sound recording by nonsubscription services,  
3 correct?

4 A That's true at present. To the  
5 extent we can measure it. There's a lot of  
6 nonmeasureable benefits to the nonsubscription  
7 services. So throw that into the equation.

8 Q And as we said before, for the  
9 reasons you've articulated, you chose not to  
10 make any kind of adjustment in your model to  
11 account for the fact that most users are not  
12 willing at this time to pay for statutory  
13 license webcasting; correct?

14 A Right, and I think it's very  
15 important that what's paid in the market  
16 reflects the current statutory rates. So the  
17 statutory rate allows an ad-supported service  
18 with relatively limited revenue coming from  
19 that to be in the market.

20 Q Now for the reasons you state in  
21 your report, you assume that it is appropriate  
22 to generalize from the circumstances of the

1 highest valued user to the entire statutory  
2 license webcasting market, right?

3 A I think that that is what the  
4 willing seller would do if it's setting a  
5 single price in all markets.

6 If this soda seller was | had his  
7 prices determined by a court, and that's where  
8 he could make the money, I would not force him  
9 to set a price at the beach that was based on  
10 prices off the beach.

11 MR. STEINTHAL: Your Honor, I'm at  
12 an appropriate breaking point, and I have not  
13 very much more.

14 CHIEF JUDGE SLEDGE: We're reaching  
15 a point in cross-examination near the end of  
16 the day.

17 We'll recess until 9:30 in the  
18 morning.

19 (Whereupon at 4:58 p.m. the  
20 hearing in the above-entitled matter was  
21 adjourned, to reconvene at 9:30 a.m. the next  
22 morning)

CERTIFICATE

This is to certify that the foregoing transcript in the matter of:

The Digital Performance Right in  
Sound Recording and Ephemeral  
Recordings (Webcasting Rate  
Adjustment Proceeding)

Before: Copyright Royalty Board

Date: Monday, May 15, 2006

Place: Washington, D.C.

represents the full and complete proceedings of  
the aforementioned matter, as reported and  
reduced to typewriting.

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