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COPYRIGHT ARBITRATION ROYALTY PANEL

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-----+ In the matter of:		Docket No.
		2000-9
Digital Performance Right in Sound Recording and Ephemeral Recording		CARP DTRA
-----+ -----+ -----+		1 & 2

Conference Room 216
Second Floor
Offices of Arnold & Porter
555 12th Street, N.W.
Washington, D.C.

Friday,
October 19, 2001

The above-entitled matter came on for rebuttal
hearing, pursuant to notice, at 9:00 a.m.

BEFORE

THE HONORABLE ERIC E. VAN LOON	Chairman
THE HONORABLE JEFFREY S. GULIN	Arbitrator
THE HONORABLE CURTIS E. von KANN	Arbitrator

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Corporation; Radioactive Media Partners, Inc.;
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C-O-N-T-E-N-T-S

WITNESS DIRECT CROSS REDIRECT RECROSS

David Fagin
By Mr. Cohen 12112
By Mr. Levine 12124
By Ms. Woods 12133
Jonathan Zittrain
By Mr. Cohen 12144 12215
By Mr. Katz 12157 12216
Richard Seltzer
By Mr. Jacoby 12221
Adam Jaffe
By Mr. Rich 12310
By Mr. Garrett 12463

EXHIBIT DESCRIPTION MARK RECD

RIAA
114 RPX Press Release Jupiter Media 12182
115 RPX BitBop Screen Shot 12203 12205

SERV Rebuttal

4 Work Paper 12239 12307
5 List of Variables 12240 12307
6 1999 Sales Data 12240 12307
7 RESL 73/74 12240 12307

1 you to return to your students.
 2 We will reconvene at 2:00, at which point
 3 we'll be hearing from Dr. Jaffe. And I gather we have
 4 an updated schedule here.
 5 (Whereupon, the foregoing matter went off
 6 the record at 1:01 p.m. and went back on
 7 the record at 1:01 p.m.)
 8 CHAIRMAN VAN LOON: Mr. Jacoby?
 9 MR. JACOBY: Yes. I'd like to offer
 10 Service rebuttal Exhibits 4 through 7.
 11 MR. SCHECHTER: No objection.
 12 CHAIRMAN VAN LOON: No objection?
 13 Admitted.
 14 [Whereupon, SER. Rebuttal
 15 Exhibits 4, 5, 6, 7 were
 16 received for evidence]
 17 CHAIRMAN VAN LOON: Adjourned until 2.
 18 Whereupon, the proceedings went off the
 19 record from 1:02 p.m. until 2:07 p.m.)
 20 CHAIRMAN VAN LOON: Good afternoon
 21 everyone.
 22 Welcome back, Mr. Rich. Glad to see you.

1 CHAIRMAN VAN LOON: Okay. I think we
 2 would like the time at the break to take a look at it.
 3 Thank you.
 4 Yes?
 5 MS. WOODS: I'm sorry. Just one other
 6 thing. We have apparently been receiving telephone
 7 calls in our practice development department about the
 8 dress for the weekend.
 9 CHAIRMAN VAN LOON: Something on.
 10 MS. WOODS: And there's been some
 11 suggestion about business casual. It really doesn't
 12 matter to us, but they'd like some instruction on if
 13 it's more casual for the weekend.
 14 CHAIRMAN VAN LOON: Is this for them or
 15 for us?
 16 MS. WOODS: For this proceeding. I don't
 17 know why they're getting the telephone calls, but
 18 apparently they are.
 19 CHAIRMAN VAN LOON: Is that my wife
 20 calling?
 21 Is there a firm policy generally?
 22 MS. WOODS: Oh, no one at the firm cares.

1 MR. RICH: And likewise.
 2 CHAIRMAN VAN LOON: And welcome back
 3 Professor Jaffe.
 4 THE WITNESS: Thank you.
 5 CHAIRMAN VAN LOON: Glad to see you.
 6 Let the record reflect that you have
 7 probably the most colorful tie of any witness in the
 8 whole proceedings so far.
 9 I also note that we appear to have shed I
 10 think four witnesses. I propose that we not talk
 11 about it right now, but give the panel during the
 12 break a chance to sort of look at it and reflect. And
 13 then we can discuss it.
 14 Ms. Woods?
 15 MS. WOODS: I just wondered when. Would
 16 it be after the next break you would be discussing it?
 17 I'm just not planning to stay for this, but just to
 18 come back for the schedule.
 19 CHAIRMAN VAN LOON: Oh, well. Let's not
 20 inconvenience you.
 21 MS. WOODS: No, no. They can just call me
 22 to come down.

1 MR. GARRETT: We're already violating the
 2 firm policy. Nobody wears suits.
 3 CHAIRMAN VAN LOON: Oh, I see.
 4 Why don't we be more casual on Saturday.
 5 MR. STEINTHAL: Adam, do you don't have to
 6 wear as colorful a tie tomorrow?
 7 CHAIRMAN VAN LOON: So that burning
 8 issue's been resolved, and you can let the development
 9 people know.
 10 Mr. Rich, I believe you might have a
 11 question.
 12 Several.
 13 Whereupon,
 14 ADAM JAFFE
 15 was called as a witness, and, having first been duly
 16 sworn, was examined and testified as follows:
 17 DIRECT EXAMINATION
 18 BY MR. RICH:
 19 Q Welcome back, Professor Jaffe.
 20 A Thank you.
 21 Q In the interim since you were here, you
 22 have submitted a modest additional piece of testimony;

1 is that correct?

2 A Yes, that's maybe correct.

3 ARBITRATOR VON KANN: I thought you were
4 going to say a modest additional bill.

5 MR. RICH: That I won't even deign to
6 comment on.

7 This afternoon we will cover aspects of
8 that testimony. I'm sure the panel will be glad to
9 know not attempt to cover everything that's covered in
10 the written testimony itself.

11 We'll let the introduction and overview
12 Section I, speak for itself. Let's turn to Section 2,
13 please, and start by my asking you to briefly restate
14 how you conceptualize the willing buyer/willing seller
15 test and how that impacts on the determination of the
16 value to be ascribed to the sound recording performing
17 rights involved here.

18 THE WITNESS: Okay. Well, we talked about
19 this quite a bit the first time I was here. I did try
20 in the rebuttal testimony to carefully lay out the
21 whole argument in one place so that it would be there.
22 And because it is there, I'm not going to regurgitate

1 the whole thing now, but just to kind of set up the
2 discussion.

3 As we go, let me just briefly say that my
4 view is that because the sound recording performance
5 right is being sold in a market that is incremental to
6 the market for which the sound recording was
7 originally created, that there is no additional cost
8 associated with providing the sound recording
9 performance right on the part of the parties that own
10 it. And because the value that it creates for the
11 user is completely symmetric and tied up with the
12 value created for the user by the musical works
13 performing right, that what we'd expect is that in a
14 willing buyer/willing seller competitive market kind
15 of situation the price, if you will -- the market
16 price -- for the sound recording performance right
17 would be expected to be -- almost equal -- the same as
18 the price for the musical work before a consideration
19 of issues of promotional value or displacement, which
20 we'll come back to later.

21 BY MR. RICH:

22 Q Now, an aspect of this analysis is that

1 there is a zero incremental cost of the right being
2 transferred; is that correct?

3 A Yes.

4 Q But I believe as you do point out in your
5 written testimony -- and I would ask you to just say
6 a couple more words about it -- that does not
7 translate into the consequence that, therefore, the
8 value should be zero or that there should be a zero
9 dollar royalty resulting from this process; is that
10 correct?

11 A That's correct. All I'm asserting is that
12 in this hypothetical willing buyer/willing seller
13 negotiation we have a valuation at the top on the part
14 of the buyer for both the musical work and the sound
15 recording are the same, and the bottom is the same,
16 namely zero. And so the negotiation is going to
17 arrive in both cases at some point in between, and
18 there's no reason to believe that the point that it
19 arrives at in between would systematically favor one
20 or the other.

21 Q So for this purpose, the purpose of that
22 observation is to bolster the view that the value of

1 the respective rights, namely the sound recording
2 performing right and the musical work right, from the
3 standpoint of the willing buyer/willing seller
4 perspective should be comparable. Is that the essence
5 of it?

6 A That those should be comparable and the
7 related point, which is that the cost and risk of
8 having created the sound recording in the first place
9 would not enter into the competitive market or willing
10 buyer/willing seller determination of the price for
11 the performing right.

12 Q Now elsewhere in your testimony on that
13 last point, you observe that, at least as to that
14 observation, Dr. Nagle appears to agree with you; is
15 that correct?

16 A Yes.

17 Q Now, there has been submitted rebuttal
18 testimony on behalf of the copyright owners by
19 Professor Wildman and Dr. Schink taking issue with
20 this aspect of your analysis. Have you had occasion
21 to review that rebuttal testimony?

22 A Yes.

1 Q And would you provide the panel with your
2 response to their own critique of your approach?

3 ARBITRATOR VON KANN: Sur rebuttal?

4 MR. RICH: Sur rebuttal.

5 THE WITNESS: I think at sort of the
6 highest conceptual level, I suspect it doesn't
7 surprise the panel to learn that different economists
8 can look at a given situation from a theoretical
9 perspective and propose different theories that they
10 think should apply. And that happens.

11 In general when that happens, what we like
12 to do is to resolve that conflict by resort to
13 empirical data to see which theory actually fits the
14 data. And I've done that in my report, and I think it
15 unambiguously and overwhelmingly shows that the theory
16 that I've put forward fits observed data from the
17 world. And the theory that Dr. Schink and Professor
18 Wildman put forward does not. And we'll come back to
19 that in a minute.

20 But even at the theoretical level I do
21 want to correct what I think are either
22 misunderstandings or mischaracterizations of what my

1 doesn't fit the situation we happen to be talking
2 about.

3 I think the situation we happen to be
4 talking about is more like if you had a sheep farmer
5 who has been raising sheep and selling both wool and
6 mutton. And he gets the brilliant idea to make a few
7 extra bucks charging tourists to come and let the kids
8 pet the lambs and have a great time walking around the
9 farm. I submit that the way he would think about that
10 would be to say, well, I can make some money doing
11 that. That's completely incremental to the business
12 that I'm really in, which is growing sheep. And when
13 I decide how much should I charge those kids to come
14 and pet the lambs, I'm not going to think about what
15 does it cost me to operate my sheep farm. That's not
16 going to be the way I do that calculation. I'm going
17 to say, what are tourists willing to pay to come pet
18 sheep. And the cost of running the farm is going to
19 be something which I view as being associated with
20 growing sheep, and I have this incremental source of
21 revenue. And if there's no additional cost in earning
22 that revenue, there's no reason why the pricing of it

1 theory was, or is, that appear in those testimonies.

2 What both Dr. Schink and Professor
3 Wildman, to some extent, suggests is that my
4 characterization of the performance right for the
5 sound recording as being incremental to the underlying
6 production of the sound recording is an inappropriate
7 characterization of the relationship between those two
8 things; that I don't have any basis, they assert, for
9 saying one of these is the thing that recovers the
10 cost and the other is incremental.

11 And I think that what they would like to
12 have you take away is that somehow the sound recording
13 itself and the right to perform it on the Internet are
14 like sheep -- sorry, are like wool and mutton. There
15 are two things which are inextricably produced at the
16 same time by some production process. In that case it
17 would be growing sheep. And that to say the wool is
18 incremental to the mutton or the mutton is incremental
19 to the wool would be just arbitrary; that you can't
20 make that distinction. But I think that that
21 characterization of the two things as being jointly
22 produced in a sort of symmetric and even way just

1 should be in any way connected to the pricing of the
2 underlying primary activity.

3 Now, it's completely possible that at some
4 point in the future the economics of the recording
5 industry are going to change, and people will truly
6 start thinking of making sound recordings, in effect,
7 for the purpose of playing them on the Internet. And
8 when deciding on the margin, am I going to make
9 another sound recording, they're going to be thinking
10 about the revenues that could be generated on the
11 Internet from streaming that. That could happen
12 someday. And if someday that happens, then it would
13 no longer be the case that the market would be as I've
14 characterized, where the selling of the performance
15 right is from an economic perspective incremental to
16 the underlying creation of the right itself. But I
17 think that if you were to ask people who make records,
18 are you on the margin deciding to make another record
19 because of the revenues you might get my streaming it
20 on the Internet in the period through 2002, I
21 certainly have seen no evidence that that would be
22 part of the economic equation.

BY MR. RICH:

Q Now, another aspect of your analysis in this section of your rebuttal testimony states that in this unusual setting, where we're dealing with two inputs for which there is no incremental costs and which contributes so fundamentally to the same product, that you write at page 9 of your testimony that parties that jointly create value in that situation will split that value equally, yes?

A Yes.

Q And are you familiar with Professor Wildman's response to that, in which he says, well, in a reductio ad absurdum kind of way, how would you deal with ice cream, where you have cream and sugar? And how would you deal with script writers and actors and producers, all of whom in combination contribute to the product, but who in their right mind would suggest that one value equally those inputs?

Have you had occasion to review that testimony?

A Yes. I think this is where Professor Wildman may not have understood what I was saying,

the Wildman and Schink critique of your approach by indicating that there was, in fact, data, which have now been observed, which, in essence, allow one to get past the economic debate, correct?

A Correct.

Q This is the information I take it which you begin to put forward at page 18 of your rebuttal testimony, in Section III?

A Correct.

Q Can you set the stage for this discussion, please, by first addressing the copyright rights to which the data which you'll be discussing pertain?

A Yes. As I think we discussed a little bit when I was here the first time, it would be wonderful if we could go out and look at some other framework in which there is a competitive market for sound recording performance rights and a competitive market for musical work performance rights, and compare the two. For better or for worse, there are so few contexts in which the sound recording carries a performance right that that's just not practical. We can't observe that. But it does turn out that there

because it was essential to my argument that the inputs we're talking about have this property that there's no cost of providing them in this particular context. And that just wouldn't be true of cream and sugar. Both cream and sugar have a cost. And they reason they have a cost is because if you don't put it in the ice cream, you can use it for something else and get a value out of it.

And so I was very specific that the circumstance I was talking about was one in which the input is coming to this incremental use in such a way that there's nothing saved by not using it here. And that doesn't apply to cream and sugar, and it doesn't apply to the actor and producer in making a movie. If an actor doesn't make a given movie, he can go make some other movie or she can go make some other movie. So there's a cost associated with the actor's time in making a given movie. And in that case, that cost is going to weigh heavily on the market price for their services in that context. So I don't think his examples fit my conceptual framework.

Q Now, you began your initial response to

is a circumstance in which a copyright associated with the sound recording and a copyright associated with the musical work are both sold or licensed in very parallel circumstances. And that's the basis for the empirical test that I've constructed.

So the right that is at issue here is the right -- it's not a performance right; it's really a reproduction right. It's the right, in the case of the sound recording, to reproduce the sound recording in the sound track of a motion picture or television program. In the case of the musical work, it's the right to reproduce the musical work in the sound track of a movie or TV program. And in the jargon or lingo of the industry these have names. The name that is used for the reproduction right for the sound recording is a so-called master-use right, and the name for the use of the musical work is a so-called synchronization or synch right.

So what we have here are in both cases, again -- and this is what's crucial -- conceptually the same situation that I've been analyzing. We have an existing sound recording, we have an existing

1 musical work. The costs of creating both are sunk.
 2 There's substantial revenues that have typically
 3 already been collected toward both. And now we have
 4 this incremental use. Someone wants to make a movie;
 5 someone wants to make a TV show, and they would like
 6 to incorporate this particular performance of this
 7 particular song into this movie or into this TV show.

8 Now, that is an incremental use, and it is
 9 one for which there is no cost to the owner of the
 10 intellectual property. If they say, no, you can't
 11 have my song for this movie, it doesn't make that song
 12 any more available for other movies or for other uses.
 13 They have the same ability to use it in other movies
 14 or in other uses whether they say or whether they say
 15 no to this particular use.

16 So, once again, even though it's not a
 17 performance right, it is a circumstance that
 18 conceptually, exactly fits the circumstance that I've
 19 been talking about, in which you have these parallel
 20 negotiations to acquire a previously created right
 21 whose costs are sunk, and where you need both, and you
 22 can't put the song sung by that artist into the movie

1 observe in the data?

2 A Well, there are two ways of seeing what
 3 the implication of the Wildman and Schink analysis is.
 4 One is that the cost of having made these things to
 5 begin with is suppose to be a big factor here. It's
 6 suppose to be affecting the competitive market price
 7 for each of these rights. And if their analysis of
 8 the costs, from which they conclude that the cost of
 9 producing the sound recordings is much greater or
 10 correct, then the clear implication would be that we
 11 ought to observe that this purchase of the right for
 12 the sound recording will be, on average, at a higher
 13 price than the purchase of the corresponding musical
 14 work.

15 Now, as I've said, for any one song there
 16 could be reasons why one is worth more than the other.
 17 We'll see our data in a minute. There's an occurrence
 18 in our data where "Auld Lang Syne" is put into a
 19 movie, and the composer gets more than the songwriter.
 20 I don't know any of the details of that circumstance,
 21 but I suspect it's because if you want to have "Auld
 22 Lang Syne" in your movie, there are actually a lot of

1 unless you get both. So the circumstance we're
 2 talking about from an economic perspective has exactly
 3 the same structure as the licensing for performance
 4 purposes of the musical work and the sound recording.

5 Now, it turns out that in this case we do
 6 observe an active, reasonably competitive market in
 7 which these transactions occur. So what happens is,
 8 the director or the other creative people who are
 9 making a movie will decide that they want to use a
 10 particular song performed by a particular artist. And
 11 the studios have people whose job it is to go out and
 12 acquire the rights that are necessary to do that. And
 13 they do that by negotiating with record labels for the
 14 master use or sound recording right, and with music
 15 publishers for the musical work or synch right. And,
 16 typically, on an arms-length basis, they come up with
 17 some fees.

18 And I submit that my theory implies that
 19 what we ought to observe if we look at such fees is
 20 that, on average, they will be about the same.

21 Q Let me interrupt you to ask you, under the
 22 Wildman and Schink thesis what would you expect to

1 different recordings of it that you could use. And so
 2 in some sense, in that one case, the musical work is
 3 worth more than the sound recording.

4 Conversely --

5 CHAIRMAN VAN LOON: You mean to say, I
 6 think, that the composer got more than the artist.

7 THE WITNESS: Did I say that wrong? I'm
 8 sorry. The composer got more -- the musical work, the
 9 publisher, got more than the sound recording.

10 ARBITRATOR VON KANN: Well, the composer
 11 was Scottish, so he was a very tough negotiator.

12 THE WITNESS: In other cases, the director
 13 is going to want a particular performance by a
 14 particular artist and may pay a lot to get that. So
 15 any one case it could go one way or the other. But I
 16 submit that, on average, my theory predicts they
 17 should be about the same; whereas, Professor Wildman
 18 and Dr. Schink's theory predicts we should
 19 systematically observe a higher price for the sound
 20 recording.

21 BY MR. RICH:

22 Q And I take it, despite your conceptual

1 differences, Professor Wildman himself says the proof
2 of the pudding would be in the empirical data, and
3 would agree; is that correct?

4 A I do agree with that, yes.

5 Q Okay. Well, before we get to that
6 empirical data, one more question as to the rights
7 involved.

8 In footnotes 21 and 25 of your written
9 rebuttal testimony you discuss certain aspects of the
10 licensing of synchronization and master-use rights in
11 the motion picture, theater and television settings.
12 And can you elaborate a bit on the purpose of those
13 footnoted comments?

14 A Yes. What I'm trying to do, is I'm trying
15 to look and see, if we put the sound recording on one
16 side of the scale and we put the musical work on the
17 other side of the scale, do we observe that they're
18 about equal.

19 In general, when you do an exercise like
20 that you would worry that if there's some ancillary
21 factor that is not connected to your economic analysis
22 that is distorting one side or the other, you might

1 representing two-thirds of the data, they're exactly
2 the same. So, although, at some level you'd always be
3 worried about those kinds of confounding factors, the
4 results are so consistent, I don't think any such
5 argument really can carry much water in this case.

6 Now, let me address specifically, though,
7 the issue that's in those footnotes, which has to do
8 with a legal issue as to how the compositions are
9 licensed for use in movie theaters. And there is
10 arguably a legal difference between the way the right
11 for the sound recordings are conveyed and the way the
12 rights for the musical work is conveyed that arguably,
13 at least as a theoretical matter, would lead to an
14 upward valuation of the musical work in movies.

15 I don't think that argument's right as a
16 matter of concept, and that's explained in that
17 footnote. And further, if it were right, it has the
18 clear implication that you should see a different
19 pattern in movies than in television, because this
20 difference which occurs in movies simply does not
21 exist on the TV side. And what we'll see in a minute
22 when we look at the data is that not only is there

1 want to worry about that. So if there's something
2 that causes -- something else that causes the musical
3 work to go at a higher price, you might be worried
4 that what's really going on is the sound recording is
5 worth more, but that's being offset by this other
6 factor that is sort of distorting the comparison of
7 the two.

8 Now, as a threshold matter we're going to
9 see in the data in a minute that for two-thirds of the
10 songs, almost 500 different songs, the price at which
11 the sound recording sells and the price at which the
12 musical work sells are not just similar; they're
13 identical to the penny. So it seems to me that just
14 as an threshold matter, given what the data look like
15 where two-thirds of the cases they're the same to the
16 penny, any kind of argument that says, well, your
17 analysis is biased because Factor X is distorting the
18 musical works side, and that's somehow masking the
19 reality, the supposed reality in which the sound
20 recording is worth more, is just implausible because
21 it requires that these two things offset each other so
22 precisely and so evenly that for almost 500 songs

1 this very clear pattern of equality, there's no
2 evidence of any difference between movies and
3 television. So I just think there's no issue there
4 with respect to this complication of how the rights
5 are conveyed.

6 MR. RICH: Mr. Chairman, for this next
7 section, but only for this next section, of my direct
8 examination, we will need on a restricted record.

9 CHAIRMAN VAN LOON: Okay. Let's go on a
10 restricted record then. If I could ask that the sign
11 be put outside to indicate a closed session. And I
12 believe there's no one to ask to leave at the moment.

13 (Whereupon, at 2:33 p.m. the proceedings
14 went into Closed Session.)
15
16
17
18
19
20
21
22

1 Q Now in sum, Professor Jaffe, what do these
2 studio data which you've now reviewed tell you about
3 the validity of your conceptual analysis about the
4 relative value of the sound recording performing right
5 and the musical work performing right?

6 MR. STEINTHAL: Should we go back on the
7 public record at this point?

8 MR. RICH: I think we can, yes.

9 CHAIRMAN VAN LOON: Back to the start of
10 this question.

11 THE WITNESS: Well, as I sort of implied
12 in my written testimony, this is verification of an
13 economic theory of a surprisingly strong form. I
14 mean, I've written a lot of papers where I've tried to
15 test my theories using empirical data, and it's pretty
16 rare that the test is this clean, this unambiguous and
17 this compelling. I think it just rules out any
18 interpretation other than that in this competitive
19 market setting where there is a valuation of, on the
20 one hand, an incremental use of the sound recording,
21 and on the other, an incremental use of the musical
22 work. There is anything other than approximate parity

1 between the two in market value.

2 ARBITRATOR GULIN: Professor, would it be
3 reasonable to assume that when a motion picture or TV
4 program incorporates one of these sound recordings
5 that there's a promotional value to the sound
6 recording, and it's going to promote the sale of CDs?

7 THE WITNESS: There could be, and I think
8 I have --

9 ARBITRATOR GULIN: So it would be?

10 THE WITNESS: Sorry?

11 ARBITRATOR GULIN: Would you guess there
12 would be?

13 THE WITNESS: I would guess there would
14 be. Now, how big it is, I don't know. Most movies
15 flop, so that you're making a movie hoping it's going
16 to be a big success, but most of them aren't.

17 As far as I can tell, I asked the studio
18 people did these other considerations ever come up in
19 these negotiations-- the cost or the promotional
20 value. From the studio people's perspective they kind
21 of complained that these guys demand all this money,
22 and they don't seem to take into account that there

1 same analysis you did with respect -- that's why you
2 had a downward adjustment in your rate.

3 THE WITNESS: I think conceptually you can
4 ask that question. And there's two comments I would
5 make on that. One would be, there's a limit to how
6 big even I would say the promotional value effect
7 would be. So if you carried that out, you might look
8 at these data and say, aha, the true value before
9 promotional value considerations is not equal; it's
10 30 percent higher for sound recordings. That's a lot
11 closer to equal than to the implied rates in the RIAA
12 proposal.

13 But I think more fundamentally, the
14 problem I have with that analysis is the one I
15 mentioned at the beginning, about two-thirds of them
16 being equal to the penny. I mean, somehow it just
17 doesn't seem plausible to me that there's this
18 uncertain promotional value out there which is
19 operating. And the impact that it has is to offset
20 the intrinsically greater value of sound recordings,
21 and to do it coincidentally with such precision that
22 we end up at exactly the same point. I don't find

1 are all these other benefits to them of putting it in
2 the movie.

3 The fact of the matter is, whatever are
4 such effects, they either are not big enough or not
5 perceived as big enough or sure enough to actually
6 affect these outcomes, as far as I can tell.

7 ARBITRATOR GULIN: Let me think about that
8 for a moment.

9 If, in fact, they are having an
10 effect -- maybe you're right that they're not, but
11 maybe they are, and we just don't see it. I think in
12 your direct testimony you made clear that when a CD is
13 sold that that benefits the record companies a lot
14 more than the PROs.

15 THE WITNESS: Correct.

16 ARBITRATOR GULIN: Correct? Now if that's
17 the case, and that's happening here, and the absolute
18 values of master-use rights and synch rights were
19 truly equal, would not one expect that the record
20 companies would accept less for the master-use right
21 than the PROs for the synch right? Because they're
22 making it up in promotional value. And that was the

1 that plausible.

2 ARBITRATOR GULIN: Well, if you're a
3 record company, and you say to yourself, boy, if we
4 can get exactly the same as the synch rights, we've
5 got a built-in premium, so let's just go for getting
6 exactly the same -- if that premium is 30 percent or
7 whatever it happens to be -- we don't know. There's
8 been no surveys done as far as -- certainly not
9 anything presented in this proceeding. But wouldn't
10 that be a reasonable way to proceed if you're a record
11 company? Say, let's just go for parity, and we're
12 making 30 percent, or whatever the figure is.

13 THE WITNESS: I'm not going to try to
14 guess what they might be thinking. When I talked to
15 the studio people and specifically asked them is it
16 their impression that's what's going, I didn't hear
17 that. Now, I don't know what the record label people
18 would say.

19 ARBITRATOR VON KANN: We may have a chance
20 to find out.

21 BY MR. RICH:

22 Q Professor Jaffe, just following on Judge

1 Gulin's questions, looking at the other side of the
2 equation, that is with respect to the musical works
3 and possible other royalty opportunities, any thoughts
4 what a successful exploitation of that product might
5 do with respect to boosting other sources of income to
6 the music publisher?

7 A I hesitated to get into this because it's
8 complicated. This is where the similarity of the
9 results for the movies and TV actually gives me a fair
10 amount of comfort, because one of the things that goes
11 on which is -- so you're saying, which I think may be
12 right, conceptually, "We're thinking about this movie.
13 If we get the song in the movie, it will boost the
14 sale of CDs." That benefits the sound recording more
15 than it benefits the musical work.

16 There's another phenomenon which is also
17 going to go on, which is if that movie is a success,
18 and presumably there's not going to be much
19 promotional value for CDs if it's not a success, it's
20 also going to end up on television later. And when
21 the movie is shown on television, the musical work
22 commands a performance royalty but the sound recording

1 symmetry of sound recording and musical work
2 performing right valuations.

3 A Yes.

4 Q I take it that synthesizes in one place
5 the various aspects of this issue, which to you
6 coalesce in the conclusion you've reached?

7 A Yes. I just tried to pull together in one
8 place in my testimony, in fairly condensed form, all
9 of the arguments or the important arguments about the
10 equality of the two works.

11 Q The last bullet of which is the data you
12 just described.

13 A That's correct.

14 Q Let's turn next to the fee model, which
15 you have sponsored here on behalf of the Services.
16 Beginning at Page 25 of your written testimony you
17 discuss that model. Am I correct that you have recast
18 that model in certain respects? And if I am correct,
19 can you tell the Panel why you did so and how
20 conceptually different the recast model is?

21 A Yes. I did, and it's not conceptually
22 different. It's presentationally different.

1 does not. So that there is an offsetting factor with
2 respect to movies, in terms of promotional value,
3 connected to the additional performance royalties that
4 the composer will get when the movie is on TV that the
5 sound recording doesn't get, which would tend to
6 offset -- if they really are thinking this far down
7 the road about these sort of subsequent royalty
8 implications, that would tend to offset the CD sales,
9 and it would imply that we ought to see something
10 different between movies and television because with
11 respect to television we have a different situation
12 with the rights.

13 So, again, I think the fact that we such
14 a consistent pattern across movies and TV, what it
15 suggests to me is that while these subsequent values
16 are there, they're uncertain and they don't seem to be
17 big enough to be affecting the negotiations. I think
18 that's the most plausible interpretation of the
19 numbers.

20 Q Now, if you'd look at the bottom of Page
21 23 of your prepared testimony, you have a summary
22 section dealing with what you term the fundamental

1 Obviously, at the time I wrote my direct testimony I
2 didn't know what the RIAA was going to propose. So
3 what I did was introduce a model that was
4 fundamentally based on or derived from this concept of
5 a listener hour, and from that I derived what I called
6 a listener song. And both of those, I argued, were
7 alternative ways of looking at the value of the
8 performance itself, which I argued was the appropriate
9 way to structure the model.

10 Then the RIAA, in its proposal, one of its
11 alternatives is something that it called a per
12 performance fee, which was conceptually the same as my
13 listener song fee. So what I realized or what I
14 decided on the second round I believe that it helps
15 the Panel in comparing these two approaches to focus
16 in on where they're the same so that you can then have
17 to worry about the places where they're different.

18 So all I've done here is to sort of
19 redefine the way I talk about my model to show as
20 clearly as possible how to compare it to the RIAA
21 model. So what I did was instead of starting from a
22 listener hour and then deriving from that a listener

1 song, what I have now done is to say, okay, I'll start
 2 from a listener song and, you know what, I'll even
 3 call it a performance since that's what RIAA calls it
 4 so we can just agree on that terminology.
 5 So I'll start by constructing a
 6 competitive market value for a performance in the same
 7 way I did before, so it's the same conceptual
 8 approach. And I will derive the listener hour version
 9 of the model from that so that it's totally parallel
 10 to the RIAA presentation.

11 (Whereupon, at 2:57 p.m., the proceedings
 12 went into Closed Session.)
 13
 14
 15
 16
 17
 18
 19
 20
 21
 22

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In the matter of: _____ Docket No.
 | 2000-9
 Digital Performance Right in _____
 Sound Recording and Ephemera _____
 Recording _____ CARADOT
 | 1 & 2

Conference Room 216
 Second Floor
 Offices of Arnold & Porter
 555 12th Street, N.W.
 Washington, D.C.

Friday,
 October 19, 2001

The above-entitled matter came on for rebuttal
 hearing pursuant to notice, at 9:00 a.m.

BY: _____
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 THE HONORABLE CURTIS E. von KANN Arbitrator

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1 MR. GARRETT: Mr. Chairman, let me have
 2 that portion of the transcript --
 3 THE WITNESS: Oh, I'm sorry. Yes, I
 4 apologize.
 5 CHAIRMAN VAN LOON: Yes. We'll need to go
 6 back, please, John, and mark it restricted. Thank
 7 you.
 8 COURT REPORTER: Before Mandelbrot?
 9 CHAIRMAN VAN LOON: Yes.
 10 THE WITNESS: Should I continue?
 11 CHAIRMAN VAN LOON: Yes. I mean it's
 12 completely appropriate, we just need to be mindful of
 13 what's public information and what's not for the
 14 purposes of the public.
 15 THE WITNESS: And now that I've been
 16 reminded that these agreements are in fact restricted,
 17 I'll try to keep that in mind. I'd forgotten about
 18 that.
 19 CHAIRMAN VAN LOON: If it's necessary or
 20 helpful to make the point, it's completely appropriate
 21 for us to do it in closed session so that we have a
 22 full understanding.

1 THE WITNESS: Yes, and all I meant was
 2 I'll try to remember to say I'm about to say something
 3 restricted rather than just launching into it. If I
 4 can remember, I'll try to do that.
 5 MR. GARRETT: Don't worry, I'll remind
 6 you.
 7 (Laughter.)
 8 THE WITNESS: Okay. So the point I was
 9 making was that it's the same model. What I've tried
 10 to do is to now set it up in a way that makes it very
 11 easy to compare to the RIAA's -- what they've called
 12 their performance model.
 13 BY MR. RICH:
 14 Q Now, before we review some of the details
 15 of this model in its current form, cutting to the
 16 bottom line, what is its net impact on the fees that
 17 you propose for the various services?
 18 A Well, we may have skipped a step. Let me
 19 also just mention, because I didn't in my previous
 20 answer, I also recalculated all the numbers with
 21 updated data, so that's sort of separate issue from
 22 recasting how I've described the model.

1 The combination of those two things,
 2 recalculating all the numbers and recasting the model,
 3 has no impact on the fees for simulcasting or
 4 rebroadcasting of over-the-air signals. It does end
 5 up increasing slightly the fee for webcasting because,
 6 as we'll explain in a minute when we get to it, when
 7 you start with the performance and go from that to the
 8 hour model, the fact that there are more songs per
 9 hour in webcasting results in a slightly higher per
 10 hour fee for webcasting than the way I did it before.
 11 Q Why don't we, using Figure 3, walk the
 12 Panel through the figures as they now exist,
 13 benefitting from both the recasting and the updating
 14 of data? So if you could describe what Figure 3
 15 depicts, please.
 16 A Yes. Figure 3 is analogous to a figure
 17 that was in my direct testimony. It was called
 18 Exhibit B-2 in my direct testimony. And the numbers
 19 that were in Exhibit B-2 are shown in the righthand
 20 column of Figure 3. And I won't test your memory, but
 21 in B-2 the listener hour model came first, and then
 22 the per performance, or listener song, model came

1 second. So I've just reversed the order.
 2 And then I've recalculated, as is
 3 indicated, in the first column the actual numbers.
 4 Now, the first thing to observe in the first two rows
 5 is that the numbers are exactly the same of 0.0002
 6 dollars or 0.02 cents per performance. This is now in
 7 over-the-air radio. We haven't yet brought it over to
 8 the Internet context. And 0.22 cents per hour, per
 9 listener hour. And that's the same in both cases --
 10 to two decimal places those are the same numbers I had
 11 before.
 12 Now, let me just briefly describe the
 13 updated data. When we did this before, which was in
 14 the spring of this year, what we had were for the year
 15 2000 actual amounts paid by the licensees on an
 16 estimated basis to ASCAP, BMI and SESAC for the year
 17 2000. They had not yet reconciled and produced final
 18 numbers or final reports and final payments to the
 19 ASCAP, BMI and SESAC, so I based my calculation on
 20 those estimates. I suggested at the time that there
 21 was no reason to believe that the final numbers would
 22 vary systematically one direction or the other.

1 Those final numbers were produced between
2 the spring and the end of the summer, so I went ahead
3 and recalculated using the final numbers. I also --
4 there were a few stations for which we didn't have
5 complete data the first time around, and with the
6 additional time, we now had complete data, so you'll
7 see there's a few more stations in the recalculated
8 numbers.

9 But, essentially, it's the same
10 calculation I did before. And as I predicted, while
11 for an individual station there is sometimes a
12 variation, either up or down, in the final number as
13 compared to the estimate that I used, on average, to
14 two decimal places it doesn't change the answer. You
15 get exactly the same number I got before.

16 Q So, in essence, Figure 3 tells us that the
17 conversion metric, if you will, using over-the-air
18 broadcast fees has remain unchanged.

19 A Correct.

20 Q Okay. Now, if we could turn next to
21 Figure 4, which is the application of that metric in
22 the context of webcasters and broadcast streamers and

1 hour, and are we still now on the restricted record?

2 COURT REPORTER: I never left it.

3 THE WITNESS: Good, because I'm about to
4 avert back to the Yahoo again.

5 CHAIRMAN VAN LOON: I believe that
6 everything that was testified after that one or two
7 sentences on Yahoo was appropriate to be back on the
8 public record.

9 MR. RICH: It was indeed appropriate to
10 be. I don't think we signaled it.

11 CHAIRMAN VAN LOON: Yes. I think we
12 didn't, just that one answer. But now this answer
13 should again go to the restricted record.

14 (Whereupon, at 3:05 p.m., the proceedings
15 went into Closed Session.)

1 rebroadcasters, could you please describe how the
2 proposed fee, as set forth in the first row going
3 across, indicating webcasters fee per performance and
4 fee per tuning hour, were derived?

5 A Yes. The key link between Figure 3 and
6 Figure 4 on Figure 3 the first number in the upper
7 lefthand, the 0.02 cents per performance, or 0.0002
8 dollars per performance, that is my estimate of the
9 value of a performance of a musical work in over-the-
10 air radio. As I explained in my direct testimony, I
11 believe that because of the promotional value
12 difference, the market power of ASCAP and BMI and the
13 statutory factors, it would be appropriate to discount
14 that for Internet streaming, and I applied a discount
15 of 30 percent or equivalently multiplied that 0.02 by
16 0.7 to get what I think is the reasonable webcasting
17 fee per performance, and that's the number that
18 appears in the first box on Figure 4. So if you look
19 at Figure 4 for webcasters for fee per performance,
20 what you see is 0.014 cents per performance, which is
21 just the 0.02 on the previous page times 0.7.

22 Then moving across to the fee per tuning

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In the matter of: _____ Docket No.
| 2008-02
Digital Performance Right in
Sound Recording and Ephemeral
Recording | CARP Docket
| 1 & 2

Conference Room 216
Second Floor
Offices of Arnold & Porter
555 17th Street, N.W.
Washington, D.C.

Monday,
October 19, 2001

The above-entitled matter came on for rebuttal
hearing, pursuant to notice, at 9:00 a.m.

BEFORE
THE HONORABLE ERIC E. VAN LOON Chairman
THE HONORABLE JEFFREY S. GULIN Arbitrator
THE HONORABLE CURTIS E. von KANN Arbitrator

1 THE WITNESS: So I took the 0.014 cents
2 per performance and said my reading of the record in
3 this case, from the testimony of one of the
4 webcasters, was that there were 50 songs per hour in
5 webcasting. So I simply multiplied the 0.014 cents
6 per performance for webcasters times 15 performances
7 per hour to suggest that you could have a fee per
8 tuning hour, which is what the webcasters really can
9 measure, at least easily, of 0.21 cents per tuning
10 hour, so that that number would be an appropriate to
11 use for a webcaster, which is essentially broadcasting
12 or webcasting sound recordings more or less all the
13 time.

14 As I suggested before, if you have a
15 webcaster who has large number of hours in which they
16 don't have sound recordings for which they're paying,
17 they could use an alternative estimate of sound
18 recordings per hour times the 0.014 figure in the
19 upper lefthand corner instead, if that made sense in
20 their context.

21 Q Let me ask you this: Does the recasting
22 to calculate, first, the fee per performance and then

1 to move up, if you will, or multiply up to the fee per
2 tuning hour reflect any changed judgement on your part
3 from the time of your initial testimony, as to
4 desirability of calculating royalties, at the end of
5 the day, on the basis of aggregate tuning hours?

6 A No. I mean as I think I described the
7 first time around, there's a lot of benefit to both
8 sides in structuring these fees so that they're
9 reasonably easy to calculate. And I think the tuning
10 hours concept is very powerful and very helpful,
11 because this is something which is easily measurable
12 on the Internet. So it's beneficial to both sides to
13 have a fee that can be calculated on that basis.

14 My model, fundamentally, is derived from
15 the same performance concept that RIAA has used, but
16 what I'm suggesting is that it's important that there
17 be a per hour implementation of that performance
18 model, because it would be inefficient to require most
19 webcasters to actually go and count the specific songs
20 on an hour-by-hour basis.

21 Q Why don't you next walk the Panel through,
22 in a similar fashion, how you derived the proposed

1 fees for the broadcast streamers? That's the second
2 row on this Figure 4.

3 A Okay. Once again, the starting point is
4 the 0.02 cents per performance over the air that
5 appears on Figure 3. What I've done with respect to
6 the rebroadcasting is to recognize that there's a lot
7 of testimony in the record from Mr. Mandelbrot and
8 others about reasons why the market price for this
9 right, with respect to simulcasting or rebroadcasting,
10 is likely to be lower than the market price for
11 webcasting. The simulcasting or rebroadcasting is
12 inherently, on the user's side, competing with over-
13 the-air radio where this right is free, and that is
14 going to tend to have a downward pole on any market
15 price for the right on the Internet.

16 Many of the issues regarding displacement,
17 which have been raised as least as concerns, seem to
18 be connected to features of the Internet that would
19 not be present with respect to rebroadcasts of the
20 same material as over-the-air. So I think there is a
21 general agreement that a lower rate, in some sense, is
22 appropriate for the rebroadcasting or simulcasting.

1 I don't believe that there's anything in
2 the record that really allows one to precisely
3 quantify what that difference should be. So what I
4 propose is, as I described in my original testimony,
5 I think the evidence on promotional value, on market
6 power of ASCAP and BMI, on the international
7 comparisons of the ratio of sound recordings and
8 musical works, if you take all that together, I judged
9 a range of 40 percent to 70 percent would be --
10 anywhere in that range could be a reasonable fee for
11 the Internet. I had conservatively chosen the upper
12 end, 70 percent, for the webcasters. So what I'm now
13 suggesting is that one could choose the lower end of
14 the range, 40 percent, for the over-the-air
15 rebroadcasting and simulcasting.

16 So what I've done in Figure 4 is to take
17 that same 0.02, which appears in Figure 3, and
18 multiply it by 40 percent. That produces the 0.008
19 cents per performance that's in the lower lefthand
20 corner. Then to get over to the righthand side we
21 need to multiply that by songs per hour. I used 12
22 songs per hour. The average in my data for over-the-

1 air music stations is 11.5, so I just rounded that up
2 to 12 to keep the numbers relatively simple. And that
3 0.008 cents per performance times 12 gives you 0.01
4 cents per hour for the streaming -- the simulcast and
5 rebroadcast streaming.

6 Q And for what period of time do you propose
7 that the fees set forth in Figure 4 apply?

8 A As I explained last time, these numbers
9 are calculated on the basis of data for the year 2000.
10 So what I'd like to propose is I think a conservative
11 and straightforward of then applying them for the
12 entire period that is at issue in this proceeding. So
13 I would submit for the year 2000 these are clearly
14 appropriate fees, because they're based on the actual
15 economic experience in the year 2000. With respect to
16 the year 1999, the fundamental basis of this is fees,
17 which are based on revenue, per performance. The data
18 show clearly that revenues relative to audiences in
19 over-the-air radio for 1999 were lower. So if I had
20 done this same calculation based on 1999 data for
21 over-the-air radio, I would have gotten slightly lower
22 numbers.

1 So what I would suggest, just to keep
2 things simple, and because I haven't done the
3 calculations in any precise way, is that these numbers
4 could be applied for the entire first period; that is,
5 from the end of October 1998 up through the end of
6 2000, these fees could be applied. That's actually
7 slightly conservative, because the right numbers for
8 1999 are probably slightly lower.

9 Going forward, with respect to 2001 and
10 2002, we don't have any data yet. We don't know what
11 the fees are going to be in the benchmark for 2001 and
12 2002. Given the way the economy is going, I think
13 there is reason to believe they might actually fall
14 again, but I don't know. So what I propose, just
15 again to keep it simple, is to just increase them for
16 an estimate of inflation. So what I would propose is
17 take the numbers that appear in Figure 4, increase
18 them by three percent for the year 2001, which is
19 basically the current best estimate of the inflation
20 rate, and then to take that level and increase it by
21 another three percent for the year 2002 in order to
22 build in a small increment for inflation.

1 Q I take it that with respect to ephemeral
2 fees, your testimony and your recommendation remains
3 that there be no increment ephemeral fee payable
4 beyond the fees set forth and proposed in your model;
5 is that correct?

6 A That is correct.

7 Q For the reasons that you have earlier
8 testified to.

9 A Yes.

10 Q Now, beginning at Page 40 of your
11 testimony, you address an additional issue which the
12 Panel has expressed interest in, which is whether
13 there are any other categories or subcategories of
14 webcasters for whom different fees should pertain.
15 Could you briefly summarize the gist of that
16 testimony, please?

17 A Yes. I've given this a lot of thought,
18 and I think it's important when you're asking yourself
19 whether some difference in circumstances demands a
20 difference in fees that you focus in on the question
21 of whether the difference in circumstances leads you
22 to believe that the value of a performance in

1 translated from one context to another. But if you
2 valued the performance itself, the mere fact that over
3 here there's additional things that generate more
4 revenue just doesn't matter. You don't need to worry
5 about it.

6 To change slightly the analogy I used in
7 my written testimony, if you're trying to figure out
8 how much a set of tires is worth and you have a car
9 sitting here and the tires on it you know are worth
10 \$200 and that happens to be one percent of the price
11 of the car, and that car is a Toyota, and over here
12 you've got a Mercedes that happens to have the same
13 tires on it, well, presumably, the value of the tires
14 themselves hasn't changed. The percentage that those
15 tires represent of the overall value has definitely
16 changed. So if what you were trying to do was to
17 value the tires on the Mercedes on a percent of value
18 basis, you have to use a different percentage, and the
19 percentage you used or the percentage that obtained on
20 the Toyota. But if you know, looking at that Toyota,
21 that the tires are worth \$200 and it's the same tires
22 on the Mercedes, they're still worth \$200. It doesn't

1 different circumstances is actually different. It's
2 very easy to have circumstances that are quite
3 different in terms of important business aspects
4 without having any reason to believe that the value of
5 the performance itself is any different.

6 And in this respect, I think we see one of
7 the main virtues of the per performance model as
8 distinct from the percent of revenue model, because if
9 you have a percent of revenue model so you observe in
10 a given benchmark that there's a two percent of
11 revenue fee and you believe that's reasonable and now
12 you've got some other circumstance over here and you
13 want to apply it over here, suppose there's all kinds
14 of other things over here that generate revenue that
15 really don't have anything to do with the performance.
16 They're just other things generating revenue in the
17 second context that weren't going on in the first
18 context.

19 If you were doing this on the basis of a
20 percent of revenue, you'd have to try to figure out
21 how to adjust your percentage so that the value you
22 attribute to the performance itself is correctly

1 matter that it's now a Mercedes. The tires are still
2 worth \$200.

3 So I think that when trying to answer this
4 question of making distinctions, you have to ask
5 yourself, is there something different about the
6 performances which leads you to believe the
7 performances should have a different value.

8 So the two issues that I looked at, which
9 are issues that have come up in this proceeding, are
10 the issues of consumer influence and the issue of
11 syndicated performances. And I would submit that in
12 both those cases, while the business models are
13 different and the revenue streams may be different and
14 the way the user gets value may be different, the
15 performances themselves are actually the same. And so
16 there is not a need to somehow value the performance
17 itself at a different rate just because it goes
18 through a second party before it gets to the user, in
19 the case of syndication, or because, in the case of
20 consumer influence, the consumer -- there's other
21 things about this service that make it attractive to
22 the consumer. The performances themselves are still

1 the same and I think should have the same value.

2 Q Let's next briefly summarize your
3 testimony beginning on page 31, respecting an
4 appropriate minimum fee. Can you summarize your --

5 CHAIRMAN VAN LOON: Thirty-one.

6 MR. RICH: Thirty-one. We're jumping just
7 a bit out of order.

8 BY MR. RICH:

9 Q Can you summarize your analysis there,
10 please.

11 A Yes. And for the most part, this
12 recapitulates material that we've already talked
13 about. My view of the minimum fee within a per
14 performance model is that since the performance
15 counting itself makes sure that regardless of what
16 happens to revenue or other economic variables, the
17 copyright owners will get appropriate compensation for
18 their performances. The only role for a minimum fee
19 is to protect against a situation in which the
20 performances are so minimal that it costs the license
21 administrator more to license this party than they're
22 going to get in royalties.

1 And so the appropriate calibration for the
2 minimum fee is the incremental cost to the license
3 administrator of adding another licensee to the
4 system. It's not the overall average cost of
5 operating a license system, because that will be
6 recovered out of some deduction from the per
7 performance fees. And ASCAP and BMI, which are my
8 benchmarks, do exactly that, they deduct some amount
9 from the royalties that they collect in order to cover
10 their administrative costs. But they do have minimum
11 fees, and I would suggest that those minimum fees are
12 indicative of what this cost of having a licensee in
13 the system are likely to be. In my report, I tell you
14 what the numbers are for ASCAP, BMI and SESAC. They
15 vary somewhat, but they are all in this range of \$250
16 that I had suggested initially.

17 Q For the sake of clarity, you're now
18 referring to the ASCAP, BMI and SESAC internet
19 licenses; is that correct?

20 A That is correct.

21 Q Okay.

22 A And, therefore, I think that the \$250

1 figure that I had previously suggested is at least in
2 the right range.

3 CHAIRMAN VAN LOON: Can I ask you on that
4 one, since SESAC is -- I think it's \$150, so much
5 lower, why not go with that?

6 THE WITNESS: I think there is no precise
7 answer to this question. I mean \$150 --

8 MR. GARRETT: Good.

9 THE WITNESS: -- would be probably okay,
10 and I think one of them is higher than \$250, I forget,

11 CHAIRMAN VAN LOON: Two sixty-eight.

12 THE WITNESS: -- like \$275, so that maybe
13 that could be okay. I think that nobody knows exactly
14 what is the right number, but I think this indicates
15 a range of a few hundred dollars.

16 ARBITRATOR VON KANN: Or arguably, you
17 should go with the three of them together, because
18 they represent parts of the total sound recording
19 repertoire, don't they?

20 THE WITNESS: But the incremental cost of
21 having somebody in your system is independent of the
22 size of the repertoire. It's really the cost of

1 mailing out an invoice, it's the cost of keeping track
2 of this guy in your computer, it's the cost of the
3 dunning them if they don't pay, and so I don't really
4 see an argument for adding up three different
5 organizations, each of which are incurring the same
6 minimum cost.

7 CHAIRMAN VAN LOON: Is there any actual
8 evidence that says these three figures are
9 representative of the minimal costs for them? I
10 understand you've sort of inferred that, but is there
11 any evidence that indicates that's where they came
12 from?

13 THE WITNESS: Not that I know of.

14 CHAIRMAN VAN LOON: Is it possible that if
15 the margin -- if 90 percent of the people that were
16 paying paid royalties enough to cover the incremental
17 costs, plus a lot more so that they had a good margin,
18 that the minimum fee that's picked is just some
19 convenient one that made it affordable for everybody
20 but doesn't really reflect the actual admin cost.
21 It's just a picked minimum because they've got enough
22 margin with this to cover everybody.

1 THE WITNESS: So what you're saying is
2 that they've made a conscious decision to set a fee
3 knowing that they're going to get some licensee that
4 they're actually losing money on, because this guy
5 really costs \$500 to service. I'm going to give him
6 his license for \$150 and make that up somewhere else,
7 and they've made a conscious decision to do that in
8 order to license as broadly as possible.

9 CHAIRMAN VAN LOON: I guess the first half
10 of the question is whether there's actually any
11 evidence that you know for sure that says they're not.

12 THE WITNESS: My understanding is that
13 these fees have not been tested as being derived from
14 cost data. I don't think -- I mean I think they are
15 set by these -- they're proposed by these
16 organizations. These licenses haven't actually been
17 accepted by very many people. They've been proposed
18 by these organizations, they have not been, for
19 example, tested in a rate court, and so,
20 unfortunately, I can't -- I'd like to tell you that
21 there is evidence that they represent the costs, but
22 I don't think that's true. It's just what is out

1 possibility of moving the final arguments to Tuesday,
2 December 11, giving the parties an additional weekend
3 to prepare, and in lieu of the historical significance
4 of that date. And now we're discussing a revised
5 schedule for next week that would waive personal
6 appearances by Coppola, Marcus, Hessinger and Price.
7 Mr. Garrett?

8 MR. GARRETT: I just wanted to put on the
9 record the fact that Ms. Leary and I had agreed the
10 other day to waive the direct and the cross
11 examination of Dr. Murdoch.

12 CHAIRMAN VAN LOON: Yes, that's an
13 important addition. I know that was done at the at
14 the very end while we were arranging boxes to leave
15 the Library building to be evacuated. Okay. Another
16 item?

17 MR. GARRETT: And further matter. The
18 Panel, as you know, had asked that we provide you with
19 certain information concerning various agreements,
20 such as the Artists Direct agreement, the radio
21 agreement. We did put together a response to the
22 Panel. We have shared it the other side a couple of

1 there in the marketplace.

2 ARBITRATOR VON KANN: Probably not going
3 to have a ten-year litigation over whether the company
4 should pay \$150 or not, although one can never tell,
5 I guess.

6 MR. RICH: I can ask the Panel's pleasure
7 about a break time, a mid-afternoon break time?

8 CHAIRMAN VAN LOON: Well, we were
9 wondering about your best estimate of -- do you have
10 another hour to go or just ten more minutes?

11 MR. RICH: An hour plus.

12 CHAIRMAN VAN LOON: An hour plus. Why
13 don't we take a break then right now, it's about an
14 hour and half, and plan to come back at quarter till.
15 And the Panel, during this break, will look at the new
16 lineup, and so you might alert Ms. Woods that at
17 quarter of that's when you all can come into to look
18 at that.

19 (Whereupon, the foregoing matter went off
20 the record at 3:26 p.m. and went back on
21 the record at 3:51 p.m.)

22 CHAIRMAN VAN LOON: -- discuss the

1 days ago. We have not gotten a response back. I
2 think I did at one time promise to have it filed with
3 the Panel by the end of the day today, but we're still
4 awaiting comment from the other side.

5 CHAIRMAN VAN LOON: Given the fact that
6 we've had to move and a few other disruptions, I'm
7 sure the Panel would be happy to wait until Monday to
8 receive it.

9 MR. GARRETT: That's fine with me.

10 CHAIRMAN VAN LOON: Any other --

11 MR. GARRETT: Yes, one other thing too.

12 CHAIRMAN VAN LOON: Another housekeeping
13 --

14 MR. GARRETT: We also have provided to
15 Yahoo's counsel, Mr. Greenstein, a sanitized version
16 or a resanitized version of the transcript of Mr.
17 Mandelbrot and have asked that he get back to us and
18 let us know whether or not it's okay with him and his
19 client. I gather he's forwarded it on to his client.
20 We obviously have not gotten a response back. I went
21 over it, I believe, yesterday. And so we have not
22 been able to provide a copy of it to RIAA yet, and

1 also we don't have a summary of what it is that Mr.
 2 Marks would be testifying to. But as soon as we get
 3 this resolved with Mr. Greenstein, we'll provide that
 4 summary as well.
 5 CHAIRMAN VAN LOON: You have a few more
 6 hours, if they're on the west coast, to try to reach
 7 him by the end of the day.
 8 ARBITRATOR VON KANN: Marks is now next
 9 Wednesday.
 10 MR. RICH: Can we also have a sense of
 11 location at this point? Is it logical at this point
 12 to assume we would stay here for the duration? Do you
 13 have any more information on Library of Congress
 14 closure?
 15 CHAIRMAN VAN LOON: The latest -- we get
 16 what are called broadcast alerts, or something like
 17 that, on voice mail, which we've been checking. The
 18 latest that we had heard from them was that they were
 19 closed till further notice. They thought that they
 20 would reopen Tuesday, but that has not been confirmed,
 21 and I guess part of the Library was used, the clinic,
 22 for testing, anthrax testing of people which concluded

1 around eight o'clock last night.
 2 ARBITRATOR VON KANN: Mostly over where
 3 you guys were sitting, I think.
 4 (Laughter.)
 5 ARBITRATOR VON KANN: So if you're eager
 6 to rush back there at this point --
 7 CHAIRMAN VAN LOON: I suppose -- one thing
 8 is we could look for the earliest possible opportunity
 9 to return to our hallowed venue or we could simply say
 10 for a last day or two why not stay here if Mr.
 11 Garrett's willing to allow us to impose on his
 12 hospitality still further. I don't know whether the
 13 parties have a preference whether --
 14 ARBITRATOR VON KANN: I guess you enjoyed
 15 that move so much that you'd like to now do it again.
 16 CHAIRMAN VAN LOON: Do you all have a
 17 preference?
 18 MR. JOSEPH: I would say that this side
 19 has a preference, probably, but we --
 20 CHAIRMAN VAN LOON: Could you reveal it?
 21 MR. JOSEPH: We wouldn't want to impose on
 22 Mr. Garrett's hospitality unless he's interested in

1 inviting us to do so.
 2 MR. GARRETT: Your bill's going to be the
 3 same regardless.
 4 MR. RICH: Regardless.
 5 (Laughter.)
 6 CHAIRMAN VAN LOON: So you all would
 7 prefer just to stay here and not go through that
 8 hassle. This may be a case of no good deed goes
 9 unpunished. We're so happily ensconced and you made
 10 a big mistake by having the brownies brought in.
 11 MR. GARRETT: We're happy to have you all.
 12 CHAIRMAN VAN LOON: Perhaps we should just
 13 say then that we'll plan to stay here unless something
 14 comes up. I suppose if the General Counsel's Office
 15 at the Library said -- were to say to us, no, it's
 16 very important that for public policy reasons or
 17 something they wanted us back, we could reopen this.
 18 MR. JACOBY: Well, we'll get an injunction
 19 against them.
 20 (Laughter.)
 21 CHAIRMAN VAN LOON: The heart of the
 22 litigator.

1 (Laughter.)
 2 MR. JOSEPH: That may at least keep it up
 3 in the air until Thursday.
 4 CHAIRMAN VAN LOON: All right. Are there
 5 any other housekeeping matters? Dr. Jaffe, you've
 6 been treated here to a rare insider's look at the high
 7 level business of the arbitration. Let's continue
 8 then, Mr. Rich.
 9 BY MR. RICH:
 10 Q Dr. Jaffe, now that we have taken the
 11 Panel through the fee model, as it presently stands,
 12 I want you to speak a bit to the three principle
 13 criticisms of your fee model, which have been leveled
 14 by Dr. Shink in his own testimony submitted on the
 15 rebuttal case. Have you had a chance to review that
 16 portion of Dr. Shink's testimony?
 17 A Yes.
 18 Q First, let me ask you to respond to what
 19 Dr. Shink describes as his important criticism, namely
 20 that you have, as he would view it, improperly sought
 21 to convert a percentage of revenue fee experience in
 22 the ASCAP, BMI, SESAC radio world into the metric

1 which you have presented to the Panel. Do you have
2 a reaction to that criticism?

3 A Yes. I think --

4 ARBITRATOR VON KANN: Can you remind me
5 sort of what page we're on?

6 MR. RICH: This is now surrebuttal.

7 THE WITNESS: This is more surrebuttal, so
8 we're not in my report.

9 ARBITRATOR VON KANN: Okay. I'm sorry.
10 This was on the notes.

11 THE WITNESS: Well, I suppose it won't
12 surprise the Panel that I think Dr. Shink's criticisms
13 of my model are wrong.

14 CHAIRMAN VAN LOON: Shocked, shocked.

15 THE WITNESS: And the fundamental issue --
16 the first issue then is this question of the percent
17 of revenue model. I think there's actually a quote
18 which is in my testimony here somewhere from
19 negotiations for these rights where Mr. Marks says,
20 "We both know that it's not revenue that determines
21 the value of performances." And I think that that's
22 true in over-the-air radio. I view a percentage of

1 percentage of revenue in another context. There is no
2 economic reason why that should be true. It goes back
3 to my tires on the Toyota versus tires on the Mercedes
4 example. The revenue is determined by many, many
5 different things. And if those things that determine
6 revenue are different in the two contexts, then the
7 percentage of revenue that is reasonable and a market
8 value in one context is not going to be the
9 appropriate percentage in another context.

10 But I think you can say, well these
11 parties -- the radios and ASCAP and BMI -- over many
12 years have developed a model for valuing performances.
13 They do it on a percentage of revenue basis, but
14 presumably that reflects their valuations of what the
15 performances are worth, and so we can figure out on a
16 per performance basis what their percent of revenue
17 model tells us the performances are actually worth.
18 And then that, because it's valuing the performances
19 themselves, can be moved from context to another,
20 because it's not tied to the particular business model
21 that drives revenue in either context.

22 BY MR. RICH:

1 revenue as a convenient proxy for the value of the
2 performances. There is nothing intrinsic that
3 determines that it's right to value performances as a
4 percentage of revenue.

5 And I think that point carries particular
6 force when you're going to, in effect, use a benchmark
7 and move from one context to another. It's one thing,
8 for example, over time to say, "Let's agree today on
9 a certain royalty and rather than having to
10 renegotiate tomorrow and the next day between the same
11 parties, we know my business may grow and therefore
12 you'd be entitled, in some sense, to more revenue,
13 let's just make it two percent of revenue, and that
14 way it will naturally increase as my business grows."
15 And that's a convenient way of avoiding having to
16 continue to revisit what's it really worth. That
17 makes a certain amount of sense.

18 But when you're going to use it as a
19 benchmark to determine a fee in a slightly different
20 context, I just think it's extremely problematic to
21 take a percentage of revenue in one context and
22 presume that the value of the performances is the same

1 Q Now, Dr. Shink also criticizes your
2 methodology, because he claims, and I'll quote this
3 portion of his testimony from Page 7 of his own
4 testimony, quote, "It is not possible to define a
5 single per listener hour fee that is comparable to the
6 percentage of net advertising revenue fee in the radio
7 broadcasting arena," unquote. And then he has some
8 appendix material where he purports to demonstrate the
9 disparity on an entity-by-entity basis. Have you had
10 a chance to consider that criticism?

11 A Yes.

12 Q And do you have a response?

13 A Actually, I have two responses. First of
14 all, what he does is he looks at, for example,
15 different formats of radio stations or different
16 markets, and he shows that if you calculate the per
17 performance fee that's paid in these different formats
18 or different markets, they vary somewhat. In fact, I
19 found his appendix quite comforting, because what it
20 showed to me is they really don't vary very much at
21 all. I calculated the number as being about 0.2, and
22 what he shows is, well, in some cases it's as low as

1 0.15, and in some cases I think it was as high as
2 about 0.3 or so. But in fact it really doesn't vary
3 all that much.

4 Now, fundamentally, the license we're
5 talking about, the radio license -- or the licenses,
6 BMI, ASCAP in particular, are negotiated on an
7 industrywide basis. It's not that KFOG goes to ASCAP
8 and negotiates a license and maybe they have a
9 different fee or fee structure from some other station
10 that goes to ASCAP and negotiates a license. They are
11 negotiated on behalf of the entire industry.

12 So, presumably, when that negotiation
13 occurs what people are thinking about is, in some
14 sense, the average value of a performance. And it's
15 the very nature of an industrywide negotiation that
16 the formula they agree upon may fit some stations
17 slightly better than others, and the result is going
18 to be that some stations might pay a little more
19 relative to their performances, and some may pay a
20 little less. That's going to be an inevitable outcome
21 of an industrywide negotiation. But what they're
22 negotiating over is the overall average, which is what

1 A Yes. I don't really understand it. The
2 blanket license model is the model which applies to
3 music formats, which is primarily what I'm talking
4 about -- webcasting and rebroadcasting of music
5 formats. So the notion that somehow it ought to be
6 the per program model that would be used as the
7 benchmark just doesn't make any sense to me. The
8 analogous users on the radio side are not using the
9 per program model; they're using the blanket model,
10 and it is a blanket license, in effect, that is being
11 priced here.

12 Q Let's turn to the discussion appearing at
13 Page 35 of your written testimony. For the reasons,
14 Professor Jaffe, you've already testified to, you use
15 the over-the-air radio ASCAP/BMI experience as the
16 basis for converting to appropriate fees here as
17 opposed to Internet experience of those entities. At
18 Page 35 of your testimony, though, you report that you
19 performed a check on that analysis by in fact
20 examining the ASCAP and BMI Internet licenses; is that
21 correct?

22 A Yes.

1 I used.

2 And if KFOG believes that they're paying
3 too much because the revenue formula really hurts
4 them, there's really not much they can do about it.
5 They really, as a practical matter, can't go on their
6 own to ASCAP and say, you know, "I don't like this
7 industrywide formula, I want my own formula," because
8 then they confront the market power of ASCAP. They
9 could take ASCAP to rate court, but for one licensee
10 to do that is an expensive proposition.

11 So I think, conceptually, if you accept at
12 all the notion that the ASCAP and BMI licenses are a
13 benchmark, they are a benchmark at the overall
14 industry average level, and the fact that the numbers
15 vary somewhat station to station is really neither
16 here nor there.

17 Q Now, third, and lastly, as to Dr. Shink's
18 critique, he obliquely criticizes your reliance solely
19 on the blanket license fee experience of radio
20 broadcasters while not extrapolating from the per
21 program fee rates for the radio industry. Do you have
22 a comment as to that criticism?

1 Q Could you describe what you did?

2 A Yes. As I explained the first time, I
3 don't think the economic experience with the Internet
4 licenses is really sufficient to draw a benchmark
5 inference from them, but it's still, I think -- the
6 Panel raised some questions, and it makes sense, to
7 ask can we -- do we see any evidence there that the
8 treatment of musical works on the Internet and, by
9 inference, the treatment of performances generally on
10 the Internet is different than in over-the-air?

11 So I looked at this two ways. The first
12 way I looked at it was just at the level of the
13 percent of revenue formula that is used by ASCAP and
14 BMI in both cases, are the formulas and the
15 percentages any higher on the Internet than they are
16 in over-the-air radio? And this is a slightly
17 difficult comparison to make, because the percentage
18 that's used in over-the-air radio is a percentage that
19 is applied to a concept that they developed of new
20 revenue, which really is calculated for their
21 purposes, and it's not clear how you would calculate
22 that for an Internet streamer. So there's a little

1 bit of ambiguity, but as I explained in the report,
2 even given that ambiguity, what the situation is is
3 that the percentage of revenue that ASCAP and BMI have
4 proposed -- now most licensees have not accepted this
5 and no rate court has approved this -- but BMI and
6 ASCAP have proposed that they collect about three and
7 a half percent of the Internet streamers revenue for
8 their licenses.

9 Q Combined.

10 A Combined. The total of BMI and ASCAP
11 would be three and a half percent. The over-the-air
12 rate on a comparable basis is somewhere in the range
13 of three to three and a half percent. It might be a
14 little lower or it might be about three and a half
15 percent. So on a percent of revenue basis, the ASCAP
16 and BMI Internet proposed models are not substantially
17 higher than the over-the-air basis. So that gives me
18 some comfort that in moving to the Internet there's no
19 evidence that an upward adjustment in the musical
20 works fee would be appropriate.

21 The other check I did requires restricted
22 information.

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COPYRIGHT ARBITRATION ROYALTY PANEL
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In the matter of: Docket No.
2000-9
Digital Performance Right in
Sound Recording and Ephemeral
Recording | CARL DTD
| 1 & 2

Conference Room 216
Second Floor
Offices of Hold & Porter
555 17th Street, N.W.
Washington, D.C.

Friday,
October 19, 2001

The above-entitled matter came on for rebuttal
hearing, pursuant to notice, at 9:00 a.m.

BEFORE
THE HONORABLE ERIC E. VAN LOON Chairman
THE HONORABLE JEFFREY S. GULIN Arbitrator
THE HONORABLE CURTIS E. von KANN Arbitrator

1 Q Let's go on a restricted record, please.
2 (Whereupon, at 4:09 p.m., the proceedings
3 went into Closed Session.)
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APPEARANCES:
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National Religious Broadcasters Music License
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1 THE WITNESS: What I attempted to do in
2 this section was to try, as I saw it, to pull together
3 a summary of the overall evidence on promotion and
4 displacement, as it appeared in the record before I
5 wrote this. And that begins on Page 51 of the
6 testimony. I think for today the only thing I would
7 emphasize is there is a flavor in some of the
8 discussion in the direct case of is it promotion or is
9 it displacement, which is it? And I just wanted to
10 emphasize that it's really not an either/or kind of
11 thing. What's probably going to happen is that to
12 some extent both will occur, and the issue is really
13 net promotion.

14 And I think, as I summarize here, that the
15 evidence is very clear that there is promotional value
16 over the air. The evidence that we do have on the
17 Internet in terms of quantitative data shows that
18 there is also net promotional value on the Internet.
19 And the evidence regarding displacement is essentially
20 anecdotal and fears about the future, but there is no
21 quantitative evidence in the record that I could find
22 of the amount -- the extent to which displacement is

1 diminishing the net promotional value now or by the
2 end of 2002. And that was true when I wrote this
3 written report, and I don't believe that anything in
4 the RIAA's rebuttal filing changes that. They did not
5 put in any quantitative data to demonstrate the
6 magnitude of displacement relative to promotion in the
7 relevant time period.

8 BY MR. RICH:

9 Q Let's turn to the last major section that
10 I want to review with you, which is Part 6, which is
11 your review of and analysis of the RIAA fee
12 benchmarks. You indicate at Page 54 of your rebuttal
13 testimony that -- or you recommend, certainly, for the
14 Panel's consideration that there are three categories
15 of issues to consider in evaluating how much reliance
16 should be placed on the various agreements into which
17 the RIAA has entered. Can you address each of these
18 three bulleted categories at a conceptual level?

19 A Yes. I think, conceptually, in order to
20 analyze whether we have benchmarks there that we can
21 use, there are three steps. The first step is, is the
22 agreement, in its own context, on its own terms,

1 likely to be evidence of a willing buyer/willing
2 seller competitive market situation that was not
3 distorted by the presence of the RIAA market power?
4 And I discussed briefly in my direct testimony, what
5 that really comes down to is did the buyer have good
6 information and access as a realistic matter to the
7 statutory license as a substitute for what RIAA was
8 offering so that that substitute -- the availability
9 of that substitute could discipline the market power
10 of the RIAA? That's the first step, and I refer to
11 that as the is it willing buyer/willing seller in its
12 own context.

13 A second issue is does it really give us
14 significant evidence of market conditions? Is it
15 economically significant? Did they actually pay real
16 money under this agreement? Is there evidence that
17 this was a viable business transaction? Because
18 otherwise it's not telling us about the market price.

19 And then, finally, there's the question of
20 even if it is economically significant and reasonable
21 on its own terms, is it comparable to what we're
22 trying to license here? Is it -- does it represent an

1 economic situation that can be appropriately
2 extrapolated to the current licensees? Because
3 otherwise it's not an appropriate benchmark.

4 Q Mr. Jaffe, have you occasion now to review
5 the record evidence with respect to the 26 licenses
6 and licensees put forward by the RIAA?

7 A Yes.

8 Q And have you had a chance to apply your
9 thinking, with respect to these three categories of
10 issues, against that record evidence?

11 A Yes, I have.

12 Q And I'm going to now hand out a
13 demonstrative exhibit, which I'm going to ask you to
14 describe, which I believe reflects your work product
15 of respecting that analysis.

16 A Now, this exhibit is certainly
17 restrictive.

18 Q Yes, and I think for a considerable
19 portion of --

20 A I was just going to say I can complete my
21 overall description of what it is without getting into
22 any information, and then we could go on the

1 restricted record. Is that the best way to proceed?

2 Q That would make sense. That would make
3 sense. Can you broadly describe what --

4 A Yes.

5 Q -- this document is?

6 A This document is just an attempt on my
7 part to organize and summarize the information that
8 I've reviewed regarding these issues of the
9 applicability of the 26 agreements. And, essentially,
10 the first four columns, which are labeled,
11 "Information Concerns," "Concerns About Timing and
12 Uncertainty," "Other Consideration Bundled with the
13 Statutory Right," and "Concerns About Cost of
14 Litigation," all go to the first of my three major
15 issues: Was the license a willing buyer/willing
16 seller agreement in its own context?

17 And the second page of the exhibit just
18 summarizes, conceptually, what's in my written
19 testimony in terms of the kinds of things that I
20 believe one looks at in those categories. The fifth
21 column addresses the comparability issue, and then the
22 final column addresses this question of, even putting

1 aside whether it was willing buyer/willing seller and
 2 comparable, is there really any economically
 3 significant evidence contained in that agreement?
 4 MR. RICH: Perhaps now we should move to
 5 a restricted record.
 6 CHAIRMAN VAN LOON: Yes, let's go to the
 7 restricted record.
 8 MR. RICH: Thank you.
 9 (Whereupon, at 4:23 p.m., the proceedings
 10 went into Closed Session.)
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In the matter of: _____ Docket No.
 _____ : 2000-9
 Digital Performance Right in _____
 Sound Recording and Ephemeral _____
 Recording _____ CARP INTRA
 _____ : 1 & 2

Conference Room
 Second Floor
 Offices of Arnold & Porter
 555 12th Street, N.W.
 Washington, D.C.

Friday
 October 19, 2001

The above entitled matter came on for rebuttal

hearing pursuant to notice, at 9:00 a.m.

BEFORE
 THE HONORABLE ERIC E. VAN LOON Chairman
 THE HONORABLE JEFFREY S. GULIN Arbitrator
 THE HONORABLE CURTIS E. von KANN Arbitrator

APPEARANCES: (Cont'd)
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 Comedy Central; Coolink Broadcast Network; Echo
 Networks, Inc.; Everstream, Inc.; Incanta, Inc.;
 Launch Media, Inc.; Listen.com; Live365.com; MTV
 Group, LLC; MusicMatch, Inc.; MyPlay, Inc.; NetRadio
 Corporation; Radioactive Media Partners, Inc.;
 RadioWave.com, Inc.; Entercom Communications
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(Certification Page)

1 more minutes, just to advise you and we'll be done
2 with direct and we're prepared to proceed on that
3 basis.

4 CHAIRMAN VAN LOON: Excellent, let's
5 continue.

6 BY MR. RICH:

7 Q Professor Jaffe, at 74 of your -- page 74
8 of your testimony, you address an aspect of Dr.
9 Nagle's initial direct testimony in which he addresses
10 or in which he performs an estimation of buyer's
11 maximal willingness to pay and in which he also relies
12 on estimates of future positions of viability and
13 extrapolations of data.

14 Could you synopsise your analysis of that
15 approach of Dr. Nagle?

16 A Yes, very briefly, I don't understand what
17 the future has to do with these for the period through
18 2002. There will be some other CARP maybe or
19 negotiations that can set those fees. And if the
20 world looks different in 2005 than it does today, they
21 can set different fees. So it would seem to me that
22 the task for this CARP, whatever its model, whatever

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BY MR. RICH:

Q Following generally, on Judge Von Kann's
questioning and coming back for a moment to the rate
which you do propose, Professor Jaffe, what degree
does that rate -- has that rate been shaped by
concerns over webcaster viability or the suggestion
that has floated through the record occasionally here
that there is some interest on the part of the
services to subsidize, to be subsidized or not to pay
fair market value? What degree does your own proposed
fee structure attempt to be sensitive or to deal with
that issue?

A It does not. And as I said a second ago,
it doesn't bother me at all if people go bankrupt
paying the rate I propose. The rate I propose has
been derived from a viable, healthy, reasonably
profitable, over the air radio business. And all I'm
saying is that these webcasters ought to pay an
appropriately comparable rate and if they can make
money doing that more power to them, and if they can't
make money doing it, then that's the way it goes.

MR. RICH: Mr. Chairman, we have about 15

1 its fee approach is to base it on economic conditions
2 today.

3 On the other point, I think conceptually
4 what Dr. Nagle has done and I don't think he really
5 disagrees with this is that he has calculated the
6 maximum amount you could extract from a hypothetical
7 streamer for this right which is by definition the
8 monopoly price. And for the reasons that are
9 articulated in my direct testimony, I don't think that
10 Congress intended to have all these people sit in this
11 room and consume tremendous amounts of time and money
12 in order to produce the rate which RIAA would have
13 gotten on its own if there had never been a statutory
14 license which is in effect the monopoly rate.

15 And so I think for that reason, this
16 analysis is not relevant to the willing buyer/willing
17 seller analysis.

18 Q And in the succeeding section of your
19 testimony, Section 8, where you talk about the
20 significance of broadcaster/webcaster projections, I
21 think you've just touched on your view of that. Is
22 there anything further you want to add respecting your

1 written testimony there?

2 A I don't think so. I think there are some
3 more minor points that are made here about what we see
4 in those projections, but the main point is that I
5 don't think they tell us about the market value today
6 of this right.

7 Q Now two moments ago Judge Von Kann made a
8 reference to other inputs, bandwidth and the like and
9 in your testimony, particularly 83, you talk about a
10 red herring that has been raised by RIAA, namely the
11 magnitude of some of these other payments. Can you
12 describe a little bit what you mean by that?

13 A Yeah, I mean what I'm talking about is the
14 notion that say my fee or other fees that the
15 streamers or webcasters have proposed can't be right
16 because the result would be that the streamer is
17 paying less for the performance than they're paying
18 for something else, for bandwidth, or it can't be
19 right because they're paying such a small percentage
20 of their overall costs.

21 And I must say I just find this argument -
22 - I just don't understand where this argument comes

1 are very important and significant other than the
2 performances themselves, because the performances are
3 available today to anyone who wants them. And if that
4 was the thing that creates value on the internet, then
5 value would have been created on the internet. So I
6 just think it's irrelevant to observe that if we apply
7 a market price-derived model, the result is going to
8 be a relatively small percentage of the costs or
9 revenues of these streamers are actually going for the
10 performances. Because my response to that is yeah,
11 and that makes a whole lot of sense. It should be a
12 small percentage because it's pretty darn clear that
13 the right to make performances is far from what you
14 need to make money on the internet. You must need a
15 whole bunch of other stuff.

16 Q As a final minor, Professor, I think there
17 is one correction you want to make to your rebuttal
18 testimony and I refer the Panel to page 4. It should
19 be page 4 on every version. And the second bullet.
20 Can you identify what the mistake is?

21 A Yes. This refers to a point that's in my
22 testimony that I actually haven't highlighted today in

1 from. It seems to be based on a presumption, almost
2 a religious presumption that it's got to be true, that
3 the performance is the thing that is really valuable
4 in terms of what streaming is about. And therefore
5 that thing has to be getting a significant fraction of
6 the total.

7 Well, it seems to me if it was
8 performances that are really valuable, we would
9 observe somebody making money with them because they
10 are easy to get. You or I can get performances, the
11 right to make performances. All we have to do is file
12 with the Copyright Office in terms of the sound
13 recording and write a letter to ASCAP and BMI and
14 indicate your willingness to be bound by their license
15 and lo and behold you've got that. You've got the
16 right to make performances. If that was the key to
17 Eldorado on the internet, then we would have seen
18 people making money on the internet and we haven't
19 really seen that. What that says to me is that if and
20 when anybody ever goes figure out how to make money on
21 the internet, it's going to be somehow bringing to
22 bear to that business something or some things that

1 the spirit of brevity about the relationship between
2 RIAA's own revenue model and it's own per performance
3 model. I say that their per performance model is 20
4 to 100 times as expensive as their percent of revenue
5 model and that's just wrong. My only excuse is that
6 it was written at an a.m. hour that is only a single
7 digit. The correct range is 4 to 25, not 20 to 100.
8 And the part of the testimony -- I mean this is the
9 summary. The substantive part of the testimony where
10 that is derived and explained is in Section roman
11 numeral 9, in particular, in connection with footnote
12 109.

13 Q The footnote is correct as stated?

14 A The footnote is correct. It's only the
15 summary that got off the reservation.

16 Q Okay. And with that, we conclude our
17 direct examination.

18 CHAIRMAN VAN LOON: Thank you very much,
19 and that was significantly under the 15 minutes you
20 projected, so that's great.

21 Why don't we take our break at this point
22 and come back at quarter past to begin the cross

1 examination.

2 (Off the record.)

3 CHAIRMAN VAN LOON: Is it true, Mr.
4 Garrett, you'd like to go to 9 tonight so that we
5 don't have to have a long day tomorrow?

6 MR. GARRETT: 9.

7 CHAIRMAN VAN LOON: Please proceed.

8 MR. GARRETT: Thank you.

9 CROSS EXAMINATION

10 BY MR. GARRETT:

11 Q Good afternoon, Dr. Jaffe. I'm Bob
12 Garrett and I represent the Recording Industry
13 Association in this proceeding.

14 A Good afternoon.

15 Q Dr. Jaffe, we've been at this now for
16 about two months and I know time flies, but there have
17 been a number of different benchmarks that have been
18 either directly or indirectly proposed in this
19 proceeding. What I'd kind of like to do at this point
20 is get certain that we're all clear on where you stand
21 on the different benchmarks, both on an absolute level
22 and a relative level.

1 Do you understand what I've done so far?

2 A I suppose, yes.

3 Q I'd like to get a sense of where on this
4 continuum you would put your benchmark, the over the
5 air radio payments to ASCAP and BMI? Now how close
6 does it come to be outcome determinative, in your
7 mind?

8 A I have great difficulty thinking about
9 that as a one dimensional question and let me explain
10 why. I think there's sort of two issues. One is how
11 good a benchmark is it and there's a separate issue
12 which is how precisely does it pin down exactly what
13 the number is and those are two different issues.

14 I think in terms of a good benchmark that
15 can be relied on, my model is outcome determinative.
16 I would be the first to admit though that it doesn't
17 give you an extremely precise number. There is some
18 estimation that is involved in it, so that it's
19 outcome determinative with a range.

20 Now I don't know how to represent that on
21 your one dimension.

22 Q Let's make it -- let's just take the top

1 And to do that, Mr. Chairman, I'd like to
2 be able to use the board if that's all right?

3 CHAIRMAN VAN LOON: Absolutely, please.
4 We'll need to call on your erasure skills first.

5 MR. GARRETT: I think I can handle that.

6 BY MR. GARRETT:

7 Q Dr. Jaffe, I'd like you to imagine for a
8 moment a continuum, two poles, sort of the extent of
9 my talent. And on the one hand we have a benchmark
10 that if it were proposed in this proceeding and there
11 were record evidence supporting it would be in your
12 view outcome determinative. It is so close to what
13 the real rate ought to be here that you would say go
14 for it. Okay? That's on one end of the extreme.
15 We'll call this the outcome determinative benchmark.

16 The other end of the continuum here, I'd
17 like you to think of a benchmark that if it were
18 proposed by any party, it would be totally
19 unreasonable. No reasonable person would rely on that
20 benchmark, okay? We'll just call it unreasonable. If
21 the Panel adopted it, they would certainly be acting
22 arbitrarily, okay?

1 continuum as being the concept, okay?

2 A Okay.

3 Q So in concept you believe what you've got
4 is at this end here, the end that would be outcome
5 determinative, right?

6 A Correct.

7 Q Why don't we just stick with the concept
8 for a moment then?

9 A Okay, fine.

10 Q And I guess I'll put it right here, this
11 would be as close as I could get it to outcome
12 determinative, is that okay to you?

13 A Fair, yes.

14 Q We'll just label the radio PRO payments,
15 okay?

16 A Okay.

17 Q Just thinking conceptually, the RIAA 26
18 agreements, where would you put those on this concept
19 continuum?

20 A I think they're unreasonable. They don't
21 tell me anything about the willing buyer/willing
22 seller rate.

1 Q Okay. So we've got a little space to make
2 up between the two of us, I guess.

3 ARBITRATOR VON KANN: We noticed that too.
4 BY MR. GARRETT:

5 Q Okay, now let me ask you this, what if we
6 had had agreements with the 12 webcasters who are
7 parties to this proceeding. Where would you put that
8 on this continuum here?

9 A I don't know.

10 Q Why not?

11 A Because it would depend on the
12 circumstances under which those agreements were
13 arrived at.

14 Q So for the 12 webcasters, you're not
15 certain. Let me ask kind of a related question. What
16 if we had an agreement with DiMA in this proceeding
17 which represents a number of webcasters. Where would
18 you put it on the continuum here, or concept?

19 A I guess again I'd have to say I don't
20 know.

21 Q Okay. You would need to know the
22 circumstances surrounding that agreement too,

1 A Have put forward, yes.

2 Q On this concept or continuum here, where
3 would you put those webcasting agreements? Should
4 they be closer to the outcome determinative side of
5 the continuum or would it be totally unreasonable to
6 rely upon them as a benchmark for setting a royalty
7 rate --

8 MR. RICH: May I object or at least ask
9 for a clarification. There's a reference to
10 agreements and the witness said forms offered. I
11 don't know which it is that Mr. Garrett is asking
12 about?

13 MR. GARRETT: You are right, that's right.
14 I'm talking about what he was talking about which are
15 the license, if you want to call it forms.

16 BY MR. GARRETT:

17 Q Is that a better way to describe it for
18 you?

19 A That's fine. Well, again, I have another
20 issue that I have difficulty fitting in one dimension
21 which is to me there's a difference between how I
22 would think about a benchmark if that was all I had

1 correct?

2 A That and I also personally don't know very
3 much about how DiMA really works and to what extent it
4 represents particular different groups and how it
5 makes decisions. I'm just not that familiar with the
6 organization.

7 Q So the bottom line though is even if we
8 had agreements here with the 12 webcasters and with
9 DiMA, we'd still have to pass the test that you have
10 constructed for determining whether or not the
11 agreement is, in fact, a reasonable reflection of the
12 royalty rate, right?

13 A Yes, but to be clear I wouldn't rule out
14 the fact that it was with DiMA might in and of itself
15 be an important factor that would get you over a lot
16 of those barriers. I just don't know as I sit here
17 enough to know that.

18 Q That's fine. Now what about -- you've
19 talked today a little bit about the webcasting
20 agreements, I shouldn't say agreements. The
21 webcasting licenses that ASCAP and BMI and SESAC have,
22 correct?

1 and I were viewing it in isolation and how I might
2 think about that same benchmark and is it useful to me
3 when used in conjunction with other benchmarks in
4 terms of reinforcing or confirming what is shown by
5 other benchmarks.

6 If you ask me -- so suppose we didn't have
7 the RIAA 26 agreements and we didn't have an over the
8 air benchmark, so the only thing we had to look at
9 were the webcaster agreements, no, now I'm falling
10 into the trap you want us to fall into, the webcaster
11 forms, I would say they would be somewhere on sort of
12 the lefthand side here because there's very little
13 experience under them. At the same time I think that
14 when looked at in conjunction with the over the air
15 model that we have available, they are more useful in
16 terms of giving more confidence to the numbers
17 produced by that model.

18 Q Well, but you have looked at, you've done
19 the analysis for commercial radio, correct?

20 A Yes.

21 Q And you know what the ASCAP forms and BMI
22 forms -- they're actually form agreements provide,

1 correct?

2 A I know what they provide in terms of a
3 percent of revenue, that's correct.

4 Q And do you feel comfortable having done
5 that analysis to say that it ought to be closer to the
6 outcome determinate side or closer to the unreasonable
7 side?

8 A If the question you're asking and this is
9 where I have difficulty interpreting your continuum is
10 for example, does the existence of those form
11 agreements provide good support for a 3.5 percent of
12 revenue, sound recording performance license, I would
13 say it's on the left hand side.

14 Q What I want to be clear about is you are
15 not here advocating that this Panel adopt the rates or
16 the terms that are set forth in the ASCAP and BMI form
17 agreements as a benchmark for setting the royalty rate
18 in this proceeding, are you?

19 A No, I'm not.

20 Q Is your view that those rates and terms
21 that is those in the ASCAP and BMI form internet
22 agreements would not be a good benchmark to set the

1 If the Panel adopted the rates and the
2 terms that are set forth in the internet agreements
3 offered by ASCAP and BMI, that would not be terribly
4 disappointing to you?

5 MR. RICH: I want to lodge an objection to
6 the preamble to Mr. Garrett's question in which he is
7 characterizing the witness's reflection as hesitancy
8 or the like. I don't think it's appropriate for
9 counsel to characterize the demeanor or the nature of
10 a witness's response as part of a question.

11 MR. GARRETT: Okay, I'll strike the
12 hesitate.

13 THE WITNESS: I think it would be a
14 mistake for this Panel to choose as its result a 3.5
15 percent of royalty formula. I do think that. I think
16 your question was wouldn't I think that was a good
17 outcome and I'm saying no, I don't think that was a
18 good outcome.

19 At the same time I do think that it would
20 be perfectly reasonable for this Panel in weighing all
21 of the different evidence before it and I have no
22 particular illusion that they're going to adopt hook,

1 royalty in this proceeding, correct?

2 A I would not think they would be a good
3 benchmark used in isolation, that's correct.

4 Q You think they might be a good benchmark
5 used in conjunction with the analysis that you've
6 done?

7 A Yes.

8 Q So in that sense because you've done that
9 analysis, correct? You've done the commercial radio
10 analysis, correct?

11 A That is correct.

12 Q So are you advocating then that the Panel
13 use the benchmark, use as a benchmark the rates and
14 terms set forth in the ASCAP and BMI internet form
15 agreements?

16 A Not per se, no.

17 Q When you say that, sort of hesitatingly,
18 not per se, I'm reminded a little bit of the Brer
19 Rabbit fable, don't throw me in the briar patch. I'm
20 not really suggesting here in any way -- if you had
21 your druthers and you got the Panel to adopt -- strike
22 that.

1 line and sinker every number and every plus sign and
2 minus sign and multiplication sign in my model.

3 They're going to look at all of the evidence and
4 decide, on balance, what to do and I do think that it
5 would be appropriate for them in the context of doing
6 that to think about what the over the air -- sorry,
7 what the internet offered license forms tell us, so in
8 that sense, I do think it's part of the evidence. I
9 don't think and that's why I carefully chose the words
10 "per se." I don't think that that license form per se
11 ought to be taken and just adopted as benchmark.

12 Q Now also just to make clear the rates that
13 are in the ASCAP and BMI agreements are not purely a
14 set of revenue rates, are they?

15 MR. RICH: Which agreements are you
16 referring to, Mr. Garrett?

17 MR. GARRETT: Form agreements.

18 MR. RICH: Internet license --

19 MR. GARRETT: Yes. Internet form
20 agreements.

21 MR. RICH: Thank you.

22 THE WITNESS: Yes, that is correct. We've

1 glossed over that. The form agreements that are
2 offered by ASCAP and BMI have a number of different
3 options, including options that are not based on a
4 straight percent of revenue.

5 It is my understanding from the way those
6 terms work that it is the percent of revenue version
7 of the ASCAP and BMI models which is, in fact, what a
8 streamer like the licensees who are in this proceeding
9 would use if they were using the ASCAP/BMI model. The
10 other alternatives are really designed for websites
11 that are not primarily related to music, but have only
12 an occasional use of music perhaps for example, on one
13 page that you might get to sometimes and so I think
14 that to the extent that there's anything there in
15 terms of probative information for this proceeding, it
16 probably is, in fact, the percent of revenue version,
17 but you're right, there are other alternatives that
18 are being offered in those form licenses.

19 Q And the other alternatives generally
20 consist of higher percent of revenues applied to a
21 smaller base of revenue and it's either the higher of
22 that percent of revenues or something that is based

1 (Pause.)

2 THE WITNESS: I don't know. I haven't
3 focused on those. I think it would depend on again
4 the circumstances under which that agreement came
5 about.

6 BY MR. GARRETT:

7 Q Describe for me the second continuum, the
8 second dimension of this continuum I'm trying to
9 construct.

10 A I'm not sure it's a second continuum. I
11 was just trying to articulate a difficulty I was
12 having with characterizing how good a benchmark is
13 along a single dimension. And I pointed out that
14 there is an issue with how precisely does a given
15 benchmark actually pin down what the right number is.

16 Q Well, I would guess that when we're
17 talking about the RIAA agreements or the record label
18 internet agreements, you would still put those down on
19 the unreasonable side, right, on this second
20 dimension?

21 A No, they're very -- well, actually, let me
22 think about that.

1 upon the number of page impressions, correct?

2 A I know that there are some higher
3 percentage of revenues and I know that there are some
4 age impression calculations. I don't actually
5 remember as I sit here, exactly how that formula or
6 those alternative formulas work.

7 Q Let me ask you about one other thing.
8 There's a number of agreements in this record here
9 dealing between record labels and various internet
10 companies concerning audio clips and music videos,
11 concert streaming, locker services, those kinds of
12 things. You're familiar with that, are you not?

13 A Yes, I'm familiar with those.

14 Q Where would you put those on this
15 conceptual continuum here?

16 A Unreasonable, because they're not for the
17 statutory license right.

18 Q Now go back to your point that there's
19 this second continuum here.

20 ARBITRATOR GULIN: Can I just interrupt?
21 How about agreements between record labels and
22 services that are DMCA compliant?

1 That's complicated. They're pretty
2 precise in terms of identifying a percentage of
3 revenue and a percent of expenses. They're much less
4 precise in identifying a per performance number.

5 Q Okay. So maybe I can get it to move a
6 little further away?

7 A No, no, well -- I guess I would break it
8 down. I would say with respect to revenue and
9 expenses, they're all the way on the right. They're
10 quite precise. They're just wrong, but they're very
11 precise.

12 (Laughter.)

13 They give us a --

14 Q I'll take what I can get.

15 A This is quite serious and this is an
16 important principle that you learn in chemistry majors
17 and undergraduates, they teach you this in science
18 classes. There's a difference between accuracy and
19 precision. Accuracy is the matter of are you right or
20 not? Precision is how precisely have you measured,
21 how narrowly have you measured whatever you've
22 measured. And you can be very precise and be wrong.

1 And you can be pretty accurate and be imprecise. And
 2 so what I would say is with respect to revenue and
 3 expenses, the RIAA agreements are quite precise. They
 4 tell us the number is 15 percent because virtually all
 5 of the percent of revenue agreements are 15 percent,
 6 percent of expenses is a little less so, some of them
 7 are higher, but certainly in terms of -- there are
 8 none lower than 5 percent. So they're precise, even
 9 if they're wrong.

10 With respect to performance they're not so
 11 precise because some of them are at .4. Some are at
 12 .35 and the Yahoo agreement is at .065. So it's much
 13 less precise with respect to pinning down a per
 14 performance number.

15 MR. STEINTHAL: In the public service, I
 16 would like to point out that should probably be
 17 restricted.

18 BY MR. GARRETT:

19 Q And for your proposal, the precision is a
 20 little bit further to the left here, of outcome
 21 determinant, is that what you said?

22 A Yes.

1 pretty up front of saying, for example, when I look at
 2 the appropriate discount, it's somewhere between 40
 3 and 70 percent, so I really haven't given you an exact
 4 number. I've told you a range that I think would be
 5 reasonable and then I've picked a number within that
 6 range, but I think I've been pretty up front about
 7 saying that that involves some judgment.

8 So the advice that I'm giving you, I think
 9 is based on a very strong conceptual approach. There
 10 is some play in that approach as to what number it
 11 tells you you should choose. I think once you choose
 12 a number, the model can work quite well in the sense
 13 that you raised, Judge Von Kann in terms of reliably
 14 telling the parties how it's going to work and what
 15 size checks they need to write. That's really a
 16 separate issue.

17 BY MR. GARRETT:

18 Q So I can complete the chart here on the
 19 precision continuum here, the RIAA agreements are a
 20 little bit to the right or a little bit to the left of
 21 the benchmark you have? Or about the same place?

22 A Well, as I said, with respect to an

1 Q So if I put it right about here, would
 2 that be all right?

3 A Yes.

4 MR. RICH: Could we ask Mr. Garrett to
 5 label either end of the spectrum on the second
 6 continuum because I don't know that outcome
 7 determinative fits precision, if I understood the
 8 witness's answer.

9 THE WITNESS: No, I can't -- it's not
 10 outcome determinative. It's just precise and
 11 imprecise.

12 ARBITRATOR VON KANN: Are you talking
 13 about the extent to which a proposed benchmark tells
 14 the parties with laser-like precision exactly how much
 15 to write on the check?

16 THE WITNESS: No, that's not what I'm
 17 talking about. I'm talking about is how precise is
 18 the judgment I've given you. So I think the over the
 19 air model, based on musical works with the
 20 confirmation that we have on equality and with the
 21 other things that we've talked about is air tight as
 22 an argument as to how to approach this, but I've been

1 expense or revenue benchmark, I would say they're all
 2 the way to the right. With respect to a per
 3 performance number, they're a fair ways to the left
 4 because the range is from .05 to .4. That's a factor
 5 of -- I can't do it any more after 5:30.

6 CHAIRMAN VAN LOON: 8.

7 THE WITNESS: A factor of 8. That's a
 8 pretty wide range.

9 BY MR. GARRETT:

10 Q All right, so that would be somewhere down
 11 here?

12 A Yes.

13 Q All right, any other potential benchmarks
 14 you think we ought to put up on any of these
 15 continuums here?

16 A I don't know what point you're trying to
 17 make so I don't know how to answer the question.

18 Q That's the idea.

19 (Laughter.)

20 I was just going to give you an
 21 opportunity if you thought I'd not fully covered all
 22 the potential benchmarks that you think the Panel

1 ought to be considering here. This is your chance to
2 speak up.

3 A I have not proposed any other benchmarks.

4 Q Okay. Now when you were here the last
5 time, I believe you had said something to the effect
6 that you thought there might be some issues with the
7 26 RIAA agreements, but that you were still in the
8 process of looking at the facts surrounding those
9 agreements more closely, correct?

10 A I think that's correct, yes.

11 Q And you said you thought there were some
12 problems, but you really weren't sure?

13 A Yes.

14 Q Because you hadn't done the requisite
15 analysis yet, correct?

16 A I think what I said is I had identified
17 categories of problems, but I hadn't yet figured out
18 to what extent they applied to each of the 26
19 different agreements.

20 Q And you have now made that determination
21 as to what the problems are with respect to each of
22 those 26 agreements, correct?

1 looked at here to determine the specific problems with
2 respect to the RIAA agreements?

3 A I've looked at the documents that were
4 produced primarily these negotiating documents, e-
5 mails and so forth and the testimony of the various
6 witnesses in the proceeding.

7 Q Have you spoken with any of the 26 RIAA
8 licensees?

9 A Yes, I have.

10 Q And who have you spoken with?

11 A I knew that was going to be the next
12 question.

13 Q I'm pretty predictable.
14 (Pause.)

15 A I'm afraid as I sit here, I can't remember
16 these names, all sort of sound the same to me and I
17 get confused as to which is which. There were two, I
18 believe, individuals that I spoke with from two
19 different licensees, but as I sit here, I can't tell
20 you which ones they were.

21 Q Do you recall the names of the
22 individuals?

1 A I certainly enumerated some of the
2 problems I found in the record with respect to the 26
3 agreements, yes.

4 Q You think there might be more?

5 A Yes.

6 Q I guess I shouldn't have asked that
7 question, huh?

8 (Laughter.)

9 ARBITRATOR VON KANN: Didn't they teach
10 you anything in law school?

11 MR. GARRETT: Yeah, they told me not to be
12 in this position at 6 o'clock on Friday night.

13 (Laughter.)

14 BY MR. GARRETT:

15 Q You, in your written testimony, have
16 focused your discussion of these agreements and the
17 problems with these agreements by looking at just the
18 record of this case here, correct?

19 A Certainly that's the vast majority of the
20 evidence, yes.

21 Q Well, that was not a good question. The
22 question really is exactly what is it that you have

1 A No.

2 Q You don't recall the specific licensee
3 either, do you?

4 A Correct.

5 Q When did you have those conversations?

6 A Those conversations were back in the time
7 frame actually before -- between the written direct
8 and my oral direct testimony when I was starting to
9 think conceptually about what are the issues that
10 might have arisen and I was trying to formulate my
11 thinking about that.

12 Q Did you make any notes of those
13 conversations?

14 A Not that I still have, no.

15 Q Do you remember what issues you discussed
16 with them?

17 A Some of them, yes.

18 Q Would you tell us?

19 A One of them dealt with sort of this
20 information issue and the question of whether the
21 individual at the time that he was dealing with the
22 RIAA, understood what the statutory license could do

1 for him and whether he made the decision knowing that
 2 the presence of the statutory license meant that he
 3 could stream without signing with the RIAA. And that
 4 helped me to think about things. I'm not relying on
 5 that representation. I mean there's not an X in my
 6 chart that is supported by that particular
 7 conversation.

8 The other one had to do with or focused to
 9 a significant extent on the interplay, really, between
 10 the bundling issue and the uncertainty issue. There's
 11 a licensee that was involved in some activities which
 12 it was at least, as I understand it, alleged by record
 13 labels, were interactive, and therefore were not
 14 subject to the statutory license and they were trying
 15 to figure out how they could resolve those issues.
 16 And again there's no X on this agreement that I'm
 17 relying on that conversation for. It was just
 18 something that I used in order to help me to start
 19 thinking about these things.

20 Q Okay. Now among the different issues that
 21 you've identified here, one is the litigation cost.
 22 You discussed that pages 64 to 65 in your testimony,

1 correct?

2 ARBITRATOR VON KANN: Which version do you
 3 have?

4 MR. GARRETT: The later version.

5 THE WITNESS: It is on page 64 on the
 6 version I have in front of me. That's all I can say.

7 ARBITRATOR VON KANN: Incidentally, when
 8 you refer to these Xs you said that that phone call is
 9 not the support for some particular action. Is there
 10 a document somewhere that explains why, for example,
 11 in relation to Cablemusic there's a check about
 12 concerns about timing and uncertainty, what the
 13 concern on timing and uncertainty was for each one of
 14 these, what the bundling issue was? Is there, in
 15 effect, a work paper or a backup that supports these
 16 Xs?

17 THE WITNESS: Yes. Well, back up the work
 18 paper. I don't think there is a work paper that is in
 19 the record because this is just a demonstrative that
 20 we worked up for today's presentation.

21 I have a list of citations either to
 22 specific documents or transcript references which is

1 the basis for every X on that chart..

2 ARBITRATOR VON KANN: Okay.

3 MR. RICH: If the Panel would desire, we'd
 4 be happy to provide it.

5 ARBITRATOR VON KANN: Let Mr Garrett, if
 6 he wants to pursue that for the moment.

7 MR. STEINTHAL: On the subject of
 8 providing the Panel, we've had another copy made of
 9 apparently the document with the correct pagination,
 10 Judge Von Kann, so if you'd like everybody is working
 11 off the same page.

12 THE WITNESS: As it were.

13 BY MR. GARRETT:

14 Q Now if I go to your chart as well, Dr.
 15 Jaffe, the demonstrative, I see that you've got checks
 16 for concerns about cost of litigation with three
 17 different licensees, correct?

18 A Yes.

19 Q It's Soundbreak and Yahoo! and MusicMatch,
 20 correct?

21 A Yes.

22 Q Now potentially all webcasters could

1 participate in CARP proceedings and therefore incur
 2 the cost of litigation, correct?

3 A They could, yes.

4 Q But you don't have checks next to any of
 5 the other RIAA licensees other than the three that we
 6 just mentioned, correct?

7 A That's correct. I didn't -- it's my view
 8 that the conceptual possibility that litigation costs
 9 may have been an important factor for any licensee, I
 10 don't think that in and of itself would be sufficient
 11 grounds to say that that's a concern about the
 12 validity of that benchmark. What I looked for was
 13 some evidence that the particular licensee felt that
 14 the cost of litigation or in their particular case
 15 would be sufficiently great, that that was an
 16 important motivating factor in signing the voluntary
 17 license.

18 Some of these licensees, I think a
 19 reasonable presumption is that if they had not signed
 20 a voluntary license and had relied on the statutory,
 21 they would not necessarily have participated in this
 22 proceeding and incurred significant litigation costs.

1 Q And in the case of Soundbreak, for
2 example, you reached the conclusion that you did based
3 upon a newspaper article that was put in the record
4 here, correct?

5 A Yes, I think that is correct.

6 Q And with respect to Yahoo!, since you
7 didn't have the benefit of Mr. Mandelbrot's testimony,
8 you relied upon a statement by Mr. Marks, correct?

9 Page 65 of your written testimony?
10 (Pause.)

11 A Yes, I don't recall, as I sit here,
12 whether there were Yahoo! documents that also conveyed
13 that or not. I just don't remember.

14 Q I've only got what you've cited here and
15 what you've cited here was a statement made by Mr.
16 Marks during the course of negotiations that it would
17 be a good idea to settle because it would avoid
18 litigation costs, correct?

19 A That's what's quoted in the written
20 testimony, that's correct.

21 Q So would it be your view that whenever you
22 had an agreement where one of the negotiators said to

1 Do you have that before you?

2 A Yes.

3 Q And you talk there about cost of
4 litigation s being a factor that might make an
5 agreement not a reliable benchmark, correct?

6 A Yes.

7 Q And incidentally, if you find that one of
8 the parties or both of the parties had concerns about
9 litigation, would that in and of itself make the
10 agreement an inappropriate benchmark?

11 A It would raise concerns and with respect
12 to Yahoo!, I think we had more than just the fact that
13 Mr. Marks raised this as a negotiating technique.

14 What we had was and specifically saying we'll pay more
15 in attorney's fees than the numbers we proposed, which
16 is not -- which is somewhat more than saying avoid
17 litigation costs. And in addition, I have the
18 knowledge that I have regarding Yahoo!'s place in this
19 industry and the fact that Yahoo! is really not
20 comparable to these other parties, so that it's
21 unlikely even before I heard Mr. Mandelbrot say it, it
22 was clear to me just as a matter of logic that it

1 the other negotiators, hey, you ought to settle this
2 and avoid some litigation costs, that in and of itself
3 would be enough to warrant a little checkmark here on
4 your chart?

5 A I don't know.

6 Q Well, I mean here you seem to have drawn
7 that conclusion solely from Mr. Marks' statement.
8 There is no other reference supporting it here in your
9 written testimony.

10 MR. JACOBY: Can I ask for a clarification
11 of the pending question, whether Mr. Garrett is
12 exploring the basis for the presence of the X of this
13 document as to Yahoo!, this document having been
14 prepared after this written testimony was prepared or
15 independently of it, whether it warrants an X based
16 solely, whether it would have warranted an X based
17 solely on the material quoted in the written testimony
18 at page 65?

19 BY MR. GARRETT:

20 Q Let me make it easier. We'll just move
21 off the demonstrative and just focus on your testimony
22 here, pages 64 and 65.

1 would be unlikely to think that Yahoo! would have been
2 able to free ride, or would have been inclined to free
3 ride and not participate actively in this proceeding
4 when -- if it had not signed a voluntary license. So
5 I'm really reading the Marks e-mail in conjunction
6 with that other information and it clearly was
7 confirmed by Mr. Mandelbrot's testimony.

8 Q Incidentally, I guess to be clear of the
9 chart, the demonstrative that you prepared, I thought
10 you said that you had prepared this before Mr.
11 Mandelbrot testified. Am I wrong?

12 A What I said was I prepared that before I
13 had completed my reading of Mr. Mandelbrot's
14 transcript. Just to be very specific. It was
15 prepared on Wednesday and Wednesday night, so Mr.
16 Mandelbrot had testified. I had heard some stuff
17 indirectly about what he said. I had not yet read the
18 transcript.

19 Q And that's why you changed the number
20 here, right?

21 A Correct.

22 Q I want to go back again though, so we're

1 clear here. Is it your statement by one of the
2 negotiators that you ought to settle because you're
3 going to avoid a lot of litigation cost. Is that in
4 and of itself enough to render a particular agreement
5 an inappropriate benchmark?

6 A Not necessarily, no.

7 Q What more do you need to know?

8 A Well, again, it's not a 0-1 thing of
9 appropriate or inappropriate. I think it's a
10 cumulative effect of evidence. I think the threshold
11 question is what evidence do you need to think that
12 this particular issue in this case, litigation costs
13 is a concern and we talked about that. I think
14 whether or not litigation costs being a concern would
15 lead you to really not rely on the agreement at all or
16 to perhaps just give it less weight, would depend on
17 the facts. And in the case of Yahoo! we have some
18 pretty specific facts. In the case of these others
19 there are other factors besides the litigation costs
20 which are also contributing to the conclusion that we
21 can't learn much from these agreements about a
22 reasonable fee. So it's not a matter of you know,

1 license fees for the PROs.

2 It operates on both symmetrically on both
3 sides in a way that is not applicable to the RIAA
4 agreements and in addition that agreement is itself,
5 comes out of a long history of agreements and is of a
6 piece with a history of agreements, some of which were
7 voluntarily negotiated, some of which were I guess all
8 of them, a history of agreements that were negotiated
9 over a period of time, subject to the oversight of the
10 rate court.

11 Q Did you make any determination as to
12 whether ASCAP entered into the agreement that it did,
13 resulted in the license fees using your benchmark,
14 whether ASCAP entered into that agreement, in part,
15 because they wanted to avoid cost of litigating before
16 the rate court?

17 A Yes, I think I did. That was discussed in
18 my direct testimony as to what was the effect on that
19 agreement of the fact that both ASCAP and the Radio
20 Music Licensing Committee were doing that knowing that
21 if they didn't reach that agreement, there would be
22 litigation in rate court. So yes, I did consider that

1 it's not like pregnancy, you're either pregnant or
2 you're not. It's a matter of cumulative evidence
3 regarding the concerns about this proposed benchmark.

4 Q Now the benchmark that you used based upon
5 license fees paid by radio stations to ASCAP and BMI,
6 correct?

7 A And SESAC, yes.

8 Q I'm sorry, and SESAC. At least in the
9 case of ASCAP those particular license fees, the year
10 2000 fees were paid pursuant to an agreement that was
11 negotiated back in the early 1990s, is that correct?

12 A I don't know exactly when it was
13 negotiated. The previous point has been in force for
14 the period of time the parties expected it to and I
15 used the fees produced in the Year 2000.

16 Q Did you make any determination as to
17 whether ASCAP, for example, entered into that
18 agreement, in part, in order to avoid the costs of
19 going to rate court?

20 A I think actually I did discuss in my
21 direct testimony the effect that the rate court has on
22 the interpretation that is appropriately given to

1 and made a determination that on balance, the effect
2 of that determination is that the rate is probably
3 high, if anything, but that it's the best indication
4 we have of a competitive market rate.

5 Q What about with respect to BMI? The
6 particular Year 2000 payments that are reflected in
7 your study were made pursuant to an interim agreement,
8 correct?

9 A That's correct, and that issue is
10 discussed in here and I talk about what BMI is
11 requesting as a final fee which is presumably greater
12 than anybody thinks they're actually going to get out
13 of the rate court determination and if you substitute
14 their ask for the actual BMI fees, it has a trivial
15 effect on the numbers that I've produced. It
16 increases it as much as a few percent. So I don't
17 think -- again, I've analyzed the effect that
18 potential litigation has on that and I've concluded
19 that it can be shown to be very minor.

20 Q And this is a piece of litigation that
21 you're involved in as well?

22 A That's not correct. I'm not involved in

1 that litigation.

2 Q You have a personal knowledge of -- strike
3 that.

4 Let me ask you about the information
5 concerns that you've identified in another category
6 here.

7 (Pause.)

8 Exactly what information must the licensee
9 have in order to pass the test that you've set up
10 here?

11 A Well, to be clear, I didn't impose a test
12 that said they have to have the information. For most
13 of these licenses, I don't know one way or the other
14 what they knew. They may well have had bad
15 information. But I haven't put an X just because I
16 don't know that they had good information. That's not
17 how I went about it.

18 What I've done is I have said if I see
19 evidence that they did not understand that the
20 statutory license was available to them, that the
21 existence of the statutory license meant that they
22 could begin streaming from the day they filed the

1 well. So I haven't made a huge deal out of this
2 information issue, but there is some evidence.

3 Q You're not suggesting that they needed to
4 be conversant with all of the provisions of the DMCA
5 here, were you?

6 A Certainly not.

7 Q Incidentally, you're aware, are you not,
8 that the recording industry is in litigation with a
9 couple of the webcasters who are on the other side of
10 the room here, correct?

11 A I am aware of that in fairly general
12 terms, yes.

13 Q There are disputes with some of the other
14 webcasters over whether or not they're operating
15 interactive services, correct?

16 A I mean I don't know -- I guess what I'm
17 hesitating over is I think there was a plural in your
18 question I'm not actually sure that it's plural. I
19 certainly know that there is some litigation. I don't
20 know how many webcasters it involves.

21 Q If we, the RIAA, were to enter into
22 agreements with any of the parties that they're

1 appropriate papers whether the RIAA wanted them to or
2 not, or that they didn't know whether or not what they
3 were doing was compliant with the statutory license
4 and if I see that affirmative evidence of that lack of
5 information, then I would have put an X here.

6 Q Is there anything else that would have
7 caused you to put an X there?

8 A I don't think so.

9 Q Basically, they needed to know that a
10 statutory license was an option, correct?

11 A Yes.

12 Q And what else did they need to know?

13 A Well, that it was an option. That what it
14 meant as an option was that there was no need for them
15 to deal with the RIAA in order to begin their
16 streaming activities and that the specific activities
17 that they wished to engage in were, in fact, covered
18 by the statutory right so that that option was a
19 meaningful and appropriate one for them. And if I saw
20 evidence that that was not the case, I'd put an X.

21 There really are only a handful of information Xs, all
22 of which are licensees that had other problems as

1 litigating with on these personalized services, would
2 that fact by itself mean that there are agreements on
3 statutory licensing rates, would be -- would not
4 provide a good benchmark for setting a royalty rate in
5 this proceeding?

6 A That would certainly be a significant
7 concern, yes.

8 Q Well, my question though is whether just
9 that fact alone.

10 A That fact alone would be a source of
11 significant concern, yes, because the most likely
12 assumption is that if I enter into a statutory
13 agreement with you in conjunction with settling
14 litigation over other issues, that there's no way to
15 know whether what I've paid for the statutory license
16 really corresponds to what the statutory license is
17 worth as distinct for corresponding to what it was
18 worth to me to settle that litigation.

19 Q So for example, if you were to enter into
20 a settlement with a webcaster such as MTV who we are
21 litigating against, that agreement would not be a good
22 benchmark for setting a royalty rate in this

1 proceeding?

2 A I would certainly have significant
3 concerns about using that agreement as a benchmark,
4 yes.

5 Q And when you say significant concerns,
6 does that mean that you're holding out the possibility
7 that it still might be a valid benchmark?

8 A Well, what I've said is you know, I don't
9 think validity of a benchmark is a yes/no thing. It's
10 a matter of degree and cumulative evidence. I would
11 -- and you're giving me a hypothetical where I sort of
12 don't know any of the other aspects and I guess what
13 I'm saying is I'm not going to sit here and say that
14 based only on what you've told me I would throw it out
15 the window and pay no attention to it. Based on what
16 you've told me I would have significant concerns and
17 I'd be inclined not to give it a lot of weight and if
18 there were other reasons to be concerned, I might well
19 give it no weight, but I don't know.

20 (Pause.)

21 Q Let me ask you about the column that
22 you've marked bundling with statutory right. You've

1 to secure non-statutory licenses, correct?

2 A Yes.

3 Q Is it again your view that the mere fact
4 that some company, some webcaster wanted to obtain an
5 interactive license or have a certain kind of
6 relationship with other record labels, that mere fact
7 alone mean that you could not look at any agreement
8 that RIAA entered into with them?

9 A No, that is not my position.

10 Q So for example, there are a number of
11 these webcasters here in this proceeding who have
12 indicated that they would like or they have other
13 relationships with record labels. Are you aware of
14 that?

15 A Yes.

16 Q And the fact that they have those
17 relationships or want those relationships is not per
18 se disqualifying their agreements with RIAA or any
19 agreement with RIAA as a benchmark in this proceeding?

20 A No, I don't think the test is that the
21 licensee wanted something more. The test is did the
22 licensee perceive, is there evidence that the licensee

1 reviewed the 26 agreements themselves?

2 A You mean the actual license documents?

3 Q That's correct.

4 A I have not reviewed all 26 of the actual
5 license documents, no.

6 Q In this section you're not suggesting that
7 there's anything in those agreements that gives the
8 licensee something beyond the statutory license rights
9 here, are you?

10 A Not in general, no.

11 Q When you say not in general?

12 A There may be one or two cases where
13 there's actually something in the agreement. I don't
14 remember.

15 Q All right, so what you're referring to in
16 your testimony here is something beyond those written
17 agreements, correct?

18 A Generally, that's true, yes.

19 Q Now for example, you say here on your
20 demonstrative that one of the things that some of the
21 licensees were getting was received enhancement
22 relationships with label community to improve ability

1 perceived that they were, in fact, getting something
2 more and that's what I've looked for and as we've
3 seen, although I agree with you, it's not part of the
4 agreement. Mr. Marks' own behavior suggests that it
5 was not unreasonable for these licensees to perceive
6 that they were getting something more.

7 Q So if Mr. Marks sends out an e-mail to all
8 of the labels and said this is a good guy, you ought
9 to help him out with what they're looking for, that
10 fact --

11 A He did more than that. He said --

12 Q I'm not asking it. I was asking you if
13 that's all, all right. If he simply sends out --

14 A I'm sorry, I interrupted you. I
15 apologize.

16 Q It's all right. If all he does is sends
17 out an e-mail saying that this is a good guy. He's
18 one of our licensees. He's looking for some -- the
19 ability to deal with the rest of you, would that fact
20 in itself mean that you can't look at the license
21 agreement any more?

22 A First of all, I never said that any one of

1 these says you can't look at the license agreement.
 2 I said that these things are sources of concern. I
 3 think if I had an e-mail from the licensee saying I'm
 4 doing this because I really want to be on good terms
 5 with the record industry and then they sign the
 6 license and I saw an e-mail from Marks saying this guy
 7 has just signed a license, I think we should be nice
 8 to him. I think yes, that would be a source of
 9 concern, that that's what the parties perceived was
 10 going on. I never said it in and of itself
 11 disqualifies the thing, but I think it would be a
 12 source of concern.

13 Q Do you think that in your competitive
 14 market that there would be a number of webcasters, who
 15 would believe that if they entered into some sort of
 16 statutory or entered into some sort of licensing
 17 arrangement with RIAA, that that would help them in
 18 the relationships with the individual record labels?

19 A Perhaps.

20 Q And the notion that if you're a webcaster
 21 entering into a deal with RIAA would help you with the
 22 individual labels, would you consider that to be

1 something that is uncommon in the industry itself?

2 A No.

3 Q But in your view it would raise concerns
 4 as to whether any agreement they entered into could be
 5 used as a benchmark for purposes of this proceeding?

6 A Yes, and to be clear I'm not saying
 7 there's anything nefarious or anything inherently
 8 nonbusiness-like of their being these other
 9 considerations. The question I'm putting to myself is
 10 we have the RIAA who is a monopolist who is putting
 11 out a price and hoping people will take it and the
 12 question I'm asking myself is can we draw an
 13 inference, an affirmative inference from the fact that
 14 certain people have chosen to take it, that that is,
 15 in fact, the competitive price. You're asking us to
 16 draw an affirmative inference from their acceptance of
 17 that price, that it is not a monopoly price, it's a
 18 competitive price. What I'm saying is some of these
 19 other considerations as common as they may be, as
 20 human nature as they may be, as natural as they may
 21 be, nonetheless, when you think them through
 22 analytically, leads you to the conclusion that you

1 can't necessarily conclude that what you're seeing
 2 here is a competitive market transaction that tells us
 3 the competitive market price for the statutory right.

4 Q Would you agree, would you not, though
 5 that there would be probably a lot of webcasters out
 6 there who would like to maintain good relationships
 7 with the individual record labels?

8 A Sure, although many of them decided that
 9 however much they might like to have that, they
 10 weren't going to sign with the RIAA. I don't take
 11 that as evidence that it was unreasonable any more
 12 than I take it in and of itself as somehow
 13 unreasonable that people wanted to do that. I think
 14 you have to analyze what does it tell you about the
 15 market prices.

16 Q I guess my only question here is whether
 17 you thought that by having -- the webcaster who had
 18 that view and wanted to maintain good relationships
 19 with individual record labels was somehow atypical of
 20 the rest of the webcasters?

21 A Well, we already said that wanting to
 22 maintain good relationships is not what caused concern

1 for me.

2 Q You talk about another concern here that
 3 there are certain licensees who thought that by
 4 entering into a license would enhance their ability to
 5 be serviced, correct?

6 A Yes.

7 Q And the notion of wanting to be serviced
 8 again is probably not atypical of the marketplace
 9 either, right?

10 A No, it's not.

11 Q And your concern is that they thought that
 12 by entering into an agreement with RIAA that would
 13 help them be serviced?

14 A It wasn't just that they thought it, it's
 15 that it appears to be have been true.

16 Q There's evidence that you've seen here
 17 that once they enter into those agreements, they then
 18 begin to get serviced?

19 A I should say that differently. There is
 20 evidence that they seem to have tried to get serviced
 21 and were told if you want to get serviced, go get a
 22 license and then we'll talk about being serviced. I

1 don't actually know what then -- I'm not sure I know
2 what then happened.

3 Q But wanting to be serviced in and of
4 itself is not something that was uncommon in the
5 industry here?

6 A No, but it's still true that if there's
7 something that everybody wants, but the only people
8 who get it are the ones who sign the voluntary
9 agreement and what is being conveyed in the voluntary
10 agreement is not just the statutory agreement, but is
11 something else and maybe it is, in fact, something
12 else that everybody wants, but the other people aren't
13 getting.

14 Q Is there any evidence that RIAA promised
15 any of the licensees that if you entered into an
16 agreement with us you would then get serviced?

17 A Not that I recall.

18 Q You also talk about ability to authorize
19 performances by third parties including
20 nonentertainment websites and radio broadcasters, do
21 you see that?

22 A Yes.

1 normal time would be to go through ballpark 6:30 which
2 is what is fast approaching.

3 Was it your -- do you have a stopping
4 point in mind that's close or are you thinking of
5 going longer?

6 MR. GARRETT: I think to do what I want to
7 do would take us well beyond the 6:30 time and so I'm
8 prepared to stop at this point and pick up again in
9 the morning.

10 CHAIRMAN VAN LOON: Okay, I'm not
11 suggesting you stop right at this instant.

12 MR. GARRETT: No, if Dr. Jaffe would be
13 fresher in the morning, too, that's fine.

14 ARBITRATOR VON KANN: All of us will be.
15 (Laughter.)

16 MR. GARRETT: I don't relish the thought
17 of doing this at 6:30 on a Friday evening, nor do I
18 relish doing it at 9:00 on Saturday.

19 (Laughter.)

20 CHAIRMAN VAN LOON: It does raise a
21 question about whether anyone thinks it would be wise
22 at all to start a little earlier tomorrow morning,

1 Q Again, that -- there are probably a number
2 of webcasters out there who wanted to have that same
3 ability, correct?

4 A Yes.

5 Q So this is not something that was uncommon
6 in the industry?

7 A The desire to have it was not uncommon as
8 far as I know.

9 Q But your concern was is that the -- would
10 it be uncommon to think that by getting a license with
11 RIAA that might help their ability to authorize
12 performances by third parties, including
13 nonentertainment websites and radio broadcasters?

14 MR. JACOBY: Mr. Garrett, could we ask you
15 to keep your voice up?

16 MR. GARRETT: I thought I did.

17 THE WITNESS: I'm sorry, I've lost track
18 of what the question was. Could you either restate it
19 or have him read it back. I'm losing my focus here.

20 (Pause.)

21 CHAIRMAN VAN LOON: Could I ask, related
22 to that, Mr. Garrett, I know we made a pledge that our

1 8:30 or whether that's a fate worse than death.

2 MR. GARRETT: Not a groundswell there.

3 CHAIRMAN VAN LOON: If we're at a place
4 where you feel comfortable pausing for the evening, I
5 think that could be wise for all of us and we'll plan
6 to reconvene in the morning with business casual dress
7 or whatever.

8 ARBITRATOR VON KANN: Mr. Garrett, can I
9 just ask this, without kind of forcing you to be
10 definitive, but some folks might like to know, do you
11 still think if we resume at 9 o'clock we probably can
12 complete Dr. Jaffe tomorrow and therefore everybody
13 can assume they'll have Sunday off?

14 MR. GARRETT: I am hopeful of that. I
15 frankly thought I'd be much further along at this
16 stage too, but certainly my goal is not to bring
17 anybody back here on Sunday.

18 ARBITRATOR VON KANN: Okay.

19 MR. GARRETT: Including myself.

20 CHAIRMAN VAN LOON: Okay, let's all try to
21 get a good night's rest and be back at 9.

22 (Whereupon, at 6:25 p.m., the hearing

1 recessed, to reconvene tomorrow, Saturday, October 20,

2 2001 at 9:00 a.m.)

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-----+ In the matter of:	Docket No.
	2000-9
Digital Performance Right in	
Sound Recording and Ephemeral	
Recording	CARP DTRA
	1 & 2
-----+	

Conference Room 216
Second Floor
Offices of Arnold & Porter
555 12th Street, N.W.
Washington, D.C.

Saturday,
October 20, 2001

The above-entitled matter came on for rebuttal
hearing, pursuant to notice, at 9:00 a.m.

BEFORE

THE HONORABLE ERIC E. VAN LOON	Chairman
THE HONORABLE JEFFREY S. GULIN	Arbitrator
THE HONORABLE CURTIS E. von KANN	Arbitrator

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Corporation; Radioactive Media Partners, Inc.;
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C-O-N-T-E-N-T-S

WITNESS DIRECT CROSS REDIRECT RECROSS

Adam Jaffe
By Mr. Rich 12648
12663
By Mr. Garrett 12523 12652

EXHIBIT DESCRIPTION MARK RECD

RIAA
116 RPX Jaffe Demonstrative 12611
001 RRX Song List 12660 12660

SERV Rebuttal

10 Disney Movie Log 12652 12663
11 Disney TV Log 12652 12663

P-R-O-C-E-E-D-I-N-G-S

(9:03 a.m.)

CHAIRMAN VAN LOON: Well, good morning everyone, it's infamous Saturday.

Mr. Garrett, I do inform you that a burning question has now arisen, whether you having been so kind as to provide breakfast this morning, whether now for the duration everybody can expect -- or whether this is a Saturday specialty. You can advise us later.

MR. GARRETT: Can I do it shortly before your decision comes in?

(Laughter.)

Don't be surprised to see a request for a higher royalty rate.

CHAIRMAN VAN LOON: Welcome back, Professor Jaffe.

THE WITNESS: Thank you.

CHAIRMAN VAN LOON: We're glad to see you and appreciate your taking part of the weekend as well to be with us.

We're in the midst of your cross

examination by Mr. Garrett and I neglected to just give a reminder yesterday. You're in the most unenviable position in that when we have breaks and even lunch time, since you're in the midst of cross examination, you're not able to consult with your counsel.

THE WITNESS: Yes, I understand that.

CHAIRMAN VAN LOON: Mr. Garrett, the floor is yours.

MR. GARRETT:

WHEREUPON,

ADAM JAFFE

HAVING BEEN PREVIOUSLY SWORN, WAS RECALLED AS A WITNESS AND TESTIFIED AS FOLLOWS:

CROSS EXAMINATION (CONTINUED)

BY MR. GARRETT:

Q Good morning, Dr. Jaffe.

A Good morning.

Q I'd like to talk for a few moments here about the study that you did on synchronization fees and master use fees, all right?

A Okay.

Q When did you do that study?

A I think we got the first data, it was a Sunday, it would have been about 10 days before the rebuttal testimony was filed.

Q When did you first come up with the idea of doing the study?

A Well, we had talked much earlier, I guess back in the winter about the possibility that we might be able to try to get some data that would confirm the theoretical approach that I formulated. My understanding is in that time frame counsel for the webcasters had attempted to determine whether there were any studios that would be willing to provide it and were not able to convince any of them to provide the information, so although we had thought about doing it, we didn't pursue it at that time.

Q But then shortly before the filing of the rebuttal case, you were able or someone on your behalf was able to persuade three companies to provide the relevant data, correct?

A Yes.

Q So you got the first batch of data about

10 days before the rebuttal cases were filed, correct?

A That's my recollection.

Q So all the data was reviewed within a 10-day period, correct?

A More or less.

Q Did you personally supervise the review of this data?

A Yes.

Q What data exactly did you review?

A Well, we got the data from the different studios in somewhat different forms. I believe you were provided in my work papers with the materials we were originally given by the studios. Do you want me to describe what each of those was with respect to each studio?

Q Do you have any of those documents with you?

A I have with me examples of each, yes.

(Whereupon, at 9:05 a.m., the proceedings went into Closed Session.)

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BY MR. GARRETT:

Q Assume that the motion picture company needed to get the consent and make compensation to the record company, the publisher, the background artists and the featured artists, separately. Would it be your view that all four of those groups would receive equal license fees?

A No.

Q Would it be your view that those four groups jointly created the sound recording?

A No.

Q If you could just turn for a moment to page 9 of your testimony.

(Pause.)

ARBITRATOR VON KANN: I turned to page 9 and I'm reading about my house in Cambridge, Massachusetts with a DSL access and I suddenly realized I've slipped into Zittrain testimony.

MR. GARRETT: You noticed the difference?

ARBITRATOR VON KANN: Yes, I noticed the difference.

MR. RICH: Why don't we give him his

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Q Dr. Jaffe, one other question here about background artists, assume for the moment that the motion picture company was required to pay not only the publisher and the record company, but it was also required to compensate the background artist. Would it be your judgment that those background artists would receive a royalty or a license fee equal to that of, generally equal to that, of the record company or the publisher?

A No.

Q One could say, could they not, that all three of those groups jointly created the particular sound recording of the motion picture was using, correct?

A I'm sorry, who are your three groups?

Q Record company, publisher, background artist.

A No, I don't think you could say that.

Q I take it your answer would also be the same if I broke out the featured artists, correct?

MR. RICH: Exactly what your hypothetical would be there, Mr. Garrett?

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choice?

(Laughter.)

BY MR. GARRETT:

Q You say there in that final paragraph on page 9 that the notion that parties jointly create value will split that value equally is also confirmed by the very statute in which this proceeding occurs, correct?

A Yes.

Q And then you refer to I believe it is the section of or provision of Section 114 that says that the record companies and the artists, both featured and nonfeatured would split whatever royalties or pay pursuant to Section 114, correct?

A Yes.

Q What exactly is the relevance of the statutory provision here to the point that you're advancing here?

A Well, I was just making the observation that I've put forward a view of this which is divorced, sorry, I put forward a view of this which is that you don't look at what did it cost to make the

1 sound recording and what did it cost to make the
 2 musical work when you are figuring out for this
 3 incremental use their relative values, but rather that
 4 because they're coming to this symmetrically, they
 5 would get likely equal values and I was just making
 6 the observation that when Congress faced the question
 7 of splitting up the sound recording portion of it
 8 between the record companies and the artists, Congress
 9 didn't say you split that up in proportion to somehow
 10 how much it cost each of them to -- what was their
 11 relative original contribution to that sound
 12 recording. They just said divide it in half. And
 13 that's not the basis for my view because I don't know
 14 why Congress did that. I'm just making the
 15 observation that that is conceptually analogous to the
 16 way I've looked at the sound recording versus the
 17 musical work.

18 Q Are you familiar with the Audio Home
 19 Recording Act?

20 A No.

21 Q Are you aware of the fact that the
 22 royalties paid pursuant to the Audio Home Recording

1 Act are split two thirds to record labels and one
 2 third to publishers?

3 A No.

4 Q Would you consider that at all relevant to
 5 your theory?

6 A Not unless I knew more about why it was
 7 done that way or what was being accomplished by that,
 8 no.

9 Q Dr. Jaffe, in doing your study on sync and
 10 master use fees here, did you consider any other
 11 alternatives to that study?

12 A Yes.

13 Q Did you consider looking at the way
 14 musical work royalties and sound recording royalties
 15 are divided in the digital arena in any way?

16 A Well, I'm not sure what you mean by
 17 considered. I have a knowledge of how they're divided
 18 with respect to digital cable radio and I'm very aware
 19 of that situation and that has factored into my
 20 thinking about this case from the beginning.

21 If there are other digital contexts in
 22 which both are valued, I have not looked at them.

1 Q Okay, you're just not aware of any of
 2 those situations?

3 CHAIRMAN VAN LOON: Mr. Garrett, I'm
 4 having trouble --

5 BY MR. GARRETT:

6 Q Sorry, you're just not aware of any of
 7 those situations?

8 A I haven't focused on them, no.

9 Q Let me ask you to page 17 of your
 10 testimony for a second.

11 (Pause.)

12 COURT REPORTER: Will be going into public
 13 record now?

14 MR. GARRETT: We've gone into things that
 15 are clearly public and have for a while here.

16 CHAIRMAN VAN LOON: Let's certainly go
 17 back on the public record now and I guess the question
 18 is whether we could go back to the beginning of that,
 19 your theoretical questions when you were asking about
 20 whether the three groups, the record companies, the
 21 publisher and the background artists had shared
 22 equally and then the question about the four, you

1 added in featured as well as background.

2 MR. GARRETT: That's certainly fine with
 3 me. I think it's everything since the last time I
 4 mentioned a studio by name, probably.

5 CHAIRMAN VAN LOON: That's easier to find.
 6 (Pause.)

7 CHAIRMAN VAN LOON: I think it's only
 8 shortly before that because that's when the series of
 9 questions began. No, no, these other ones --
 10 theoretical ones came into play.

11 So let's continue in open session.

12 BY MR. GARRETT:

13 Q You are on page 17, Dr. Jaffe?

14 A Yes.

15 Q Could you just briefly summarize the point
 16 that you're making there?

17 ARBITRATOR VON KANN: This is in Roman III
 18 that you're talking about?

19 MR. GARRETT: It's right before Roman III.

20 ARBITRATOR VON KANN: Before that.

21 MR. GARRETT: The very paragraph before
 22 that.

1 THE WITNESS: Okay, well, this is a
 2 section that I didn't discuss orally yesterday because
 3 I think it's very much second order.
 4 I've explained why I think theoretically
 5 and why I think the data show empirically that the
 6 relative cost contributions in the sound recording of
 7 the recording company and the artists on the one hand
 8 and the publisher and the composer on the other hand
 9 are irrelevant because it's an incremental use.
 10 In this section, what I do is I say well,
 11 not withstanding the fact that it's irrelevant, I
 12 don't think that the evidence necessarily supports the
 13 conclusion that the contribution of -- on the sound
 14 recording side is, in fact, greater. And I'm dealing
 15 here with an issue that came up in the direct which
 16 was the suggestion that well since the revenues that
 17 are earned from the sale of a CD by the sound
 18 recording owners are greater than the revenues that
 19 are earned by the musical work owners, doesn't that
 20 show that their contribution to the creation of that
 21 CD must have been greater? And the point that I'm
 22 making here is that that doesn't necessarily follow

1 and there are two reasons. One is the statutory
 2 limitation on the mechanical royalty which is part of
 3 that, but even putting aside the statutory limitation
 4 of mechanical royalty, since we know that composers
 5 earn very significant revenues from performance rights
 6 in radio, which they can't get unless their song is on
 7 a CD, they might well have an incentive to lower the
 8 price that they charge for putting it on the CD in
 9 order to get access to those performance royalties in
 10 over the air radio and that's the point on page 17.
 11 Q Could it be the other way around? That
 12 they would actually take a lower performance royalty
 13 in order to generate higher mechanical fees?
 14 A Well, that wouldn't make sense in the face
 15 of the statutory limitation on the mechanical royalty.
 16 The market, they can't get a market rate for their
 17 mechanical royalty, so it wouldn't make sense for them
 18 to somehow try to raise that, plus I don't really see
 19 how it would work because there are different parties,
 20 how would an agreement to charge less to radio
 21 stations per performance royalty help them in getting
 22 a higher mechanical?

1 Q It is a fact, is it not, Dr. Jaffe, that
 2 publishers receive substantially more in the way of
 3 mechanical royalties than they do in performance
 4 royalties from radio?
 5 A Now you're singling out the publishers as
 6 distinct from the publishers and the composers?
 7 Q Publishers as the representatives of the
 8 copyright owner, or of the original copyright owner.
 9 Do you know what the breakdown of income is for
 10 publishers here in the United States between radio
 11 performance royalties, mechanical royalties and other
 12 forms of income, do you know?
 13 A Well, I have an estimate of that that I
 14 used in my original promotional value analysis. I
 15 must admit as I sit here I don't remember the numbers.
 16 Q One other question here. We talked
 17 yesterday about the minimum fees, do you recall that?
 18 A Yes.
 19 Q And I believe you had said that -- let me
 20 ask you this. Is it your notion here, is it your view
 21 that the minimum fees set in this proceeding should
 22 solely compensate for the incremental cost of

1 processing an individual webcaster's payments?
 2 A Assuming that the fee model which applies
 3 to everyone is a per performance model, so that all
 4 the performances that are being made are being paid
 5 for regardless of, for example, the revenue expenses
 6 or other economic indicia of the licensee. The only
 7 economic justification I can think of for a minimum
 8 fee is the one you indicated, the incremental cost of
 9 servicing the licensee.
 10 Q And if a percentage of revenue metric that
 11 the Panel adopted, would there be any other basis for
 12 having the minimum fee?
 13 A Well, that's a hard question because what
 14 you're basically saying is percentage of revenue
 15 doesn't work very well because it has the problem that
 16 you can have a licensee that makes a lot of
 17 performances, but doesn't have very much revenue.
 18 If the Panel should choose to adopt the
 19 model that doesn't work very well, do I think that
 20 they need to solve that problem with some other
 21 minimum fee? I don't know how to answer that
 22 question, but you're right, that in a percentage of

1 revenue model, there is an additional issue which is
2 the concern that you could be making a lot of
3 performances and not paying for them and to me, the
4 solution to that problem is a per performance model,
5 but if you didn't achieve that solution, I would agree
6 that you might want to think about some other kind of
7 solution. I don't know what it would be.

8 Q Well, what would be objective of the
9 minimum fee in that case in the percentage of revenue
10 model?

11 A Well, I think it would depend on what was
12 the logic that led you to choose the percent of
13 revenue model. I can't answer it -- you're asking me
14 to provide a good way of doing what I see is a bad
15 model and I don't really know how to do that.

16 Q On page 34, you give the different minimum
17 fees for the three performing rights societies,
18 correct?

19 A The internet license minimum fees, that's
20 correct.

21 Q Right. The BMI fee, you've listed as 259
22 which indeed the smallest minimum fee. But is it not

1 the case that BMI has three different minimum fees?

2 A I don't recall.

3 Q You're not aware that it actually
4 escalates depending upon the revenues?

5 A Well, if it escalates depending on
6 revenues, then the minimum is the minimum.

7 I mean, the idea of a minimum fee is what
8 you would pay if otherwise you would pay nothing
9 because a model generates a smaller fee. So if you
10 have a quote minimum fee that escalates with revenue,
11 then the minimum fee is the lowest number that that
12 formula produces, presumably that is what they believe
13 they need to get to cover their incremental costs for
14 a licensee that has de minimum revenue.

15 Q Okay. Do you have your Exhibit 1B handy
16 there?

17 A No, I do not.

18 Q The website music performance agreement
19 for BMI, the form agreement.

20 On page 3 is the minimum fee table. It
21 appears, does it not, that the minimum fee for 259 is
22 for anybody, any webcaster with up to \$12,000 in

1 revenues?

2 A That's correct. So it's the minimum fee
3 that you pay regardless of your revenues is \$259. The
4 only reason you would pay more than that is if you
5 have more revenue, so the minimum fee is \$259.

6 Q And that goes to \$517, right?

7 A The fee goes to \$517 if you have more
8 revenue and therefore not paying the minimum.

9 Q What would be the purpose of having that
10 minimum fee escalate like that?

11 A BMI's model is predicated on revenue.
12 They are trying to collect the value of the
13 performances based on revenue, and so it is a generic
14 feature of their model that the greater is your
15 revenue, the more you pay and that's how they capture
16 the value of their property.

17 Q I believe the incremental cost of -- well,
18 strike that.

19 (Pause.)

20 I'd like to go back again to your analysis
21 of the RIAA agreements, if I could.

22 ARBITRATOR VON KANN: Will this be the

1 restricted session or not?

2 MR. GARRETT: I believe so, yes.

3 CHAIRMAN VAN LOON: Maybe this would be a
4 good point to take a morning break. We've been going
5 about an hour and a half and we're going to be going
6 to a different subject matter.

7 MR. GARRETT: That's fine.

8 CHAIRMAN VAN LOON: Back at quarter of or
9 20 of, 20 of.

10 (Off the record.)

11 *****CLOSED SESSION*****

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Are we in restricted session?

MR. RICH: No. We're in open.

MR. GARRETT: Let me just ask you then,
your reasons why webcasters should not be valid

1 Q This is a concern that they may not have
2 a clear understanding of how the statutory license
3 works. Correct?

4 A Yes.

5 Q Your conclusion that there is a concern
6 here is based, as I take it, solely on this one email?
7 Is that right?

8 A As I sit here, I don't recall whether
9 there are other emails or testimony that is part of
10 the background for this. This is all I have cited in
11 the report.

12 Q Okay. Is it important that the licensee
13 have an understanding of how the statutory license
14 works at the outset of its negotiations or its
15 contacts with RIAA?

16 A No. I think what you would want would be
17 that before they sign the license, they understood the
18 nature of the options that were available to them and
19 how they worked.

20 Q So even though they may have started out
21 under some misapprehension of how the statutory
22 license works, as long as they got it right before

1 benchmarks is labeled as a restricted document. Is
2 there any reason that our discussion of all those
3 reasons needs to be in closed session?

4 MR. RICH: No. That does not, as long as
5 it is not tied to specific licensees.

6 THE WITNESS: I think that page one
7 clearly has restricted information in that it relates
8 to, for example, the economics of licenses. So the
9 footnotes just carry the same restriction, but the
10 footnotes are just conceptual.

11 MR. GARRETT: Okay.

12 MR. RICH: If the RIAA is not
13 uncomfortable with that testimony being public, we're
14 not.

15 MR. GARRETT: We're okay.

16 BY MR. GARRETT:

17 Q Let me, without identifying, so we can
18 stay in open session here, let me without identifying
19 the source of this particular quote. There on page 58
20 you indicate why one of the licensees raises some
1 concern with you. Is that a fair statement?

2 A Yes.

1 they signed on the dotted line, then we're okay?

2 A I think that would be right.

3 Q Have you reviewed the information that the
4 DiMA has put on its website concerning the operation
5 of the statutory license?

6 A Yes.

7 Q Do you believe that -- do you have an
8 opinion as to whether one who read and understood that
9 explanation, that the DMCA would have a clear
10 understanding of how the statutory license works?

11 A I think if they read it and understood it,
12 they would have a reasonable understanding, yes.

13 Q Are you familiar with the information that
14 the Recording Industry Association of America, RIAA,
15 has put on its website concerning the operation of the
16 statutory license?

17 A Yes.

18 Q Do you have an opinion as to whether, if
19 someone read and understood what was said on the RIAA
20 website on this issue, whether that person would have
21 a clear understanding of how the statutory license
22 works?

1 A I mean you could define understood it as
2 knew everything they needed to know, in which case
3 your question is a tautology. If we define
4 "understood it" to just mean they read those sentences
5 and they saw what was there and on some level they
6 absorbed it, I don't know that what's there is really
7 sufficient to make them understand what their options
8 were.

9 I think the fact that that website was
10 there the whole time and various licensees are writing
11 emails that clearly indicate that they don't
12 understand, suggests that it is not sufficient.

13 Q Let me go back to this RIAA Exhibit 116
14 RPX, and just number three there. I will try to
15 reverse the context here. If you found that a
16 licensee had a desire for rapid licensing for purposes
17 of satisfying potential investors, that I take it
18 would raise a concern to you?

19 A Yes.

20 Q Now when you say "for rapid licensing"
21 what do you mean by that?

22 A They felt that they needed to be licensed

1 rates to which any of the licensees agreed to were too
2 low?

3 A No.

4 Q In going back to this number three here,
5 dealing with rapid licensing, is it relevant to look
6 at the amount of time that the parties engaged in
7 negotiation or discussion of a license here in
8 determining whether or not this particular concern is
9 present?

10 A I don't think so, no.

11 Q I take it that the mere fact that one of
12 the licensees was trying to obtain investors, that
13 that fact in and of itself would not raise a concern
14 in your mind, would it, Dr. Jaffe?

15 A No, not absent some indication that the
16 licensee perceived that the lack of a license was a
17 problem in that regard.

18 Q On number four, I take it that the mere
19 fact that the licensee was out trying to obtain
20 additional customers, that fact in and of itself would
21 not suggest that there was a concern there. Correct?

22 A Again, not in the absence of some

1 faster than they could be licensed. I'm sorry. They
2 felt that they needed to have a license with license
3 terms faster than they would be able to get by relying
4 on the statutory license and this proceeding.

5 The whole issue with that is that RIAA has
6 market power unless the statutory license provides a
7 reasonable alternative. If I have a customer that I
8 can't make a deal with or an investor that I can't
9 make a deal with unless I have got the completed
10 license in hand with its terms, then the statutory
11 license isn't going to be a substitute for a voluntary
12 license unless it's going to be available in the
13 timeframe that I need to make a deal with that
14 investor or that customer.

15 Q Incidentally, I take it that the concerns
16 that you have raised here largely point in the
17 direction that the royalty rates to which RIAA
18 licensees agreed were too high. Is that a fair
19 statement?

20 A Yes, because of the market power of RIAA.

21 Q Are there any circumstances that you can
22 conceive of here that would suggest that the royalty

1 indication that the licensee felt that he needed to
2 have a license to deal with this customer.

3 Q One other thing. Number 10 here, your
4 note three about press releases. Is the fact that a
5 licensee, the mere fact that the licensee after the
6 signing a deal with RIAA issues a press release, does
7 that in and of itself raise some concern in your mind?

8 A No.

9 Q What additional factors would you need to
10 consider besides that they simply issued a press
11 release?

12 A Some indication that the publicity they
13 were getting by becoming licensed was an important
14 consideration as to why they were doing it.

15 Q I take it with all of the various concerns
16 that you have raised here, you have concluded that
17 there is no way to adjust for any of them. Is that
18 right?

19 A As I suggested in my report, the only one
20 that I can think conceptually of how you would adjust
21 for would be the cost of litigation one. But in the
22 cases where it applies, it appears to be so large that

1 it's not -- I mean if you did the adjustment, it would
2 imply a zero royalty, and I am not proposing that.

3 MR. GARRETT: I'm done. Thank you very
4 much, Dr. Jaffe.

5 MR. RICH: We would appreciate perhaps 15
6 minutes of time, chargeable against our clock, to
7 discern whether we have any redirect.

8 CHAIRMAN VAN LOON: Do we want to do some
9 of ours before?

10 MR. RICH: I'm certainly happy to wait
11 with any questions we have if the Panel prefers to go
12 forward.

13 CHAIRMAN VAN LOON: There is one issue I
14 would like to ask you about, Dr. Jaffe, that I have
15 been puzzling with, and if we can have the benefit of
16 your answers to think about during the break.

17 This is back at the theoretical level when
18 you were talking about the sunk costs, and the
19 argument that because they are sunk costs and there's
20 not an additional cost in going forward to making a
21 new deal, really the marginal costs for either side is
22 zero because that's all been taken care of.

1 litigators, the sheep farmer might want to have a big
2 liability policy just to cover himself. Right?

3 THE WITNESS: I think that's exactly
4 right. I think that so that would be an incremental
5 or a marginal cost that would be associated with this
6 new use. I think when I talked about that example, I
7 said that would factor into the price that might be
8 charged.

9 So I have tried to be pretty clear when I
10 talk about the model that I have and the conclusion
11 that I draw about this equality between the musical
12 work and the sound recording. I think of that as sort
13 of before we get to any consideration of displacement.

14 So I think conceptually the way I would
15 suggest you think about it is I proposed a benchmark
16 which is based on the musical work situation, with an
17 adjustment for promotional value. I believe that
18 should apply to the sound recordings on the Internet.

19 To the extent that you believe there is
20 evidence that there is an incremental risk for the
21 sound recording owners associated with this use, which
22 is different from risks that are faced by the

1 THE WITNESS: You've got it right.

2 CHAIRMAN VAN LOON: At a couple of points,
3 including once this morning, you expanded that a
4 little bit to say sunk costs and sunk risk, or you
5 didn't use the word sunk risk, but the costs and risks
6 are both accompanied up to that time. Right?

7 THE WITNESS: Correct.

8 CHAIRMAN VAN LOON: That's certainly
9 accurate from the point of view of the economic costs
10 of producing CDs or whatever up until then. At least
11 part of the argument here, the way I understand it, is
12 that there is however, a perceived risk going forward
13 and making a deal, and that is the risk that sales
14 would be diverted or streams will be ripped or in
15 other ways, there will be lost sales. So that there's
16 perhaps a cost going forward, a marginal cost that is
17 more in the nature of risk than other production
18 costs.

19 Perhaps with your example from the sheep
20 salesman or the sheep farmer, if the sheep farmer is
21 in a neighborhood where a lot of the kids coming to
22 the petting zoo would be the children of powerful

1 benchmark situation, the musical works licensors in
2 over-the-air radio, and you believe that you can
3 quantify the magnitude of that risk, I think that that
4 would result in an upward adjustment of the market
5 royalty relative to that parity point for exactly the
6 reason you have articulated, that that is an
7 incremental cost. That is not sunk. That is
8 associated with the going forward activity.

9 Now in my testimony I have said I haven't
10 seen any quantified evidence that sort of during this
11 period that's really going to happen. But
12 conceptually, if you draw the conclusion that that is
13 a real risk, that would be an incremental risk that
14 could result in an upward adjustment from the equality
15 point.

16 CHAIRMAN VAN LOON: Okay. Let's assume
17 for the purposes of the discussion that there is no
18 quantified evidence. In a couple different places in
19 your testimony, you say well, one place is the
20 reference to Nagle, you say we'll go forward. There's
21 going to be a negotiation. You talk about maybe this
22 is a part of an upper bound or a lower bound, but you

1 are not offering a suggestion of where in the spectrum
2 two negotiators might end up with on the price point.
3 That it could be negotiation skills. Even at one
4 point, you say bladder control, whatever.

5 THE WITNESS: They tried to make me take
6 that part out.

7 MR. GARRETT: They should have succeeded.

8 MR. JACOBY: Can we take a break now?
9 (Laughter.)

10 CHAIRMAN VAN LOON: In any event, I mean
11 you make the point. I think it's accurate. There is
12 a negotiation going on. There is a question of, on
13 the one hand, skills, and on the other hand, perceived
14 issues. There certainly can be economic circumstances
15 in which apart from the pure value, the perception or
16 the circumstances of the negotiator may drive a deal
17 more in the favor of one or the other.

18 I am thinking, for example, we go in to
19 buy a car. There is some range. It may make a
20 difference on the car salesman side if it's the last
21 day of the month and he's got a quota to fill and he's
22 willing to take a tiny margin or he's got a huge

1 inventory and they have got to clear that inventory
2 out because it's this time of year, the old model year
3 to get in another. So that might be something that
4 would induce the car seller to accept a lower price.

5 Similarly though, if I am coming in and my
6 other car has just died or wrecked or whatever, and I
7 have got to be on the road tomorrow, I may have an
8 incentive -- I may have to make a deal even if I am
9 going to accept more than I otherwise would.

10 What I am wondering is if there is a
11 strongly believed fear on the one side that this is a
12 major factor, and in a pure market case where there is
13 a willing buyer, a willing seller, but exactly where
14 you come out is partly motivated by these kind of
15 factors, whether that might not in fact lead the
16 party, the negotiating party that has the fear to hold
17 out for a higher price than absent the fear. Again,
18 we are surmising that the question here is not whether
19 he has got documented evidence of that fear, but --

20 THE WITNESS: I understand. That is a
21 good distinction. I think my first answer didn't make
22 that distinction. So I now understand what you are

1 saying.

2 I think that there are a couple levels on
3 which that might operate. Obviously if we imagine
4 this hypothetical negotiation, the fearful record
5 label is going to go in and say I need a higher
6 royalty because I think there's going to be a lot of
7 displacement. The other party is going to discount
8 that. There is actually a literature in economics,
9 what's called cheap talk. The cheap talk, actually,
10 effect, you know negotiating outcomes. If you just
11 say something, but you can't prove it or you can't
12 demonstrate it, does that matter? It is hard to say.

13 I think that then there is the more subtle
14 point that I think which is what you are really
15 getting at, which is that even if the other side
16 doesn't believe it, if the seller really believes it,
17 if it is a real fear, then I think you are right, that
18 we can't rule out that that would somehow affect where
19 things would come out.

20 That again, is going to be -- you know, I
21 guess what you are saying is it might affect that
22 negotiation even if it can't be quantified. But of

1 course for you to incorporate it in your decision, you
2 are going to have to quantify it somehow in terms of
3 how much impact you think it might have, which I think
4 would be hard.

5 There is one final thing I would just say
6 just to think about, because I don't know the right
7 answer to this myself, but just to think about. Which
8 is what you are basically saying is if the market
9 price, because we are using this hypothetical
10 negotiation as kind of our way to think about the
11 market price, if the market price really would be
12 affected by kind of irrational behavior, fears that no
13 one can demonstrate or fears that are actually even
14 inconsistent with the data in the time period that
15 we're talking about, should that affect the outcome of
16 this proceeding.

17 I don't know how to answer that question.
18 I mean I think as an economist, what I would say is
19 when I think about the market price, I would like to
20 think about the market price in a market in which
21 people are acting based on reality. But I won't deny
22 that in real markets, they are sometimes affected by

1 irrationality. So in a sense, you could say that that
2 is the market price, even if it is inconsistent with
3 what the evidence shows about what is actually
4 happening during the relevant time period.

5 CHAIRMAN VAN LOON: But to call it
6 irrationality is obviously a loaded word. I mean
7 we're wrestling with a willing buyer and a willing
8 seller and trying to put ourselves back into the
9 mindset in the absence of market power.

10 We do have a bunch of evidence about
11 economic projections at different times from the
12 different companies. Now the projections from 1998
13 may all, you know with the wisdom of 2001 hindsight,
14 we know that they are all wrong in the terms or were
15 certainly not right on target. The fact that they --
16 maybe this is back to that distinction yesterday
17 between accuracy and precision. I mean if those are
18 sincerely held perceptions, business projections at
19 the time of a negotiation, that would have led the
20 actors to do X or Y, the fact that they didn't have
21 perfect knowledge I think is a little different from
22 irrationality.

1 happen ten years from now. I mean that's one whole
2 way to look at it.

3 Another way to look at it is that the
4 negotiators in the early period of everything, they do
5 know that whatever deal they make is going to be a
6 benchmark for better or for worse. It is going to be
7 a precedent. That is not to say that there will never
8 be any change over time, but I suspect that a piece of
9 the factor that led the parties not to reach an
10 agreement in this case when they had the negotiation
11 period set forth in the statute was not necessarily a
12 deeply held difference of view about the problem of
13 displacement right now in the year 2000, but the year
14 2005 or 2010.

15 THE WITNESS: So what you are saying is
16 that in putting aside whether what you decide would be
17 a precedent for future, which is I think a separate
18 issue, what you are saying is that in a hypothetical
19 business negotiation, if two parties are negotiating
20 a license for a fixed time period of a couple years,
21 they are going to recognize and take into account and
22 be affected by the fact that when they go to negotiate

1 So I am wondering whether --

2 THE WITNESS: That's fair. I guess I
3 would just -- I think you are right. I agree with
4 that. Let me just put one last qualification on it,
5 which is to come back to this. We are talking about
6 a particular time period issue. The fact that they
7 had fears that some day this could be a big problem I
8 don't think would affect the willing buyer, willing
9 negotiators' negotiation for a fixed period of time
10 that has a termination date where they have an
11 opportunity to come back and say this really is
12 getting bad, we have got to deal with this.

13 But I think with that qualification, I
14 think I would agree with you that sincerely held
15 beliefs, even if they don't have a factual basis,
16 might well affect the outcome of the negotiation.

17 CHAIRMAN VAN LOON: The one other thing
18 that you touched on that we keep wrestling with is the
19 idea of the time period. There's certainly a strong
20 argument, hey, we have got it easy. We are only
21 looking at four years, and we're already through three
22 of them, and we don't have to worry about what might

1 the subsequent period, what they agreed in this period
2 will somehow influence that negotiation.

3 CHAIRMAN VAN LOON: RIAA comes to you and
4 says we want to hire you as a consultant for this
5 year. You know that whatever rate you say, it's a
6 one-year deal, and five years from now you can ask for
7 more. But if you ask too low now, there may be real
8 limits on how much you can change that subsequently.
9 Or if you are a lawyer with a client giving them an
10 hourly rate.

11 THE WITNESS: I think there's probably
12 something to that. I think it is of limited -- there
13 is actually evidence in the record of its limited
14 impact. For example, in the -- it's okay for me to
15 just mention the name of a licensee, right, without
16 going on the restricted record?

17 CHAIRMAN VAN LOON: Maybe mention it, and
18 we could go back. John has alerted that this may be
19 a point in the transcript.

20 (Whereupon, at 11:49 a.m., the proceedings
21 went into Closed Session.)
22

1 ARBITRATOR VON KANN: Does that last
2 answer depend a little bit on how much the transaction
3 costs are involved in revisiting this every couple of
4 years? What if yes, sure, this is only for a short
5 term, we can do another CARP, but it costs \$5 million
6 each time you convene a CARP or whatever it is. It's
7 a very, very expensive exercise. Does that have some
8 impact on the perception of the parties that when they
9 start their very first go-round, we really need to
10 look at this a little bit more than just two or four
11 years because yes, of course we could do it all over
12 again, but god, it's going to be expensive.

13 THE WITNESS: I think what would happen,
14 I mean again talking not about the CARP but about
15 business negotiations, I think what would happen is if
16 parties were negotiating a transaction where they felt
17 that it was going to be very costly to do it again,
18 they would extend the term and they would avoid that
19 harm.

20 I think the very fact that they there is
21 nothing that compels in private negotiations parties
22 to decide on one year, or two years, or anything else,

1 point really in sort of responding to Dr. Schink and
2 Wildman, the sheep farmer business. Then you said
3 something which I made a note of, I think pretty close
4 to verbatim, which was this. We could sometimes get
5 to the point where the record companies would look at
6 sound recordings as being produced for streaming as
7 well as sales. At that point, they probably would
8 look to start recovering some of their original
9 production costs from the royalties for streaming
10 because that is the way they are now looking at this
11 product. It is not just a product for selling CDs.
12 This is also a product for streaming, as I understood
13 your testimony. Correct?

14 THE WITNESS: Yes. I think that is
15 correct.

16 ARBITRATOR VON KANN: Why are we not
17 there? In October 1998, the U.S. Congress said this
18 stuff will be available to streamers. If you can't
19 work out a deal, tough, the CARP will set it. It is
20 now, it's out there. The streamers have got it.
21 There is a forced -- you don't have a choice of
22 whether you want it. It is now forced on you that you

1 I think that they make the decision of how long to
2 make the initial agreement precisely on the basis of
3 a tradeoff between on the one hand, if we make it
4 long, we minimize transactions costs, but we increase
5 the chances that it is going to extend into a period
6 where what we have agreed to no longer really seems to
7 be the appropriate economics. So they balance that.
8 One of the reasons they may choose a short term is
9 precisely because they recognize that hey, this is a
10 very rapidly changing situation and I don't want to
11 promise anything now about what I am going to be
12 willing to do in three years or five years.

13 ARBITRATOR VON KANN: Eric, are you done
14 with that line of questioning?

15 CHAIRMAN VAN LOON: With that particular
16 one.

17 ARBITRATOR VON KANN: I have one that's
18 related if I could ask.

19 CHAIRMAN VAN LOON: Sure.

20 ARBITRATOR VON KANN: This is on this
21 issue of the it's all sunk cost business. When you
22 were discussing that in direct yesterday, you made the

1 are producing sound recordings not just for CD sales,
2 but for people to stream on the Web.

3 So for three years, that has been the
4 case. Why wouldn't a rational record company say
5 well, I didn't necessarily want to get into this but
6 we're in it. Congress has put it in. So let's try to
7 recover some of our costs from these guys too because
8 this is now part of our -- this is what happens to
9 this product.

10 THE WITNESS: I think the reason is
11 because even under RIAA's proposal, this is not going
12 to generate enough revenue to really be a significant
13 part of the equation in the time period that we are
14 talking about. It is not just that it's a fact that
15 it happens, it has got to be that it's an economically
16 significant venue for the sale of the intellectual
17 property. I personally have my doubts as to whether
18 we're ever going to see it, but I think it is pretty
19 clear that in the time frame that we're talking about
20 in this proceeding, it is not going to be big enough
21 to be anything more than incremental.

22 ARBITRATOR VON KANN: As whoever it was,

1 Everett Dirksen said, a billion here, a billion there,
2 pretty soon you are talking real money. I mean even
3 under, I think even under your model, because
4 webcasters did submit a chart, you add it all up, I
5 can't remember exactly, but it's a seven figure number
6 of royalties for all collectively.

7 THE WITNESS: The entire universe.

8 ARBITRATOR VON KANN: >From this group of
9 parties. There's a lot of others out there. We may
10 not be talking a huge percentage in relation, but we
11 could be talking of potentially about several million
12 dollars. It seems to me that is enough to begin to
13 say let's recover a little bit from these guys anyway.
14 Maybe not as big a chunk as from the brick and mortar
15 stores, but why shouldn't they bear a little bit of
16 the cost.

17 THE WITNESS: Again, I am not saying the
18 royalty should be zero. What I'm saying is the
19 magnitude of the costs that we're incurring, which is
20 billions of dollars against billions of dollars of
21 revenue on the CD side, is that magnitude of costs
22 going to come to bear in thinking about how to price

1 this incremental use where what's at stake is
2 potentially millions of dollars, which is you know,
3 less than one percent.

4 So I agree with you. I am not going to
5 say it's zero, but I don't think it is going to really
6 be part of the economics of investment in sound
7 recordings through the end of 2002.

8 CHAIRMAN VAN LOON: Why don't we take a
9 slightly longer break than usual, 20 minutes, for
10 everybody to have a chance to really look at their
11 notes and figure out. We would like to ask then when
12 we reconvene, best guess of sort of how long cross,
13 recross is going to be, redirect.

14 MR. RICH: I can indicate just for
15 planning purposes that at most it will be a very brief
16 redirect.

17 CHAIRMAN VAN LOON: I see. Okay. Twenty
18 minute break, and we'll reconvene.

19 (Whereupon, from 11:58 a.m. to 12:28 p.m.
20 the proceedings went off the record)

21 CHAIRMAN VAN LOON: Mr. Rich?

22 MR. RICH: Very brief redirect.

1 CHAIRMAN VAN LOON: Take however much time
2 you would like.

3 REDIRECT EXAMINATION

4 BY MR. RICH:

5 Q Mr. Jaffe, could you put Figure 5 in front
6 of you, please?

7 A Okay.

8 Q You will recall that Mr. Garrett asked you
9 a series of questions attempting to elicit, based on
10 the six reasons why RIAA negotiated agreements are not
11 valid benchmarks from the demonstrative -- to apply
12 those against the estimated fees set forth on
13 Figure 5. Do you remember that colloquy?

14 A Yes.

15 Q And he asked you in words or substance if
16 agreements reflecting these projected sums had been
17 negotiated as between RIAA and these individual
18 entities, what precedential value you would ascribe to
19 them; do you recall that?

20 A Yes.

21 Q And my question to you is, when you
22 present this data to the panel as a result of your own

1 methodology, what weight do you believe the panel
2 should ascribe to these fees and how representative do
3 you believe they are of the fees that a hypothetical
4 competitive market would generate?

5 A Well, the fees that are here are derived
6 from the model that we've talked about, which is based
7 on hundreds of millions of dollars of fees. And I
8 think they are indicative of competitive market fees.

9 There's a difference between saying, if I
10 observed, for example, MyPlay having negotiated a
11 license with RIAA for \$809, and that was all I knew,
12 was that MyPlay had negotiated this license with RIAA
13 for \$809, would I be able to conclude from that deal
14 alone that that represents a reasonable market fee.
15 And I believe I answered to Mr. Garret that, no, not
16 necessarily if that's all you knew because there's not
17 enough money there to know that you're seeing
18 significant market transactions.

19 That's a very different proposition from
20 the question, if I have a model which is based on
21 other data that has a very sound and complete economic
22 basis, and I then bring it to bear on MyPlay, and the

1 answer it produces is \$809, is there any reason to
2 believe that that would be unreasonable; I think the
3 answer is no.

4 MR. RICH: That concludes my redirect. I
5 would want to offer at this point, since Mr. Garrett's
6 cross-examination utilized the so-called Disney movie
7 log, we're proposing to offer that in evidence at this
8 point, and for the sake of completeness to offer the
9 corresponding Disney television log, which would give
10 then the complete pic which has been previously
11 produced in this case to the other side.

12 But let me actually ask the witness -- if
13 we don't have multiple copies, I apologize for this.
14 But I want to show the witness a document labeled XJAJ
15 Rebuttal 0414 for identification purposes.

16 Professor Jaffe, do you recognize this
17 document?

18 THE WITNESS: Yes. This is the so-called
19 Disney TV log. The pages are actually labeled Music
20 Licensing Review. And in the same way I discussed
21 with respect to the movie log, based on my discussions
22 with the individual at Disney, this is a course of

1 [Whereupon, SERV Rebuttal
2 Exhibits 10 and 11 were marked
3 for evidence]

4 CHAIRMAN VAN LOON: Mr. Garrett?
5 MR. GARRETT: I have no objection, at
6 least on the condition that I could ask some
7 additional questions so that we're all certain exactly
8 what's in this document.

9 CHAIRMAN VAN LOON: Of course.
10 We will admit them both in, subject to an
11 opportunity. Would you like to do that while it's
12 fresh, and we'll have it all in one place on the
13 record?

14 MR. GARRETT: Sure.

15 RECROSS-EXAMINATION

16 BY MR. GARRETT:

17 Q Dr. Jaffe, let me ask you to turn to the
18 Disney movie documents you have there.

19 Dr. Jaffe, let's just go to that column
20 again that is marked as S/TRK and ADV and Royalty; do
21 you see that?

22 A Yes.

1 business record from Disney where they keep track of
2 the licensing of songs and television shows.

3 ARBITRATOR VON KANN: You're offering the
4 log but without the accompanying declaration or
5 affidavit that gave -- Mr. Garrett's concern?

6 MR. RICH: That's correct. And so at this
7 point, we would move into evidence both XJAF Rebuttal
8 0332, which is the Disney movie log, and XJAF Rebuttal
9 0414, which is the Disney TV log. Beginning with
10 those numbers. They run 414 to 0482 in the case of
11 the TV log, and 0332 through 0413 for the movie log.

12 CHAIRMAN VAN LOON: So the 0332, the first
13 one, is the one that was previously attached as
14 Exhibit A to the affidavit that we have got.

15 MR. STEINTHAL: They were two separate
16 exhibits, one for the movie logs and one for the TV
17 logs.

18 CHAIRMAN VAN LOON: Wait a minute.
19 Exhibit A includes the second one as well?

20 MR. STEINTHAL: Yes.

21 MR. RICH: And these would be proposed as
22 Service Rebuttal Exhibits 10 and 11.

1 Q I think we agree that that refers to Sound
2 Track Advance Royalty, correct?

3 A Yes.

4 Q And I think it's clear, but just to
5 reaffirm, you did not include any of the Information
6 that is in that column, Sound Track Advance Royalty,
7 in your analysis, correct?

8 A That's correct. If you were to try to
9 include that, you'd have to figure out a way to
10 include the mechanical royalties and other associated
11 royalties that would be associated with the sound
12 track.

13 Q All right. And you would also have to
14 figure out exactly how many units of each of the sound
15 tracks were actually sold or figure out what the total
16 compensation was to the record label, correct?

17 A Yes. And conceptually, if you were going
18 to try to mix that in, you'd also have to figure out
19 the performance royalties that the composers are going
20 to earn if the sound track gets played on radio. I
21 mean, there's -- you could take this -- if you're
22 going to take it to additional levels, you'd have to

1 do that in a symmetric way.

2 Q Going further with the point that the
3 panel made the other day, you would also have to go
4 and see how many units of the song itself were sold as
5 a result of having been included in the movie or in the
6 sound track, correct?

7 A I don't know what you mean by units of the
8 song.

9 Q Well, take for example the first song
10 there, "Ten LeFay," I believe. Presumably that's on
11 another album someplace, correct?

12 A Correct.

13 Q And as a result of including "Ten LeFay"
14 in this particular movie, "Crazy Beautiful," there may
15 be some number of consumers who actually go out and
16 purchase the album "Ten LeFay," correct?

17 A There might be. We don't have any
18 evidence. As you pointed out, it's a background
19 performance on the sound track. We don't -- I mean,
20 I don't know of any evidence that that generates
21 significant CD sales, but there might be.

22 Q Are you aware of any evidence from Sound

1 in general they are small and uncertain and don't
2 affect this decision. And in any event, they affect
3 different songs differently. And the fact that we can
4 just exclude the groups that are affected and get the
5 same answer suggests that, in fact, none of that stuff
6 makes any difference.

7 Q In the very first example here you have a
8 sync quote of \$10,000 and a master quote of \$1,000,
9 correct?

10 A That is correct.

11 Q And so that shows a pretty big disparity
12 between what the record company was actually receiving
13 from the motion picture company and what the publisher
14 was receiving, correct?

15 A In that particular case, yes.

16 Q And do you think it's fair to assume that
17 the record company in agreeing to this particular
18 master quote may have considered the potential for
19 earning additional licensing fees as a result of the
20 sound track sales?

21 A Perhaps. And if you're worried about
22 that, what I would do would be to exclude the songs

1 Data as to the number of people who identify TV films,
2 as a major reason for their purchase of sound
3 recordings?

4 A I do not, no.

5 Q If we're really trying to figure out how
6 much is generated for both the sound recording owner
7 and the publisher as a result of including the song in
8 this movie here, there are a number of things we would
9 have to look at that you haven't looked at; is that
10 fair?

11 A No, I don't think that's correct. I mean,
12 I think what we've said is that there is a right that
13 is at issue in these data, which is including it in
14 the movie for the purpose of showing in theaters. And
15 that is a well-defined right that has a well-defined
16 value that I have calculated in a well-defined way.
17 And I don't think anything that we've been talking
18 about for the last few minutes ought to be added into
19 that.

20 There are subsequent values that one can
21 hypothesize, come about when it is included in the
22 movie. And I've discussed at great length why I think

1 that are sound tracks, and just say those may be your
2 tainted; let's look at the ones that aren't.

3 Q Also so that we're clear here on what's
4 included --

5 A By the way, I would just note the very
6 next one. Although there is a sound track advance,
7 the sync quote and the master quote are very equal.
8 So I think that the -- if you want to draw inferences
9 about the overall broad pattern, you should look at
10 the broad data, not at one or two songs.

11 Q Well, I guess one of the advantages of
12 having the whole document in the record is that we can
13 go through the entire document and make all of those
14 different calculations. But the point is, from the
15 standpoint of someone who's negotiating this
16 deal -- the record label who's negotiating this
17 deal -- they're probably looking at the deal with a
18 couple of different sources of revenue in mind, don't
19 you think?

20 A That could be.

21 Q And probably true for the publisher as
22 well, correct?

1 A That could be.
 2 Q And to really figure out what this deal is
 3 worth to a particular record label, one needs more
 4 data than the data that's simply here in this exhibit.
 5 A I don't think that's true.
 6 Q Okay. Also, as we look at this exhibit,
 7 we see in the first column the song and the artist,
 8 correct?
 9 A Yes.
 10 Q And I guess it would be fair to say just
 11 looking at this exhibit alone we're not going to be
 12 able to determine whether the artist in each case is,
 13 in fact, the artist with which the public might be
 14 most familiar, correct? If there were multiple
 15 versions of a sound recording.
 16 A I'm not even sure that's a well-defined
 17 concept. The artist the public is most familiar, but
 18 certainly there's nothing in this document that tells
 19 you anything about that.
 20 Q Well, we discussed before about how, in
 21 negotiations between the record label and the motion
 22 picture company, the motion picture company might say,

1 look, we'd like to have your particular version of the
 2 sound recording. But we really don't need it because
 3 we can go out and get version two or version three.
 4 Maybe they're not quite as well known, but they'll
 5 serve our creative purposes, right? And that happens
 6 in negotiations as you understand it.
 7 A Yes, that happens.
 8 Q But we don't know whether or not, without
 9 looking at additional information, whether the
 10 particular sound recording that has been licensed here
 11 is, in fact, the one that may have generated the most
 12 sales, for example.
 13 A That's correct.
 14 MR. GARRETT: Also, in the sake of
 15 completeness, what we would like to have included in
 16 the record is an additional document that shows the
 17 specific songs that were excluded from Dr. Jaffe's
 18 analysis here.
 19 CHAIRMAN VAN LOON: Do you have a document
 20 already which indicates that?
 21 MR. GARRETT: Yes. It was one of the
 22 documents that they provided.

1 MR. STEINTHAL: Is that the document that
 2 indicates the reasons for exclusion as well?
 3 MR. GARRETT: Yes.
 4 MR. RICH: May we see a copy?
 5 MR. GARRETT: It has both the ones that
 6 are excluded and included in this study.
 7 MR. RICH: We have an objection.
 8 CHAIRMAN VAN LOON: Do we have a label, a
 9 number to go with it?
 10 MR. GARRETT: Number 001 RRX.
 11 [Whereupon, RIAA Exhibit 001
 12 RRX was marked for evidence]
 13 CHAIRMAN VAN LOON: 001 RX?
 14 MR. GARRETT: RRX. I think it's the only
 15 restricted exhibit that we've offered in
 16 cross-examination.
 17 CHAIRMAN VAN LOON: I see. Then that will
 18 be admitted as well.
 19 [Whereupon, RIAA Exhibit 001
 20 RRX was received for evidence]
 21 MR. STEINTHAL: Just to be clear, the
 22 first three pages are what are excluded, and the rest

1 of the document is what is included?
 2 MR. GARRETT: Let me just ask, if you
 3 will, questions about it.
 4 Dr. Jaffe, I've given you documents marked
 5 RIAA Exhibit 001 RRX. And let me direct your
 6 attention to the first three pages of that.
 7 THE WITNESS: Okay.
 8 BY MR. GARRETT:
 9 Q Can you identify what those three pages
 10 are?
 11 A Yes. This is a printout of a spreadsheet
 12 that we produced indicating the songs that we had some
 13 kind of information on from one of the three studios,
 14 but which were not used in the study. And it includes
 15 the reason why they weren't use, which in the vast
 16 majority of cases is simply because the information
 17 was incomplete. And then there a few in which there
 18 are other reasons why we concluded that we couldn't
 19 use it -- that we shouldn't use it.
 20 Q And then turning your attention to the
 21 remainder of the document, could you identify that?
 22 A I believe that the remainder of the

1 document is a complete list of all songs, including
 2 the ones that are on the first three pages. In
 3 addition, it includes the ones that were used. So the
 4 first three pages are actually a subset of the songs
 5 that appear in the remainder of the document. And you
 6 can tell that by noticing that there are -- there's a
 7 column, Reason for Exclusion, in pages 2797 and
 8 forward, which is almost always blank, but
 9 occasionally indicates that it was excluded.

10 Q The one thing that's not on here, that's
 11 probably going to be helpful for the record here, is
 12 the titles of the different movies.

13 Okay. No, I'm sorry.

14 A Yes. That is the column entitled, Title.

15 Q That's why I missed it.

16 I think this is clear on the record,
 17 Dr. Jaffe, but you had indicated that the other
 18 documents that you reviewed here did not have any
 19 information on which movies generated sound tracks,
 20 correct?

21 A That's not quite correct. With respect to
 22 the other studios, the basic information that I was

1 those transactions where there do not exist both sync
 2 and master-use data, and therefore, where the
 3 comparison could not be made, what impact on your
 4 analysis and on the outcome of that analysis of
 5 comparability occurs where you do add back in the
 6 other transactions that were excluded; that is where
 7 there were sync and master-use rights data but, which
 8 for reasons you explain in your rebuttal testimony,
 9 you chose to exclude from the analysis?

10 A If you put them back in, I believe it
 11 reduces very slightly the ratio of the sound recording
 12 to musical works ratio, but qualitatively it's
 13 essentially the same result.

14 MR. RICH: Thank you. I have nothing
 15 further.

16 CHAIRMAN VAN LOON: Mr. Harding, are the
 17 sandwiches that you had mentioned here?

18 MR. HARDING: Yes, they're I believe
 19 upstairs. You would have to take an elevator upstairs
 20 to eat.

21 MR. GARRETT: They're in the building.

22 CHAIRMAN VAN LOON: I see. We were

1 provided did not give that indication. With respect
 2 to one of the other two studios, someone from my staff
 3 actually spent some time in their offices reviewing
 4 further information beyond that basic printout, which
 5 I believe would have allowed looking at some other
 6 information. But I just don't recall as I sit here
 7 exactly how that was tabulated.

8 MR. GARRETT: All right. With that, I'd
 9 say I have no objection to their including the movie
 10 document into the record

11 CHAIRMAN VAN LOON: Okay. So all three of
 12 them will be admitted.

13 [Whereupon, SERV Rebuttal
 14 Exhibits 10 and 11 were
 15 received for evidence]

16 MR. RICH: Mr. Chairman, if I may ask a
 17 question or two on 001 RRX?

18 CHAIRMAN VAN LOON: Please.

19 REDIRECT EXAMINATION

20 BY MR. RICH:

21 Q Professor Jaffe, I believe you may have
 22 testified to this earlier. Putting to one's side

1 thinking about sort of a very short recess where
 2 people will just grab a sandwich and bring it in, so
 3 we can get through this last part quickly. But it
 4 sounds like it may be more of a deal, and we shouldn't
 5 bring any food back here.

6 MR. GARRETT: No, it's not a big deal at
 7 all. You can go upstairs and get them, bring them
 8 back down, then we can continue. It's not a problem.

9 ARBITRATOR VON KANN: I guess I would like
 10 to say to the parties, I feel very much of a culprit
 11 here. It is a gorgeous Saturday afternoon, and
 12 everybody, including me, would like to get out of
 13 here. But I must say that I in reading the 80 pages
 14 of Dr. Jaffe wrote a number of questions, some of
 15 which have been answered but some of which haven't.
 16 And I really do feel the need to spend a little time
 17 with him dealing with that. I hope it won't take too
 18 long. So maybe the sensible thing is grab the
 19 sandwich, and come back in, and we can keep rolling.
 20 And that will get us all out of here earlier. Is that
 21 okay?

22 CHAIRMAN VAN LOON: Why don't we think of

1 it as 20 minutes that we'll hope everybody's got a
2 sandwich and ready to continue at quarter past.
3 (Whereupon, the foregoing matter went off
4 the record at 12:53 p.m. and went back on
5 the record at 1:19 p.m.)

6 CHAIRMAN VAN LOON: We hope you enjoyed
7 your lunch, Dr. Jaffe.

8 THE WITNESS: Thank you, Mr. Garrett.

9 CHAIRMAN VAN LOON: The panel has a few
10 questions for you.

11 ARBITRATOR VON KANN: Let me say that I
12 found both your direct testimony and your rebuttal
13 testimony very thought-provoking, and I have been
14 thinking about a lot of the issues raised there and
15 trying to work my way through them, make sure that I
16 understand them. And I have questions in several
17 areas where I want to make sure that I understand your
18 argument or your thesis, so I can, obviously, think
19 about it.

20 One of the first areas that I'd like to go
21 to is something we did talk about a moment ago. And
22 in my version this is the discussion that appears sort

1 of on pages 5 to 7, or 8, I guess, about the willing
2 buyer/willing seller. And, in particular, the notion
3 that with respect to musical works and sound
4 recordings, as we've said several times, the main
5 production costs are sunk. We're now dealing with
6 this new use that comes along of the Internet.

7 You say on page 5 that buyers need both
8 the sound recording and the musical work rights in
9 order to make public performances. And because of
10 that symmetry and mutual necessity, as you describe
11 it, the buyer's willingness to pay for each right will
12 be derived in the same way from the value that the
13 buyers expect to derive from making the performances.

14 Hence, there's no difference in the buyer's
15 willingness to pay for the musical work performance
16 right and the sound recording right. Going into
17 negotiations over either right, the buyers will be in
18 the same position.

19 Why isn't that equally true of the
20 position with respect to negotiations over the royalty
21 rates for the software that streamers will need to
22 operate their service? We've been told by several

1 witnesses here that virtually all of the services in
2 order to do what they do have to have software. And
3 that some of them developed themselves and a number of
4 them went out and obtained it from Microsoft or other
5 software suppliers, and they are paying a royalty for
6 the use of that software.

7 And it seems to me that Microsoft, or
8 whoever it is, their costs are sunk. They've
9 developed their software, and it's ready to go, and
10 along comes this new use, Internet streamers. Hey,
11 great. We never knew we'd have customers there, but
12 terrific; there they are.

13 So therein it seems to me a somewhat
14 similar position to the holders of musical works and
15 sound recording rights; that is, they don't have to
16 recover their original costs. They're looking at this
17 as a new incremental use. The buyer of the service
18 needs to have this software to operate. They can't
19 get up and running and put the music out, apparently,
20 without appropriate software. They need it just as
21 much as they need the musical works and the sound
22 recordings, I think.

1 So from the point of view that they need
2 both the sound recording and the musical work rights
3 in order to make public performances, you could take
4 out musical work rights and put in software.

5 Why wouldn't the royalty rate for these
6 sound recordings be equivalent to or determined by
7 what the services have to pay to get this other
8 necessary input, which is being offered as sort of an
9 incremental additional use by the software developer?
10 I guess I don't see how the software license is any
11 different than the musical works license?

12 THE WITNESS: Okay. Well, I think there
13 are some similarities. I think there are also a
14 couple of important differences, though. One
15 difference is that the -- whatever is the value of the
16 software, it's not linked -- in terms of the aggregate
17 business of the streamer, I think I would agree with
18 you that the software is essential, the musical
19 performing rights are essential, the sound recording
20 performance rights are essential. There is not quite
21 the same degree of symmetry, though, because the
22 software is not linked to the individual performance

1 in the same way. In other words, every time they play
2 a song, they make one performance, they are bringing
3 to bear in a very symmetric way the sound recording
4 performance right and the musical work performance
5 right; whereas, the software is more of an overhead
6 kind of input to the business operating. So that's
7 one difference.

8 The other difference is -- and I don't
9 know the details of the nature of this software. But
10 it seems to me there's sort of two possibilities. One
11 is that this isn't incremental; that, basically, this
12 is software that was developed for the purpose of
13 streaming on the Internet, and that's really what it
14 is. And if that's what it is, then it's not
15 incremental. And although for any one user, it would
16 in a sense be incremental because they've incurred the
17 cost of creating it. From the body of the Internet
18 streamers they have to recover the cost of developing
19 that specialized Internet streaming software because
20 that's really what it was developed for. So that's
21 one possibility.

22 The other possibility, as you

1 indicated -- and as I say, I'm not sure what the facts
2 are -- that this is more like an application of
3 software that was previously developed for other uses,
4 which is now being adopted in the streaming context.
5 And in that case it's true that it's incremental, but
6 it's also true, probably, that there is in some sense,
7 and already established market price now. If what
8 we're talking about is kind of the server equivalent
9 of Windows -- this is basically just a big operating
10 system that Net Radio uses and Arnold & Porter uses,
11 there probably is an established market price for
12 that; it's probably not being established by the
13 streamers.

14 So it seems to me whichever of those two
15 cases applies-- either it's not incremental because
16 they really did develop it for this use; or in a way
17 it's incremental but it's still just another use of
18 the same thing as distinct from a CD, which is a
19 physical product that is sold as a physical product,
20 and then the right to perform that CD later, which is
21 an incremental, non-tangible good that you're selling
22 based on that physical product.

1 So I think while you're right, at some
2 high level there are some similarities to software, I
3 think there are also some important differences.

4 ARBITRATOR VON KANN: I think there may
5 well be differences, because I don't know the details
6 of this software-- was it developed just for this use.
7 I can't remember, frankly, if any of the witnesses
8 that we've heard have dealt with that. That would be
9 primarily, I think, on the seller's side of the
10 equation.

11 On the buyer's side for the moment, trying
12 to understand the rationale of what you have here,
13 which is, I think, to put out every song, I need
14 musical works and sound recording. Let's assume that
15 to put out every song I also need the software. Every
16 single time I play a song, I need --

17 THE WITNESS: No, I would agree with you.
18 If you limit it to the buyer's side, then I think
19 there would be a greater degree of similarity. But
20 looking only at the buyer's side doesn't tell you
21 anything. You need to put the two together in order
22 to say something about market price. But I agree with

1 you. Purely from the buyer's side there is quite a
2 bit of similarity.

3 ARBITRATOR VON KANN: A little bit farther
4 on in this discussion, at what's on page 8 of my
5 version of your rebuttal, you have a paragraph that
6 begins, "Note that this analysis does not in any way
7 suggest that the zero incremental cost of the right
8 being transferred would lead to a zero royalty. Quite
9 the opposite. Intellectual property with zero
10 incremental cost is routinely licensed at positive
11 royalty rates.

12 With respect to both musical works and
13 sound recording, as we have a buyer, potential
14 licensee, some maximum willingness to pay as derived
15 from the value to the buyer of the performances, and
16 we have the seller with a minimum willingness to
17 accept equal to the zero incremental cost.

18 The economics of bargaining, as well as
19 common sense, suggests that the parties will reach
20 agreement at some point in between. Economics cannot
21 really tell us where in the interval, between the
22 buyer's maximum royalty and the seller's minimum

1 royalty the parties will come out. It will depend on
2 the stubbornness, negotiating skill, and, perhaps,
3 bladder control of the parties."

4 Now, if I understand that, I think what
5 you are saying is that economic theory can get us only
6 so far in this exercise and perhaps establishing the
7 range. But one cannot sit here and sort of reason a
8 priori as a matter of pure economic theory where in
9 that range the parties will ultimately come out. Is
10 that correct?

11 THE WITNESS: I think it's correct for one
12 level of the analysis. I think that what I'm arguing
13 here -- or what I'm trying to think about here is this
14 conceptual proposition of the relationship between the
15 sound recording and the musical work. And what I'm
16 saying there is that in each case there's a range.
17 And the ranges in each case, if you accept the
18 premises of this section, are the same. And we don't
19 know where in that range each would come out, but
20 there's no reason to believe that it would go
21 systematically one way or the other, so that there is
22 an equivalence of position of the two. And in that

1 not say, I can tell you, this is what the fair market
2 rate for this particular item is, purely as a matter
3 of economic theory without ever having looked at what
4 has happened in the real world. At some point, one
5 has to get some real-world data.

6 THE WITNESS: Absolutely. I couldn't
7 agree with that more.

8 ARBITRATOR VON KANN: Now, let me ask you
9 why I shouldn't, therefore, have some concern in
10 looking at your model from the following point of
11 view.

12 The 26 RIAA agreements clearly need to be
13 viewed with considerable caution in a number of
14 respects. They can't just be blindly applied. And
15 there are all kinds of reasons, some of which you'd
16 talked about, maybe even some others. But for better
17 or worse, those are instances in which some number of
18 buyers and sellers in the marketplace that we have to
19 try to replicate did sign on the dotted line to some
20 numbers.

21 If I'm correct, nobody in the real world
22 has agreed to the numbers that you have proposed in

1 sense, I'm not using this section of the analysis to
2 try to pick a number; I'm just trying to think about
3 this equivalence issue.

4 When I actually implement this, what I do
5 is go to a very specific context where there has been
6 a lot of negotiation and a lot of back and forth over
7 the years and the presence of a rate court, and that
8 does produce a number. Now, that could have produced
9 a different number if there had been a different
10 sequence of negotiations or a different sequence of
11 history in that industry. But, nonetheless, it has
12 produced a number, and I believe it's the best
13 indication we have as a value, in that case for the
14 musical work. And my argument is, while it's true
15 that the number for the sound recording, if we were
16 really having this hypothetical negotiation, could be
17 somewhere in this range, a good benchmark for where
18 we're likely to be would be the number that has been
19 arrived at in this parallel musical works framework.

20 ARBITRATOR VON KANN: But does that
21 indicate -- it seems to me what you're saying is that
22 one could not work oneself through to a -- one could

1 Figure 4. There is no agreement anywhere that
2 reflects those rates. They are derived by you from a
3 different market with certain extrapolations applied
4 for which you've explained the rationale. But there
5 isn't a single real-world agreement that reflects
6 those rates. True?

7 THE WITNESS: Not for the sound recording
8 performance right; that's correct.

9 ARBITRATOR VON KANN: Let me ask about
10 something a little farther along here in your
11 testimony.

12 CHAIRMAN VAN LOON: Is it also related to
13 this same point?

14 ARBITRATOR VON KANN: No, it's moving on.

15 CHAIRMAN VAN LOON: Let me ask you a
16 related sort of question that I've been thinking
17 about.

18 Have you done some consulting work for
19 business people?

20 THE WITNESS: Yes.

21 CHAIRMAN VAN LOON: And have you noticed
22 a difference between the way economists think and

1 business people think?
 2 THE WITNESS: Sometimes.
 3 CHAIRMAN VAN LOON: Sometimes. How would
 4 you characterize a part of that difference?
 5 THE WITNESS: Well, business people tend
 6 to be less interested in the theoretical framework and
 7 more interested in the practical outcome. And also,
 8 business people tend to not care about broader public
 9 policy objectives, and they only care about making
 10 money, typically; whereas, as an economist you're
 11 coming from a broader perspective. So, sure, there
 12 are differences.
 13 CHAIRMAN VAN LOON: And especially, they
 14 tend to be more interested in making money, right?
 15 THE WITNESS: Well, as an economist I
 16 think that's good. I mean, I'm not -- I don't mean to
 17 imply that there's something bad about them wanting to
 18 make money; that's their job.
 19 CHAIRMAN VAN LOON: But my question is to
 20 emphasize that there maybe is a fundamental
 21 difference.
 22 THE WITNESS: My analysis is predicated

1 economist, perhaps you, saying to the record industry
 2 folks, "Your costs are sunk. You don't have any need
 3 to recover these costs in this new arena." And I can
 4 imagine somebody from the record label saying, "Yes,
 5 but goddammit we're going to try. We're going to go
 6 out there and get the best rate we can, and why
 7 shouldn't we try to recover a little bit of our costs
 8 in this new arena? These people are going to launch
 9 a new business and they want to make a lot of money,
 10 and if it succeeds, maybe I don't have to, as a matter
 11 of economic theory, but I'm going to sure try."
 12 I guess, to some extent, I'm thinking --
 13 I can't speak for my colleagues -- that wouldn't there
 14 be a substantial component of this which is, for lack
 15 of a better word, real politik? How much can we, in
 16 a straight face, go into a room and ask for and let's
 17 see what we can get? And how much -- on the other
 18 side, how much can we, with a straight face, go in and
 19 try -- I mean why isn't there going to be a
 20 substantial element of that?
 21 THE WITNESS: There is, and I'm not
 22 suggesting for a minute that they're not going to try

1 upon the assumption that all of the people involved --
 2 the record labels, the webcasters, the streamers, the
 3 over-the-air radio stations that agree to the over-
 4 the-air licenses, and the performing rights
 5 organizations and the composers and publishers they
 6 represent -- are all interesting in making money. I
 7 mean that's a fundamental premise of my analysis. So
 8 I don't think that I'm somehow not taking that into
 9 account.
 10 CHAIRMAN VAN LOON: Well, I don't mean to
 11 suggest that you're not, but I presume that that
 12 translates into then when we're doing our analysis and
 13 trying to figure out working willing buyer/willing
 14 seller, we should be thinking in terms of willing
 15 business buyer and willing business seller and with an
 16 acute sense that each one of them is going to be
 17 trying to maximize their profits, to the extent they
 18 can get away with it.
 19 THE WITNESS: I agree with that.
 20 ARBITRATOR VON KANN: And to sort of
 21 follow that a little bit, I guess an example of what
 22 might be different there is I could imagine an

1 to get as much as money as they can. That's the
 2 fundamental premise of this. And the owners of the
 3 musical work performance rights try to get as much
 4 money as they can. And the question is, is the
 5 outcome of that tussle back and forth between them and
 6 the licensee who wants to pay as little as they
 7 possibly can going to be different in these two
 8 different context? And I guess what I'm suggesting is
 9 they may try to recover some of their costs, but at
 10 the end of the day they are sunk. And, again, I come
 11 back to we do have data from this movie arena, which
 12 I think is -- everything we've been saying applies
 13 there as well, and we see what happens. And what we
 14 see if fundamental equality.
 15 So I'm not for a minute suggesting that
 16 the record companies are bad business people who would
 17 not, in this hypothetical negotiation, be trying to
 18 get as much as they possibly can in negotiation for
 19 their rights. All I'm saying is that the outcome of
 20 that is going to be negotiated, and theory suggests it
 21 would be no different than for the musical work, and
 22 the data confirms in a situation where the same

1 principles apply that that's in fact what happens.
2 ARBITRATOR VON KANN: Let me ask you a
3 little bit about something a bit farther in your
4 rebuttal, and, again, on my pages it's at 42 and 43.
5 I think it might be --

6 THE WITNESS: I've been doing pretty well.
7 I've just been adding --

8 ARBITRATOR VON KANN: You've been
9 guessing? It's right preceding Section G, which is
10 called, "Services Proposed Royalty Rate."

11 THE WITNESS: Yes, I see it.

12 ARBITRATOR VON KANN: And you talk a
13 little bit here about the beginning, "I do not
14 believe," you talk about having developed the range in
15 your direct testimony, included that a sound recording
16 performance royalty in a range of 40 to 70 percent of
17 the musical works rate would be reasonable and so on.
18 You said, "I then propose a fee model based on the
19 absolute upper limit of this range." And at the top
20 of the next page you say, "Given the factors discussed
21 above, I believe it would be reasonable for the
22 rebroadcaster rate instead of being at the upper end

1 ought to be zero within the 150 miles just wasn't a
2 very good way to do that.

3 So what I've done, in effect, is to
4 discard any exclusion for people within 150 miles and
5 instead to just use the lower end of the range to
6 begin with, which has a somewhat similar magnitude.
7 And the motivations for doing it are basically the
8 same as the ones I had before, but I think it's just
9 a more straightforward way of dealing with that set of
10 issues.

11 ARBITRATOR VON KANN: Okay. Thank you.
12 Then a question on Page 43 to 44, and here I may well
13 be misunderstanding what you're saying, so I just want
14 to get this clarified. But you talk in here a little
15 bit about the ADH data.

16 THE WITNESS: Okay.

17 ARBITRATOR VON KANN: And part of this has
18 to do with preparing the chart that we asked you to
19 prepare. But it appears, and maybe this is where
20 maybe I'm misunderstanding, but at the bottom of that
21 page there's a sentence that says, "When a licensee
22 instead calculates its fees, it will have the option

1 of the 40 to 70 range to fall in the lower end of the
2 range. What has changed since your direct testimony
3 last month that causes you to move from the top of the
4 range to the bottom of the range?

5 THE WITNESS: Well, with respect to the
6 webcasters, I've stayed at the top of the range. In
7 my direct testimony, with respect to the broadcasters,
8 rebroadcasters, what I had done last time was just use
9 that same upper end of the range but then to make a
10 deduction or proposed that the Services would be
11 permitted to make a deduction for users who they could
12 demonstrate were within 150 miles. And I kind of
13 justified that on the basis of the overall 150-mile
14 exemption that is in the law if everybody was within
15 150 miles.

16 And on thinking about it some more,
17 frankly, as a result, partially, of some questions
18 that Judge Gulin asked, I decided that that was really
19 not an overall consistent way to deal with what is
20 fundamentally the same issue, which is that there is
21 this competition with another medium in which it's
22 free, that tying it to the 150 miles and saying it

1 to base its calculation on the industry average or on
2 a reasonably reliable estimate specific to that
3 licensee, songs per hour times tuning hours."

4 And I may well be misunderstanding, but if
5 the Panel were to adopt a rate based on a per
6 performance model, why do we have to get into
7 estimates at all? Can't we -- this is the Digital
8 Age. There are, I would have thought, fairly easy
9 ways to have data that will tell us exactly what songs
10 were performed and how many hits or how many people
11 are listening. And maybe I'm wrong about that, but I
12 guess I just don't quite understand why we have to do
13 this, in any extent, on the basis of estimates.

14 Is it -- and maybe I should have got this
15 out of Zittrain when he was here -- but is it your
16 understanding that it is not possible to have actual,
17 precise counts of how many listeners tuned in to
18 listen to our service play this particular song last
19 night?

20 THE WITNESS: Okay. My understanding is
21 that it is possible to keep track of how many
22 listeners are listening for what period of time, and

1 this is basically the aggregate tuning hours. The
 2 number of songs, certainly, on the rebroadcast
 3 simulcast side where what they're doing is they're
 4 taking an audio signal that was produced for their
 5 over-the-air broadcasting and then just feeding it
 6 over to the Internet side, my understanding is it is
 7 not practical for them to keep track of how many songs
 8 that were played, because what comes over to the
 9 Internet side is just a continuous signal that was
 10 generated in the analog world of over-the-air radio.
 11 So that's part of the concern.

12 With respect to the webcasters, I would
 13 suspect, but I don't know for sure, that there is more
 14 ability, although there still are a lot of complicated
 15 issues, like what do you do -- how do you keep track
 16 of people who listen to a song but then their modem
 17 went bad and they got knocked off and they come back
 18 on and so forth? And so my understanding is although
 19 there's more ability there, that it's not as trivial
 20 as you might think, and it does seem to me it's in
 21 everyone's interests to keep this reasonably simple.
 22 Nobody loses by having an estimate which is not

1 biased, which both parties can agree is reasonable, so
 2 that, on average, you're getting the right number of
 3 songs per hour times some measure of the listening
 4 audience.

5 ARBITRATOR VON KANN: Okay. I'd just say
 6 to the parties, we're getting down to the point where
 7 we don't have too many more witnesses coming, but at
 8 least this one Panel member is still not -- does not
 9 have a super command on what is technologically
 10 possible and not possible in this area and would
 11 welcome any clarification and help I could get. And
 12 I realize I probably should have asked more of
 13 Zittrain a couple of days ago and I'm sorry. And
 14 maybe it's already in the record, and I have -- it's
 15 just gone past me. And that was helpful too,
 16 Professor Jaffe.

17 On Page 51 of my version, you begin a
 18 section to talk about the RIAA benchmarks, and we've
 19 had quite a bit of discussion of that already today.
 20 I don't want to retrace that, but I do want to ask a
 21 couple of things in that area. At the top of my Page
 22 52, you have a paragraph that says, "If the first of

1 these questions cannot be answered in the affirmative,
 2 then we cannot conclude that the contract at issue
 3 represents reasonable rates and terms even if it's own
 4 context. Buyers who did not have good information
 5 about their alternatives cannot be considered willing
 6 buyers in the sense of replicating competitive market
 7 outcomes."

8 And I guess my question about that is
 9 this: I would have thought that in any market where
 10 there's a significant number of buyers and sellers
 11 there are going to be some substantial variations in
 12 the extent of information that any particular buyer
 13 has in relation to some others. Some of them will
 14 have done a due diligence like you wouldn't believe,
 15 and they'll know everything there is to know about the
 16 product that they're considering buying. Others will
 17 be more, I don't know what, they are entrepreneurs who
 18 go by their gut and they don't do all that stuff.
 19 They go in and size it up quickly, and they march into
 20 the table and they -- there's a tremendous range, I
 21 would have assumed, in the extent of information,
 22 knowledge, research, sophistication, understanding in

1 any competitive market. And I guess I wonder a little
 2 bit how do we grade, how do we assign -- you know,
 3 you've got 97.2 percent and you're okay, but you've
 4 only got 87.

5 How do we decide how much knowledge is
 6 enough that we could -- I mean I would have thought
 7 that it all contributes to what the marketplace is
 8 doing. There may be some number of people who are not
 9 doing nearly as much research as they should, but
 10 they're in the market bidding, and they're signing
 11 deals. There are others who are extraordinarily
 12 knowledgeable. Doesn't this all, in a sense, get
 13 sorted out by where the center of the gravity of that
 14 market ends up being?

15 THE WITNESS: Well, it's certainly true
 16 that in any real market, as you say, there's going to
 17 be this variation. If the market is a well-
 18 functioning competitive market, which I would submit
 19 is your benchmark here, so I'm not talking about --
 20 and you may have read that the Nobel Prize in
 21 economics for the last year went to three economists
 22 essentially for information economics. And what they

1 have made a career doing is studying particularly
 2 problematic markets that don't work very well, because
 3 there are information problems. And, certainly, in
 4 that case, the market outcome is very much affected by
 5 the fact that some people don't have good information.
 6 But we tend to think of that as a problem, as an
 7 exception to the norm that a reasonably well-
 8 functioning competitive market has at least pretty
 9 good information.

10 And in a reasonably well-functioning
 11 competitive market, there's still going to be some
 12 people who, as you say, don't do any research or don't
 13 know what they're doing, but they're not going to
 14 determine the competitive price. The competitive
 15 price is going to be determined at the margin by the
 16 people who are reasonably well informed, and in some
 17 sense the people who are not well informed are going
 18 to ride along on that if the market really is
 19 competitive and working well.

20 Now, still it's not a matter of they've
 21 got to have -- you know, be able to pass a multiple
 22 choice test on the copyright law. I mean I'm not

1 saying that have to absolutely know everything you
 2 could imagine they need to know. The idea that I was
 3 trying to get across is what we're looking for here is
 4 was the statutory license a reasonable alternative to
 5 them just accepting what the RIAA offered if,
 6 hypothetically, the RIAA were to attempt to extract
 7 monopoly prices?

8 So what I'm looking for is evidence that
 9 they don't seem to have really understood that they
 10 had that option, that in order to begin streaming all
 11 they needed to do was do some paperwork. They could
 12 stream without ever talking to the RIAA, let alone
 13 signing something with them. And at the end of the
 14 day, you know, if you look at my demonstrative, there
 15 are really only a small number of cases where I've
 16 said that really seems to be a concern.

17 ARBITRATOR VON KANN: Okay. In a sort of
 18 a comparable way, I want to ask you about something
 19 that appears a few pages later. Again, on my version
 20 it's Page 56, and it's in a section, "Concerns About
 21 Timing and Uncertainty." Several licensees
 22 demonstrated a sense of urgency because of a variety

1 of other business matters that were affected by the
 2 RIAA negotiations, including a need on the licensees'
 3 part to procure an RIAA license as a predicate to
 4 concluding a webcast radio syndication agreement with
 5 a third party or in some cases to secure investors.

6 Again, I would have thought that those are
 7 fairly typical things that happen to buyers and
 8 marketplaces. There's some number of them that are
 9 under pressures of one sort or another, whether it's
 10 they got a really great deal they want to secure over
 11 here and wrapping up this thing with the RIAA will
 12 help them, or they've got some Nervous Nellie investor
 13 who says, "I want to know." That just strikes me as,
 14 I would have thought, fairly garden variety stuff that
 15 happens in the marketplace.

16 THE WITNESS: But, again, it's the same
 17 issue. I'm not saying there's something anti-
 18 competitive about them being in a hurry. What I'm
 19 saying is were it not for a statutory license, we
 20 would presume that a deal with the RIAA is a monopoly
 21 deal, because they're the only one who can offer it.
 22 The only reason we might think that these voluntary

1 agreements are representative of competitive markets
 2 is because the licensees had recourse to the
 3 compulsory license. And it happens to be the case
 4 that the compulsory license is not something you can
 5 get quickly.

6 And so we need that availability of the
 7 alternative to inoculate the transaction against the
 8 presumed market power of the RIAA. And while you're
 9 right, urgency in other context is often just part of
 10 life, in this particular context, the consequence it
 11 has is that it takes away our protection against the
 12 market power of the RIAA.

13 ARBITRATOR VON KANN: I guess -- and I
 14 don't want to belabor this too much -- but it strikes
 15 me that if one were to really try to run this to
 16 ground, it would be a more complex analysis than that,
 17 because it would seem to me that the presence of the
 18 compulsory license is a very substantial offset to the
 19 greatest power that a seller has, which is to withhold
 20 his product. And if you've got a bunch of buyers who
 21 are very eager to get your product and you have the
 22 capacity -- I guess this is another way of saying

1 monopoly power -- you have the capacity to withhold
2 it, the fact that there is this license which says,
3 "You can start using it right away and you don't have
4 to pay us for three or four years until the CARP gets
5 around to it," is a very potent offset.

6 And it would seem to me that if you were
7 really going to try to deal with that factor, you
8 would have to not only look at the licensees who may
9 not have been able to fully take advantage of that
10 because they have Nervous Nellie investors, then you'd
11 also have to factor in on the other side the licensees
12 who used it to the hilt and may have been able to
13 bargain the price down because of that availability.

14 I mean it would seem to me it could have
15 offsets on both sides, and it would be a tremendously
16 difficult exercise to figure, well, in this particular
17 licensee, because he was under pressure from some
18 investors, couldn't use the compulsory license factor
19 too effectively. This one over here was able to use
20 it extremely effectively. And that that would --
21 there would ultimately be almost a very tricky
22 offsetting exercise that you'd have to go through one

1 ARBITRATOR VON KANN: On that point about
2 trying to develop precedent for this proceeding,
3 certainly that's an issue that's been raised. Mr.
4 Marks and perhaps other RIAA witnesses have indicated,
5 in essence, I think, "Yes, we were trying to establish
6 precedent but precedent in the sense of trying to get
7 the market and get all these other folks to line up,
8 "Ah, we heard Yahoo struck a deal. Let's all go over
9 and sit down with Marks and strike deals."

10 It doesn't -- and I guess I'd like your
11 comment on this -- it doesn't strike me that I could
12 imagine a situation in which RIAA was signing up these
13 agreements for both purposes. If we can get everybody
14 in the market to sign up at about this level, great,
15 we don't have to worry about the CARP. If it falls
16 through, we've got these agreements for the -- those
17 don't strike me as mutually exclusive objectives.

18 THE WITNESS: Yes. And I wasn't
19 suggesting, and I don't suggest in my testimony, that
20 I'm relying in any way on an assumption that what RIAA
21 was doing was creating precedent. I really don't care
22 what RIAA was trying to do. I'm looking at this from

1 by one. I don't know how you do it.

2 THE WITNESS: Well, I disagree. I think
3 if the standard is the competitive market, then there
4 isn't any such offset. What you want is that fully,
5 totally potent, as you put it, statutory license as
6 the offset to the market power of the RIAA. And any
7 limitation on that moves you away from the competitive
8 benchmark. RIAA was under no compulsion to sign any
9 of these licenses, and although I normally try not to
10 put myself in the heads of negotiators, I doubt that
11 the \$500 or the couple thousand dollars they were
12 getting from some of these licensees were the primary
13 reason why they wanted to get those licenses signed.

14 I think that they wanted to get a number
15 of those licenses precisely because they were trying
16 to generate precedent for this proceeding. And if a
17 licensee said, "You can't charge that. I've got the
18 option of a statutory license," RIAA could say, "Okay,
19 I'll see you in court." And they had no -- there's
20 nothing that could -- they were not in any way
21 compelled to sign on to a below competitive market
22 price.

1 the perspective of a licensee. I made the comment
2 about RIAA only in the context of your observation
3 that there seemed to be this sort of symmetric
4 difficulty derived from the statutory license.

5 ARBITRATOR VON KANN: Okay. Just one
6 more. In the -- I guess two more. Again, my version
7 it's Page 80. It's in your Section, "Nine
8 Consequences of the RIAA Fee Proposal." There's a
9 discussion here in a paragraph beginning, "More
10 fundamentally, this is the cage of the Golden Goose --

11 THE WITNESS: Yes.

12 ARBITRATOR VON KANN: -- and the sheep,
13 the bladder and the Golden Goose." And the notion
14 here is that if the sound recordings were the key,
15 these folks should be making money hand over fist,
16 because they've had the use of those from the get-go
17 for free. It seems to me that what -- and this is a
18 little bit of an issue that I haven't quite figured
19 out in my own mind, but that your testimony here sort
20 of highlights it -- the problem, it appears, from the
21 evidence that we've heard, the reason that very few,
22 perhaps none, of the services have been able to be

1 profitable has nothing to do with the expense side of
2 the ledger. It has to do with the revenue side of the
3 ledger.

4 There is no evidence before me that would
5 permit a rational conclusion that if we adopted your
6 rate, these services would become profitable. Because
7 at this point, the evidence is fairly overwhelming
8 that there's been very little capacity to generate
9 revenue to pay any of the expenses, to pay bandwidth,
10 to pay software, to pay employees, to pay whatever.
11 There's a big revenue problem here, clearly.

12 And so it doesn't seem to me that,
13 frankly, the fact they aren't making money says very
14 much about the value of the sound recording versus the
15 musical works versus anything else. What it says is
16 there's no revenue flowing in here, and unless some
17 revenue starts coming from somewhere, nobody's going
18 to make money regardless of what royalty you geniuses
19 set.

20 So I guess my reaction to this was this
21 doesn't really establish -- say much about the issue
22 we're having to deal with. What it speaks to is the

1 somehow the sound recording is the essence of what
2 they're doing, and therefore if they do ever figure
3 out how to generate significant revenue, a significant
4 chunk of that revenue should go to the sound
5 recordings. That was the argument -- specific
6 argument I was addressing.

7 And my point was just I see no reason why
8 that's true. I don't see how a priori you can say the
9 sound recordings are what ought to get a big chunk of
10 that revenue. And, in fact, on the contrary, if all
11 it took to generate a lot of revenue was that you had
12 the sound recording performance right, we should see
13 people having revenue because they've got that. So if
14 anyone is ever going to generate revenue, it's going
15 to be because they figure out how to do something
16 else. And, therefore, there's no reason why, if that
17 does happen, any particular percentage of that ought
18 to go to sound recordings.

19 ARBITRATOR VON KANN: Last question I had
20 has to do with your Section 10 on ephemeral issues.

21 THE WITNESS: The ephemeral section?

22 ARBITRATOR VON KANN: The ephemeral

1 difficulty that apparently the advertising industry
2 has not been convinced that this is worth putting very
3 much money into.

4 THE WITNESS: Well, let me explain what I
5 was trying to do in this paragraph, because it was
6 just addressing a fairly minor point. And I don't
7 disagree with anything you said. I certainly don't
8 think that the key to profitability in this industry
9 is that you adopt my model in this proceeding. I've
10 said repeatedly that I don't care whether this
11 industry is ever profitable or not; that's not the
12 point. And I don't think -- and I agree with you that
13 the reason they're not profitable is primarily the
14 revenue side.

15 What I was trying to address was the
16 notion that if somehow they ever did become profitable
17 by which I mean they managed to generate real revenue,
18 and under my model they would be generating
19 significant revenue and making money, and darn it, the
20 sound recording performance owners would be getting
21 under my model only a relatively small portion of
22 that, and there's something wrong with that, because

1 section. And I think I understand your thesis here
2 that, in essence, the only reason to get these
3 ephemeral copies is to do the performances. And if
4 you're going to pay a royalty for the performances,
5 that ought to be able to cover this in a single place.
6 If you want to, you could divide it up and put a
7 little over here on ephemerals and a little on
8 performance. But once you've fixed out the fair rate
9 for performance, it doesn't make any sense to have to
10 pay additional for ephemeral.

11 Putting the aside for the moment, in the
12 context of webcasters, that doesn't answer the
13 question of the background music services who do not
14 pay the performance royalty, right?

15 THE WITNESS: That is correct.

16 ARBITRATOR VON KANN: And have I missed
17 where you address that in here?

18 THE WITNESS: That is not addressed in
19 here. I did address it in my direct testimony, and I
20 didn't have anything more really to say on the
21 subject, which is why I think there really isn't
22 anything more in that area.

1 ARBITRATOR VON KANN: So whatever you said
2 in direct testimony is -- that's still what you say
3 about this subject; is that --

4 THE WITNESS: Yes.

5 ARBITRATOR VON KANN: Okay. All right.
6 Nothing further for me.

7 CHAIRMAN VAN LOON: I had a couple of
8 areas, but it will be more brief. And picking up
9 right here in the ephemeral part, you say there's
10 nothing from an economic perspective that justifies an
11 additional fee. If we're back in the old willing
12 buyer/willing seller but it's a businessman and not an
13 economist, can't you be 100 percent right that there's
14 nothing from sort of pure economic theory that
15 justifies that, but where from the business side it's
16 something, it's a service, it's another piece, and if
17 they can get an additional charge for it, that that is
18 the way the market would work regardless of sort of
19 theory?

20 THE WITNESS: Well, I guess the difficulty
21 I have with trying to figure out where that takes you
22 is then, in some sense, I'm not sure I have any

1 particular day. But that's just my take on it.

2 CHAIRMAN VAN LOON: Well, just on that
3 one, I mean isn't it -- aren't we charged in fact with
4 the task of willing buyer/willing seller as opposed to
5 the test of fair and reasonable? And wouldn't fair
6 and reasonable be more of the public policy we weigh
7 all the considerations but we've been told that the
8 statute and a number of other things tell us, no,
9 we've got to go to the market, to willing
10 buyer/willing seller?

11 THE WITNESS: But then it's a question of
12 what does that actually mean, I think. And, again, I
13 wasn't there, I'm not a congressional scholar, I'm not
14 going to pretend to be inside the heads of the
15 Congress people, but I think that -- and I'm not
16 suggesting fair and reasonable as an alternative, I'm
17 suggesting willing buyer/willing seller meaning
18 competitive market. And in my first testimony,
19 actually, I talked about why I think that that's what
20 it means. And I think that that ought to be
21 interpreted in the context of why the competitive
22 market is a good benchmark, rather than just in some

1 analytical framework. I mean if I concede to you,
2 which I do, that business people are kind of practical
3 and don't worry about the theory too much and do what
4 sort of makes sense to them, and they may do things
5 that make sense, even if my theory says that that's
6 not what would happen in a market, then, in some
7 sense, we've now said anything could happen, and I
8 can't, on some fundamental level rule that out. But
9 I guess I would go back to the way I would approach
10 your task, if I were in your shoes, which is to think
11 of it as fulfilling a public policy objective.

12 And I guess I think of the market test as
13 being there for a reason. I mean it's not because the
14 market, as it occurs on the corner of 12th Street and
15 E Street, has some particular moral or philosophical
16 glory to it. I think that the reason we make
17 reference to market tests is because we believe that
18 in general well-functioning, competitive markets do a
19 good job of pricing things. And so the thing we're
20 making reference to really is, in some sense, my
21 theoretical concept of the market, not a businessman's
22 what might happen in a particular market on a

1 literal sense saying, "Oh, well, they set the market.
2 Let's try to figure out what happens in some specific
3 market, given the business people might do this or
4 might do that."

5 CHAIRMAN VAN LOON: Let me take that one
6 then to maybe the easier example -- minimum fee. You
7 say there's really no economic rationale for charging
8 more than what would be essentially the administrative
9 cost of setting up and running each incremental
10 account at the margin. Now, again, if I'm a business
11 person, though, am I going to do that? Am I going to
12 provide that service at cost or doesn't the willing
13 seller say, "I've got to have some margin. It might
14 be that I'd like to have a huge margin. It might be
15 that I'd have to settle for a modest margin." But if
16 we knew, and we don't have any clear evidence of
17 what's the actual cost, but wouldn't we, in fairness,
18 have to have some margin there?

19 THE WITNESS: Well, I think you might,
20 but, again, there, actually, I think that's easier
21 because we have actual evidence. We know what ASCAP
22 and BMI and SESAC have decided they want, and they've

1 concluded that what they want is somewhere in the
2 range of a few hundred dollars. And I would think
3 that they want to make money as much as anybody else,
4 so to the extent that you're looking for what would
5 business people in the real world do, as opposed to my
6 economic theory, I don't think you need my economic
7 theory. You can just look at what we actually observe
8 in the world, which are minimum fees for a similar
9 kind of service that are on the order of a few hundred
10 dollars.

11 CHAIRMAN VAN LOON: Well, I agree. I mean
12 that's the practical world answer, but I want to stick
13 now for a minute --

14 THE WITNESS: Okay.

15 CHAIRMAN VAN LOON: -- on the opposite
16 side. And what I'm understanding you to say is you
17 would agree that if we knew what the actual cost was,
18 it would be fair to add on a margin.

19 THE WITNESS: Well, as an economist, I
20 don't know what fair means. I mean that's not a word
21 that I use very much.

22 CHAIRMAN VAN LOON: What we knew what the

1 economic value to having the availability, having
2 access, having the right? Each one of my credit cards
3 I pay an annual fee. It's to have that convenience.
4 I might never use it a single time during the year and
5 never pay any extra fees. Or if I used it a lot, I
6 might pay a lot more. But there's that sort of
7 convenience fact or right factor, and wouldn't it be
8 economically logical or justifiable that a minimum
9 could -- that an appropriate basis for having a
10 minimum could also be sort of the right to exercise,
11 to play?

12 THE WITNESS: Yes, I think there's
13 something to that. I think what I would say would be
14 the magnitude of such a consideration, to take your
15 credit card example, would be a fee that is quite
16 small relative to what people typically pay for
17 actually using it. So in your credit card example,
18 the average credit card user, between late payments
19 and the implicit fees that they pay when they pay a
20 store and the store is charged, pays probably
21 thousands of dollars a year for the use of the credit
22 card. And the fee for just having it is typically \$20

1 actual cost was.

2 THE WITNESS: I think if you knew what the
3 actual cost was, if you said to me, "We're going to do
4 actual cost plus some margin, because we think that's
5 what a business person would do," I don't think I
6 could argue with that, if the margin was modest. I
7 mean I don't know what business people would really
8 do, so that could happen.

9 CHAIRMAN VAN LOON: Let me ask you about
10 another aspect of it.

11 ARBITRATOR VON KANN: Are you done with
12 the ASCAP, BMI part, because I've got -- could I ask
13 a follow-up if you're to --

14 CHAIRMAN VAN LOON: Well, let me stick
15 with the minimum for a minute --

16 ARBITRATOR VON KANN: All right. Go
17 ahead.

18 CHAIRMAN VAN LOON: -- and then go back.
19 The other thing, your argument is that assuming we're
20 on a per performance model, then essentially the
21 administrative costs of having the account sort of
22 should be the measure. But isn't there a separate

1 to \$50, which I actually think, from the credit card
2 companies' point of view, is tied to their view of the
3 incremental cost of having a credit card account for
4 you. So I actually think that your credit card
5 example is quite consistent with my theory.

6 But if you did want to sort of have this
7 notion of a fee sort of for the right, even if you
8 don't use it, I don't think I could rule that out.
9 But, again, I think it would be on the order of
10 hundreds of dollars, not thousands of dollars, given
11 the fact that we've already discussed many of the
12 licensees who make use of this license, even on a
13 royalty basis, are going to be paying on the order of
14 thousands of dollars. And so to have a minimum that
15 -- to have a fee for just the right to do it which was
16 as big as most people would be paying for actually
17 using it doesn't strike me as a good concept of a
18 minimum fee.

19 ARBITRATOR VON KANN: One question related
20 to the ASCAP, BMI, SESAC thing, and I confess I
21 haven't quite figured out where this leads, but it
22 seems to me that looking at those minimum fees is only

1 useful if we have comparability, if what ASCAP, BMI
2 and SESAC are doing is comparable to what the licensor
3 here. And it seems to me they aren't for a couple of
4 reasons. First of all, the performing rights
5 organizations, as I understand it, what they're doing
6 is applying a percentage of revenue model. We don't
7 have to keep track of what songs we're playing, we
8 don't have to keep track of how many people listen to
9 them, we don't have to keep track of anything except
10 what was your revenue, and take out a calculator and
11 multiply a percentage. And the minimum fees come
12 along because there was hardly enough revenue to argue
13 about. So what they're doing is an extremely de
14 minimis operation.

15 Now, with respect to -- if we were to
16 adopt a per performance model that has something to do
17 with how many songs are played and how many people
18 listen to the song, we do get into some more complex
19 calculations, I would have thought -- data keeping and
20 analysis -- that is quite different than what the
21 performing rights organizations do. Perhaps because
22 it's minimum, there isn't very much of that to do, but

1 it's still different. And so I don't know that what
2 it is the fair charge to figure out, "Hey, Charlie,
3 they only made \$1.75, they don't owe us much," is a
4 little different to say, "Well, they made -- let's see
5 here, they had 17 performances, and I've got to check
6 how many listeners that is." It is a different
7 exercise, isn't it?

8 THE WITNESS: I guess I see two parts of
9 that, one part where I don't think there's any
10 difference and one part where there might be. In
11 terms of just recording the tuning hours or whatever
12 is going to be the basis of the model, presumably
13 that's going to be done by computerized systems that
14 are set up to deal with everybody, and I don't think
15 there's going to be a significant incremental cost
16 associated with just kind of receiving the data just
17 because it's perhaps somewhat more complicated data.

18 Now, I suppose there might be an issue if
19 someone's paying the minimum fee of some minimal
20 auditing to ensure that they qualify for the minimum
21 fee; and I guess I could see an argument maybe that
22 that auditing, to make sure that they qualify for the

1 minimum fee, might be conceivably somewhat more
2 complex. Although, frankly, having looked at the
3 data, you know, for many of these stations it's very,
4 very clear that their activity is de minimis. There
5 are very few people listening, and I actually don't
6 think there's a significant cost associated with sort
7 of confirming that whatever the minimum fee is going
8 to be this guy is in the minimum category.

9 CHAIRMAN VAN LOON: There are a few more
10 questions, both from myself and from Judge Gulin, but
11 we're going to need to have a very brief, we'll call
12 it, six minutes restroom break.

13 THE WITNESS: I appreciate that as well.

14 CHAIRMAN VAN LOON: Be back in our chairs
15 at 2:30.

16 (Whereupon, the foregoing matter went off
17 the record at 2:22 p.m. and went back on
18 the record at 2:31 p.m.)

19 CHAIRMAN VAN LOON: I have only two other
20 areas, one, I think, very short and only because I'm
21 lazy. But Page 52 in your testimony you're going
22 through a bunch of bullet points summarizing things.

1 And in the third one, sort of in passing, you say,
2 "The value of promotion to musical works is less than
3 for sound recordings."

4 PARTICIPANT: I'm sorry, which number?

5 CHAIRMAN VAN LOON: This is the third
6 bullet on Page 52. Starts off "Royalty rates for
7 Internet performance ASCAP, BMI do not appear to be
8 significantly higher.

9 PARTICIPANT: That's not matching at my --

10 THE WITNESS: It's the fifth bullet in the
11 overall list --

12 CHAIRMAN VAN LOON: Right.

13 THE WITNESS: -- which begins with,
14 "Putting aside anecdotal evidence," if that helps
15 anybody.

16 CHAIRMAN VAN LOON: No, no.

17 THE WITNESS: Oh, am I in the wrong place?

18 CHAIRMAN VAN LOON: I think you are.

19 THE WITNESS: Okay. Tell me again then,
20 I'm sorry.

21 CHAIRMAN VAN LOON: Fifty-two.

22 THE WITNESS: Well, see we have this page

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1 problem. Tell me what section.
 2 CHAIRMAN VAN LOON: For me, it's the fifth
 3 bullet --
 4 ARBITRATOR VON KANN: "There's no evidence
 5 of displacement"?
 6 CHAIRMAN VAN LOON: One, two, three, four,
 7 five. It starts out, "Royalty rates --
 8 THE WITNESS: Yes, I have that.
 9 CHAIRMAN VAN LOON: -- for Internet
 10 performance."
 11 THE WITNESS: Okay, I have that.
 12 CHAIRMAN VAN LOON: Yes. Okay. And I'm
 13 going to the next sentence, "The value of promotion to
 14 the musical works is less than to sound recordings,"
 15 although it is and then you go on.
 16 THE WITNESS: Right.
 17 CHAIRMAN VAN LOON: And I wanted to ask
 18 you to sort of crystallize the way and the why the
 19 value of promotion --
 20 THE WITNESS: Okay. This goes back to
 21 some stuff that was discussed at more length in my
 22 direct and not really in here. In other words, when

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1 that. That was the point that was being made in this
 2 bullet.
 3 CHAIRMAN VAN LOON: Okay. That's what I
 4 thought. The last question is the 800-pound gorilla
 5 -- Yahoo.
 6 THE WITNESS: Okay.
 7 CHAIRMAN VAN LOON: Yes. I guess this
 8 should be in restricted.
 9 (Whereupon, at 2:35 p.m., the proceedings
 10 went into Closed Session.)
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1 a CD is sold, I think the evidence shows that the
 2 value of that -- both sides benefit. The sound
 3 recording owners benefit, and the composers and the
 4 publishers benefit, but per CD the benefit is greater
 5 to the sound recording. So that's sort of --
 6 CHAIRMAN VAN LOON: That's all you mean.
 7 THE WITNESS: That's all I was saying.
 8 CHAIRMAN VAN LOON: The dollar amount that
 9 the record company and the artists get --
 10 THE WITNESS: Right.
 11 CHAIRMAN VAN LOON: -- is bigger than the
 12 dollar amount --
 13 THE WITNESS: Exactly.
 14 CHAIRMAN VAN LOON: Okay.
 15 THE WITNESS: But there is still something
 16 to the musical works owner so that if it were true
 17 that there's promotion in the over-the-air but no
 18 promotion on the Internet and if ASCAP and BMI
 19 understood that, which I would think they -- or I
 20 would hope that they would, they would be demanding
 21 significantly higher fees on the Internet for that
 22 sort of low cost promotion value, and we don't observe

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 3 (Certification Page)
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