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Case: Digital Performance Rights

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Before the
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In the matter of:	
The Digital Performance Right in Sound Recordings and Ephemeral Recordings	Docket No. 2005-1
CRB DTRA	
(Webcasting Rate Adjustment Proceeding)	

Volume XLIV

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Monday,
November 27, 2006

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

BEFORE:

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

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9:34 a.m.

CHIEF JUDGE SLEDGE: On the record. Welcome everyone back on the weekend of Thanksgiving.

MR. HANDZO: We are thankful to be back.

CHIEF JUDGE SLEDGE: Mr. Handzo.

MR. HANDZO: Thank you, Your Honor. Before I begin with Dr. Pelcovits, our schedule tomorrow just to clarify the witness order will begin with Ms. Kessler, followed by Mr. Wheeler and Mr. Lee.

CHIEF JUDGE SLEDGE: Thank you.

MR. HANDZO: Sound Exchange calls as its next witness Dr. Michael Pelcovits.

Whereupon,

MICHAEL PELCOVITS

was called as a witness by the counsel for Sound Exchange, and having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. HANDZO:

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

A Yes. Michael P. Pelcovits.

Q And where are you employed, Dr. Pelcovits?

A I'm employed by the consulting firm of Mike MECRA in Washington, D.C.

Q And what does MERCA stand for?

A Mecra Economic Consulting and Research Associates.

Q And you are an economist?

A I am.

Q And you testified previously?

A I have.

MR. HANDZO: Your Honor, Dr. Pelcovits was accepted an expert previously with respect to applied microeconomics. I would offer him again on that basis.

CHIEF JUDGE SLEDGE: Any objection to Dr. Pelcovits testifying as an expert in microeconomics?

(No response.)

CHIEF JUDGE SLEDGE: Without objection he's accepted.

BY MR. HANDZO:

Q Dr. Pelcovits, you have a massive notebook in front of you. Could you just open that up and identify the first document for us?

A Yes, the first document is a copy of my prefiled rebuttal testimony in this case.

Q Dr. Pelcovits, could you just quickly kind of refresh us on the benchmark analysis that provided in your opening testimony in this case?

A Yes, in the opening case I proposed that the Court use a benchmark approach to set the rates in this proceeding and I proposed to use the interactive webcasting market as the benchmark. I propose that because I believe that the interactive market is a good benchmark. It's similar with

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1 respect to a number of characteristics,
2 including similar buyers, similar sellers.
3 Many aspects of the use for the
4 music are similar. The single dissimilarity
5 is the absence of interactivity in the
6 statutory market and I've proposed an
7 adjustment to take account of that.
8 Q Now in your benchmark analysis,
9 did you address the possibility that the
10 benchmark market, the interactive market,
11 might substitute for CD sales to a greater or
12 lesser degree than your target market, the
13 market for DMCA compliant webcasting?
14 A Yes, I did. I did consider that
15 factor in my testimony.
16 Q And when you say you considered
17 it, what exactly did you do?
18 A What I did is I performed a
19 sensitivity analysis to show the effects of a
20 certain level of difference in
21 substitutability between the benchmark and the
22 target markets and show the effect that it

1 would have on the rates that I recommended.
2 Q And what level of difference did
3 you use for your sensitivity analysis?
4 A I used a difference of two CD
5 purchases per year per customer.
6 Q So in other words, the interactive
7 market would cause a substitution of two CD
8 per year more than the non-interactive target
9 market?
10 A Correct. That's what I did.
11 Q Now are you aware that the webcast
12 services in their direct case presented
13 evidence regarding promotion and substitution
14 in those markets?
15 A Yes.
16 Q And is that a topic that you've
17 explored further in your rebuttal testimony?
18 A I have. I've explored that
19 further after reviewing what I've seen in the
20 case so far.
21 Q What evidence have you found on
22 the issue of promotion substitution as between

1 these two services?
2 A I have found evidence on a number
3 of different aspects of promotion and
4 substitution. With respect to promotion, I
5 have looked at the data on the use of the buy
6 buttons by various music services. With
7 respect to substitution, I have provided and
8 presented data from a survey conducted by NPD.
9 Q Let me start with NPD data. First
10 of all, who or what is NPD?
11 A NPD is a large survey firm that
12 has been in business for about 40 years and
13 conducts surveys of a wide range of consumer
14 goods including music services, music
15 purchases.
16 Q And how did you find out that NPD
17 has some relevant data?
18 A It was quite by accident. I asked
19 one of my research assistants to dig, continue
20 to dig, in this area and see what he could
21 find and he found a press report on an NPD
22 survey and it was really the first and only

1 thing I had seen which quantified or attempted
2 or I would say could be used to try to
3 quantify the extent to which there was
4 substitution for music purchases by customers
5 of various types of music services on the
6 internet.
7 Q Did you arrange to obtain access
8 to some of the NPD survey data?
9 A I did.
10 Q Now generally what kinds of
11 questions did the NPD survey ask?
12 A In this particular survey, they
13 asked questions on use of various types of
14 digital music, their subscription to music
15 services, webcasting, purchases of digital
16 downloads, file sharing, CD burning as well as
17 purchases of recorded music either through CDs
18 or downloads.
19 Q Do you know when that survey was
20 conducted?
21 A Yes. It was conducted in December
22 of last year, 2005.

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1 Q And do you know generally speaking
2 how it was conducted?
3 A Yes. The way it was conducted,
4 it's called an internet survey. There's a
5 large pool of respondents or potential
6 panelists that NPD turns to and it sends those
7 respondents what's called a web survey. It's
8 a survey that's conducted entirely through
9 responses electronically back and forth
10 between the survey group and the respondents.
11 Q Do you know what the size of the
12 respondent group was for this survey?
13 A Yes. There were about 4,000, I
14 think a little bit over 4,000 responses.
15 Q And do you know what efforts, if
16 any, NPD make sure that its survey respondents
17 match the U.S. demographics?
18 A Well, that's essentially their
19 business and that's what they do by both
20 determining who they send the survey out to.
21 They have to gather and maintain data on the
22 demographics of the panelists and on the

1 respondents to try to get as good as they can
2 a representative sample of the U.S.
3 population.
4 Q By the way, how do you know how
5 they do what they do?
6 A I had several discussions with the
7 personnel at NPD, people involved in survey
8 design and stats, statistical issues and
9 that's what we discussed and essentially their
10 approach and their efforts was consistent with
11 what I've learned about a lot of different
12 survey firms that essentially do this on a
13 regular, professional basis.
14 Q What exactly did you receive from
15 NPD?
16 A I received from them what's called
17 "cross tabs" which essentially turns out to be
18 just a large Excel spreadsheet which gives the
19 purchases of CDs and other types of recorded
20 music by the respondents to the survey broken
21 down based on their responses to other
22 questions. So for example, it would give the

1 average number of CDs purchased by customers
2 who respond to a question "Do you listen to a
3 certain type of music on the internet" and
4 then you would get the actual average response
5 for the customers that fall in that particular
6 category.
7 Q And what did you do with the NPD
8 data?
9 A What I did is I looked at the data
10 to try to get some sense of the effect of
11 subscription to a either interactive music
12 service on the one hand or to a webcast, in
13 this case, a free webcast service on the other
14 hand and to see to what extent the customers
15 and the respondents said that they changed
16 their purchases of recorded music as they
17 signed up to one of these services.
18 Q And were you able to actually
19 perform that analysis?
20 A I was able to use the data, I
21 would say, to get very indications of what was
22 going on here.

1 Q If you wouldn't mind, please turn
2 to page 27 of your written testimony and
3 you'll see a table there that says "Results
4 from NPD Survey of Digital Music."
5 A Yes.
6 Q I take it that reflects the
7 results of your analysis.
8 A That is the results of my
9 analysis.
10 Q Now the top half of that chart is
11 headed "Subscribed to a Digital Music
12 Service." Do you see that?
13 A Yes.
14 Q And what does the digital music
15 service represent to you?
16 A Digital music service is the best
17 that it's possible to categorize these things,
18 these are the interactive services that formed
19 my benchmark market in my rate proposal.
20 Q And how do you know that the
21 respondents who said they subscribe to a
22 digital music service are using an on-demand

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1 or an interactive service?
2 A Right. Well, they never ask that
3 question directly. So some of the this is
4 inference but they were asked how much they
5 paid for the service on a monthly basis and
6 these are respondents, this excludes
7 respondents who paid less than five dollars a
8 month because those could potentially be
9 subscribers to the non-interactive webcasts.
10 So I wanted to exclude those customers. These
11 are the remaining subscribers to a digital
12 music service and the other very powerful
13 indication here is that the question in the
14 survey included as examples, the Rhapsody I
15 believe, and I don't remember one other music
16 service.
17 Q But those are interactive
18 services?
19 A Yes.
20 Q And do you know if the survey
21 separately asked about download services?
22 A It did ask about download

1 services. I believe the questions were
2 clearly differentiated enough so when the
3 customer said "I subscribe to a music service"
4 the customer or the respondent was not
5 confusing that with a service where the only
6 money they were spending was to buy digital
7 downloads. This was a subscription service.
8 Q Right. Now right below that, you
9 have categories of less than one year and more
10 than one year. What does that represent?
11 A One of the questions they asked is
12 how long have you been a subscriber to the
13 service. So I divided. They actually broke
14 it down into a lot of smaller categories, I
15 forget exactly, three to five months, five
16 months to seven months, that type of
17 breakdown. I aggregated that to two different
18 categories, one customers who had subscribed
19 for less than one year and the other category,
20 those that had subscribed for more than one
21 year.
22 Q So the survey was in December of

1 2005. People who subscribed for less than one
2 year began to subscribe in 2005.
3 A Yes, that would be the logical
4 implication of what the survey says.
5 Q Okay. And then you have in the
6 line that says less than one year, you have
7 some numbers under 2004 and 2005.
8 A Right.
9 Q What does those represent?
10 A Okay. Let me explain what I'm
11 doing here. I think in general what I'm
12 trying to do is to see what happens to the
13 respondents' purchases of CDs in a before and
14 after world. So looking at the survey and in
15 this case we're looking at the group that
16 subscribed to the interactive services.
17 The customers are asked how many
18 CDs they purchased in 2005 and they are also
19 asked how many they purchased in 2004. For
20 the customers in this first row here, the
21 less-than-one-year customers, as I just said
22 we know that those are customers who began to

1 use an interactive music service in 2005. So
2 we know that 2004 is a before snapshot and
3 2005 is at least partially if not entirely
4 depending on how long the customer has been a
5 subscriber is an after snapshot. So this says
6 these customers on average purchased 5.7 CDs
7 in 2004, 5.5 CDs in 2005. The different which
8 is the last column is -0.2 CDs per year.
9 Q And so that represents from the
10 survey data the effect on CD purchases of
11 subscribing to one of these services.
12 A Yes.
13 CHIEF JUDGE SLEDGE: Mr. Joseph.
14 MR. JOSEPH: Objection. Leading.
15 CHIEF JUDGE SLEDGE: Sustained.
16 BY MR. HANDZO:
17 Q What does that represent?
18 A Well, that represents essentially
19 the change between before and after and would
20 be an indication of whether subscription to
21 the music service caused a change. In this
22 case, we're trying to see whether it led to a

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1 significant amount of substitution between use
2 of the music service and purchases of CDs.
3 JUDGE WISNIEWSKI: If I could just
4 ask a question here. Maybe I missed
5 something. Did you say the NPD survey was a
6 longitudinal survey?
7 THE WITNESS: It was, meaning I'm
8 --
9 JUDGE WISNIEWSKI: Meaning that in
10 fact you have the same people participating in
11 the survey over periods of time.
12 THE WITNESS: It is not, but these
13 are questions asked of the same people "What
14 did you buy this year? What did you buy last
15 year?" This is not comparing two different
16 surveys.
17 JUDGE WISNIEWSKI: Okay. Thank
18 you.
19 THE WITNESS: You're welcome.
20 BY MR. HANDZO:
21 Q Now in the next line you have
22 people who subscribed to a digital music

1 service for one year or more. Do you see
2 that?
3 A Yes.
4 Q And so you've also have lines that
5 show the change there with respect to CD
6 purchases. Do you see that?
7 A Yes.
8 Q And do you have an opinion as to
9 what those numbers represent?
10 A Yes. Let me tell you what I was
11 trying to do with this. I was just trying to
12 see -- There's essentially a lot of data here.
13 I'm trying to see what does it tell us. I
14 looked at the one year or more data to try to
15 see if it were true that over time a customer
16 tended to reduce his CD purchases as he got
17 more accustomed and tended to rely more on
18 listening to music on the internet through the
19 music services. That would really be this
20 sort of an indication of a longer run
21 adjustment and a longer run substitution of
22 the music service for purchases of CDs or

1 other recorded music.
2 Q And what did you find?
3 A I found a very small difference.
4 There is a one CD difference here which I in
5 fact -- This shows CD purchases. I believe
6 that even this change is offset by an increase
7 in purchases of digital downloads by those
8 customers.
9 Q Now did you perform the same
10 analysis with respect to people who streamed
11 music from a free website?
12 A I did.
13 Q And again, the category of
14 streaming music from a free website, what does
15 that represent here?
16 A That represents to the best I can
17 tell subscribers to what would be DMCA
18 compliant services. These would be our target
19 market. Essentially this sets up the
20 comparison of the benchmark market to the
21 target market.
22 Q You said subscribers. Is it

1 subscribers or listeners?
2 A I think it is both if I recall
3 correctly. They subscribe and listen to it.
4 When they listen to it, they don't have to
5 subscribe if it's free.
6 Q Right. Okay, and what about the
7 survey questionnaire tells you that streaming
8 music from a free website is essentially akin
9 to listening to a webcasting service?
10 A Well, first of all, the fact that
11 it's free tells me that it's not one of the
12 on-demand services and it also in the survey
13 questionnaire gives examples of types of music
14 services which would satisfy this non-
15 interactivity.
16 Q So it gives examples of webcasting
17 services.
18 A Yes.
19 Q And I take it that the analysis
20 for the webcasting services is the same as the
21 analysis for the on-demand services in terms
22 of looking at the before and after picture.

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1 A Exactly. It's the same numerical
2 calculations to try to again capture whether
3 there's a before and after change in CD
4 purchases by this group.
5 Q And what did the data show you?
6 A Actually the data shows very
7 similar results to the top half of the chart,
8 to the customers in the interactive services.
9 It shows a slight reduction in the CD
10 purchases and essentially shows that there is
11 no observable significant difference between
12 customers of the interactive music services
13 and the non-interactive music services.
14 Q No observable difference with
15 respect to what?
16 A Substitution of the music service
17 for purchases of CDs.
18 Q Now going back to your testimony
19 at the beginning of this morning, you
20 indicated that in your original benchmark
21 analysis you employed a sensitivity analysis
22 that assumed two CD substitution differential

1 between interactive and non-interactive
2 services. What does this data tell you about
3 that sensitivity analysis?
4 A Well, it tells me that the two CD
5 simulation analysis is far more generous than
6 it needs to be, that I see no evidence at all
7 in this survey, not only from this table, just
8 from reviewing the results and looking at the
9 survey and aggregating data in a lot of
10 difference ways, I come to the conclusion that
11 any difference between the two services is
12 almost certainly going to be much smaller than
13 the two CD effect that I presented in my
14 direct testimony.
15 CHIEF JUDGE SLEDGE: Mr. Joseph.
16 MR. JOSEPH: Your Honor, move to
17 strike the answer insofar as it includes
18 comments concerning other review and analysis
19 of the data beyond that which is presented in
20 this testimony. You were given essentially
21 one comparison that Dr. Pelcovits said he was
22 testifying about in his testimony. I have no

1 objection to purporting to draw conclusions
2 from the analysis he's presented here. But to
3 say, "And also I reviewed the data in the
4 different ways," we don't know what different
5 ways he's reviewed the data. He hasn't
6 testified to what different ways and it's not
7 in here. So we don't know enough. He didn't
8 explain any other examination.
9 CHIEF JUDGE SLEDGE: Mr. Handzo.
10 MR. HANDZO: Your Honor, I think
11 Mr. Joseph is reading a whole lot more into
12 the answer than is really there. What I
13 understood him to say is that in his original
14 benchmark analysis he assumed that there was
15 a difference between interactive services and
16 non-interactive services with respect to
17 substitution. In the NPD, he looked at
18 interactive services and the degree to which
19 they cause substitution. He looked at non-
20 interactive services to the degree they cause
21 substitution and he sees that the difference
22 between the two is much less than the

1 sensitivity analysis he used in benchmark
2 analysis. That's all he's saying.
3 CHIEF JUDGE SLEDGE: So you would
4 have no objection to sustaining the objection
5 to the extent that it goes beyond what is your
6 explanation.
7 MR. HANDZO: Yes, I don't think
8 that would result in striking anything, but,
9 yes, that's right.
10 CHIEF JUDGE SLEDGE: Mr. Joseph,
11 does that satisfy your concern?
12 MR. JOSEPH: Well, Your Honor, Mr.
13 Handzo in his explanation said he looked at
14 the NPD data. In fact, he testified about
15 looking at some very specific pieces of the
16 NPD data and making some very specific
17 comparisons. My objection does not go to any
18 conclusions he seeks to draw from the analysis
19 he presented in his written testimony. To the
20 extent he was saying he did more than that or
21 he was drawing conclusions for more than that,
22 that's where my objection is.

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1 CHIEF JUDGE SLEDGE: There's no
2 dispute on that. To the extent that anything
3 could be read into his answer beyond that, the
4 motion would be granted.
5 MR. JOSEPH: Thank you, Your
6 Honor.
7 DIRECT EXAMINATION (Cont'd)
8 BY MR. HANDZO:
9 Q And let me just try and clarify,
10 Dr. Pelcovits, in your answer with respect to
11 the appropriateness of the two CD sensitivity
12 analysis, were you relying on anything other
13 than what's presented here in this data that
14 you've just been discussing?
15 A Well, the quantitative results are
16 presented right here. I did as it says in my
17 testimony I examined the survey results and as
18 a economist and social scientist, I looked at
19 that data and obviously not just doing a
20 simple calculation. So to form my expert
21 opinion, I was looking at the data overall and
22 trying to see if there were anomalies or

1 something that would suggest that the
2 conclusions drawn from this particular
3 calculation were supportable and justifiable.
4 Q Did you find any anomalies that
5 would undermine this data?
6 A No.
7 Q Did you have an opportunity to
8 perform any statistical testing on the
9 validity of the NPD data?
10 A I did not.
11 Q Why not?
12 A I could not do it on my own
13 because I did not have the raw survey results
14 that NPD collects and so I was unable to do it
15 myself and I did ask NPD to perform various
16 tests and they were unwilling to.
17 Q Does that affect your conclusions
18 here?
19 A It does not affect the general
20 conclusions that I draw about the overall
21 difference in substitution in the two markets
22 compared to a two CD benchmark. I would not

1 claim based on the results that I have or the
2 results I've computed that I know precisely
3 what the difference as to whether it's going
4 to 0.2 or -0.3 or whatever. I cannot conclude
5 that. I can assign a statistical liability to
6 that, but the data overall in these
7 calculations give me very strong reason to
8 believe that my two CD substitution simulation
9 as I said earlier was far more generous than
10 it needed to be.
11 Q Now you also mentioned, Dr.
12 Pelcovits, that you looked at buy button data.
13 A I did.
14 Q And just remind what buy button
15 data is.
16 A Sure. Buy button data is data on
17 purchases of either CDs or digital downloads
18 by listeners to various webcasts. Most of the
19 webcasts when they're playing a song give the
20 listener the ability to click on a direct link
21 to allow them to buy the music.
22 Q And where did you obtain buy

1 button data from?
2 A There is data in the course of
3 this proceeding that has been made available
4 to me from three different sources, from
5 AccuRadio (1), from Bonneville (2) and from
6 Yahoo (3).
7 Q Okay. Let's start with AccuRadio.
8 What data did you get from AccuRadio?
9 A AccuRadio reports the purchases of
10 CDs by listeners to AccuRadio via the buy
11 button. Those are purchases made on Amazon.com
12 and something for which AccuRadio receives a
13 commission.
14 Q And do you have data that shows
15 you how many CDs AccuRadio sold in the course
16 of a year?
17 A I do.
18 Q Do you recall what year that was
19 you have the data for?
20 A Yes, that's for 2005.
21 Q What other data did you have from
22 AccuRadio?

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A I also had data on their listening audience, a number of unique listeners to AccuRadio during October 2005.
Q What did you do with that data?
A What I did with the data is I took the number of CDs purchased through the buy button for 2005 and I divided that by the number of unique listeners in October 2005 making the assumption that that was a reasonable proxy for the average number of listeners throughout the year.
Q And what was the result of that calculation?
A The result was that the average number of CDs purchased via the link on AccuRadio was 0.02 CDs per listener per year, so two-one hundredths of a CD per listener per year.
Q Now looking at the buy button data, does that tell you anything about whether webcasting services would be substitutional for CD sales or just whether

they tend to promote?
A This would be just dealing with any promotional effect. It's not giving you any information on a substitutional effect. You very well could have a customer buy a certain number of CDs through the links, but on net that customer might buy fewer CDs in total because his desire to listen to music is being satisfied through the web service.
Q Now tell us about the Bonneville data that you got.
A The Bonneville data is from two Bonneville stations and in this case it provides the total number of digital downloads. These are tracks. So it's not entire CDs. It's just one of the tracks on a CD. That's the total number of digital downloads during four weeks of October 2005 and I use that data to perform a similar calculation.
Q What were the results of that calculation?

A The calculation which essentially is using this data on purchases of digital downloads, dividing it by the number of listeners, is a number that actually turns out to be the same as it is for AccuRadio which again is 0.02 CDs purchased per year per listener.
Q Now you mentioned that with Bonneville, they were selling digital downloads. Did you do a calculation to change downloads into CDs?
A Yes. I did a calculation where I assumed or essentially converted downloads to CDs assuming there were ten tracks on a typical CD. So actually there were 0.2 downloads per year per listener which if you assume that's one-tenth of a CD per download that's what gives you the 0.02 CDs.
Q And lastly, you mentioned you had data from Yahoo. What did you get Yahoo?
A What I got from Yahoo this was information from the purchases of downloads

and digital albums by Yahoo customers where these were Sony BMG recorded music. So I had information on purchases of Sony BMG music by Yahoo customers of all sorts.
Q And did you adjust that data in any way to reflect the entire market and not just the Sony BMG share?
A Yes, I made the assumption that I could take this data and essentially gross it up based on the share of Sony BMG. So I want to say hypothetically Sony BMG had 25 percent of the market. I grossed this number put by multiplying it by four.
Q Now I think you may have indicated this already but are these purchases just by people who are listening to Yahoo's webcasting service or is it all of Yahoo?
A It's all of Yahoo's subscription, non-subscription or even just purchasing music after not even listening to anything but simply reading about music on a Yahoo music homepage.

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1 Q And did you then sort of calculate
2 what the average listener was buying from
3 Yahoo?
4 A I did again using this gross up
5 and working with bigger categories than ideal.
6 But this showed an effect consistent with the
7 other buy button data of, in this case, 0.014
8 CD equivalent per year, essentially albums per
9 year.
10 Q Now what conclusions do you draw
11 from the buy button data?
12 A I draw the conclusion that from
13 this most direct form of what you would expect
14 to be promotional effects the extent of the
15 promotional effect is very, very small,
16 essentially close to zero in terms of the
17 effects it would have on any rate
18 recommendation I'd be making.
19 Q Now is it possible that people are
20 listening to music and want to buy it but they
21 don't use the buy button? They do it some
22 other way?

1 A It is.
2 Q Does that affect your conclusion?
3 A No, I think that there still --
4 Since this is the most direct way for a
5 customer to buy the music, I would still
6 expect that if there is a significant or a
7 pronounced promotional effect it would show up
8 in the buy button data. It's true it could
9 indirectly lead to sales through some other
10 means, but there are offsetting factors which
11 would potentially make this an overstatement
12 of a promotional effect.
13 Q Did you say "they are offsetting
14 factors" or "there are"?
15 A "There are" sir.
16 Q My apologies. Switching gears
17 here, Dr. Pelcovits, have you reviewed Dr.
18 Jaffe's written testimony and his oral
19 testimony in the direct phase of this case?
20 A I have.
21 Q And are you familiar with the fact
22 that he proposes a different benchmark based

1 on the rate paid for music works?
2 A Yes, I am familiar with that.
3 Q And do you have an opinion about
4 the validity of that proposed benchmark?
5 A Yes, I believe that this approach
6 is not valid and not appropriate for this
7 case.
8 Q Why is that?
9 A There are a number of reasons both
10 relating to, I'd say, empirical things, namely
11 facts in the market and also I have
12 disagreement with what I'd say is his overall
13 conceptual approach, his theory.
14 Q Let's talk about the empirical
15 issues first. What are the empirical issues
16 that you've identified?
17 A The empirical issues boil down to
18 the fact that he presents data from only one
19 market where musical works and sound recording
20 copyrights are needed by the service, by the
21 product, namely the case of music used as
22 background in television shows or movies. So

1 that's the one piece of evidence he relies on.
2 He ignores several other markets which tell a
3 very different story.
4 Q Now before we sort of get into
5 those other markets, when Dr. Jaffe looks at
6 the market for music and TV and movies, what
7 aspect of this theory is he addressing there?
8 A He is making the claim that -- The
9 fundamental claim he's making is that these
10 two rights both should and will receive the
11 same payment in the marketplace. His basic
12 theory is since both are needed they should
13 both get the same amount of money.
14 Q And what markets did he not look
15 at?
16 A He did not look at several markets
17 including the interactive webcasting market
18 which was the market I used as my benchmark.
19 He did not look at the ring tone market or the
20 digital download market, the music video
21 market or the market for clip samples.
22 Q Now in those markets that you just

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1 mentioned, are there any where the sound
2 recording rights and the musical work rights
3 are valued the same?
4 A There are none where that is the
5 case.
6 Q And which of those rights is paid
7 more?
8 A The sound recording right is
9 always paid more than the musical work right.
10 Q Let me ask you to turn, Dr.
11 Pelcovits, to page four of your written
12 testimony and can you tell us please what the
13 chart on that page represents?
14 A Yes. The chart represents the
15 fees paid to sound recording copyright holder
16 and the musical work copyright holder for the
17 five different markets that I mentioned
18 earlier.
19 Q Now are there any of those markets
20 that sort of stand out in your mind as
21 particularly instructive?
22 A Yes. I think again the weight of

1 the evidence comes from the fact that these
2 are several markets and you have quite a --
3 it's quite important that you see this across
4 all markets. I think the one I look at sort
5 of a good example of what we can learn about
6 the compensation paid to the two different
7 copyright holders is the ring tone market.
8 Q Why is that?
9 A Well, the ring tone market,
10 there's a lot of -- It's a relatively new
11 market and we've seen significant developments
12 in that market and I will start sort of with
13 the fact that even under a variety of changes
14 in this market, we see this type of evidence
15 presenting itself.
16 Q Now are you familiar with how the
17 ring tone market developed?
18 A Yes. The ring tone market, what
19 we're talking here about is having your cell
20 phone play a tune instead of some one of these
21 typical Nokia tunes or whatever else that
22 would typically be programmed into the phone.

1 So it allows the user to have a favorite song
2 played.
3 Initially, the ring tones that
4 were played were what are called monophonic or
5 polyphonic tunes which essentially was just
6 the tones of a particular song. It was not
7 the actual full music as you would hear it on
8 a CD or the radio.
9 Q And when there were just those
10 kinds of ring tones, was it necessary to have
11 the song recording rights?
12 A No, it was not necessary because
13 they were not playing a sound recording. They
14 were just playing the notes of the music.
15 Q Was it necessary to have the
16 musical works right?
17 A It was.
18 Q Do you know what compensation was
19 paid to the holders of the musical works right
20 for those tones?
21 A Yes, approximately ten percent of
22 the retail price of the ring tone provided to

1 the ultimate consumer.
2 Q And when cell phones were
3 developed to the point where they could
4 actually play a portion of the sound
5 recording, what happened?
6 A At that point, you needed the
7 sound recording copyright and two things
8 happened, (1) the price to the consumer
9 increased and (2) the sound recording
10 copyright holder had to be compensated and
11 receive fees in the range of 50 percent of the
12 retail price.
13 Q And once that happened, what was
14 the payment to the holder of musical work
15 right?
16 A It remained in the same range of
17 about ten percent.
18 Q Now do you have an understanding,
19 Dr. Pelcovits, of who in this market obtains
20 the rights of the musical works?
21 A In the ring tone market, my
22 understanding is that certain cases it's

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1 negotiated by the music publisher directly and
2 in other case and this is something that the
3 record labels have been trying to secure, they
4 actually secure this right from the music
5 publisher and then they are able to offer the
6 sound recording including the musical work
7 license to the ring tone company.
8 Q And do you have an understanding
9 of whether ring tones are considered
10 promotional or substitutional for CD sales?
11 A Yes.
12 MR. STEINTHAL: I'm going to
13 object on foundation grounds. There's no
14 evidence that he did any kind of study about
15 whether or not ring tones are promotional or
16 substitutional.
17 CHIEF JUDGE SLEDGE: Mr. Handzo.
18 MR. HANDZO: Let me ask other
19 questions and lay the foundation.
20 CHIEF JUDGE SLEDGE: All right.
21 BY MR. HANDZO:
22 Q Dr. Pelcovits, what did you do to

1 determine how this market works and what the
2 views of the parties are?
3 A I reviewed, obviously, the
4 evidence and the written testimonies and I've
5 spoken to Mr. Eisenberg about this market.
6 Q Including the point that I just
7 raised?
8 A Yes.
9 MR. STEINTHAL: It doesn't solve
10 my problem. There's nothing in his report
11 about this and the fact that he has now read
12 between his deposition, Mr. Eisenberg's
13 testimony or somebody's testimony about a
14 promotional value issue associated with ring
15 tones doesn't give him the entitlement to
16 speak to it today. It's certainly not in his
17 report.
18 CHIEF JUDGE SLEDGE: The objection
19 is premature.
20 BY MR. HANDZO:
21 Q Do you have an understanding, Dr.
22 Pelcovits, of whether these ring tones are

1 considered by the recording industry to be
2 promotional or substitutional?
3 MR. STEINTHAL: Objection, Your
4 Honor.
5 CHIEF JUDGE SLEDGE: Mr. Handzo.
6 MR. HANDZO: Your Honor, my
7 question was whether he has an understanding
8 of what the record industry thinks and he has
9 talked to a representative of the industry.
10 Mr. Eisenberg certainly has his views.
11 CHIEF JUDGE SLEDGE: Objection
12 sustained.
13 BY MR. HANDZO:
14 Q Now, Dr. Pelcovits, if you were
15 looking for a market to see the relative
16 values of musical works and sound recordings,
17 how in your opinion does the ring tones market
18 compare to the market for the use of music and
19 TV shows and movies?
20 A I think it's a far better
21 benchmark to examine this issue than the
22 market that Dr. Jaffe looked at.

1 Q Why is that?
2 A I think this is a market where
3 first of all the music is provided and sold
4 directly eventually to the customer. The
5 customer wants to listen to a particular sound
6 recording or use it as a ring tone. So it's
7 a direct purchase of a particular sound
8 recording or a right to play the sound
9 recording by the customer as opposed to the
10 market that Dr. Jaffe relies on where there is
11 no direct sale or evaluation of the music by
12 the customer and that has a number of
13 implications for, I think, how the market
14 values these two different copyrights.
15 Q Now what in your view explains the
16 results that Dr. Jaffe found in the market for
17 movie and TV rights?
18 A I think what explains the
19 uniqueness of that market, and I think that's
20 the key thing. The reason why it is unique
21 and different than these five other markets is
22 that the transaction in this case between

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1 let's say a movie producer and the copyright
2 holders is in a setting where the music
3 producer is not as dependent or reliant on a
4 particular sound recording, let alone of a
5 sound recording made of a particular musical
6 work. The movie producer has many, many
7 options available to the license of a
8 particular sound recordings. This is an
9 option in other markets is not something
10 that's available.
11 Q For example, are you familiar with
12 the term "cover bands"?
13 A I am.
14 Q What is that?
15 A A cover band would be using a band
16 other than the well known band that might have
17 made the original sound recording to make a
18 separate sound recording of a particular
19 musical work.
20 Q And does the availability of
21 substitutes to the sound recording in the
22 music and TV business, would you expect that

1 to affect the price?
2 A Absolutely.
3 Q In what way?
4 A The availability of these
5 substitutes makes the sound recording of the
6 established recognized group much less
7 important to the movie producer and the movie
8 producer can in that case say to the owner of
9 the copyright, "I don't really need your
10 particular sound recording. I have an
11 alternative. I'm not going to pay based on
12 the popularity of your group."
13 Q You also mentioned, Dr. Pelcovits,
14 that you had some basic theoretical issues
15 with Dr. Jaffe's approach. Do you recall
16 that?
17 A Yes.
18 Q And just what is the most
19 significant in your view theoretical issues
20 here?
21 A Yes, my most significant criticism
22 of what he's done is with essentially the

1 whole paradigm of framework that he
2 establishes where he says where there are two
3 rights needed to use music, they are both
4 going to be compensated the same amount and
5 essentially as I understand his theory is that
6 since either the sound recording copyright
7 holder or the musical work copyright holder
8 can deny a user the ability to make use of a
9 particular piece of music. They both can keep
10 it from happening and they both then will
11 receive and should receive the same license
12 fee.
13 Q Do you think that theory would
14 hold in real markets?
15 A I do not think it would hold in
16 real markets except in cases where there were
17 rights established and it allowed one of those
18 rights holders to take advantage of its
19 ability to control the use of the music. I
20 would regard that as being sort of a -- It's
21 called an economic opportunistic behavior
22 where you take advantage of a situation where

1 after the fact you are needed even if before
2 the fact you weren't needed.
3 Q On a sort of going forward basis,
4 what would you expect to happen if the owners
5 of musical works tried to exercise a sort of
6 holdout power?
7 A I expect that if this were to be a
8 common practice where the providers of the
9 musical works to sound recordings were trying
10 to extract equal amounts of a payment from the
11 users of the music that the record companies
12 would not be willing to allow that separate
13 holding of a copyright to control how the
14 music would be used. It could be done in a
15 variety of ways and there are plenty of
16 examples in economics where firms do things to
17 prevent opportunistic behavior but basically
18 they would either have the music written and
19 they would control the copyrights directly or
20 they would have a contract whereby they were
21 able to sell or license the music together,
22 both the sound recording and the musical work,

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1 and they were able to sell that directly in
2 the market.
3 Q And are you --
4 MR. STEINTHAL: I'm going to move
5 to strike that last answer as being well
6 beyond the scope of his statement and one for
7 which he has no foundation whatsoever.
8 MR. HANDZO: Actually I was just
9 going to ask him whether he's aware of
10 situations in the market where precisely that
11 has happened.
12 CHIEF JUDGE SLEDGE: I'll let you
13 ask.
14 BY MR. HANDZO:
15 Q Dr. Pelcovits, are you aware of
16 situations in the market where what you've
17 just described happened, that is, that the
18 owners of the sound recordings acquired the
19 musical works so that they could sell a
20 package?
21 A I am aware that that's happening.
22 For example, the ring tone markets where the

1 sound recording, the record labels have
2 secured these rights from the publishers so
3 they could offer a complete set of rights and
4 ability to use the music to the ring tone
5 providers.
6 MR. STEINTHAL: I'm going to press
7 the foundation objection. This is a witness
8 in his deposition --
9 CHIEF JUDGE SLEDGE: Before
10 hearing voir dire, we had ruled on the
11 foundation objection.
12 MR. STEINTHAL: Sorry.
13 MR. HANDZO: That completes my
14 question on that subject.
15 CHIEF JUDGE SLEDGE: Objection
16 sustained.
17 BY MR. HANDZO:
18 Q Dr. Pelcovits, let me take you to
19 the last subject in your testimony on the
20 definition of revenue. Have you reviewed
21 Sound Exchange's proposed definition of
22 revenue?

1 A I have.
2 Q And just generally can you
3 describe what approach that definition of
4 revenue takes?
5 A Yes, it tries to capture the major
6 sources of revenues of the music services that
7 use the sound recordings either through
8 subscription or through other direct charges
9 as well as trying to give definitions of the
10 different ways in which advertising revenue
11 might be collected from the service.
12 Q And this approach of sort of
13 giving specific definitions of what revenue
14 would be captured as part of the definition
15 revenue, is that consistent with what you've
16 seen in marketplace agreements?
17 A It's consistent with what I've
18 seen and in particular the interactive
19 agreements that I've read in preparing my
20 initial testimony.
21 Q Okay, and just to be clear when
22 you refer to the interactive agreements, do

1 you mean they have precisely the definition of
2 revenue here or do you mean that they just
3 sort of generally take the approach of trying
4 to be specific about what's in and what's out?
5 MR. STEINTHAL: Objection.
6 Leading.
7 CHIEF JUDGE SLEDGE: Overruled.
8 THE WITNESS: I would say that
9 they similar in the sense of trying to be
10 specific. There are different sources of
11 revenues generally in the two markets. So
12 it's not the same specific definition, but
13 rather the same approach.
14 BY MR. HANDZO:
15 Q And what is the advantage of
16 taking an approach where you're trying to be
17 specific about what's captured and what's not?
18 A The advantage is that it helps
19 remove uncertainty and future disputes about
20 the way in which the agreement will be
21 implemented going forward.
22 Q Are there disadvantages?

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1 A Well, the disadvantages are that
2 to the extent that there are either sources of
3 revenue that are hard to define very
4 specifically or for which there might be new
5 sources of revenue in the future if those are
6 not included the seller is going to get less
7 money.
8 Q And would you expect that the
9 definition of revenue and percentage of
10 revenue would be negotiated together or be
11 related in a marketplace negotiation?
12 A I would expect that they would be
13 considered as a package and therefore would be
14 negotiated together.
15 Q And what would be the effect of
16 negotiating a sort of specific and perhaps
17 narrower definition of revenue?
18 A Certainly anything that narrows
19 the definition of revenue and would limit the
20 ability to recover revenue from new sources or
21 hard to classify sources would lead everything
22 else being equal to a higher percentage of

1 revenue.
2 Q Now in your testimony, you
3 addressed in particular the issue of bundled
4 services and what are the issues that arise
5 with respect to bundled services?
6 A The basic issue with respect to
7 bundled services is it's very difficult to
8 quantify the value to consumers of any piece
9 of the bundle.
10 Q And what approach does Sound
11 Exchange's proposal make with respect to
12 valuing the music services included as part of
13 a bundle of services?
14 A With respect to a bundle that
15 includes a music service where that music
16 service is also available on an alla carte
17 basis, namely sold by itself, it uses the
18 price in the alla carte offering as the
19 essentially imputed price for the bundled
20 offering.
21 Q And is that a reasonable approach
22 in your opinion?

1 A Yes.
2 Q Why is that?
3 A That is the best evidence in the
4 market of what this service is valued by
5 consumers.
6 Q Now what about a circumstance
7 where the music service that's part of a
8 larger bundle isn't offered separately in the
9 marketplace? How do you approach that?
10 A The approach in the Sound Exchange
11 proposal which I believe is a good one is it
12 doesn't try to value it directly or try to
13 unbundle the bundle in some way. Rather it
14 relies on the different part of the rate
15 structure, namely the per play rate to come up
16 with the fee for the use of the music in a
17 bundle service.
18 Q And under Sound Exchange's
19 proposal, is it just the flat per play rate?
20 A It is a per play rate, but it is
21 not the same per play rate that is a part of
22 the three part structure where indeed it is

1 possible to measure the revenue directly
2 coming from the subscription to the music.
3 Q You said it's not the same per
4 play rate. What's the difference?
5 A The per play rate is increased by
6 25 percent from the recommended per play rate
7 in the three part structure.
8 Q And is that a reasonable approach
9 in your view?
10 A I believe it is and in my opinion
11 it's reasonable because you're giving up
12 something when you no longer have the revenue
13 part of the rate structure, keeping in mind
14 that the proposed rate structure is a greater
15 than rate structure. In my opinion if you are
16 losing one of the legs of that structure and
17 losing the opportunity to get more revenue if
18 in fact the music is valued more and more by
19 consumers, I believe it would be appropriate
20 to take the per play rate from the three part
21 structure and increase it somewhat to handle
22 this very tricky case of bundled services.

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1 Q And are you aware of instances
2 where that sort of approach has actually been
3 adopted in the marketplace?
4 A I am.
5 Q What is that?
6 A There is an agreement between Sony
7 BMG and Yahoo for customized radio where they
8 too have to deal with this issue of bundled
9 services and in terms of the handling of the
10 bundled service fees, they took this precise
11 approach which was to use the per play rate
12 that was part of a rate structure, a two-part
13 rate structure, where it was not a bundled
14 service and take the per play rate and
15 surcharge where it was going to be the only
16 element in the rate structure.
17 MR. HANDZO: Thank you. I believe
18 that's all I have, Your Honor.
19 CHIEF JUDGE SLEDGE: Let's go
20 ahead and take an early morning recess for ten
21 minutes and then we'll begin with cross
22 examination. Off the record.

1 (Whereupon, at 10:36 a.m., the
2 above-entitled matter recessed and reconvened
3 at 10:49 a.m.)
4 CHIEF JUDGE SLEDGE: On the
5 record. Mr. Steinthal. On that break, we
6 were able to review the proposals on the
7 schedule and we'll get you an order out
8 hopefully tomorrow, but we're concerned about
9 the proposal to the extend that it would leave
10 us only one day to have the findings and
11 responses before the closing argument, one day
12 given the ways that we get pleadings and so we
13 wouldn't see it more than one day in
14 preparation for the closing arguments.
15 We'd like to have your findings on
16 December 12, a Tuesday, and then we need your
17 responses by December 15, a Friday, and that
18 will give us at least two days to consider
19 what you filed before your closing arguments
20 and allow us to be more able to respond or to
21 receive the closing arguments.
22 MR. HANDZO: And, Your Honor, I

1 frankly just don't remember what we proposed
2 for the dates of closing argument.
3 CHIEF JUDGE SLEDGE: The same day,
4 the 21st.
5 MR. HANDZO: The 21st.
6 CHIEF JUDGE SLEDGE: We didn't
7 change that. We just moved the others up a
8 little bit to give us some time to benefit
9 from what you file.
10 MR. HANDZO: Thank you.
11 CHIEF JUDGE SLEDGE: So initial
12 12, response 15 and argument 21. Mr.
13 Steinthal.
14 MR. STEINTHAL: Thank you. I'm
15 going to leave the issue of the NPD study
16 largely to what we say my learned friend
17 learned last week. So you refer to the other
18 lawyers in the case as your learned friends.
19 CROSS EXAMINATION
20 BY MR. STEINTHAL:
21 Q Dr. Pelcovits, just to start, I
22 just want to be clear. The benchmark services

1 that you refer to as interactive webcasters
2 are really conditional download on-demand
3 screaming services, are they not?
4 A I'd have to go back and try to
5 refresh my memory, but I think for the most
6 part they are. They certainly are on-demand
7 and I think for the most part they do allow
8 for conditional downloading.
9 Q You do remember that you're
10 relying on the Napster agreements, the Music
11 Net agreements, the services that gave you the
12 conditional downloads and on-demand streaming.
13 Right?
14 A I absolutely remember that. I do
15 not recall whether they all allow for
16 conditional downloads or do not. I don't
17 recall.
18 Q You're not using as benchmark
19 agreements the customized radio services that
20 labels feel are interactive. Right?
21 A No, I'm not trying to --
22 Hopefully, let's try to make sure I'm not

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1 trying to mess, to confuse things. My only,
2 I was relying on those services that you just
3 mentioned such as Napster and Rhapsody, Yahoo
4 Music, that stream music on demand and I do
5 not recall whether all of them allow for
6 conditional downloading or not. That's the
7 only --
8 Q But Yahoo Music in that sentence,
9 you meant Yahoo Music Unlimited, the
10 conditional download on-demand streaming
11 service that powers by Music Net. Right?
12 A Yes, I'm excluding, just again to
13 make sure that we have our categories set, I'm
14 excluding the services that allow conditional
15 downloads to portal devices. Those were not
16 in my benchmark analysis.
17 Q Okay. In other words, the same
18 services that provide for conditional
19 downloads that also sell portability, you
20 didn't look at the portability aspect of those
21 services.
22 A I did not use -- I did look at

1 them, but I did not use those as the basis for
2 my benchmark.
3 Q I just wanted to be clear because
4 you were using the phrase, "interactive
5 webcasting" this morning rather generally. I
6 just wanted everybody to be focused on the
7 fact that we're not talking about what the
8 labels may view as interactive webcasting from
9 a customized radio service. Your benchmark
10 was the on-demand streaming conditional
11 download services.
12 A Yes, I have no problem with that
13 characterization at all.
14 Q Okay.
15 A I don't think we have any
16 disagreement on that.
17 Q Now let's -- If you take your
18 report out, the rebuttal report, on page four
19 where you focus us all on your chart, you have
20 the lead-up where you say "and virtually every
21 market where broad or blanket licenses are at
22 issue, the sound recording commands

1 significantly greater compensation than the
2 musical work." Do you see that?
3 A Yes.
4 Q First of all, let's put aside
5 interactive webcasting which I know you
6 studied because you testified about it the
7 first time around. In reality as of the date
8 of your deposition which was October 31st of
9 this year, you had done no independent
10 analysis of the ring tones market. Correct?
11 A I think it's correct to say that
12 the fees that are recorded here are not
13 something that I did independently.
14 Q You just took them from Mr.
15 Eisenberg's statement.
16 A Correct, but I just wanted to make
17 clear it's not as if I had no understanding of
18 this market ahead of time.
19 Q But isn't it true that you didn't
20 know what the legal status of the rights were
21 as between the mechanical rights and the
22 performing rights associated with ring tone?

1 A I said that I was not certain that
2 what the, in this case, figure given for the
3 musical works fee, what particular right that
4 pertained to and that my understanding was
5 limited to the extent that this is what had to
6 be paid in order to be able to use the musical
7 work.
8 Q Just to be clear, isn't it true
9 that you had conducted no independent
10 investigation of the nature of the licenses in
11 the ring tone market at the time you did your
12 written testimony?
13 A That's correct.
14 Q And wouldn't the same be true with
15 respect to the music video market that you
16 summarized on this chart?
17 A Yes.
18 Q And wouldn't the same be true of
19 the clip sample market with respect to this
20 chart?
21 A Yes.
22 Q And wouldn't the same be true of

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1 the digital download market?
2 A Yes.
3 Q Now is it correct that you either
4 understand or observed it to be the case that
5 the licensees in these markets that you
6 summarized on page four require a broad or
7 blanket repertoire license to have any
8 offering that is compelling in the
9 marketplace?
10 A I think it's important that they
11 have a broader blanket license where broad is
12 seen, I want to make sure we understand the
13 term "broad" as I use it, means that they're
14 not buying one or two or a small handful of
15 recordings or musical works. They're buying
16 a large group in order to be able to have a
17 substantial offering to the customer.
18 Q You would agree, wouldn't you,
19 that a major hole in the repertoire of sound
20 recordings available on any of the services of
21 the nature you summarize on page four would it
22 make it difficult for that licensee to offer

1 a competitive product in the market?
2 A Not necessarily. I would not
3 agree with that.
4 Q Would you agree that there would
5 be a significant disadvantage to the licensee
6 in any of the markets that you summarized on
7 page four if they didn't have a broad catalog
8 including the repertoires of each of the four
9 majors?
10 A I would not agree with that.
11 MR. STEINTHAL: Let me ask you to
12 take a look at your deposition. This would be
13 Services Rebuttal Exhibit 25.
14 (Whereupon, the document
15 referred to was marked
16 as Services Rebuttal
17 Exhibit No. 25 for
18 identification.)
19 BY MR. STEINTHAL:
20 Q You recall your deposition was
21 taken on October 31st.
22 A I do.

1 Q Take a look if you will. These
2 are -- I think we all have the menu script.
3 So this would be page 34 which is the upper
4 left-hand quadrant on pages 34 through 37.
5 Starting on line 13 on the subject of the
6 broader blanket licenses you were asked "And
7 what kind of general observation have you made
8 to draw that conclusion?"
9 A I'm sorry. What page are we on?
10 Q It's on page 34. It's the upper
11 left-hand quadrant of pages 34 through 37.
12 A Oh, pages.
13 Q The page number exists on the
14 bottom right-hand corner of each quadrant.
15 A On the bottom.
16 Q Very hard to find sometimes.
17 A Thank you.
18 (Off the record comments.)
19 MR. STEINTHAL: That's a problem.
20 Anybody have one with page numbers?
21 MR. SMITH: They are only missing
22 the bottom.

1 MR. STEINTHAL: Okay.
2 BY MR. STEINTHAL:
3 Q So you're looking then for the one
4 with pages 34 and 36 in the middle of the page
5 and the question was "And what kind of general
6 observation have you made to draw that
7 conclusion?" Answer: "I've looked at a lot
8 of the major websites and looked through their
9 catalogs and their advertising and they all,
10 the major ones, seem to have very, very broad
11 catalogs and seem to promote the fact that
12 they have very large catalogs and it seems to
13 be an important competitive variable so that
14 if one of them did not have a very broad
15 catalog and the other one did it would seem to
16 be a significant disadvantage." Do you agree
17 with that testimony?
18 A Yes.
19 Q So at some point, there's a
20 significant competitive disadvantage to a
21 service that's offering any of the products
22 that you summarize on page four if they don't

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1 have certain repertoire.
2 A No.
3 Q Then how do you square what you
4 said in your deposition with that answer?
5 A Because the question in my
6 deposition is with respect to digital
7 downloads and you asked me whether the need
8 for a broad catalog was true with respect to
9 any of these and it's not true with respect to
10 some of them.
11 Q Okay. So it is true as to digital
12 downloads.
13 A I believe it is true that you need
14 a broad set of licenses, yes.
15 Q And with respect to interactive
16 webcasting or interactive services, I think we
17 already talked about that and you would say it
18 is important. Right?
19 A I would agree with that.
20 Q And with respect to ring tone,
21 wouldn't you agree that it would be a rather
22 bad consumer experience if I went to a website

1 and I wanted Beyonce as my ring tone or I
2 wanted the Rolling Stones as my ring tone and
3 when I asked for it I didn't get it?\
4 A Not necessarily, no.
5 Q Why would I go back to that
6 service if I were a customer if every time I
7 went there or on a number of occasions I went
8 there and I wasn't getting the music that I
9 was seeking to buy?
10 A It's not at all the case that I
11 would expect that consumers when they're
12 looking for ring tones have a powerful demand
13 for a particular piece of music and would not
14 accept a second best or a third best
15 substitute.
16 Q Now of course, you haven't studied
17 this market independently. You're just making
18 that assumption at this point.
19 A I have looked at the market. I
20 have seen first of all that ring tone
21 providers do not provide full catalogs of
22 music. There is usually a limited number of

1 titles that they offer at any point in time.
2 It's nothing like the interactive webcasting
3 or the digital downloads where there would be
4 sometimes two million or so titles. They just
5 don't do that with respect to the ring tones.
6 It's also true that there have been ring tone
7 providers that have not had the music catalogs
8 of all four major record labels in the market.
9 Q Let me ask you to take a look at
10 pages 32 to 33 of your deposition. Again,
11 I'll wait until people find the page 30 in the
12 middle of the page. We're talking about the
13 top right quadrant of pages 30, 31, 32 and 33
14 and on line 19 of page 32 you were asked "What
15 do you base your statement that in the master
16 ring tones market services need a broad or
17 blanket license?" Answer: "That's why I
18 didn't use the term `need.' My understanding
19 is that there are very broad licenses but I
20 don't know for sure whether that is a
21 development that might have in fact gone a
22 different way." Is that testimony still true?

1 A Well, I have learned something
2 about the ring tone market since the
3 deposition. So I do know more about how the
4 market went in a particular case, but other
5 than that, what I said there is -- I would
6 stand by that.
7 Q And then when you were asked
8 specifically as to the ring tone market on
9 line 9 of page 33, just skipping down to the
10 bottom right-hand quadrant, "Have you
11 conducted any independent investigation of the
12 nature of the licenses in that market?" You
13 answered "No." Correct?
14 A That's correct.
15 Q But since then you have had more
16 conversations with Mr. Eisenberg.
17 A I have.
18 Q And clip licenses are generally
19 designed to promote sales of digital
20 downloads, are they not?
21 A Either digital downloads or sales
22 of CDs, yes.

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1 Q So you would agree that as to clip
2 samples you would have to have a very broad
3 catalog in order to have a viable service.
4 A Yes, I would agree with that.
5 Q Now it's true, is it not, that
6 with respect to all of the markets that are
7 summarized on page 4 of your rebuttal
8 testimony, the catalogs of each majors are not
9 substitutes for one another? Are they?
10 A I believe that's correct with
11 respect to all the places other than ring
12 tones. I think there is a degree of
13 substitutability that's greater in the ring
14 tone market.
15 Q And that degree of
16 substitutability that you just talked about
17 with respect to ring tones is based on your
18 assumption that you can get by without a broad
19 catalog in a ring tones market?
20 A It's based on more than an
21 assumption. It's based on both looking at the
22 services and seeing that they don't provide a

1 million different offerings and understanding
2 that from an analysis of what I would expect
3 consumers to be doing in this market is that
4 they would be more willing to accept or to use
5 a substitute piece of music for their ring
6 tone and, thirdly, based on what I learned in
7 my discussions with Mr. Eisenberg that a ring
8 tone provider did not reach an agreement in
9 one case with Sony BMG but yet was still
10 offering service in the marketplace.
11 Q Now it's true, is it not, that in
12 ring tones you don't see repertoire of a
13 million or two million songs? You testified
14 to that. Right?
15 A Yes.
16 Q And other than your conversation
17 with Mr. Eisenberg with whom we can talk
18 directly, so I think we should do that on
19 Thursday, are you aware of any major ring tone
20 provider that is operating without a license
21 from each of the majors?
22 A If by "license to the majors" you

1 mean for some of their titles, no, I'm not
2 aware of that.
3 Q So when you gave your testimony,
4 you talked about there generally being a broad
5 catalog of rights being available for all of
6 the services that listed on page 4. You
7 included the fact that each one of those kinds
8 of services typically has a license from all
9 the major license companies. Correct?
10 A Yes, I think that is correct in
11 the market that they typically do have those
12 licenses from all four majors.
13 Q Now would you agree with the
14 proposition that in light of the
15 characteristics of the markets that you've
16 discussed in your testimony the sound
17 recording owner has substantial market power
18 relative to the licensee?
19 A If by "market power" we mean the
20 ability to have price set above marginal cost,
21 I would agree that there are independent
22 demands for independent copyrighted works and

1 they are not close substitutes one for the
2 other whether it be from one song to another
3 or for one group of songs to another.
4 Q And that's akin to the market
5 power that you talked about that exists in the
6 interactive webcasting market that you
7 testified about the first time around?
8 MR. HANDZO: I would object to
9 making him try and recall whatever he said how
10 ever many months ago it was.
11 MR. STEINTHAL: That's all right.
12 We can just go back to that testimony later.
13 We do have to do that now.
14 THE WITNESS: That's fine.
15 BY MR. STEINTHAL:
16 Q Now let's shift to the music
17 publisher side of the equation with each one
18 of the kinds of services that are listed on
19 your chart on page 4. Isn't it true that
20 music publishers in each one of the examples
21 on your chart on page 4 must license on a
22 basis such that their ability to take

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1 advantage of whatever market power they have
2 is constrained by a statutory license or
3 antitrust consent decree that effectively
4 limits their royalties to reasonable
5 competitive market levels?
6 A Not necessarily.
7 Q Let's take them one by one. Okay?
8 Interactive webcasting. Now music publishers
9 in terms of the licensing of the performance
10 rights and musical works to entities that are
11 engaged in interactive webcasting are subject
12 to the constraints of the ASCAP and BMI
13 Consent Decree Courts, are they not?
14 A I don't know how the parties view
15 that in terms of interactive webcasting. I do
16 know that regardless of the consent decree
17 that this fee is still under negotiation. So
18 it's hard to say that the fee itself is
19 determined by the rate court or by the consent
20 degree.
21 Q I didn't hear you. "It's hard to
22 say that the fee itself..."

1 A Is set by the rate court or by the
2 consent degree.
3 Q Don't you think that the fees that
4 evolve from a marketplace in which absent
5 agreement there is resort to the rate court
6 are fees that will be constrained by the
7 existence of that independent rate setting
8 body?
9 A They might. They might not.
10 Q Isn't that the gist of your
11 testimony in rejecting the customized radio
12 deals that they are somehow tainted because of
13 the existence of the statutory license for
14 sound recordings?
15 A No.
16 Q So your testimony is not that the
17 voluntary agreements between record companies
18 and customized radio services are tainted in
19 terms of their value as a benchmark because of
20 the existence of the rate setting body that we
21 have under Section 114?
22 A I was disagreeing with your use of

1 the word "tainted." I was saying that there
2 is a constraint. There is the fact that the
3 providers of the service of customized radio
4 can by modifying their service somewhat offer
5 something that's compliant with the statutory
6 service and that would limit its value to see
7 it as a separate independent marketplace piece
8 of evidence.
9 Q Wasn't your testimony as well that
10 prior voluntary agreement between the RIAA and
11 Sound Exchange on the one hand and the DiMA
12 companies on the other couldn't be used as a
13 benchmark either because it was tainted by the
14 fact that there was -- it was negotiated in
15 the backdrop of a compulsory license?
16 A Are you talking about the carry
17 forward of the earlier rates?
18 Q I'm talking about the agreement
19 entered into in 2003 that set rates and terms
20 for webcasting under the statutory license for
21 the period January 1, 2003 through December
22 31, 2005 and I thought your testimony was you

1 couldn't look at that as a benchmark in any
2 respect because it was negotiated in the
3 backdrop, with a backdrop, of a compulsory
4 license.
5 A That is essentially correct.
6 Q So what I'm having trouble with
7 why when you're analyzing this for the sound
8 recording owners there's this taint but you
9 seem to be distinguishing between the outcome
10 of negotiations with the backdrop of this
11 Board and as opposed to the backdrop of a
12 consent decree rate court setting. Are you
13 distinguishing between the two?
14 A I'm distinguishing between the
15 case where the rates are set explicitly by the
16 court in the case of webcasting which is a
17 close substitute for customized radio. In the
18 case here of the musical work fee for
19 interactive webcasting, there is no set rate
20 for this use of musical works. This is still
21 being negotiated.
22 Q You have something in your chart,

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1 don't you?
2 A No, I think what I was saying is
3 there was no rate set by a court.
4 Q We have musical work fee that you
5 put in your chart at six to sixteen percent,
6 right, for interactive webcasting?
7 A Yes.
8 Q Now my question is aren't those
9 figures constrained by the existence of an
10 ASCAP and BMI Rate Court to which users can go
11 if they perceive that ASCAP and BMI are
12 seeking supra competitive fees.
13 A It might be. It might not be
14 constrained. It depends on where the market
15 would end up in the absence of the rate court
16 and what I've said is there's still evidence
17 here in the market where there is no rate
18 actually set and determined by the rate court.
19 Q I'm not really understanding
20 because I'm not sure whether your testimony is
21 that there has to be a rate set for the
22 consent decree court to have this effect

1 constraining price or whether it's mere
2 existence as a place to go act as the
3 constraint on price. Which is it?
4 A A rate set by a court is a certain
5 constraint and depending on what we're looking
6 at as far as other markets and what would
7 happen in those other markets because of the
8 existence of a set rate by a court such as the
9 case of the customized radio would be one
10 thing. The possibility of going to a rate
11 court could constrain. It might not
12 constrain. It depends on where the market
13 will end up or would end up absent the rate
14 court.
15 Q And it's okay for you when you
16 construct your chart on page 4 to look at
17 rates that have been constrained by a
18 compulsory license on the musical works side,
19 for example, the 9.1 cents per track. That's
20 a compulsory license rate for digital
21 downloads, is it not?
22 A Yes.

1 Q Okay. Do you believe that is a
2 rate that has been artificially constrained by
3 the existence of a statutory license?
4 A Again, I'm not certain.
5 Q But you know it's the outcome of a
6 proceeding and ultimately a rate setting under
7 the Section 115 compulsory license. Right?
8 A Yes.
9 Q And that didn't stop you from
10 using a musical work rate that has been the
11 subject of oversight via a CRB or rate court
12 setting even though whenever it comes to a
13 sound recording rate that's the subject of a
14 voluntary agreement and the backdrop of a
15 compulsory license you don't want to look at
16 that at all. Right?
17 MR. HANDZO: I object to the
18 characterization of his testimony. That was
19 a speech not a question.
20 CHIEF JUDGE SLEDGE: Overruled.
21 THE WITNESS: I think it is
22 important to distinguish what I'm doing in

1 this table from the concern I have about using
2 customized radio as a benchmark in this case.
3 BY MR. STEINTHAL:
4 Q Let's take customized radio out of
5 the equation. Let's focus on the voluntary
6 agreement reached between DiMA and the RIAA
7 and Sound Exchange in 2003. You threw that
8 out as well, didn't you?
9 A I --
10 Q Yes or no?
11 A No, I don't think yes or no where
12 I didn't say I threw it out. I did not rely
13 on it. I do not think it's a good benchmark
14 and --
15 Q And yet you had no compunction
16 about -- I'm sorry.
17 A No, no. And I think there were a
18 number of factors that went into that
19 specifically that this was seen as a temporary
20 agreement which was a carry-forward in order
21 to take the industry through to the next rate
22 proceeding.

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1 Q And don't you know as a matter of
2 fact, Dr. Pelcovits, that the 9.1 cents per
3 track for digital downloads musical work rate
4 and the 10 percent musical work fee for master
5 ring tones for musical works are being
6 challenged by the publishers who believe
7 they're entitled to more than that?
8 A I don't know about that.
9 Q But you didn't do any
10 investigation and you just listed them on your
11 column to show relative values between sound
12 recording fees and musical work fees even
13 though all of the rates under the musical work
14 fee column are rates that are either set by a
15 rate court or a mechanical license compulsory
16 license or negotiated with a backdrop of a
17 rate court or a compulsory license? Isn't
18 that right?
19 MR. HANDZO: Objection. That
20 assumes facts not known. He hasn't
21 established any of that.
22 CHIEF JUDGE SLEDGE: Overruled.

1 He asked him to ask him that question that
2 you've just said that it's not been
3 established.
4 MR. HANDZO: Yes, he has asked the
5 question and he didn't get an answer that now
6 establishes the factual predicate of his
7 question. That's my concern.
8 CHIEF JUDGE SLEDGE: And I think
9 that's part of the question.
10 MR. HANDZO: Okay.
11 THE WITNESS: With respect to some
12 of these there are rates established under
13 statutes such as digital downloads, with
14 respect to, for example, master ring tones
15 where the rates, and in particular, this ten
16 percent rate, was negotiated before any
17 determination was made by any court or by this
18 court. So there are cases here where there
19 are influences of a court or a regulatory
20 decree but these are what prevails in the
21 marketplace and have prevailed consistently
22 for these types of musical works and I'm also

1 --and I think it's very important to see here
2 that the issue here is the relationship
3 between the sound recording fee and the
4 musical work fee and I'm not saying that you
5 should set the fee in this case based on this
6 relationship. I am simply saying that Dr.
7 Jaffe has ignored all of these other markets
8 where certainly the legal and other situations
9 are very different, but yet you see the
10 persistence of the sound recording fee being
11 significantly greater than the musical work
12 fee.
13 BY MR. STEINTHAL:
14 Q I don't think you answered my
15 question. So we're going to go through one by
16 one and I would submit to you that Dr. Jaffe
17 explained why he found those other markets not
18 being persuasive, but we will go back to that
19 testimony and focus on yours today.
20 Let's -- Again I had asked you
21 whether each of these musical work fees on
22 your chart on page 4 are constrained by the

1 existence of a compulsory license or the
2 ASCAP/BMI Rate court. Let's take it one by
3 one. First of all, the interactive
4 webcasting, you would agree with me, right,
5 that the streams made by interactive
6 webcasting services are public performances of
7 the musical works?
8 A Yes.
9 Q And any licensee of ASCAP and BMI
10 that objects to the fees being sought by ASCAP
11 and BMI has a right to secure a rate setting
12 of what is a reasonable fee under the ASCAP
13 and BMI Consent Degree Courts. Correct?
14 A It has a right to go to the court.
15 Exactly what would happen, it's hard to say.
16 Q And it's true, is it not, that the
17 charter of the rate court is to set a fee that
18 is reasonable which has been construed by the
19 ASCAP and BMI Rate Courts as setting a
20 competitive market fee? Do you remember that?
21 A I don't recall. I don't recall
22 that specifically.

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1 Q All right. So you're with me that
2 there is such a constraint on the interactive
3 webcasting fees. Let's go to master ring
4 tones. You're familiar, are you not, with the
5 fact that there is a compulsory license under
6 Section 115 of the Copyright Law governing
7 musical work reproductions made in the
8 delivery of ring tones?
9 A Yes.
10 Q Are you familiar with the fact
11 that publishers challenged that because they
12 wanted the ability to charge more than they
13 could get under the mechanical compulsory
14 license?
15 A I am aware that there has been an
16 issue and it was recently ruled on by this
17 Court.
18 Q It was the Copyright Office that
19 ruled, did it not, that the mechanical license
20 does cover ring tones?
21 A That's my understanding of the
22 decision, yes.

1 Q And you understand as you sit here
2 today that the publishers are upset with that
3 because it constrains their pricing ability
4 with respect to mechanical rights and ring
5 tones?
6 A I don't know if I can say what I
7 think they've done and what their views on
8 this are.
9 Q Well, could you infer from the
10 fact that they challenged that ring tones
11 should be covered by the compulsory license
12 that they preferred so that they would have
13 greater pricing flexibility to not be covered
14 by the compulsory license?
15 MR. HANDZO: I object to asking
16 him speculate about what one could read into
17 the minds of people who decided to bring
18 litigation.
19 CHIEF JUDGE SLEDGE: Mr.
20 Steinthal.
21 MR. STEINTHAL: I'm asking him to
22 make an inference as an economist based on

1 knowing that an economic actor challenged
2 whether or not it was subject to a compulsory
3 license, that the reason for doing so as a
4 matter of economics was to avoid being subject
5 to pricing constraint.
6 CHIEF JUDGE SLEDGE: Objection
7 sustained. Your explanation is not the
8 question you asked.
9 MR. STEINTHAL: Well, let me ask
10 it again then.
11 BY MR. STEINTHAL:
12 Q Can you infer from the fact that
13 the publishers challenged whether or not the
14 reproductions made in ring tones were subject
15 to a compulsory license, that they preferred
16 not be to subject to that compulsory license
17 when it comes to the pricing of rates and
18 master incomes?
19 A I think it's a reasonable
20 inference, but I don't know enough of the
21 details of what they have done in the courts
22 to say for sure what they think is going to

1 happen and what they think they would be able
2 to get in the market absent that compulsory
3 license.
4 Q Now the master ring tones
5 percentage that you have under the musical
6 work fee, is it correct, sir, that that is
7 just for the reproduction right and doesn't
8 include any public performance right?
9 A That is what was agreed to and
10 paid for the ability to use the musical works
11 back before this issue was resolved.
12 Q Well, is it not the case that the
13 agreements to which you refer if you're
14 familiar with them from speaking with Mr.
15 Eisenberg in fact cover only the mechanical
16 reproduction right and leave out the question
17 of fees for the public performances associated
18 with ring tones if it is ultimately determined
19 that there is a licensable public performance
20 in the delivery of a ring tone?
21 A That's not my recollection.
22 Q Excuse me?

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1 A That is not what I recall.
2 Q And as you sit here today, you
3 just don't know one way or the other?
4 A I don't know one way or another.
5 Q Are you aware that the public
6 performance organizations, ASCAP and BMI, have
7 sought public performance licenses for the
8 delivery of music in ring tones?
9 A I believe that to be correct, yes.
10 Q Do you know what the resolution of
11 that is in any respect?
12 A That that potentially decided in
13 that Librarian's decision but I don't recall
14 exactly how the ruling came out. I am looking
15 at what is negotiated in the market.
16 Q And as you sit here today, you
17 don't know whether that figure, and I want to
18 keep it on the public record, so I won't say
19 what it is, associated with master ring tones
20 includes or does not include public
21 performance rights. Correct?
22 A I understand in my belief based on

1 what Mr. Eisenberg has in his testimony is
2 that is what is paid. That is what the music
3 ring tone companies are paying to be able to
4 use a musical works in their ring tones.
5 MR. STEINTHAL: Let's mark this as
6 Services Exhibit R-26 an agreement between Mr.
7 Eisenberg's company, Sony BMG, and Verizon
8 with respect to ring tones and see if we can
9 shed some light on this. Your Honor, this
10 agreement has been marked as restricted as
11 produced by Sony BMG. I will try to ask the
12 questions in a fashion so as not to have us go
13 off into restricted session, but I'm sure that
14 Mr. Handzo will remind if we go astray.
15 BY MR. STEINTHAL:
16 Q Is this one of the agreements,
17 Services Rebuttal Exhibit R-26, that you
18 received from Mr. Eisenberg for your review?
19 A I did not review this. I can't
20 tell you that.
21 MR. STEINTHAL: Let me ask you to
22 turn to page SX REB, this is the Bates stamped

1 number on the bottom right-hand corner, REB
2 003948. I'll represent to you this is a
3 document that was produced by Sound Exchange
4 in the rebuttal phase discovery. I'm going to
5 ask you to read to yourself paragraph 5.04
6 and, Mr. Handzo, I'd like to read just a
7 portion of the paragraph that relates to whose
8 responsibility it is to clear composition
9 performance rights. I don't think that would
10 well to be deemed to be confidential but I
11 leave to you whether you want to put it on a
12 restrictive record.
13 MR. HANDZO: Well, first of all, I
14 have a more general objection which is an
15 objection to examining the witness about a
16 document that he hasn't seen before.
17 CHIEF JUDGE SLEDGE: Mr.
18 Steinthal.
19 MR. STEINTHAL: He's given
20 testimony about his understanding from talking
21 to Mr. Eisenberg that the public performance
22 rights associated with ring tones were in fact

1 included in the chart that he presented on
2 page 4. I'm asking him to take a look at
3 paragraph 5.04 and ultimately will ask him
4 whether looking at this makes him confident in
5 his testimony or not as to who or whether the
6 public performance right and the composition
7 is covered under the typical label ring tone
8 provider agreement.
9 CHIEF JUDGE SLEDGE: Mr. Handzo.
10 MR. HANDZO: I don't think that
11 solves the problem and in addition to the
12 extent that Mr. Steinthal is holding this out
13 as typical there is certainly no foundation
14 for that either.
15 CHIEF JUDGE SLEDGE: The objection
16 is overruled.
17 MR. HANDZO: Just to complete the
18 record, can I just have again which part
19 you're referring to?
20 MR. STEINTHAL: It's paragraph
21 5.04, the "In addition" sentence.
22 MR. HANDZO: Okay. I'm not going

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1 to invoke the objection with respect to that.
2 BY MR. STEINTHAL:
3 Q First of all, the use of the
4 phrase, "digital downloads" in the context of
5 this ring tone agreement, Dr. Pelcovits, if
6 you look at page 5, it's a very long
7 definition, but it is meant to include the
8 ring tone itself. I'll represent that to you
9 and then what I'm asking you to focus on is in
10 paragraph 5.04 where the sentence is "In
11 addition in the event that the delivery or
12 other use of digital downloads as authorized
13 under this agreement constitutes a public
14 performance of any composition embodied there
15 in, Company agrees, represents and warrants
16 that it will be responsible for obtaining and
17 paying for such performance licenses with
18 respect to such compositions, i.e., to ASCAP,
19 BMI and SESAC. The parties acknowledge that
20 the foregoing requirement does not express or
21 imply any agreement by the parties that
22 performance licenses are necessary for such

1 purposes." And my question is whether looking
2 at that clause gives you pause about your
3 testimony that the number in your chart
4 includes public performance rights, if any,
5 associated with ring tones.
6 MR. HANDZO: Your Honor, I am
7 sorry. Let me just propose an additional
8 objection and that is this entire line of
9 questioning presumes that this is a ring tone
10 agreement. There's no foundation for it and
11 I don't believe that it is.
12 CHIEF JUDGE SLEDGE: Overruled.
13 THE WITNESS: Could I have the
14 question read back please?
15 CHIEF JUDGE SLEDGE: Mr.
16 Steinthal.
17 BY MR. STEINTHAL:
18 Q My question is simply whether
19 looking at that passage gives you any caution
20 about your testimony as to whether the figure
21 in your chart includes whatever public
22 performance rights, if any, are associated

1 with the delivery of ring tones.
2 A No, this is one agreement. I'm
3 not sure what it is.
4 Q Okay.
5 A And my statement was based on my
6 understanding of Mr. Eisenberg's testimony.
7 Q Okay. We will deal with Mr.
8 Eisenberg on that. Do you recall testifying
9 at your deposition that with respect to the
10 musical works part of ring tones you did not
11 recall specifically what the different rights
12 were that were implicated?
13 A Yes.
14 Q All right. So we've gone down the
15 first two on page 4. Now the next of the
16 markets that you referred to there is the
17 digital download piece and I'm going to ask
18 you, I think you've already acknowledged this,
19 but the 9.1 cents per track that you list
20 there is a figure that was set under a
21 compulsory license. Correct?
22 A Yes.

1 Q And are you familiar with whether
2 or not music publishers have taken the
3 position that there is a public performance in
4 the delivery of a digital download to which
5 they are entitled to compensation?
6 A I'm not aware of that.
7 Q You don't know one way or the
8 other?
9 A I do not know one way or the
10 other.
11 Q And is it correct, however, that
12 this 9.1 cents is just for the mechanical
13 right and to the extent that there's a public
14 performance right associated with the musical
15 work in the delivery of a digital download
16 that's not included in the 9.1?
17 A That would be my understanding,
18 yes.
19 Q Now on music videos there, what
20 are we talking about there in terms of the
21 rights that are implicated first on the sound
22 recording side? What rights do labels license

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1 in music videos?
2 A They certainly license the
3 performance right there. As I think I said in
4 my deposition, I'm not sure whether this also
5 involves any sort of a copying by the music
6 service, but these are the rights that they
7 need in order to be able to provide the
8 services.
9 Q Is it in fact a right in the sound
10 recording that they license the labels or is
11 it some other copyright right that they have
12 an entitlement to with respect to music
13 videos?
14 A I don't know the nature of the
15 legal right here. I know that these are the
16 prices that have to be paid to use what the
17 sound recording companies own.
18 Q Isn't it true, sir, that what is
19 licensed in the context of a music video
20 agreement is the copyright in the audio visual
21 work itself?
22 A You're asking -- I mean I don't

1 know the answer to the legal definition of
2 what right is being licensed here.
3 Q Hypothetically, if you don't know
4 one way or the other, if what's being licensed
5 is a right in an audio visual work in which
6 the visual creation and right is copyrighted
7 and has distinct value, don't you think that
8 looking at the full price for the integrated
9 work overstates the value of the sound
10 recording itself?
11 A I think the only information that
12 we can take from this market is that this is
13 a work, a copyrighted work, by the sound
14 recording company which includes music and
15 audio, I'm sorry, includes music and video and
16 this is the price paid for it. It is what it
17 is.
18 Q And you have done no analysis to
19 try to discern how much of the value is
20 associated with the video or the audio visual
21 copyright as distinguished from the value of
22 the sound recording itself. Correct?

1 A I've not done that. I don't think
2 it can be done.
3 Q But you didn't even try to do it,
4 did you?
5 A Like I said, I don't -- In terms
6 of trying to take apart something that's sold
7 as an entity, I don't think it can be done.
8 I did not try to do it.
9 Q Now on the music video side as we
10 shift over to the right-hand column for
11 musical works, again with respect to
12 exploitation of music videos that are
13 streamed, those would be public performances
14 subject to the constraints of the ASCAP and
15 BMI Rate Courts. Is that a fair statement?
16 A I would agree with you that those
17 are performances. The nature of the
18 constraint as I said earlier I'm not sure how
19 binding it is and how influential it is on the
20 prices paid.
21 Q And the 5.1 to 6.5 percent, what
22 does that cover? Is that for the music

1 performance rights in the musical works?
2 A That's my understanding. As I
3 indicate in the footnote, there are additional
4 payments for synch rights that have not yet
5 been set.
6 Q It's not just synch rights, is it,
7 Dr. Pelcovits? There is server copy that
8 needs to be made to deliver the music video
9 and that involves a reproduction of a musical
10 work, does it not?
11 A I have -- I do not know what the
12 status is of that.
13 Q Well, that server copy is
14 different than the synch right, isn't it?
15 A I don't know how that's handled
16 legally.
17 Q So in your analysis of this
18 market, you didn't even discern whether there
19 were one or two different reproduction rights
20 associated with delivery of music videos on
21 the musical work side that are not captured in
22 the 5.1 to 6.5 percent entry on your chart.

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1 Isn't that a correct statement?
2 A I have relied on Mr. Eisenberg's
3 testimony and it says what it says and I refer
4 to it in my testimony.
5 Q Are you familiar with the fact
6 that there have been infringement lawsuits
7 brought by music publishers against companies
8 that have not gotten server copies associated
9 with the delivery of music services?
10 A No.
11 Q Now even familiar with the fact
12 that Universal Music Group was one of them in
13 the Farm Club litigation where they were sued
14 by music publishers for failing to get server
15 copies?
16 A No.
17 Q You didn't consider any of that in
18 your analysis. Correct?
19 A I did not have any knowledge of
20 that when I put my testimony together.
21 That's correct. As I said, I'm relying on the
22 assistance of these fee levels based on Mr.

1 Eisenberg's testimony.
2 Q Just to finish the chart, clip
3 samples, would you agree with me that the
4 streaming of clip samples invokes a public
5 performance right in the musical work?
6 A I don't know the legal status.
7 Q The 5.1 percent figure there, do
8 you know whether that's just a performance
9 right or whether it includes any related
10 reproduction rights or server rights?
11 A I don't know what it includes.
12 Q Would you agree that at least the
13 public performance piece is subject to ASCAP
14 and BMI Rate Court rate setting mechanisms in
15 the event the licensee and ASCAP and BMI can't
16 reach an agreement on an appropriate fee?
17 A I believe it could be brought to
18 the rate court. That's not saying that the
19 rate court either has set a rate or what
20 people's expectations of that would be.
21 Q The rate court has set rates in
22 different media which it has determined to be

1 reasonable rates. Correct?
2 A Yes.
3 Q Now is it a fair statement that
4 you criticized Dr. Jaffe for not having done
5 an analysis of these markets?
6 A Yes.
7 Q And you have no hesitation having
8 essentially done no analysis other than
9 looking at Mr. Eisenberg's statement
10 testifying that it was inappropriate for Dr.
11 Jaffe to not look at these markets?
12 A I have no hesitation at all. If
13 you have -- I'll explain my answer. If you
14 have many markets where both rights are
15 provided he looked at one of them. The
16 industries, musical works and sound
17 recordings, are very different. The costs are
18 different. The level of revenues collected by
19 the two industries are very different and in
20 fact, overall the sound recording industry has
21 revenues many times higher than the musical
22 works industry. There's a persistence of this

1 fact that sound recordings receive much more
2 money than musical works and I think that Dr.
3 Jaffe erred by ignoring that entire trend in
4 the market and just selecting one single
5 example where they on average were receiving
6 the same fee. In spite of all of the
7 institutional details that we've talked about
8 here, there is this persistence in the market
9 and the market goes on and continues with
10 these types of fees present and with these
11 types of relative revenues present and I think
12 that, yes, regardless of what exact rights
13 exist in any particular use of the music that
14 is the persistent fact in the market and
15 that's what he should have looked at.
16 Q And you're not referring to any
17 markets other than the ones on your chart
18 though. Just to be clear, there are the ones
19 you're referring to that tell us more in your
20 economic judgment than the master use synch
21 rights market. Correct? Yes or no?
22 A No. I think that he has to look

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1 at the industry as a whole and I'm sure he has
2 as I have and if you look at this industry
3 regardless of looking at any individual market
4 you will see that the relationship between the
5 revenues collected by the record companies
6 versus the music publishers is only identical
7 in this synch market and it is exceptional
8 relative to the overall level of revenues in
9 the market, the overall level of costs in the
10 markets and these particular examples where
11 both rights have been provided.
12 Q I'm going to come back and we're
13 going to talk about why in a few minutes.
14 Okay? My question was whether there are any
15 other aspects of the market where you did a
16 comparison of the compensation between the
17 sound recording owners on the one side and the
18 musical work owners on the other, other than
19 the ones that are shown on your chart on page
20 4.
21 A And I would say yes, but it is
22 also very relevant and I have looked at the

1 overall level of revenues that are earned by
2 the record companies relative to the music
3 publishers.
4 Q You mean in the aggregate as an
5 industry.
6 A The aggregate as an industry I
7 think is very relevant.
8 Q Okay. Now in every one of the
9 instances that we've looked at on your chart
10 on page 4 it's true that the sound recording
11 owner is not constrained from using whatever
12 market power it has to extract license fees
13 from licensees. Correct?
14 A I would not view this as an
15 extraction of market power but if it is true
16 that there are no constraints of a legal or
17 other judicial kind of ruling on these
18 particular negotiations.
19 Q Just a couple more things on your
20 numbers in your chart on page four. Now there
21 are a couple of cases, are there not, where
22 the publishing royalty is actually the

1 responsibility of the sound recording company
2 to pay out of the royalty that it collects
3 from its licensee? Is that not the case?
4 A That is true in some of the cases.
5 Q It's true with respect to ring
6 tones, is it not?
7 A As far as -- It is certainly true
8 with respect to some of the ring tone
9 agreements. I don't know if that's true with
10 respect to all of the agreements.
11 Q And it's true with respect to
12 digital download sales as well, is it not?
13 A I do not recall that.
14 Q Now let's take the ring tone
15 example because you do recognize that there
16 are instances where the publisher royalty
17 comes out of the sound recording royalty. Now
18 when that's the case, your numbers really need
19 to be adjusted to be fair comparisons, don't
20 they, because you would have to deduct out of
21 the sound recording compensation number that
22 which flows out to the music publishers.

1 Right?
2 A If you wanted to get an exact
3 ratio, yes, but it would not change the
4 overall conclusion I draw that the sound
5 recording fee is much higher than the musical
6 work fee.
7 Q But to be accurate, wouldn't you
8 want to take out from the sound recording
9 compensation part of your chart and put in a
10 number that is net of what the sound recording
11 company has to pay the publisher for the
12 publishing rights?
13 A If you wanted an exact ratio,
14 that's what you would need to do. I agree.
15 Q And with respect to music videos,
16 are you aware of the fact that the label is
17 often responsible for the synch rights, the
18 original synchronization right, associated
19 with the creation of the music video?
20 A I do not recall that fact.
21 Q Have you seen, for example, the
22 Sony agreement with Yahoo on that subject?

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1 Have you seen any music video agreements? I
2 won't show it to you if you haven't.
3 A I have not seen that.
4 Q Do you have any idea what the
5 liability is associated with the costs of
6 securing sink rights to music videos?
7 A No.
8 Q But you would agree, would you
9 not, that that too would have to be backed out
10 to have a fair, accurate rendition of the true
11 ratio between the musical work and sound
12 recording compensation rights?
13 A If there was a payment by the
14 sound recording copyright holder to the
15 musical work provider, yes, that should be
16 backed out to get an accurate ratio. Correct.
17 Q Now you would agree, would you
18 not, that sunk costs -- We'll change the
19 subject a little bit.
20 A Okay.
21 Q That sunk costs are not part of
22 marginal costs. Correct?

1 A I would agree with that.
2 Q And would you agree that as a
3 matter of economics pricing decisions
4 typically are conducted on the basis of
5 considering marginal costs and marginal
6 revenue?
7 A I would agree that that is true as
8 a general matter, but it is -- There's a
9 significant difference in markets for
10 intellectual property.
11 Q Take a look if you will at page 11
12 of your deposition. Actually, it's page 12.
13 I'm having trouble with the page numbers
14 myself.
15 A This is the bottom right-hand
16 corner now?
17 Q Yes.
18 JUDGE ROBERTS: It would be the
19 top right corner.
20 MR. STEINTHAL: I'm sorry. The
21 top right corner of that page.
22 THE WITNESS: Thank you.

1 BY MR. STEINTHAL:
2 Q Now at your deposition, actually
3 the question starts at line 22 on page 11
4 which is the bottom left-hand quadrant. The
5 question was "But as an economic matter, does
6 that fact that a cost may be sunk -- Let me
7 rephrase. Is that a cost may be sunk relevant
8 in pricing decisions?" Answer: "It usually
9 is." "And what way is it usually relevant?"
10 "Well, sunk costs are not part of marginal
11 costs and at least with respect to the
12 particular service or good that we're looking
13 at and most pricing decisions are done on the
14 basis of marginal costs, marginal revenues, so
15 it doesn't enter into the same way..." I'm
16 sorry. "It doesn't enter it," I guess we're
17 missing a word, "the same way some costs, I
18 suppose, that that wasn't sunk." When you
19 gave that answer, you didn't say except in the
20 case of intellectual property, did you?
21 A That's not the nature of the
22 question. You're asking me to compare answers

1 to two different questions.
2 Q Now you criticize Dr. Jaffe's
3 analysis, do you know, by focusing on a market
4 for sound recordings in which you say the
5 musical work is merely an input. Correct?
6 A Yes.
7 Q Now the fact is that in your
8 analysis you don't really distinguish between
9 the broader market for the sale and
10 distribution of sound recordings and the
11 narrower market for the performance of sound
12 recordings, do you?
13 A I do not distinguish with respect
14 to analyzing pricing issues with respect to
15 this industry.
16 Q You viewed the broader market for
17 sale and distribution of sound recordings and
18 the narrow market for the performance of sound
19 recording as being interchangeable, didn't
20 you?
21 A I don't agree with that
22 characterization.

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1 Q Let's go back to your deposition
2 then and make sure I have the right page with
3 all this. It would be starting on page 15,
4 line 14. This is the bottom left-hand corner
5 of the quadrant. The question was asked "Now,
6 Dr. Pelcovits, are we in this proceeding
7 talking about the market for musical works and
8 sound recordings?" Answer: "We're talking
9 about the market for sound recordings."
10 Question: "Are we talking about the market
11 for sound recordings or the market for the
12 performance right and sound recordings?"
13 Answer: "I would say I've used those terms
14 interchangeably. That is I'm using them
15 interchangeably." So you did give the
16 testimony in your deposition that you used
17 those terms, the broader market for sale and
18 distribution and the narrower market for
19 musical performance rights interchangeably,
20 didn't you?
21 A In the responses to the questions
22 that he asked me in the deposition.

1 Q And didn't you in doing your
2 analysis in your rebuttal statement do the
3 same thing that you looked at the market
4 broadly as the music market rather than
5 looking at the narrower market for the
6 performance of sound recordings as a separate
7 market?
8 A No, I think that's incorrect. I
9 think if we focused on what we started with a
10 minute ago which is the point I made about
11 musical works being an input into the sound
12 recording that is a statement about the
13 industry in general and how music is created
14 as a general matter. That doesn't mean there
15 are not issues with respect to the way in
16 which licenses are provided and offered in the
17 industry.
18 Q Would you or wouldn't you dispute
19 that there are different characteristics as
20 between the market for the sale and
21 distribution of sound recordings on the one
22 hand and the market for the performance of

1 sound recordings on the other and by "sale and
2 distribution" I mean for example licensing to
3 brick and mortar record stores, licensing to
4 iTunes for digital download sales, but
5 basically the sale of sound recording through
6 Amazon, brick and mortar stores, etc.
7 A Here what I would say to that that
8 I think there is certainly a difference in the
9 institutional nature of how these transactions
10 take place. There is not a difference in the
11 sense that the underlying economics of the
12 industry is not different from one to the
13 other, that what will overall in a free market
14 drive prices and the returns to the different
15 participants in this market are subject to the
16 same laws of economics. So that's why I
17 emphasize the importance of considering the
18 musical work principally as an input into a
19 market where generally speaking what is being
20 bought and sold by users and consumers are
21 particular pieces of sound recordings where
22 the musical work is an input.

1 Q Now just as I heard you say that,
2 you were talking about the purchase and sale
3 or the delivery and sale of music and again
4 isn't it true that you viewed as
5 interchangeable the sale and distribution of
6 music as one market and the public performance
7 of music as a separate market?
8 A No. I think that what I am saying
9 is interchangeable is that in looking at these
10 markets what is fundamentally going on is the
11 production and the sale of music which
12 includes sound recordings and musical works
13 where musical works properly viewed as an
14 economic model are an input. They are sold.
15 As I said when I'm analyzing a particular
16 subpart of the market, I'm going to want to
17 understand the market as a whole. I'm not
18 isolating pieces of that market and saying
19 look at that. Look at the rights. Look at
20 the facts that there are two rights and ignore
21 the fact that there is a bigger broader market
22 under which this is occurring.

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1 Q You didn't do a separate supply
2 and demand analysis of the sale and
3 distribution market for sound recordings from
4 the musical, I'm sorry, from the performance
5 market for sound recordings. Correct?
6 A I didn't undertake a specific
7 analysis of the market for sale of and
8 distribution of sound recordings through CDs
9 and other purchases. I did look at the market
10 as a whole and tried to understand the
11 economic forces that influence all different
12 parts of the market and in my opinion, that is
13 the way to try to understand fundamentally the
14 way that a market with willing buyers and
15 willing sellers would come to an agreement on
16 the prices for the different components of
17 what is eventually sold in the market.
18 Q I think my question was capable of
19 a yes or no answer. So the answer is you
20 didn't do a separate analysis, did you?
21 A I would say, yes, I did an
22 analysis in the sense of reviewing and

1 analyzing and looking at the industry as a
2 whole. Yes.
3 Q But you didn't do a separate
4 analysis of the supply and demand
5 characteristics of the market for the sale and
6 distribution of sound recordings on the one
7 hand as distinguished from the market for the
8 performance of sound recordings. Correct?
9 A I did to the extent that that is a
10 feature of the market as whole. If by
11 analysis, you're saying that I undertake an
12 effort to estimate supply and demand and do a
13 full scale analysis, the answer is no, I
14 didn't do that.
15 Q Now I believe your testimony is
16 that in the market for music generally a
17 musical work is a mere input into the sound
18 recording. Right?
19 A Yes.
20 Q Now suppose I want to use a
21 particular sound recording in a TV show or a
22 movie as a theme song that people recognize or

1 a well-recognized recording for the background
2 to a scene. The musical work is still
3 embedded in that sound recording, is it not?
4 A Yes.
5 Q Is that any different in terms of
6 the musical work being an input into the final
7 product than in respect of the other markets
8 that you looked at?
9 A Yes.
10 Q In what respect?
11 A That the producer of the movie or
12 the TV show would and as we have seen in the
13 market will purchase the musical work right
14 directly and substitute for the sound
15 recording. It will unbundle in some sense
16 those two different pieces of intellectual
17 property.
18 Q You're changing my hypothetical.
19 My hypothetical is I want a specific sound
20 recording for purposes of a theme or for
21 purposes of the scene. Okay? I don't want
22 just any music. I want Sinatra's performance

1 or Billy Joel's performance. I don't want
2 some cover band. I want somebody that
3 somebody's heard of before. Okay? In that
4 hypothetical is the musical work any less of
5 simply being an input your words in the
6 ultimate product being delivered in that
7 license than with respect to the other markets
8 that you talked about?
9 A If we take that hypothetical that
10 the movie producer wants Frank Sinatra's
11 singing of Moon River, is the Moon River
12 copyright part of the sound recording? Yes.
13 I would agree with that.
14 Q So the musical work is just an
15 input in the final product in that instance,
16 no differently than the other examples that
17 you talked about earlier.
18 A Well, now you're getting to
19 discomparable to what I've talked about with
20 respect to the industry in general and the use
21 of something as an input. That's sort of hard
22 to say that by picking a hypothetical you've

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1 captured what I've described as the general
2 pattern in the industry.
3 Q Did you look at the volume of
4 licenses that were the subject of Dr. Jaffe's
5 study in 2001?
6 A I did at that time. I don't
7 recall specific numbers.
8 Q And your -- By the way there is
9 some degree to which you keep on referring to
10 that as a study in 2001. You're familiar, are
11 you not, with the testimony in this case that
12 the existence of effectively a one-to-one
13 relationship between musical work license fees
14 for synch rates and master use license fees
15 from the sound recording owners continues to
16 be predominantly one-to-one to this day?
17 Correct?
18 A You have to point me to something
19 specific.
20 Q Ms. Ulman's testimony, the
21 testimony of Mr. Simson of Sound Exchange and
22 I believe the testimony of several of the

1 labels as well. But there is no dispute in
2 the case, is there, that the licensing of
3 master use rights on the one hand and the
4 sounding recording and sync rights on the
5 other tends in virtually all circumstances to
6 have a value of one-to-one to each other?
7 A That might well be but his study
8 was of 2001 licenses. So that's his analysis.
9 Q And do you have any evidence
10 whatsoever that the relationship is anything
11 other than one-to-one even in the
12 circumstances where the producer wants a sound
13 recording for purposes of the given scene,
14 movie, theme, whatever?
15 A I don't know what the producer
16 wants and I can't tell that based on what it
17 bought because it might have negotiated in
18 such a way that it didn't have to pay much
19 more for the specific sound recording than it
20 would have for a cover band or some other
21 sound recording.
22 Q Are you aware of the fact that Dr.

1 Jaffe's study excluded situations where there
2 were cover bands precisely not to have a
3 disproportion between where there was just a
4 synch right without a master use right?
5 A That doesn't matter.
6 Q Excuse me?
7 JUDGE WISNIEWSKI: Mr. Steinthal,
8 how are you defining cover bands in your
9 question?
10 MR. STEINTHAL: In my question, I
11 mean --
12 JUDGE WISNIEWSKI: Because as you
13 know there are well known artists who do
14 covers.
15 MR. STEINTHAL: That's not what I
16 was referring to. I think my question and let
17 me try to clarify with him.
18 BY MR. STEINTHAL:
19 Q When you use the phrase "cover
20 bands," are you referring to the fact or the
21 circumstance where a studio hires a band to
22 play a song and thereby pays only a synch

1 right for the musical work but not a master
2 use right for a prior recording of that work?
3 A I refer to it where there is a
4 substitute whether it is that's the exact
5 arrangement undertaken or some other method to
6 substitute for the existing sound recording.
7 Q So you're now saying that the mere
8 fact that one has a choice whether it be in
9 the sound recording or the musical work is a
10 cover situation?
11 A No. I'm just saying that the
12 exact nature of how the movie producer
13 arranges or creates a different sound
14 recording is what's relevant and I'd consider
15 -- You had a specific example of the way that
16 rights are established in that case. The
17 studio could just as easily pay a band to make
18 the recording and let that band have a sound
19 recording right and pay them the right.
20 Q Do you have any information to
21 challenge the proposition that when studios
22 seek to use a previously performed song in an

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1 existing sound recording as part of their TV
2 show or movie that in that situation the rates
3 or anything other than one-to-one with the
4 synch right associated with the embedded
5 musical work?
6 Q No, and I would not expect them to
7 be. It doesn't influence my opinion or the
8 statements about Dr. Jaffe's approach.
9 A Let me ask you this. Even if you
10 accept that Product No. 1 is an input into a
11 final product, okay, we'll call it Product 2,
12 it's not necessarily the case that the aspects
13 of the final product unrelated to Product 1,
14 the input, are themselves worth more than the
15 input. Isn't that right?
16 A I would agree with that. I think
17 the term you're looking for is "value-added."
18 Q Dr. Pelcovits, is it fair to say
19 that one hallmark of a competitive market is
20 the ability to choose from competing suppliers
21 who offer products that are substitutable one
22 for the other?

1 A I think my answer is no. I'm not
2 sure I understand your question.
3 Q Let me try it this way. Is it
4 true that in a market characterized by
5 multiple sellers and multiple buyers who have
6 the ability to choose from substitutable
7 products in that market that those are
8 characteristics of a competitive market?
9 A So you're talking about the
10 ability directly of the buyers and sellers to
11 choose, not necessarily the inputs to the
12 suppliers because that's the way I understood
13 your question.
14 Q A hypothetical market where you
15 have multiple sellers of substitutable
16 products and multiple buyers that have choices
17 among the different product offerers. Isn't
18 that a hallmark of a competitive market?
19 A I'd say generally that is.
20 Q And isn't it true that the ability
21 to choose among substitutes acts as a
22 constraint on pricing by suppliers generally?

1 A Yes.
2 Q And isn't that very
3 characteristic, one that you noted with
4 respect to the market for the licensing of
5 musical work synchronization rights and sound
6 recording master use rights?
7 A Yes.
8 Q So then going back to the chart on
9 page 4, is it a fair summary that all of the
10 instances that you refer to on page 4 are
11 instances in where the sound recording owners
12 are not subject to a marketplace in which
13 there is substitutability generally, whereas
14 Dr. Jaffe's market is distinguishable
15 precisely because it is a market in which
16 there is substitutability?
17 A I think that's wrong from two
18 standpoints. I think it's wrong from the
19 standpoint of the fact that if you take
20 substitutability to the level at which it
21 exists in Dr. Jaffe's synch rights markets
22 where the users are relatively or could be

1 relatively indifferent between a sound
2 recording of the Beatles and a sound recording
3 of someone or some cover band performing a
4 Beatles song, they might be very well
5 substitutable in that market, but that's not
6 an indication of more competitive. It's an
7 indication of a market where you've seen no
8 particular value attached to the Beatles
9 versus some cover band and that's not
10 characteristic of the way music is purchased
11 in general. That's the way it's an exception.
12 It's not the fact that there's more
13 competition. It's the fact you've taken away
14 or you've looked at the case where the value
15 of the sound recording copyright is much
16 lower.
17 The other way in which you said is
18 or what you posed I disagree with is I think
19 the master income market is a good example
20 where there is far from being a need for a
21 complete catalog. There is a lot -- There is
22 not a demand by consumers I believe for a full

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1 catalog of ring tones. There should be and I
2 expect there to be a significant amount of
3 substitutability there from one sound
4 recording to another, but it's clearly not at
5 level that it is in the synch rights market.
6 Q I'll stand by your first
7 discussion of substitutability in the ring
8 tone market and come back to that in the
9 briefing. Let me ask you this question
10 however. With respect to circumstances where
11 I want a given sound recording in the musical
12 work and sound recording synch rights and
13 master use rights market, you don't know of
14 any evidence, do you, that the sound recording
15 right attracts a higher rate than the musical
16 work right? Correct?
17 A I don't know of any case where I
18 can find out how badly a particular movie
19 producer wanted a particular sound recording.
20 I think that's impossible to analyze.
21 Q Because in part with respect to
22 the licensing in that market, at some degree

1 if the price being sought is too high, you can
2 choose another Sinatra song that may be
3 published by a different musical work owner or
4 in the catalog of a different record company.
5 Right? You do have some degree of choice.
6 A I don't disagree that the
7 existence of choices affects prices. What I
8 was disagreeing with is whether it was
9 possible to use evidence from the synch rights
10 market to try to find how much a movie
11 producer values a particular sound recording.
12 I just don't know what they would have paid
13 and how important it was to them. All he has
14 is evidence on what the transactions that
15 actually occurred which were subject to
16 whatever marketplace pressures were existing
17 at the time.
18 Q Let me ask you a few questions
19 about what's in your written statement before
20 I move onto a different subject. Why don't
21 you turn to page 2. You make a point here
22 about sunk costs and the decision about

1 whether or not to invest. My only question
2 here was with respect to each new album don't
3 the record companies face the should
4 we/shouldn't we invest decision that they
5 faced before the advent of webcasting?
6 A They face the same decision to
7 invest or not but that decision is based and
8 will take into account different
9 considerations when there is webcasting versus
10 when there is not.
11 Q And on page 3 where you talk about
12 the criticism relating to relatively small
13 webcasting revenues not being irrelevant, are
14 you positing here essentially that a profit
15 maximizing entity will always seek to charge
16 a price that maximizes the benefits to it?
17 A Yes, I'd say specifically
18 maximizing profits and by "profits," I would
19 mean long-run profits.
20 Q And then in your sentence that
21 ends in the middle of the page on page 3, you
22 say that "the record companies perceive that

1 the market for the sales of physical products
2 such as CDS long their primary source of
3 revenue is steadily eroding and a digital
4 distribution of music through webcasting and
5 other digital distribution channels is what
6 they must increasingly look to for their cost
7 recovery and profits in the future." Let me
8 ask you this. Are you aware of the data in
9 the case that shows that if you just look at
10 the sales of music and look at not just
11 physical CDs but also sales of downloads and
12 sales to subscription on-demand services that
13 are your benchmark market that the combination
14 of CDs sales which may be lower but plus-ed up
15 by iTunes and other digital download sales and
16 revenues from subscription on-demand services
17 that in fact the record companies now are
18 making more than they were making three or
19 four years ago?
20 A I think that depends on which
21 years you use as a comparison and the RIAA
22 data which is on shipments of both CDs and

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1 sales of digital downloads, I recall that
2 revenues over the last several years have
3 declined.
4 Q Well, if in fact the record
5 companies are now making more than they were
6 two years ago and three years ago and four
7 years ago from sales defined to mean not just
8 sales of CDs but sales of CDs or permanent
9 downloads, digital downloads and subscriptions
10 where you get your on-demand streaming and
11 conditional downloads. Would that change your
12 testimony if in fact they're making more from
13 the sale of music now than they were before?
14 A If that were true, it would not
15 change anything in my testimony. Basically
16 the testimony again, and I want to make sure
17 it's clear here, is that sellers will care
18 about what they make in any market regardless
19 of whether it's small or large and this is
20 many millions of dollars and to say that this
21 is an afterthought to these companies and they
22 would not seek to maximize their profits in

1 that market because it's small it's
2 nonsensical to me.
3 Q I think we all agree that entities
4 will profit maximize to the extent they can.
5 So that's not the issue. Now take a look if
6 you will at page 5. And you make a statement
7 here on the issue of substitutability within
8 the synch and master use market that I wanted
9 to ask you about. In the middle of the
10 paragraph, the long paragraph in the middle,
11 you say "Instead the evidence Dr. Jaffe relies
12 on from the synch and master use market is
13 from a market where the users purchase
14 individual sound recordings or musical works
15 and therefore, have the ability to find
16 substitutes for both the musical works and
17 sound recordings." Now my question relates to
18 your focus on the word "individual" here.
19 Isn't the substitutability a consequence of
20 the fact that the license decision is being
21 made before the music is put into the film
22 rather than the fact that the license may or

1 may not be sold individually by the publisher
2 or the record company?
3 A I don't understand that question.
4 Q Well, are you familiar with the
5 fact that there are certain record companies
6 and music publishers that issue catalog
7 licenses to studios or producers so that
8 basically they can choose from their catalog
9 as they see fit in the middle of a production
10 schedule to choose this song or that song,
11 this record or that record, to be used within
12 a film?
13 A I don't recall that specifics but
14 I'll accept that if you want me to.
15 Q Hypothetically, isn't it true if
16 you accept that there's the opportunity to do
17 a catalog license so that I'll pay you X
18 dollars per synch right or per master use
19 right for your catalog basically avoiding
20 transactions costs on a license by license
21 basis? There would still be substitutability
22 existing in the market for synch licensing and

1 master use licensing in that marketplace
2 setting, wouldn't there?
3 A There would be substitutability
4 from the standpoint that the movie producer
5 could after the fact choose or after the broad
6 license was entered into could choose which
7 particular musical work to put in the movie.
8 Q Or if it had a deal which
9 basically said I'm going to pay X units per
10 synch right or master use right but didn't tie
11 you to a certain minimum per year you'd still
12 have substitutability in terms of the ability
13 to choose Warner's sound recording or
14 Universal's sound recording and it's that
15 opportunity to choose that creates the
16 substitutability, isn't it?
17 A No, I think the substitutability
18 is simply that when it comes down to it, the
19 music, I'm sorry, the movie studio can easily
20 use one of many different songs for its
21 purposes. It doesn't have a demand or a very
22 strong demand for one piece of music over the

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1 other.
2 Q It's true, is it not, that
3 somebody that uses a DMCA complaint radio
4 station doesn't have the ability to pull the
5 particular song it wants to choose at a given
6 point in time? Isn't that right?
7 A That's true of the consumer that
8 they can't select on a song-by-song basis. It
9 doesn't mean that they don't have a strong
10 demand for a music service that has particular
11 sets of titles in their repertoire.
12 MR. STEINTHAL: I think this is a
13 good time to break. I'm going to go onto a
14 different subject.
15 CHIEF JUDGE SLEDGE: All right.
16 We'll recess until 2:00 p.m. Off the record.
17 (Whereupon, at 12:31 p.m., the
18 above-entitled matter recessed to reconvene at
19 2:03 p.m. the same day.)
20 CHIEF JUDGE SLEDGE: On the
21 record. We'll come to order. Mr. Steinthal.
22 CROSS EXAMINATION (Cont'd.)

1 BY MR. STEINTHAL:
2 Q Good afternoon, Dr. Pelcovits.
3 A Good afternoon, Mr. Steinthal.
4 Q I'm going to shift subjects to the
5 SDAR services, XM and Sirius. Okay. You
6 addressed the rates charged by the SDAR
7 services starting at page 6 of your testimony.
8 A Yes.
9 Q Now is it a correct statement that
10 you agree with the proposition that webcasters
11 and the XM and Sirius SDAR services share
12 important characteristics?
13 A Yes.
14 Q Such as?
15 A They both stream music to
16 listeners very often without commercial and
17 without any user control over the stream.
18 Q And you refer on page 6 at the
19 bottom, the last paragraph, on this page to
20 satellite radio having been a nascent industry
21 at the time of the negotiations of the SDAR
22 services voluntary deal with Sound Exchange.

1 Do you recall doing that?
2 A Yes.
3 Q Relative to broadcast radio,
4 wouldn't it be fair to say that the webcasting
5 industry remains in a nascent state?
6 A I would use the term "nascent" to
7 mean quite early. It's sort of just forming.
8 So I think webcasting has gone beyond being
9 nascent, but I certainly would agree that it
10 has not developed to nowhere near developed to
11 the same point as broadcast terrestrial radio.
12 Q Now you agree, do you not, that
13 RIAA had projections of subscription
14 information, revenue information, for the SDAR
15 services when it negotiated the voluntary
16 agreement with the SDAR services. Correct?
17 A That's what I understand from Mr.
18 Marks' deposition.
19 Q And you'd agree as well, wouldn't
20 you, that when the SDAR services/RIAA
21 agreement was negotiated in 2003 there was
22 some uncertainty on both sides as to whether

1 the services would meet or exceed those
2 projections?
3 A Yes, in general, although I assume
4 that satellite providers did not have the
5 projections that RIAA had. So I think just
6 responding to the question there's significant
7 uncertainty on both sides.
8 Q Now if the parties to the 2003
9 voluntary agreement between the SDAR services
10 and RIAA had negotiated a percentage of
11 revenue, you can't say one way or the other
12 whether the fee would be higher or lower for
13 a nascent industry, can you?
14 A I think that would still possibly
15 play a role even in a percentage of revenue
16 fee.
17 Q Wouldn't it depend on both
18 parties' expectations and projections of where
19 the industry was going to go?
20 A Well, it certainly would still
21 depend on that, yes.
22 Q I just didn't hear the end.

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1 A I said yes, it still would depend
2 on their projections of where the industry was
3 going.
4 Q And you don't know whether the
5 parties to that negotiation, meaning the SDARS
6 agreement and RIAA, actually thought about
7 what they thought about the agreement in terms
8 of a projected percentage of revenue. You
9 don't know what they thought about that.
10 Correct?
11 A I don't know what they projected
12 or expected as far as what this would
13 translate into as far as a percentage of
14 revenue.
15 Q Did you do any inquiry into what
16 the sellers of the sound recordings were
17 projecting for the SDAR service revenues over
18 the time period of the license?
19 A No, I did not.
20 Q Did you examine public projections
21 from analysts with respect to the two SDAR
22 services at the time in 2003 when this

1 agreement was entered into?
2 A I did not. I actually did not.
3 I've looked at some analyst, quite a lot of
4 analysts' reports, on this industry and I did
5 not see any from back then.
6 Q Well, the companies were public
7 companies that were making quarterly filings,
8 were they not, XM and Sirius?
9 A They were public companies then,
10 yes.
11 Q And just to be clear you don't
12 conduct any independent examination or
13 investigation as to what was publicly reported
14 about their projections at that time?
15 A Their own projections you mean?
16 Q Yes.
17 A I do recall looking at their
18 public statements that I cite here, the XM
19 10K. That's newer, but I did look at the
20 statements. I don't recall what they said at
21 the time about their projections of ultimate
22 subscription levels.

1 Q Did you factor into your analysis
2 any of the information that you gleaned from
3 those public reports?
4 A The only thing I factored in is a
5 recognition that this was very, very early in
6 the stage of the industry and that therefore
7 was going to be very difficult or it would
8 have been difficult at the time to have a good
9 projection of where the industry was going.
10 Q But that uncertainty would exist
11 on both sides between the satellite services
12 and RIAA. Correct?
13 A Yes.
14 Q Now you say in the first paragraph
15 on page 7, four lines down, that the market
16 has changed drastically or dramatically in
17 three years. Let me ask you this question.
18 Would you agree that the change in the SDARS
19 business would not affect the validity of the
20 2000 agreement as a benchmark for webcasting
21 if what you were trying to do was to draw an
22 analogy based on what the expectations were in

1 2003?
2 A I'm not sure I understand the
3 question.
4 Q Well if -- You're familiar with
5 utilization of benchmarks based on the
6 circumstances at the time that benchmark
7 agreement is entered into. Right?
8 A Yes.
9 Q And if we were focused on
10 expectations as of 2003, then the fact that
11 business has changed, circumstances have
12 changed, since 2003 doesn't effect the
13 validity of looking at the expectations
14 surrounding the benchmark agreement. Correct?
15 A Correct if you could really go
16 back and find out something about
17 expectations. Yes.
18 Q And you didn't go back and try to
19 find anything out. Right?
20 A I did not go back and find
21 anything out.
22 Q At the bottom of page 7, you

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1 mention statutory factors. Do you see that?
2 A Yes.
3 Q Now you don't know whether
4 consideration of those factors would have
5 raised or lower the actual negotiated price as
6 between the SDAR services and RIAA, do you?
7 A I don't know and I think as I
8 point out there what's most important is I
9 don't know what the parties would have
10 expected the use of those statutory factors to
11 do and how they would influence the decision
12 of the copyright royalty panel at that time.
13 Q It's true, is it not, that in the
14 kind of negotiation leading to a lump sum
15 agreement that occurred with the SDAR services
16 and RIAA the flat fee that emerges may be
17 presumed to factor in each side's evaluation
18 of the marketplace information that they had?
19 A Well, I think that along with
20 other things. It's not just the marketplace,
21 but their expectations of how the copyright
22 court would rule absent an agreement.

1 Q But there's no presumption you
2 would draw that the entering into an agreement
3 on a lump sum basis based on a consideration
4 of all the information that each party has
5 favors one side or the other to that lump sum
6 agreement. Correct?
7 A I'm -- Let me make sure I
8 understand. Are you saying this specifically
9 with respect to a lump sum agreement or with
10 respect to the agreement in general?
11 Q With respect to the 2003 SDARS
12 agreement with RIAA which resulted as you know
13 in a lump sum agreement over a period of
14 years, you don't have any basis to presume
15 that it's being entered into on a lump sum
16 basis favored one side or the other at that
17 time. Correct?
18 A Yes, but I would not use the term
19 "favored" really. It would be sort of was it
20 "sought by" or "preferred" by one party or
21 another I think is what I would say. I don't
22 know based on the agreement about that.

1 Q Let me try to -- I'm not sure
2 whether you said the word "favored" is what
3 the problem was. But it's true, is it not,
4 that you don't have any reason to believe that
5 the fact that a lump sum agreement was arrived
6 at in the 2003 negotiation with or as between
7 the SDAR services and RIAA resulted in a more
8 beneficial outcome to one side than the other?
9 A In and of itself, I don't know
10 everything else being equal who that would
11 have favored.
12 Q You make a point on page 7 in
13 evaluating the SDARS agreement with RIAA that
14 there was a desire to avoid costs of
15 litigating. Do you see that in the paragraph
16 starting "Finally" on page 7?
17 A Yes.
18 Q In a situation where the deal is
19 between the RIAA on behalf of the record
20 companies and all of the SDAR services so that
21 there's no one else left to bring a CARP or
22 CRB proceeding, in fact RIAA could avoid

1 totally the cost of litigating by entering
2 into a voluntary agreement with XM and Sirius
3 at that time. Right?
4 A Yes, that's my understanding of
5 the situation.
6 Q And that's a different situation
7 than it is in the Section 114 Compulsory
8 License where even if RIAA could reach an
9 agreement with the commercial webcasters it
10 might still have to incur essentially the same
11 costs of litigation against terrestrial
12 simulcasters, smaller webcasters and non-
13 profits. Right?
14 A Yes.
15 Q Now you say that the -- Let me get
16 that language here. In the last sentence, you
17 say "Indeed the SDARS agreement is an even
18 poorer benchmark because the negotiators might
19 have been uncertain how the different
20 statutory factors would be interpreted which
21 would have colored the negotiation of that
22 voluntary agreement." I have a couple

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1 questions about that. First of all, isn't it
2 common for participants in a marketplace
3 negotiation to negotiate in uncertain
4 circumstances?
5 A Certainly.
6 Q And the result of marketplace
7 negotiation in uncertain circumstances is
8 generally one where each side evaluates the
9 uncertainties and comes to an agreement based
10 on their evaluation of whether it's at the end
11 of the day worth doing. Isn't that right?
12 A Yes, I would put it as rather than
13 "comes to agreement" there is they accept the
14 terms of the agreement given their
15 expectations of what they think will happen
16 absent the agreement.
17 Q And you wouldn't throw out of your
18 consideration of marketplace agreements to
19 consider in a given market agreements that are
20 entered into between parties merely because
21 there was some uncertainty in the market.
22 Isn't that right?

1 A I would not. That in and of
2 itself would not disqualify an agreement if I
3 had a sufficient confidence in the ability to
4 understand how the parties reacted to the
5 uncertainty.
6 Q There are things like ranges of
7 inflation that are unknown, supply conditions
8 that are unknown, in everyday circumstances in
9 a market. Isn't that right?
10 A There is certainly uncertainty,
11 yes.
12 Q And the existence of those
13 uncertainties doesn't render the underlying
14 agreements from being appropriate reflections
15 of marketplace behavior. Correct?
16 A It doesn't render it as long as
17 you can get a handle on it and interpret the
18 situation correctly.
19 Q And ultimately the outcome of the
20 SDAR service negotiations with RIAA tells us
21 how Sound Exchange or RIAA and the SDAR
22 services arrived at a compromise after

1 factoring in whatever uncertainties they faced
2 in the marketplace. Right?
3 A It doesn't tell you how they
4 arrived it at. It tells you what they arrived
5 at and then the issue is can you use that as
6 a benchmark in light of both the differences
7 between this market and let's say the market
8 that we're dealing with in this case as well
9 as trying to understand what the parties were
10 thinking at the time.
11 Q Now you're aware, are you not, of
12 Sound Exchange's position in the current SDARS
13 case. Right?
14 A Yes.
15 Q You're actually testifying as an
16 expert in that case for Sound Exchange, are
17 you not, as well?
18 A I have filed testimony, correct.
19 Q And you're aware then, are you
20 not, that the Sound Exchange position is that
21 the statutory factors under Section 801(b)
22 which govern the determination in that case do

1 not require and should not be construed so as
2 to establish royalty rates lower than would
3 arrive in a fair market value analysis?
4 Correct?
5 A That's correct with respect to the
6 first three factors. There's a fourth factor
7 dealing with the impact on the SDARS industry
8 and that is a different consideration that for
9 certain circumstances could affect the rate
10 and support something different than what the
11 market might arrive at.
12 Q Isn't the Sound Exchange position
13 that consideration of that factor combined
14 with everything else is such that the CRB
15 should not establish a rate lower than a fair
16 market value rate?
17 A The position is that it should
18 establish a rate over the lifetime of the
19 agreement and in particular in this case
20 towards the end of the period of the
21 agreement, then would be arrived at by a
22 market. But certainly it could have been an

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1 important factor back in 2003 at the early
2 stages of the industry and even more
3 important, the question would be what Sound
4 Exchange might have thought the CARP would
5 have done based on those factors back then.
6 Q But as you testified earlier, you
7 didn't evaluate that in your analysis.
8 Correct?
9 A I did not try to reproduce what
10 the parties were expecting back in 2003.
11 Q And just to be clear, you don't
12 know how the parties evaluated the 801(b)
13 factors in arriving at the lump sum agreement
14 that was entered into in 2003. Correct?
15 A Yes, although to be precise, in my
16 mind it doesn't matter what they evaluated to
17 be on their own. It's what they project the
18 court would do when it evaluated those
19 factors.
20 Q Just one question on the subject
21 of the Yahoo deals with independent record
22 companies.

1 A Yes.
2 Q That you address in your
3 statement. Do you have any reason to believe
4 that the independent record companies that
5 entered into these arrangements with Yahoo
6 were thinking that they were not in their best
7 interest to do so?
8 A No.
9 Q Turn to page 9 of your written
10 statement. This is part of your evaluation of
11 the Yahoo agreements with the independent
12 record companies. In the last sentence of
13 that page, you say, "As the CARP recognized in
14 2002, agreements between large sophisticated
15 players and small entities with little market
16 share should carry little weight at
17 benchmark." Do you see that?
18 A Yes.
19 Q That statement is generally
20 applicable to the marketplace that you're
21 evaluating here?
22 A I think it's applicable to these

1 particular agreements.
2 Q Is there anything about that
3 statement that's not applicable to your
4 analysis of the sound recording and musical
5 work marketplace more generally?
6 A I'm not sure I understand your
7 question.
8 Q Well, does this statement apply no
9 differently to your benchmark interactive
10 service market?
11 A It does not apply to the ones I
12 relied on for purposes of developing my
13 benchmark rate and applying the benchmark
14 rate.
15 Q Why would this statement be
16 applicable to agreements between Yahoo and
17 independent record companies but not
18 applicable to agreements between the four
19 major record companies and small interactive
20 webcasters?
21 A It potentially could be a factor
22 if they were looking at agreements with small

1 interactive webcasters, but I was looking at
2 large interactive webcasters.
3 Q Let's follow that through. Do you
4 know what the market capitalization of
5 MusicNet is?
6 A No.
7 Q Do you know what the market share
8 of MusicNet is?
9 A No.
10 Q Do you know the capitalization of
11 Napster LLC?
12 A No, it was -- No, I do not know.
13 I am more than -- Well, there's no question
14 pending.
15 Q What about MusicNow before it was
16 acquired by AOL? Any idea what its
17 capitalization was?
18 A No.
19 Q Is it fair to say then that you
20 didn't evaluate the marketplace size of either
21 Napster, MusicNet or MusicNow?
22 A That's correct.

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1 Q And what about Musicmatch before
2 it was acquired by Yahoo? Any idea how it
3 fared in the market in terms of its market
4 size?
5 A No.
6 Q Now on page 10 you talk about
7 certain rights that are sometimes sold
8 together in a bundle. Let me ask you this
9 question. Do you agree with the proposition
10 that it is difficult to judge the willingness
11 to pay for one component part of a bundled
12 service offering based on the price of the
13 bundle as a whole?
14 A If that's the only information you
15 have, I would agree with that.
16 Q So that if all we have is
17 information that a consumer is willing to pay
18 X for a bundle of products and services for
19 the entire bundle, you'd agree that it tells
20 us virtually nothing about what the consumer
21 is willing to pay for any one individual
22 component of the bundle.

1 A I wouldn't say "virtually
2 nothing." It does give us how much the
3 customer is willing to pay for the bundle and
4 then depending on what the components are and
5 what more you know about the prices of those
6 components in the marketplace, you can infer
7 certain things.
8 Q Well, let's keep it clear as to
9 what we know and what we don't know. Is it
10 fair to say that you cannot infer from the
11 willingness to pay X for a bundle of products
12 and services that the buyer is expressing a
13 willingness to pay any particular amount for
14 specific component parts of the bundle?
15 A If that's all you know, yes.
16 Q Turn to page 12 if you would.
17 Talk about the hypothetical that I asked you
18 about the first time around and explain
19 certain aspects of it. Now first of all,
20 this, to remind the panel, you're referring to
21 the hypothetical where 10 percent of the
22 demand in the market is willing to pay $9 per

1 unit and 90 percent of the demand is willing
2 to pay no more than $1.10 per unit. Do you
3 remember that?
4 A Yes.
5 Q And I asked you whether the
6 supplier would be better off charging $9 or
7 $1.10 assuming a seller has to charge one
8 price and you agreed with the proposition that
9 selling at $1.10 to 90 percent of the market
10 makes more sense. Right?
11 A If that indeed are the correct
12 assumptions of the hypothetical that those
13 that pay $1.10 will not pay anything more.
14 Q And you didn't raise the issue of
15 cannibalization at the time when we had our
16 question and answer back a few months ago.
17 Correct?
18 A I believe I said that if those are
19 the assumptions you gave me that's the
20 calculation I get.
21 Q Now in reference to your testimony
22 about cannibalized customers here, can you

1 point me to any record evidence in this case
2 of subscription customers who have been
3 cannibalized by advertiser supported services?
4 A I've seen no evidence that
5 quantifies that effect. I believe the
6 similarity of those services, the offering by
7 many companies of both type services and the
8 combined growth in the market of both type
9 services is very strong indication that these
10 are not completely independent markets where
11 the price charged in one has no effect on the
12 demand in the other.
13 Q But just to be clear, you did
14 nothing to seek to try to quantify or find any
15 evidence of actual cannibalization of the
16 nature that you posit at this part of your
17 paper. Correct?
18 A I did not try to quantify it with
19 respect to the basis of my statement and
20 information I relied on. I did what I
21 described in my previous answer.
22 Q Did you consider efforts made by

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1 Yahoo to up-sell customers to its subscription
2 product? Are you familiar with the word "up-
3 sell"?
4 A Yes, I have read about that.
5 Q Do you remember Mr. Roback's
6 testimony that it was an extremely difficult
7 proposition to up-sell and support its service
8 users to the subscription service?
9 A I read that. I also saw figures
10 showing Yahoo's subscription services growing
11 in percentage terms?
12 Q Well, that does tell us anything
13 about cannibalization, does it, because we
14 don't know whether those people that are
15 buying it were actually up-sold from the ad
16 supported service? Right?
17 A We can't say anything in terms of
18 quantifying that but I think it's a reasonable
19 judgment based on what we've seen in the
20 market.
21 Q It's your reasonable judgment.
22 A It is my reasonable judgment.

1 Q Now you would describe a customer
2 who would pay for the subscription services in
3 the hypothetical if he or she didn't have the
4 choice of non-subscription services as one
5 that would be willing to pay for the
6 subscription service at the subscription
7 service price. Isn't that right?
8 A Yes.
9 Q And those are the customers that
10 you describe as having been cannibalized.
11 Right?
12 A Yes.
13 Q So let me see if I understand
14 this. You criticize my hypothetical for not
15 taking a count of cannibalized customers.
16 Right?
17 A Yes.
18 Q Now I proposed a hypothetical in
19 which 10 percent of the customers were willing
20 to pay $9 per unit and 90 percent were not
21 willing to pay more than $1.10. Right?
22 A Yes.

1 Q And you agree that if the price
2 were $1.10 everyone would pay the $1.10.
3 Right?
4 A Yes.
5 Q But you have ten percent of the
6 customers who would have paid the $9 if the
7 $1.10 service wasn't available. Right?
8 A Yes, although it's -- It depends
9 what we take as the hypothetical and I
10 understand the hypothetical to be that there
11 are 10 who are paying $9 for the service.
12 Q But in the hypothetical those are
13 the 10 that are willing to pay $9 even if the
14 only offering out there were $9 and there
15 wasn't a $1.10 offering. Right?
16 A Yes.
17 Q Why aren't those 10 your
18 cannibalized customers in the hypothetical?
19 A Well, they might well be
20 cannibalized customers in which case the way
21 the example would work out is you would have
22 to compare the revenues with it never -- Let

1 me restate that. If the hypothetical is that
2 these are exactly the willingness to pay and
3 that the customers that would be willing to
4 pay $9 in the absence of or in the presence of
5 the lower price service would only pay $1.10,
6 there was only one price, then this is the
7 result that you get. But if this is to bear
8 any relationship to what we see in the market,
9 then I interpret the number 90/10, the split
10 of the market, as not the split of customers
11 and their willingness to pay, but the split of
12 what you see in the market in terms of the
13 number of customers who buy the lower price
14 service and the number who buy the higher
15 price service.
16 Q But that 10 percent would be the
17 cannibalized universe in the hypothetical,
18 wouldn't it?
19 A It would be in a hypothetical
20 where you set up the hypothetical not based on
21 looking at a market where there were 90
22 customers buying the low price, 10 customers

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1 buying the high price. But if you set your
2 hypothetical by saying, this is no
3 relationship to what I see in the market, but
4 I'm telling you that there are only 10
5 customers who will pay $9 and there are 90
6 customers who will only pay $1.10.
7 Q But it's true, is it not, if both
8 are in the market, if you have this offering
9 for $9 in the market and 10 people are taking
10 it and an offering for $1.10 in the market and
11 90 people are taking it because there is some
12 differentiation in the actual offering that
13 that's the marketplace choosing how many
14 people are willing to pay the $9 for the
15 differentiation, isn't it?
16 A At current prices, that is, but it
17 does not achieve what you suggested which is
18 that does not represent your cannibalized
19 customers, meaning that does not represent the
20 customers that would pay for the higher price
21 service were the lower price service not
22 available. We don't see that in the market.

1 Q By the way, I didn't see in your
2 analysis any consideration of the testimony
3 from Mr. Roback that the future business
4 opportunity in this marketplace lies in the
5 $20 billion ad supported market and not a
6 subscription marketplace in which people
7 aren't used to paying for radio. Is that in
8 your analysis here?
9 A It's not in my analysis. It's in
10 my testimony.
11 Q I want to ask you some questions
12 on the issue of the buy button that you
13 testified about this morning. It's in your
14 testimony on page 20.
15 A Okay. Thank you.
16 Q Now of the several million unique
17 listeners. Since that's in shaded provisions
18 of your testimony, I won't read out the number
19 of unique listeners that you've referred and
20 these are unique listeners per month. Is that
21 right?
22 A Unique listeners in a particular

1 month, yes.
2 Q Now is the definition of "unique
3 listeners" you used any person that spends any
4 time listening to the service at all?
5 A I don't recall if it was any or
6 there has to be a certain amount of time that
7 the customer is actually online at any point
8 during the month.
9 Q As you sit here today, you don't
10 know whether it includes or doesn't include
11 people that listen for less than 15 minutes a
12 month for example?
13 A I believe it would certainly. If
14 I recall correctly, it would include those
15 that listen to it for 15 minutes a month. It
16 might not include those that listen to it for
17 a minute or 30 seconds or two minutes.
18 Q So you believe it does include
19 everyone that listened for at least 15 minutes
20 in a month. You just don't know if it
21 includes people that may have listened for
22 less than 15 minutes a month.

1 A Right.
2 Q Okay. Now do you know how many of
3 that universe of unique listeners listen for
4 say less than an hour a month?
5 A I don't know that.
6 Q You would agree, would you not,
7 with the proposition that if there were
8 promotional value in webcasting it would
9 manifest itself in respect of people that
10 spent more than just a couple of minutes a
11 month on the website?
12 A It would be much more manifest in
13 those that listen more, yes.
14 Q And you didn't try to do any
15 calculations stratifying the universe of
16 unique listeners. Right?
17 A I did not although the
18 subscription customers who account for a lot
19 of the buy buttons here are certainly
20 listening to this service I would expect quite
21 a bit or they would not subscribe.
22 Q Now you mentioned this morning

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1 that this analysis doesn't cover purchases
2 that are made by a consumer at a venue other
3 than from clicking on the buy button. Right?
4 A Yes.
5 Q Did you seek to look at any data
6 reflecting purchases made by users of Yahoo or
7 any of the other services not immediately to
8 buy button but by clicking on, for example,
9 Amazon or iTunes?
10 A Separate from their use of a buy
11 button, I have not seen any analysis of that
12 particular issue. There is a reference to
13 something by a Mr. Hansen, but not a set of
14 numbers or a study.
15 Q Isn't it true that the customers'
16 technology that they use may dictate how they
17 buy music?
18 A I'm not sure I understand what you
19 mean.
20 Q For example, if I have an iPod and
21 I'm an iTunes user, if I hear a song listening
22 to Launchcast, wouldn't you agree with me that

1 the likelihood is if I'm going to buy a
2 digital download I'm going to switch over to
3 iTunes where I have compatible ways of buying
4 and using of my iPod?
5 A That would be true for -- I think
6 I would agree with that for iPod users and
7 obviously for non iPod users they would find
8 it very easy to get downloads from the music
9 service and certainly for CD purchases it
10 wouldn't matter whether someone was an iPod
11 users or some other type of customer.
12 Q Are you familiar with how much of
13 the digital download market iTunes represents
14 in the United States?
15 A I have seen that. I know it's
16 very large. I don't recall the exact number.
17 Q Let's look at the numbers
18 themselves. Now assuming the generally
19 prevailing price for a digital download,
20 you're familiar with the fact that it's
21 generally 99 cents?
22 A Per track, yes.

1 Q Per track.
2 A Yes.
3 Q So if I'm looking at the paragraph
4 starting "The evidence however..." on page 20.
5 Do you see that?
6 A Yes.
7 Q So if we ascribe, let's round it
8 up from 99 cents to $1. Okay?
9 A I'm fine with that.
10 Q So if we call it $1 a download for
11 the figure that is shaded in the middle, the
12 numbers of downloads sold over a six month
13 period, then the average price of a digital
14 album is $10 an album. Is it not?
15 A Yes.
16 Q So if we add the two up, I don't
17 think we're breaching any great privilege here
18 to say that in the six month period there
19 would be if I add those two figures up based
20 on actual buy button sales somewhere in the
21 neighborhood of $2.5 million in revenue to the
22 sound recording owners over that six months.

1 Right?
2 A Hang on one second.
3 Q I'm multiplying the number of
4 digital albums by 10.
5 A Okay.
6 Q And I'm multiplying the number of
7 digital download unit sales by $1.
8 A By one essentially.
9 Q Don't we come up with
10 approximately $2.5 million?
11 A No. I'm multiplying the smaller
12 number here by 10 and that gives me a
13 relatively low number. I'm multiplying the
14 other one by one. So I'm adding together this
15 shaded number starting with four to the 10
16 times the shaded number starting in one and I
17 get a number below $1 million.
18 Q We're going to have to -- I'm
19 going to have to ask these questions using
20 real numbers because I'm lost.
21 A All right.
22 Q Or maybe I'm just doing my math

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1 wrong.
2 JUDGE WISNIEWSKI: There's a
3 precedent for that in this room.
4 MR. STEINTHAL: Excuse me?
5 JUDGE WISNIEWSKI: There's
6 precedent for that in this room.
7 MR. STEINTHAL: Yes, I'm sure.
8 BY MR. STEINTHAL:
9 Q The number of downloads is equal
10 to the number of dollars, right, because we're
11 applying $1 per?
12 A Yes.
13 Q And then the number of digital
14 albums -- Okay. Sorry.
15 A I see where we're differing. I'm
16 looking at the --
17 Q Two different places in here.
18 Okay.
19 A All right.
20 Q That's the problem with trying to
21 do it my way.
22 A Now I see where we're --

1 Q If you use your calculations based
2 on extrapolating from Sony BMG's market share.
3 A Okay.
4 Q You would agree with me, would you
5 not, that over the six month period for which
6 you had data you would come to approximately
7 $2.5 million in revenue to the sound recording
8 owners derived from buy button sales at Yahoo?
9 A It would be approximately that
10 number in total for purchase of the digital
11 downloads.
12 Q Yes, for that --
13 A Not necessarily, in fact, not all
14 of it going to the sound recording owners.
15 Q Excuse me?
16 A Not all of it going to the sound
17 recording owners.
18 Q Right, but that would be the price
19 paid for the digital downloads and the albums
20 would be approximately $2.5 million over that
21 six months. Right?
22 A Yes.

1 Q And of course that would turn into
2 $5 million over a year. Right?
3 A Yes.
4 Q Is it your testimony that $5
5 million in supplemental purchases is an
6 irrelevant number?
7 A No.
8 Q Let me ask you some questions
9 about the issue of definition of revenue.
10 THE WITNESS: I beg the Court's
11 indulgence for a two minute break.
12 CHIEF JUDGE SLEDGE: Sure.
13 THE WITNESS: Okay.
14 CHIEF JUDGE SLEDGE: We'll go
15 ahead and take our scheduled time at this time
16 and break 10 minutes.
17 THE WITNESS: Okay. Thanks.
18 CHIEF JUDGE SLEDGE: Off the
19 record.
20 (Whereupon, at 2:48 p.m., the
21 above-entitled matter recessed and reconvened
22 at 3:01 p.m.)

1 CHIEF JUDGE SLEDGE: On the
2 record.
3 CROSS EXAMINATION (Cont'd.)
4 BY MR. STEINTHAL:
5 Q Dr. Pelcovits, I just wanted to
6 ask you some questions about the backend of
7 your rebuttal statement in connection with
8 your revenue definition testimony and the
9 like. It starts on page 30, I believe. First
10 of all, is it correct that you have no prior
11 experience in creating definitions of revenue
12 in agreements such as legal licenses?
13 A That's correct. I have experience
14 working a lot with tariff definitions but not
15 specifically with the definitions of revenue
16 in the context of musical recordings.
17 Q Or other IP I gather? You have no
18 experience in defining revenue for purposes of
19 other sales of intellectual property. Isn't
20 that a fair statement?
21 A I have done some other work in IP
22 relating to right-to-use fees for telecom

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1 switches. I don't recall whether a
2 definitional issue was significant in that
3 case.
4 Q And you've had no experience
5 before this one in analyzing an allocation of
6 revenues for bundled services in webcasting
7 markets. Right?
8 A Yes, that's correct.
9 Q Now in your briefly testimony
10 today on the subject of the definition of
11 gross revenue you did say that there was some
12 advantages of specificity in defining revenue
13 for a license pertaining to webcasting.
14 Correct?
15 A Correct.
16 Q And one of those benefits is that
17 it leads to certainty. Correct?
18 A It increases certainty. Yes,
19 that's what I said.
20 Q And the avoidance of potential
21 disputes between licensors and licensees if
22 the definitions are rendered fairly specific

1 as to what's included and what's not. Right?
2 A Yes.
3 Q And in particular on page 31 of
4 your written testimony in the first full
5 paragraph you again speak of the benefit of
6 clarity in helping to provide specifics to
7 break down issues from broader categories.
8 Right?
9 A Yes.
10 Q Let me ask you some questions
11 about your criticism of Mr. Fancher on page
12 32. Now first, you criticize his exclusion of
13 revenues from software used to access a music
14 service if the software can also do other
15 things such as pay video. Let me press that
16 a little bit. Is it your testimony that when
17 Apple sells an iPod on the iTunes store or
18 website the sale of the iPod should come into
19 the revenue base upon which Apple would pay
20 for music if it was paying on a percentage
21 basis?
22 A No, that's not my testimony. I

1 think that's a different case. The iPod is
2 not bundled with the iTunes in the sense that
3 it's required to be purchased from the site as
4 a condition of listening to or purchasing
5 iTunes' services.
6 Q Well, then I'm a little confused
7 here. Is your testimony that the software
8 should not come into the revenue base as long
9 as it's not required to play the music?
10 A As long as it's not needed in
11 order to subscribe and listen to the music on
12 the service.
13 Q So if it's just optional, it
14 shouldn't come into the revenue base.
15 A That -- Yes, that's what I would
16 agree with.
17 Q Now then you -- I'll come back to
18 this in a minute. Let's take a look at the
19 actual Sound Exchange definition of revenue to
20 which you refer in your direct testimony.
21 This is actually an attachment to the rebuttal
22 or it's part of the rebuttal statement of

1 Sound Exchange which is --
2 COURT REPORTER: Twenty-seven.
3 MR. STEINTHAL: We'll mark it as
4 Services Exhibit R-27.
5 CHIEF JUDGE SLEDGE: Is that a
6 different take on what's already an exhibit?
7 MR. STEINTHAL: I thought that we
8 had marked this. I'm not going to put it into
9 evidence, but --
10 JUDGE WISNIEWSKI: What is it?
11 MR. STEINTHAL: It's the rebuttal
12 statement of Sound Exchange Inc.
13 JUDGE WISNIEWSKI: That'S R-1.
14 MR. STEINTHAL: That's what I
15 thought, R-1. Good memory, Judge.
16 BY MR. STEINTHAL:
17 Q I believe if you turn to page 12
18 we gave the section on gross revenues and then
19 the definition of gross revenue proposed by
20 Sound Exchange begins in Section E on page 13.
21 First of all, Dr. Pelcovits, did you draft
22 this definition of gross revenues?

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1 A No.
2 Q Did you participate in the
3 drafting of it at all?
4 A I had some discussions with Mr.
5 Perrelli about this topic during the time that
6 it was drafted.
7 Q Do you remember which specific
8 parts you provided input about?
9 A I do. I definitely recall
10 discussing with him the issue of bundled
11 services. I know we have some other general
12 discussions, but in terms of the most specific
13 discussions it dealt with bundled services.
14 Q Let's take a look at the very
15 first sentence of the definition of gross
16 revenues. It says, "Gross revenues shall mean
17 all gross monies and other consideration paid
18 or payable to or on behalf of any person or
19 entity that are directly or indirectly
20 attributable to a service including without
21 limitation nonreturnable advances and
22 guarantees..." and then it goes on. Did you

1 have any input in the drafting of the
2 "directly or indirectly attributable"
3 language?
4 A No.
5 Q Excuse me?
6 A No.
7 Q You would agree with me that that
8 doesn't fall into the bucket of a specific
9 definition of revenues with concrete
10 categories that provides guidance, does it?
11 A Not without further definition
12 later on in the document.
13 Q What does "indirectly
14 attributable" mean?
15 A Well, I would say that includes
16 examples of cases here where a customer clicks
17 via a general music page onto a non-
18 interactive webcast service and to the extent
19 that is attracting the customer to that
20 general music page and there is revenue that
21 is received from that I would consider that to
22 be indirect but yet something that's picked up

1 here.
2 Q What about if I'm going to the
3 Yahoo home page and there is along with the
4 dozens of different things I can do there's an
5 icon that says I can go to music and you click
6 on it and it takes you right to the Yahoo
7 music home page. Is that indirectly relevant
8 and indirectly attributable to the home page
9 revenue?
10 A I think that could be considered
11 indirectly attributable but it is not picked
12 up in any of the definitions later on in the
13 document.
14 Q Now when you look at the second
15 part of this where it says "Gross revenues
16 shall include but not be limited to..." The
17 phrase "include but not be limited to" is
18 hardly specific or delimiting, is it?
19 A This would be -- Let me make sure
20 I have the right point.
21 Q It's on page 13 just before the
22 listing of certain categories that presumably

1 are "included but not limited to those that
2 Sound Exchange would put into the bucket of
3 gross revenues."
4 A Thank you.
5 Q My question is whether that kind
6 of language is -- Let me put it this way.
7 Isn't it true that that language is not
8 specific or delimiting?
9 A That is possible, yes.
10 MR. STEINTHAL: Let's actually go
11 -- I mean in your written testimony you say
12 "It's good to look at what the labels
13 themselves have done." So I want you to take
14 a look at one of the Sony agreements with
15 Yahoo. So let's mark as Services Rebuttal
16 Exhibit R-27 a document marked "Confidential
17 Short Form Agreement." It bears the Bates
18 stamped numbers SX18392 and onward.
19 (Whereupon, the document
20 referred to was marked
21 as Services Rebuttal
22 Exhibit No. 27 for

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1 identification.)
2 BY MR. STEINTHAL:
3 Q Is this one of the forms of
4 agreements between one of the majors and one
5 of the webcasters that you had reference to in
6 giving your testimony on gross revenue
7 definition?
8 A No.
9 Q Do you know specifically which
10 ones you did and which ones you didn't have
11 access to?
12 A I had access and reviewed the
13 agreements for interactive or what we called
14 "on-demand webcasting."
15 Q So you didn't bother to look at
16 agreements like the video agreement.
17 A I did not look at these.
18 Q Did you look at any agreements
19 with Yahoo itself and another record company?
20 A I don't believe so.
21 Q Let's take a look at page 6 of the
22 document, SX18397.

1 A Okay.
2 Q And if you read the definition of
3 gross revenues which is in paragraph 4(a) the
4 second full sentence, it says "Gross revenues
5 means all monies received by Yahoo in
6 connection with the performance of music
7 videos" and then a parenthetical "from" and
8 then it lists specific things, "sponsorship
9 specifically of the video player, in-stream
10 advertisements on the video player," I'm
11 skipping the parentheticals, "banner ads on
12 the video player, synchronized with such in-
13 stream advertisements on the video player and
14 commerce revenue excluding sales of download
15 and packaged media if reasonably tractable on
16 the video player." So would you agree with me
17 that that's an example of a definition of
18 gross revenues that is specific and delimits
19 the categories that are within it?
20 A Yes.
21 Q And then if you skip down in the
22 next sentence starting "Video." I'm sorry,

1 after the next sentence. There's a sentence
2 that starts "In the event that Sony BMG videos
3 are exhibited in the absence of the video
4 player" and skipping the parenthetical, "and
5 Yahoo receives monies of the types described
6 in 2 and 3 above which are directly
7 attributable to the music video plays, then
8 the label revenue share..." That's an example
9 where the use of the phrase "directly
10 attributable" is used in a record label
11 agreement with Yahoo, is it not?
12 A Yes.
13 Q So this is an example where
14 they've chosen in a voluntary agreement to use
15 the phrase "directly attributable" instead of
16 the phrase "directly or indirectly
17 attributable" which is in the Sound Exchange
18 proposed language. Is that right:?
19 A Yes.
20 Q Now let's talk about the bundles
21 service aspects of the definition of revenue
22 and I think if you turn to page 14 of the

1 Sound Exchange rebuttal case in subparagraph
2 2 at the top this is the part where it refers
3 to a licensee bundling access to or use of the
4 service and I think you testified about that
5 in response to the questions from Mr. Handzo
6 this morning. Do you remember that?
7 A Yes.
8 Q Now I believe your testimony was
9 if there's a standalone or alla carte price
10 for an aspect of the bundle you would support
11 utilizing that standalone market price when
12 you unbundle what's being paid for the actual
13 package of goods and services that a consumer
14 is buying?
15 A I think what I said is if there
16 was a comparable music service available in an
17 alla carte basis, then that should be used as
18 the review for the monthly fee for customers
19 that subscribe to a bundled service that
20 includes a compliant webcast service.
21 Q Let's take a real world
22 hypothetical instead of a hypothetical

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1 hypothetical. Let's take the SBC-Yahoo
2 service. You are familiar with the fact that,
3 I'm going to call it SBC-Yahoo even though SBC
4 is now part of AT&T, but people tend to call
5 it the SBC-Yahoo bundle. Are you familiar
6 with that bundle?
7 A Yes.
8 Q It consists principally of high
9 speed internet access, does it not?
10 A It's high speed internet access
11 bundled with certain Yahoo services.
12 Q And the Yahoo services that are
13 bundled within it are a suite of services that
14 include enhanced email, virus protection,
15 security features, along with Launchcast Plus
16 music service. Correct?
17 A Yes.
18 Q Do you know exactly how many
19 different features there are in the Yahoo
20 media package that forms part of the SBC-Yahoo
21 bundle?
22 A I do not know the exact number.

1 Q But it's at least between five and
2 ten different feature, isn't it?
3 A I think that's about right. I
4 would agree with that.
5 Q Now are you familiar with the data
6 that reflects how many -- Strike that. Are
7 you familiar with the data the reflects what
8 percentage of the actual SBC-Yahoo bundled
9 subscribers use the Launchcast Plus service?
10 A I don't recall seeing that.
11 Q Well, the testimony is that it's a
12 very small fraction in the range of 10 percent
13 of the bundled purchasers that actually at any
14 given time use the Launchcast Plus service.
15 Take that hypothetical if you will. Don't you
16 think that it is inappropriate where 90
17 percent of the universe of the purchasers of
18 a bundle are not even using a music service to
19 simply use the price paid by alla carte
20 subscription users to the music service as the
21 value when unbundling the bundle?
22 A I believe that it is that that

1 definition encompasses more customers than
2 such probably be attributed as Launchcast type
3 customers in this calculation. If there is an
4 alternative way of handling the bundle that
5 protects the music service, then I think
6 that's worth considering.
7 Q So you would, as a matter of
8 economics, be troubled, wouldn't you, by
9 taking a price paid by an alla carte purchaser
10 that is demonstrating a willingness to by a
11 given product and ascribing that price to the
12 same service when it's transposed into a
13 bundle where the majority of the people never
14 even use the service. Right?
15 A Yes.
16 Q There's a part of this revenue
17 definition of Sound Exchange beyond the
18 question that I just asked you that I would
19 love to have an explanation since you
20 apparently worked on the bundled service
21 aspect, the last sentence of subparagraph 2 on
22 page 14 says "Where a licensee bundles access

1 to or use of the service," this is the digital
2 musical service apparently, "Where a licensee
3 bundles access to or use of the service
4 either directly or through a third party with
5 other products or services and the service is
6 not offered on an alla carte basis and does
7 not otherwise qualify as a bundled service the
8 subscription revenue attributable to the
9 service shall be the monthly fee charged for
10 the entire bundled service." What's the
11 economic explanation for taking the entire
12 amount paid for the bundle and ascribing it to
13 the revenue base when the music service is
14 only a portion of the bundle?
15 A I understand that that provision
16 protects the music services again the, I'm
17 sorry, protects the sound recording company,
18 the record companies, from music services
19 designing what I would call phony bundles just
20 to get around the percentage of revenue
21 calculation that's in the rate proposal.
22 So in another words, maybe I can

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1 make that a little clearer. If a music
2 service were to develop that was very
3 attractive and would if sold on its own have
4 a relatively high price and lead to the
5 payment of copyright fees based of a
6 percentage of that revenue it would seem they
7 could get around the percentage of revenue fee
8 by bundling the offering of music with
9 something totally incidental and not of great
10 value. So they could say we offer you a music
11 service and the only way we're offering it is
12 music for $7 a month along with a, let's just
13 say, memory key worth $12. In that case, they
14 could develop that service purely in order to
15 evade the percentage of revenue calculation
16 and this is a way to try to protect against
17 what I would consider to be an end run around
18 the revenue calculation.
19 Q Do you know whether there are
20 other ways to get around gamesmanship than
21 actually creating a provision like this that
22 would also swallow certain good faith

1 situations where the music service is bundled
2 with other services?
3 A Well, I don't know of any. I
4 think it's certainly reasonable to consider
5 them if there was a way to get around that,
6 but I do think the percentage of revenue is an
7 important part of the rate structure and if
8 bundling makes it very, very hard to apply
9 that, then it's necessary to make some other
10 adjustment such as the proposal in my
11 testimony that if you can't use a percentage
12 of revenue calculation because it doesn't
13 follow or fit into one of these categories
14 that you put a surcharge on the per play rate.
15 Q We'll come to that in just a
16 minute and that's going to be the last thing
17 we're going to talk about. But before I go
18 there, you'd agree with me, would you not,
19 that if there were less intrusive ways of
20 dealing with the gamesmanship problem that
21 you've identified they would be preferred over
22 provisions that would make innocent parties

1 have to pay on the entire bundle price?
2 A I would agree with that.
3 Q Okay. On the subject of this
4 uplift in the usage fee for bundled services
5 where you can't ascribe a revenue figure
6 because of the difficulties in unbundling, did
7 you consider at all in giving your testimony
8 that the 2003 agreement between Sound Exchange
9 and RIAA on the one side and the DiMA
10 companies on the other address the issue of
11 bundled services by basically saying bundled
12 services would pay at the per stream or ATH
13 rate without having the option of paying on
14 the percentage of revenue rate as well?
15 A I was aware of that. I don't
16 think that that's an important consideration
17 because the rate structure is not a greater-
18 than rate structure.
19 Q And you didn't give an credence to
20 the fact that there was a voluntary agreement
21 by the sound recording owners to a structure
22 just two or three years ago which made the

1 option, the webcaster's option, as opposed to
2 a greater-of formula?
3 A I did not give credence to that in
4 the context of a rate proposal that was
5 specifically designed and developed using a
6 greater-than formula which is modeled on the
7 interact market. So, no, I think that the
8 interactive market benchmark formulas are --
9 And to remain consistent with that, that was
10 far preferable than looking at the 2003
11 agreement.
12 Q Well, let's go back to the 2003
13 structure though for a minute. Are you
14 familiar with the fact that the bundled
15 service rate was exactly the same on per
16 stream or per hour basis as a normal service
17 that wasn't bundled?
18 A Yes.
19 Q Did you give any consideration to
20 the fact that when the issue arose in 2003
21 about treating bundled services under a per
22 stream or ATH meaning aggregate tuning hour

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1 basis the labels voluntarily agreed that there
2 wouldn't be a higher rate for a music service
3 delivered as part of a bundle as opposed to
4 one not delivered as part of a bundle?
5 A Again, my answer would be the same
6 which is it's a different context, a different
7 rate structure. So I don't believe it
8 applies.
9 Q Did you consider the discussion in
10 the first CARP decision about the precise
11 issue of whether there should be a higher rate
12 for services distributed through a third party
13 than when the same service was distributed
14 directly by a webcaster?
15 A I did not. I do not see how that
16 compares. It's not necessarily a bundle.
17 Q Are you familiar with the fact
18 that there was an issue in the first CARP
19 where there were what we call "white label
20 services" where an entity that was a webcaster
21 would deliver the same radio channels that are
22 available directly on a website like AOL or

1 Yahoo but that would be delivered to a third
2 party at their website on a co-branded or
3 branded basis by the third party?
4 A Yes.
5 Q Are you familiar with the fact
6 that the sound recording owners argued that
7 stations delivered in that fashion bundled
8 through a third party access vehicle should
9 command a higher per stream rate than
10 traditional webcasting stations?
11 A I don't recall that I would not
12 consider that to be a bundle. I would
13 consider that to be a branding of something
14 that was otherwise unbranded. That's not a
15 bundle.
16 Q Do you distinguish that from the
17 bundled service situation?
18 A I do.
19 Q In what respect is one more
20 valuable than the other if you can't get at
21 that third party website's revenues where
22 you're delivering that white label service?

1 Wouldn't the issue be essentially the same?
2 A No, I think that the white label
3 service there is a pretty good approximation
4 of our alla carte or standalone price. The
5 problem of the bundled service is precisely
6 where there is nothing in the market that you
7 can rely on to get a measure of revenue.
8 There's a service. You've taken music.
9 You've bundled it with some other service and
10 there is no separate price for the music. I
11 don't think that's the same as a rebranding at
12 all.
13 MR. STEINTHAL: I have nothing
14 further. Thank you.
15 CHIEF JUDGE SLEDGE: Mr. Joseph.
16 MR. JOSEPH: Thank you, Your
17 Honor.
18 CROSS EXAMINATION (Cont'd.)
19 BY MR. JOSEPH:
20 Q Good afternoon, Dr. Pelcovits.
21 A Good afternoon, Mr. Joseph.
22 Q May I ask you to turn to page 7 of

1 your written rebuttal testimony please.
2 A Very well. I have it.
3 Q Do you see where seven lines up
4 from the bottom with respect to the SDARS
5 agreement you say that "the same factors that
6 DiMA says made the agreement to push forward
7 rates, a poor benchmark, would have affected
8 the participants to the SDARS 2003 agreement
9 in the same way or would have also affected
10 them?
11 A Yes.
12 Q Now earlier today, you said that
13 you were asked about that agreement and a
14 reason, in fact the only reason I believe,
15 that you said you believed that it was not a
16 good benchmark was that the 2003 agreement,
17 I'm sorry, the 2003 -- Well, they are both
18 2003 agreements. So now I'm getting sloppy.
19 But the 2003 DiMA-RIAA agreement was not a
20 good benchmark was that it was just a
21 temporary agreement to carry forward the rates
22 to the next, what was then, CARP proceeding.

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1 Do you remember that earlier today?
2 A I do.
3 Q Is it your understanding that the
4 2003 SDARS agreement was just a temporary
5 agreement to carry forward existing rates to
6 a next proceeding?
7 A No, it was not.
8 Q Is it your understanding that the
9 participants in the 2003 SDARS agreement had
10 just spent millions of dollars on a CARP for
11 a prior period in which a decision had been
12 rendered?
13 A I don't recall that.
14 Q You don't know one way or the
15 other?
16 A I don't know one way or the other.
17 Q Is it your understanding that any
18 SDARS fees were then subject to a pending
19 appeal before the D.C. Circuit or any other
20 court?
21 A Are you referring to the rates
22 that were agreed to in 2003?

1 Q I'm asking whether it's your
2 understanding that any SDARS rates were as of
3 the time that 2003 agreement was negotiated
4 subject to appending appeal before the DC
5 Circuit or any other court?
6 A I do not know.
7 Q Is it your understanding that the
8 SDARS 2003 agreement was negotiated for a
9 period of just two years?
10 A I do not recall that.
11 Q Let me ask you to turn please to
12 page 15 on your written rebuttal testimony.
13 At the top of that page, you make a
14 confidential statement about subscription
15 services and you cite a Sound Exchange
16 exhibit, SX022RR. Do you see that?
17 A Yes.
18 Q You have no basis other than
19 Exhibit 22RR for that statement, do you?
20 A That's correct.
21 Q You then refer to Dr.
22 Brynjolfsson's statement in the next paragraph

1 that ad supported webcasting will become more
2 lucrative than subscription webcasting. Do
3 you see that? It's about halfway down the
4 page.
5 A Yes, I'm not sure he uses the term
6 "more lucrative" but he says "have a higher
7 upside."
8 Q The next sentence, "will be more
9 lucrative."
10 A Oh, he does. Yes. I had
11 forgotten the wording.
12 Q You didn't attempt to analyze that
13 issue on your own, did you?
14 A I did not.
15 Q So when you wrote your written
16 rebuttal testimony you didn't have a view on
17 that issue as a matter of fact, did you?
18 A Not as a matter of independent
19 analysis.
20 Q A little further down on page 15
21 you make a confidential statement about how
22 the record companies are generally

1 compensated. Do you see that?
2 A Yes.
3 Q Now that was a reference back to
4 your benchmark market of interactive services.
5 Correct?
6 A Yes.
7 Q In fact, you weren't referring to
8 any other market there, were you?
9 A That's correct.
10 Q Let me ask you to turn please to
11 page 17. Now in the last paragraph second
12 sentence you said that "the anecdotal evidence
13 suggests that both interactive and non-
14 interactive webcasting is substitutional."
15 Just so the record is clear, the only
16 anecdotal evidence to which you are referring
17 and here I emphasize the only anecdotal
18 evidence to which you are referring is what
19 you cite on page 21. Correct?
20 A That's correct. The reference to
21 the testimony of the label witnesses.
22 Q Eisenberg and Kenswil.

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1 A Correct.
2 Q Now let me ask you to turn to the
3 next page, the next page after 17 not after
4 21, on page 18. In the second paragraph in
5 the first sentence, you refer to academic
6 literature reaching a conclusion that
7 terrestrial radio is not promotional and you
8 cite the Liebowitz paper in Footnote 21. Do
9 you see that?
10 A I do.
11 Q Now it's true, is it not, that the
12 only academic literature you meant when you
13 said that the academic literature has reached
14 a contrary conclusion was that article?
15 Correct?
16 A That's correct. That's the only
17 academic literature I could find that deals
18 with the topic.
19 Q Now in the next sentence, you say
20 that there are important differences between
21 terrestrial radio and webcasting that render
22 it less likely that terrestrial, I'm sorry,

1 that webcasting is promotional in terrestrial
2 radio. Do you see that?
3 A I do.
4 Q Okay. Among the differences that
5 you were referring to you include the fact
6 that terrestrial radio have disc jockeys that
7 promote or select particular music. Correct?
8 A That would be one factor, yes.
9 Q And in addition, it's your opinion
10 or your view that the listening experience of
11 webcasting is closer to CD listening than the
12 listening experience of terrestrial radio.
13 Correct?
14 A Yes, closer and more likely to be
15 a substitute.
16 Q Now on -- Let's see. You then
17 discuss buy buttons, I believe, on page 19 and
18 I'll be brief lest I cover ground that Mr.
19 Steinthal has covered. You would agree, would
20 you not, that the buy button is not the only
21 way that a webcast listener can buy a
22 recording. Correct?

1 A Correct.
2 Q They can go to another website.
3 Correct?
4 A That's correct.
5 Q They could go to a record store.
6 Correct?
7 A Correct.
8 Q On page 19, you discuss some data
9 related to Bonneville. Do you see that in the
10 next to the last paragraph, the last full
11 paragraph?
12 A I do.
13 Q Do you understand those data to be
14 based on buy button?
15 A That is my recollection of buy
16 buttons or a direct ability to buy a download,
17 yes.
18 Q Direct ability from where?
19 A From the station.
20 Q Do you know whether that ability
21 included the ability to purchase entire CDs?
22 A I don't believe so. I think this

1 was the data on individual tracks. So to the
2 best of my recollection, it would be tracks,
3 not CDs.
4 Q So if a consumer wanted a CD, they
5 had to go somewhere else. Correct?
6 A That's correct.
7 Q Now do you know when this buy
8 button or this facility or this ability that
9 you've testified to purchase tracts was first
10 made available by Bonneville?
11 A No, I do not.
12 Q Do you know how the time when it
13 was made available relates to the four weeks
14 in October of 2005?
15 A I do not recall.
16 Q Did you review Mr. Coryell's
17 testimony about these particular data?
18 A I did.
19 Q Do you recall him saying that this
20 was a new feature of those two websites?
21 A I do not recall that specifically
22 but it was available in October 2005.

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1 Q Did you review the transcript of
2 this oral testimony?
3 A I believe I did, but I don't
4 recall.
5 Q Let me ask you to turn to page 22
6 please. In the second full paragraph I
7 believe you say that the average consumer in
8 the U.S. who is older than 10 buys only about
9 three CDs a year. Is that your testimony?
10 A Yes.
11 Q And you derive that number by
12 looking at RIAA data for the total number of
13 CDs sold in 2005 and dividing it by the U.S.
14 population?
15 A Above the age of 10, yes.
16 Q Now in the last sentence you say
17 "if the average consumer buys only three CDs
18 a year an assumption that interactive services
19 substitute for two is highly conservative
20 since it represents a very high percentage of
21 total CD purchases." Are you in that sentence
22 attempting to relate the number 2 to the 3.2

1 CDs you derived from the RIAA population data?
2 A Yes.
3 Q In making that statement, did you
4 perform any analysis to confirm that the
5 average number of CDs purchased by the
6 population that subscribes to interactive
7 webcasting services would be the same as the
8 average of the population as a whole but for
9 their subscription to interactive services?
10 A Well, there is certainly
11 information on that in the NPD data and based
12 on that, there seems to be relatively
13 comparable not a significant different in CD
14 purchases across the population as a whole and
15 customers of webcast services. I don't recall
16 the exact relationship, but it was not a very
17 large difference.
18 Q Interesting that you mention the
19 NPD data. In fact, according to the NPD data
20 that you rely on, didn't subscribers to
21 digital music services costing more than $4.99
22 purchase an average of more than 12.5 CD

1 equivalents during 2005?
2 A I'd have to go back and check
3 that. As I said, it was higher. I also think
4 that in terms of judging the absolute number
5 of CDs probably what's a better measure is to
6 compare those to the responses of the average
7 customer. So it is larger. The exact
8 magnitude I can't say for sure.
9 Q As you sit here, you don't
10 remember how many people subscribers to
11 digital music services costing $4.99 or more
12 in the NPD study bought in 2005?
13 A How many CDs they bought?
14 Q How many CDs?
15 A I do not recall at all.
16 (Off the record comments.)
17 MR. JOSEPH: Let me see if I can
18 refresh your recollection here with a document
19 that was produced by Sound Exchange.
20 (Whereupon, the document
21 referred to was marked
22 as Services Rebuttal

1 Exhibit No. 28 for
2 identification.)
3 BY MR. JOSEPH:
4 Q Dr. Pelcovits, I've handed you a
5 document that was produced to us by Sound
6 Exchange with Bates numbers SXREB 003149 that
7 has been marked as Services Rebuttal Exhibit
8 28. Is this data that you -- Well, let me ask
9 you to tell me what this is actually.
10 A Okay. This does come from my
11 firm. It's dated that we prepared it and it
12 looks at as it says here customers who
13 subscribe to a digital music service and say
14 they pay $4.99 or more and this would be -- my
15 expectation is that these would be customers
16 of on-demand, interactive services and this
17 gives the purchases or the customers' reports
18 on the purchases of CDs and other forms of
19 recorded music in two different periods,
20 essentially 2005 and 2004.
21 Q And are the numbers in the column
22 marked "Weighted Average Annual Number of

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1 Albums Purchased by an Individual" the number
2 of either CDs or the equivalent of CDs based
3 on downloads that were purchased by the
4 individual?
5 A Yes. I would say that the
6 individual self identified as what is
7 purchased as work. That's correct.
8 Q And by the way, it's true, is it
9 not, that Group F which is this group that's
10 being reflected here was defined by NPD as
11 individuals who said they subscribed or
12 listened to a digital music service or that
13 they or someone in their household paid more
14 than or equal to $4.99 a month for that
15 service? Correct?
16 A That's correct.
17 Q And that's what you took to be an
18 interactive digital music service. Correct?
19 A That's correct.
20 Q And by the way, the NPD study
21 showed that the average individual in the
22 population purchased an average of almost six

1 CDs or CD equivalent in 2005, didn't it?
2 A The average across its whole
3 population, I believe that's correct, yes.
4 Q Yes.
5 A And I think it indicates people
6 tend to overestimate how many CDs they buy.
7 But that does not detract from the utility of
8 looking at something like that to look at
9 changes or relative purchases. So I think
10 it's fair to say that based on these numbers
11 subscribers to interactive music services, I
12 would say probably buy twice as many CDs as
13 the average person in the population. At
14 least that's what I draw looking at the paper
15 right now.
16 Q And you have your doubts about the
17 accuracy of the numbers reported by
18 individuals when they are self reporting CD
19 purchases.
20 A I have some doubts whether they
21 accurately estimate how many they bought, the
22 absolute number that they bought. Yes I do.

1 Q Okay. Now on pages 23 and 24 of
2 your testimony, you discuss -- Let me just
3 see. Actually it's on pages 22 and 23 that
4 you discuss some data you receive from a
5 Liebowitz study on CD purchases. Do you see
6 that?
7 A Yes, I do see that.
8 Q Now the data you relied on didn't
9 differentiate subscribers to interactive
10 webcasting services from other individuals,
11 did it?
12 A It did not and that's why I
13 carried out the exercise I did to try to see
14 how sensitive the CD purchases would be to
15 different variables.
16 Q Now in fact the Liebowitz data
17 didn't give you data on individuals at all.
18 It gave you data on city aggregates. Right?
19 A That's correct.
20 Q Did you analyze the data to
21 determine the amount of music purchased by
22 those who subscribe to interactive webcasting

1 services?
2 A I did not do that directly because
3 it did not have information on subscribers to
4 music services.
5 Q And Dr. Liebowitz had as his goal
6 in the paper that you took this data -- Or the
7 paper that he was working with these data of
8 assessing the substitutional effect of file
9 sharing on record sales, didn't he?
10 A Yes, that's correct.
11 Q And in assessing the
12 substitutional effect of file sharing, Dr.
13 Liebowitz used internet access as a proxy for
14 file sharing, didn't he?
15 A Yes.
16 Q So in fact the people with
17 broadband access that analyzed were precisely
18 the people that Dr. Liebowitz had theorized
19 would engage in the most substitutional file
20 sharing. Correct?
21 A Well, that's the test that he was
22 trying to perform to see to what extent

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1 greater internet access, greater penetration
2 of internet access, would be correlated with
3 declines in CD purchases.
4 Q And given Mr. Liebowitz's data,
5 did you do anything to remove the effect of
6 file sharing from your analysis?
7 A Well, he did not have, as I said,
8 file sharing directly in the study. So, no,
9 I could not do that.
10 Q Did you -- Now on page 25, Dr.
11 Pelcovits, you begin your discussion of the
12 data you received from NPD. Correct?
13 A Yes.
14 Q Now that survey that generated the
15 data wasn't designed by NPD to compare music
16 purchased by your benchmark market with music
17 purchased by your target market, was it?
18 A That's correct. It was not
19 designed. I was not involved in the design of
20 the study and there was a broader purpose than
21 the use I put it to.
22 Q Did you review the methodology

1 used by NPD to weight the data?
2 A No, I did not.
3 Q Do you know whether NPD weighted
4 the data to approximate the U.S. population of
5 large or -- Well, first of all, do you know
6 whether NPD weighted the data?
7 A Yes, they weighted the raw
8 responses to account for the fact that the
9 respondents might not be representative of the
10 population as a whole, so they, which is a
11 very traditional approach, so they weighted
12 those to try to build up and come up with an
13 estimate that would be more representative of
14 the population as a whole rather than the
15 actual respondents to the questionnaire.
16 Q Do you have anything in writing
17 that describes the methodology used by NPD to
18 weight the data?
19 A I do not have that and I can say
20 that in my request for additional information
21 from NPD they were not willing to provide what
22 they viewed as their proprietary methods.

1 Q In fact, you didn't review any of
2 NPD work papers or individual respondent
3 responses, did you?
4 A Yes, if we say work papers meaning
5 something that takes the raw responses and
6 derives the study results. I did not see
7 that. They were not willing to provide me
8 anything beyond the cross tab results that
9 I've talked about earlier.
10 Q And you didn't receive any data
11 from which you could analyze the amount of
12 time spent listening to different kinds of
13 music services, did you?
14 A That's correct. I don't believe
15 that was part of any of the questions in the
16 survey.
17 Q Now in the first full paragraph,
18 second sentence of page 26, you say that the
19 first group that you looked at consisted of
20 subscribers to digital music services who
21 claimed they are paying more than $4.99 a
22 month for the service. Correct?

1 A Yes.
2 Q And you assume they were the
3 interactive service subscribers.
4 A Yes.
5 Q But I think as we've discussed the
6 survey didn't ask whether anyone subscribed to
7 interactive webcasting, did it?
8 A They asked do you subscribe to a
9 digital music service and then they gave a
10 couple examples, but they did not define it as
11 interactive as opposed to non-interactive.
12 Q And I believe you testified on
13 direct that you excluded from the group of
14 subscribers those who said they paid less than
15 $4.99 because they might have subscribed to a
16 non-interactive service. Correct?
17 A Correct.
18 Q But you included the subscribers
19 to an interactive service those who subscribed
20 to some form of service but who didn't know
21 how much they paid for their digital music
22 service, didn't you?

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A I did.
Q So the group could have included individuals who weren't subscribing to interactive services. Correct?
A It could have. I discussed this with NPD in terms of looking at this as well as looking at just those that said they paid more than $4.99 and they recommended presenting it this way although I also looked at it the other way and that is even sort of a stronger result.
Q You didn't present it the other way. Correct?
A Not in the testimony. I did as you see in the work papers which I provided on discovery. I did provide the results for what's called your Subgroup F.
Q And in fact Subgroup F only had 77 individuals who said that they had subscribed within the last year. Correct?
A That's correct.
Q And 61 who said they had

subscribed more than a year ago. Correct?
A That's correct.
Q And -- Well we'll come back to that actually. Now the number of individuals you analyzed which included those who said they paid more than $4.99 and those who didn't know was a total of 192 individuals for the so-called interactive services. Is that correct?
A I don't recall the exact number. That seems about right.
Q And is it right that about 109 had been listening for a year or less and 83 had been listening for a year or more?
A That sounds about right.
MR. JOSEPH: Why don't we do 3145.
(Whereupon, the document referred to was marked as Services Rebuttal Exhibit No. 29 for identification.)
BY MR. JOSEPH:

Q I've just handed Services Rebuttal Exhibit 29, Dr. Pelcovits. This is your work paper comparable to Services Rebuttal Exhibit 28, but this includes the groups A and B which are the groups you actually did analyze. Correct?
A It's the -- That's correct. These are the groups that I presented in the testimony.
Q And those group had between them 109 who had subscribed for a year or less and 83 which subscribed for more than a year. Correct?
A That's correct.
Q And I take it that if you subtract the 100, I'm sorry, the 138 individuals in Group F from the 192 individuals in Groups A and B you would come up with a number who didn't know how much they paid for their subscription. Correct?
A Yes, that's correct.
Q Now it's also true in your

analysis of those who subscribed, who you construed as having subscribed to interactive services in Groups A and B, that you included people who also listened to free webcasting. Correct?
A I'm sorry. I missed the question.
Q It's true, is it not, that your population of people that you deemed the subscribers to interactive music services that you analyzed as parts of Groups A and B also included or included individuals who listened to free over-the-air webcasting? Correct?
A Yes, listened to in that case both the digital music paid for services as well as free webcasting, yes. That's why there are two groups here, A & B.
Q And in fact, Group B is the group of people who listened to the subscription service costing either $4.99 or more or some unknown number and also to free webcasting. Correct?
A I hadn't -- I actually did not

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1 recall whether it was A or B, but I'll take
2 your word that it's B.
3 Q You don't have to take my word for
4 it, sir.
5 A Okay.
6 Q Look at your document down where
7 it says in the notes, the fifth line of the
8 notes, where it says "Group A is defined..."
9 and the seventh line "Group B is defined..."
10 A Thank you.
11 Q Were those statements accurate
12 descriptions of the group?
13 A Yes. Absolutely.
14 Q So Group A was those who "listened
15 or subscripted to a digital music service and
16 someone paid more than $4.99 a month or they
17 didn't know how much they paid and they
18 subscribed or listened," I'm sorry, "and they
19 listened to a music stream from a free website
20 during the past 12 months." Correct?
21 A Yes.
22 Q That's Group A. And Group B

1 "didn't listen to music stream from the free
2 website." Correct?
3 A No, Group B is they did listen to
4 music from a free website.
5 Q I'm sorry.
6 A Group A they didn't listen to
7 music from a free website.
8 Q Thank you, sir. I had that
9 backwards. It was not intended as a trick
10 question. Did you anything to control for the
11 effect of listening to music on free
12 webcasting in the group that you used as
13 subscribers to an interactive service?
14 A I did not have -- No, I did not do
15 that although again looking at A and B
16 separately if I recollect there was no big
17 difference between the two.
18 Q In fact, the total number of
19 people in Group A, those who listened to
20 subscription services, a digital music service
21 but didn't listen to music stream from a free
22 -- Let me before I ask that question make sure

1 we have these groups right. Group A did
2 listen to what you called the digital music
3 service but did not listen to free webcasting.
4 Correct?
5 A Yes, that's what's in the printout
6 here. I assume that's correct. Yes. So A is
7 did not.
8 Q Did not.
9 A Did not.
10 Q And B is did.
11 A Did.
12 Q Okay. The total population of
13 Group A was 60 individuals. Correct?
14 A I don't recall the number.
15 (Whereupon, the document
16 referred to was marked
17 as Services Rebuttal
18 Exhibit No. 30 for
19 identification.)
20 BY MR. JOSEPH:
21 Q Dr. Pelcovits, I've handed you
22 Services Rebuttal Exhibit 30 which I will

1 represent to you was produced by Sound
2 Exchange and I'm just going to ask if looking
3 at this document refreshes your recollection
4 about the total population in Group A.
5 A Yes, it does.
6 Q And that total population is 60.
7 Correct?
8 A Yes, that's correct.
9 Q And if you look down on the left
10 column, it's true, is it not, that of those 60
11 only 24 individuals starting listening within
12 the last year? Is that correct?
13 A That's correct. That would be
14 totaling up 9, 8 and 7. Yes.
15 Q Now it's true, is it not, that NPD
16 told you that when they were analyzing data
17 from this survey they looked for groups with
18 at least 200 people in them and they said you
19 should approach below that level with caution?
20 Correct?
21 A Yes, that's what they said to me.
22 We had quite a few discussions about that

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1 issue.
2 Q And in fact, they told you that
3 before comparing groups with counts below 200
4 individuals you should use a T-test or some
5 other statistical method. Correct?
6 A They did say that along with in
7 general saying taking point estimates from a
8 smaller group was problematic. But we did
9 discuss this at length and in terms of getting
10 a general comparison where the groups are
11 smaller to see whether effects are different
12 from one group to another, they believe that
13 what I was doing was reasonable even though
14 the groups were less than 200.
15 (Whereupon, the document
16 referred to was marked
17 as Services Rebuttal
18 Exhibit No. 31 for
19 identification.)
20 BY MR. JOSEPH:
21 Q Let me show you a document
22 previously marked for identification for your

1 deposition as Rebuttal Deposition Exhibit 3.
2 Dr. Pelcovits, do you recognize this document?
3 A I do.
4 Q This was an email sent to you by
5 NPD. Correct?
6 A Yes, that's an email we provided
7 in discovery.
8 Q And in the last of three bullets
9 it tells you that they typically look for at
10 least a 200 raw base count and counts below
11 that level should be used directionally and
12 with some degree of caution. Correct?
13 A Yes.
14 Q And for comparing groups which is
15 what you've described, they say "utilizing a
16 T-test would provide a confidence range for
17 the observed differences between the various
18 groups." Correct?
19 A That's correct.
20 Q Now a T-test is a statistical
21 measure of the significance or confidence in
22 the statistic. Correct?

1 A In a statistical estimate, yes.
2 Q And neither you nor NPD performed
3 a T-test on the results that you report in
4 your testimony, did you?
5 A I did not because I did not have
6 the raw data. They would not even though I
7 asked that they perform such tests.
8 Q So you weren't able to derive any
9 confidence ranges in connection with the data
10 you report from the NPD study, were you?
11 A Not from a statistically
12 meaningful standpoint, that's correct. I
13 could not derive a T-test or a confidence
14 interval.
15 Q In fact you didn't perform any
16 statistical analysis of the data, did you?
17 A I did not perform any formal
18 statistical analysis. That does not in my
19 opinion preclude using the data from the
20 survey and making certain judgments based on
21 the data.
22 Q And you did not --

1 JUDGE ROBERTS: Dr. Pelcovits, why
2 wouldn't they perform that kind of analysis?
3 THE WITNESS: I believe they were
4 very reluctant to get into a situation where
5 what they believed were their survey
6 techniques and statistical techniques would
7 end up getting revealed publicly. They regard
8 this as sort of a very significant trade
9 secret of theirs and they felt that if they
10 were to do these tests and essentially get
11 their methodology dragged into the proceeding
12 as I think the way they put it, they thought
13 this could expose them to that risk.
14 JUDGE ROBERTS: Thank you.
15 CROSS EXAMINATION (Cont'd.)
16 BY MR. JOSEPH:
17 Q You didn't perform any
18 quantitative measure of the variability of the
19 data or the samples responses, did you?
20 A I did not perform any statistical
21 tests but I had the responses that we see in
22 the exhibit that you just showed me, Services

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1 Rebuttal Exhibit 30 and I was able to just
2 generally get a feel for and an understanding
3 of the data and I was able to see whether
4 there was any evidence that was contrary to
5 the conclusion that I was trying to draw.
6 Q You didn't perform any
7 quantitative measure of the variability of the
8 data, did you?
9 A That's correct. I did not have
10 the information necessary to do that.
11 Q Now let me ask you to turn please
12 to page 26 of your written rebuttal testimony.
13 Actually, you're already there and you say in
14 the last paragraph that "neither listening to
15 music stream from a free website nor
16 subscribing to an interactive music service
17 had an effect on the purchases of recorded
18 music." Do you see that?
19 A Yes, I followed that up. It does
20 have an effect, but I say the effect is not
21 significant enough to undermine my sensitivity
22 analysis.

1 Q And you spoke in the last sentence
2 of new subscribers to the digital music
3 service. Correct? I'm sorry. The next to
4 the last sentence.
5 A I'm sorry. The next -- New
6 subscribers, yes. That's referring to the
7 subscribers during 2005.
8 Q You define those as individuals
9 who had listened or subscribed for under a
10 year. Correct?
11 A Yes, I believe the question they
12 respond to is how long ago did you subscribe
13 to the music service.
14 Q Well, actually, the data didn't
15 differentiate between the subscriber and
16 somebody who listened, did it?
17 A I believe that what they provided
18 me with is those that listen and subscribe,
19 but the question is how long have you
20 subscribed.
21 Q Why don't you take a look back at
22 Exhibit 29 where Groups A and B are defined

1 with respect to the subscribers and it's true,
2 is it not, that Group A is defined as
3 individuals who said they subscribed or
4 listened and they or someone in their
5 household paid more than $4.99 a month.
6 Correct?
7 A That's correct, but I would have
8 to go back to the questionnaire to see exactly
9 how that was established.
10 Q As you sit here, you don't recall.
11 A I don't recall.
12 MR. JOSEPH: Why don't we show you
13 the questionnaire? Exhibit 6. I'm sorry.
14 That was Deposition Exhibit 6, Your Honor.
15 Lest there be confusion in the record, we'll
16 have a formal rebuttal exhibit number.
17 (Whereupon, the document
18 referred to was marked
19 as Services Rebuttal
20 Exhibit No. 32 for
21 identification.)
22 BY MR. JOSEPH:

1 Q Now I've just handed you, Dr.
2 Pelcovits, Services Rebuttal Exhibit 32. Do
3 you recognize that?
4 A I do. I believe that the
5 questionnaire used by NPD.
6 Q And it's true, is it not, that it
7 asked in Question 2 whether you subscribed or
8 listened to a digital music service? Correct?
9 A I'm sorry. Could you repeat that?
10 Q It asks in the second question
11 whether the respondent had subscribed or
12 listened to a digital music service. Correct?
13 A It asks it in that question but
14 then there are other questions where it just
15 asked about where you subscribe to the service
16 and I know there was some back and forth on
17 this issue with them because when they gave me
18 the results for the population as a whole, it
19 seemed to indicate a larger number of
20 respondents who were using a digital music
21 service than were in Groups A and B and I
22 asked them why that was true and they said

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1 because there were some customers who said
2 they listened to it but don't subscribe to it
3 and they excluded those. So that's the source
4 of some confusion here but certainly in terms
5 of differentiating what I would consider to be
6 the newer from the older customers that's
7 based on a response to the question at the
8 bottom of the first page here which is "When
9 was the first time that you..." and then if
10 you turn to the next page, the third question
11 would be "subscribed to a digital music
12 service" and the same thing "streamed music
13 from a free website." That's clearly not a
14 subscription issue. So that's why I'm trying
15 to make sure we're not getting the wrong
16 impression about these respondents.
17 Q Is it your understanding that the
18 data only included the actual subscribers or
19 are you unsure whether the data included also
20 people who listened but weren't the actual
21 subscribers?
22 A I'm pretty sure it includes just

1 the subscribers.
2 Q In any event you describe the new
3 subscribers as with respect to the interactive
4 services with respect to what you called the
5 digital music services as those who had
6 listened for under a year. Correct?
7 A For those who answered the
8 question "When was the first time you
9 subscribed to a digital music service" is
10 those who for the first time subscribed within
11 the previous 12 months, right.
12 Q And it included those who had
13 subscribed or indicated that they subscribed
14 within zero to three months prior to the
15 survey. Correct?
16 A That's correct.
17 Q And it included those who
18 indicated they subscribed three to six months
19 prior to the survey. Correct?
20 A That's correct.
21 Q And it included those who
22 indicated that they subscribed six to twelve

1 months prior to the survey. Correct?
2 A Actually it's seven to twelve
3 months, but, yes, that's correct.
4 Q Okay. In fact, isn't it true that
5 as of the 109 people that you counted as new
6 subscribers 74 had subscribed within the prior
7 six months, in other words, the last half of
8 2005?
9 A I would have to check that but it
10 sounds in the right range.
11 Q If it would assist, would it
12 refresh your recollection or assist you if you
13 look at the third page of Services Rebuttal
14 Exhibit 30 on Bates page 3109? Could you not
15 get it by looking, if you see on that page the
16 second time 212 shows up on the raw base?
17 A Yes, I do.
18 Q Is it your understanding that the
19 way these spreadsheet worked, and
20 unfortunately they were produced in a
21 difficult form to use, that that number would
22 represent, would be comparable, on the first

1 page of the exhibit to total subscribers to a
2 digital music service whereas the first page
3 deals with Group A, the second page deals with
4 Groups A and B?
5 A Yes, that's the way the
6 spreadsheet would run.
7 Q So that the first two numbers, the
8 32, would be those who had subscribed within
9 the past three months and the 42 would be
10 those who had subscribed within three to six
11 months. Correct?
12 A Correct.
13 Q So 74 had subscribed within the
14 prior six months. Correct?
15 A Yes.
16 Q So your count of CD purchases by
17 what you refer to as new subscribers included
18 at least six months and possibly for some as
19 many as almost 12 months when those 74
20 individuals were not subscribers. Correct?
21 A Yes, they include a period of time
22 when they are not subscribers. Yes.

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1 Q And at least for those 74 that
2 period of time was at least half the year and
3 likely more. Correct?
4 A That's correct.
5 Q And even the remaining group that
6 you considered new subscribers, the 35 who
7 said they subscribed between seven and twelve
8 months ago, could have subscribed at any time
9 during the first six months of the period.
10 Correct?
11 A That's correct.
12 Q Now your group of those who had
13 subscribed for one year or more included
14 individuals who had subscribed for two years
15 or more. Correct?
16 A That's correct.
17 Q And in fact in the group you
18 described as subscribers who interacted
19 digital music services, Groups A and B, you
20 identified 38 as having subscribed for a year
21 or more. Right?
22 A Which group are we talking about?

1 Q A and B.
2 A A and B.
3 Q Your group of interactive digital
4 music subscribers.
5 A And I'm trying to recall the
6 number here you're saying of the greater than
7 a year ago is for A and B, I believe, is 83.
8 Q That's correct.
9 A Okay. I thought you just said --
10 Q Was it 83, sir?
11 A Yes, I think you just said a
12 different number.
13 Q Well, at least of those 83, 38 had
14 subscribed for more than two years. Correct?
15 A I could check that in a minute.
16 Q You're welcome to.
17 A Okay. That's correct.
18 Q So that only 45 listeners had
19 subscribed during 2004. Correct?
20 A That's correct.
21 Q And you don't know when in 2004
22 they subscribed. Correct?

1 A That's also correct.
2 Q And at least with respect to the
3 38 who had been subscribers for more than two
4 years, during both 2004 and 2005, they were
5 subscribers to digital music services.
6 Correct?
7 A Yes, but that's -- If we go back
8 to my testimony, that's not what I was trying
9 to test. I was trying to see whether there
10 was a trend over time of subscribers to the
11 services of buying fewer CDs.
12 Q Sir, I just asked a simple
13 question. Had they been subscribers during
14 2004 and 2005 and the answer is yes. Right?
15 A The answer is yes for those
16 customers.
17 Q Now let's talk about the group
18 that listened to free webcasting. Do you
19 recall that there was a total of 423 who
20 started listening within the past year?
21 A I don't recall the exact number,
22 no.

1 Q Why don't we see if there are
2 other pages from the spreadsheet that will
3 refresh your recollection.
4 CHIEF JUDGE SLEDGE: While you're
5 marking those, we'll recess another five
6 minutes. Off the record.
7 (Whereupon, at 4:24 p.m., the
8 above-entitled matter recessed and reconvened
9 at 4:31 p.m.)
10 CHIEF JUDGE SLEDGE: On the
11 record.
12 MR. JOSEPH: Thank you, Your
13 Honor. I believe the last question had been
14 how many of the group listening to free
15 webcasting had started within the last year.
16 Well, let me --
17 CHIEF JUDGE SLEDGE: Yes.
18 MR. JOSEPH: We're missing an
19 essential participant.
20 PARTICIPANT: I apologize.
21 CHIEF JUDGE SLEDGE: We're beyond
22 our five minutes.

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1 PARTICIPANT: I'll go sit over
2 there.
3 (Off the record comments.)
4 CHIEF JUDGE SLEDGE: Let's
5 proceed, Mr. Joseph.
6 (Off the record comments.)
7 MR. JOSEPH: Let me hand out this
8 exhibit.
9 (Whereupon, the document
10 referred to was marked
11 as Services Rebuttal
12 Exhibit No. 33 for
13 identification.)
14 By MR. JOSEPH:
15 Q Dr. Pelcovits, do you recall that
16 Group C was the group defined as the group
17 that listened to free webcasting?
18 A That's correct. It's defined as
19 those who listened to free webcasting and did
20 not subscribe to a digital music service.
21 Q Now looking at page 3114, I'm
22 sorry. I've handed just for the record

1 Services Rebuttal Exhibit 33 which also
2 consists of pages from the spreadsheet
3 relating to Group C produced by Sound
4 Exchange. Is this a document that you
5 recognize?
6 A Yes, this would be comparable for
7 what we went through before for Group A and A
8 and B combined.
9 Q And with respect to Group C to
10 determine how long a respondent to the survey
11 had streamed music from a free website you
12 would look at the last cluster on numbers on
13 page 3114, correct, starting of the 1152 which
14 is the base of stream from a free website?
15 A Yes.
16 Q And so your population for the
17 last that subscribed during 2005 would be the
18 sum of 217, 102 and 104. Correct?
19 A Yes.
20 Q And it's true, is it not, that
21 those numbers mean that 319 of those listeners
22 started streaming music from a free website

1 within the six months before the survey was
2 taken?
3 A Correct. Sum of 217 and 102.
4 Correct.
5 Q And that would be 319 out of the
6 total that you defined as new listeners of
7 423. Correct? It would be 319 plus 104.
8 A Excuse me. Yes, that's correct.
9 Q And so there were only 104
10 listeners to music from a free website that
11 you were confident listened for at least six
12 months to music from free websites in 2005.
13 Correct?
14 A That's correct. Only 104 that had
15 listened to it for six months or longer, yes.
16 Q And for the other 319, for more
17 than half of the time in 2005, they were not
18 listening to music from a free website.
19 Correct?
20 A Correct.
21 Q And even with respect to those 104
22 listeners, you don't know for how long in 2005

1 or for what part of 2005 they were listening
2 to music from a free website. Correct?
3 A Other than that it was more than
4 six months.
5 Q Or that they started more than six
6 months before the taking of the survey.
7 Correct?
8 A I don't know if we're disagreeing
9 here or what. They had, these subscribers
10 had, been subscribers for at least six months.
11 I guess -- Are we saying the same thing?
12 Q Well, these aren't identified as -
13 -
14 A Yes. You're absolutely right.
15 I'm sorry for the confusion. That's correct.
16 They had been screening for somewhere between
17 seven and twelve months.
18 Q All we know was that at least
19 according to the questionnaire if you refer
20 back to Rebuttal Exhibit 32 that the first
21 time they started listening to music from a
22 free website was between seven and twelve

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1 months before the survey was taken. Correct?
2 A Yes.
3 Q Now with reference to Exhibit 33,
4 would you agree that there were 604 people who
5 started listening to music from free websites
6 at least a year before the survey was taken?
7 A Maybe I'm not getting the question
8 right. These are those that would have
9 subscribed or listened --
10 Q Started listening more than a year
11 before the survey was taken.
12 A More than a year. So that would
13 be anyone other than the first three groups
14 here.
15 Q Not counting the last group which
16 was don't know. Correct?
17 A Right. So it would be sum of 182,
18 171, 158 and 93 and --
19 Q Okay. You can add them if you'd
20 like.
21 A No, that's fine.
22 Q The record will reflect it.

1 A What was the number you gave me?
2 I can accept that.
3 Q I said 604.
4 A That looks right.
5 Q And of those 604, all but 182 had
6 been listening, who had started listening to
7 free websites more than two years before the
8 survey was taken. Correct?
9 A That's correct.
10 Q And with respect to the 182 that
11 started between one and two years ago, you
12 don't know when during that one year period
13 they actually started. Correct?
14 A That's correct.
15 Q Now let me ask you to turn back to
16 Services Rebuttal Exhibit 32 which is the
17 questionnaire. Have it?
18 A I have it. Thanks.
19 MR. JOSEPH: Your Honor, at this
20 time I would like to offer Services Rebuttal
21 Exhibit 32.
22 MR. HANDZO: I'm sorry. Thirty?

1 MR. JOSEPH: Thirty-two, the
2 questionnaire.
3 MR. HANDZO: No objection.
4 CHIEF JUDGE SLEDGE: Without
5 objection, Exhibit 32 is admitted.
6 (The document referred
7 to having been
8 previously marked for
9 identification as
10 Services Rebuttal
11 Exhibit No. 32, was
12 received in evidence.)
13 By MR. JOSEPH:
14 Q Now I believe earlier on direct
15 when you were talking about how you knew
16 streamed music from a free website meant a
17 non-interactive service that is of the kind at
18 issue in this proceeding, I believe you said
19 that a powerful reason was the list of
20 examples given after the words "streamed music
21 from a free website." Do you remember
22 testifying to that effect?

1 A I do.
2 Q Why was that a powerful reason?
3 A It was at least in my view a way
4 of trying to understand what the customer was
5 responding to, I'm sorry, what the respondent
6 was saying yes to and the fact that some of
7 these examples are given and these are to the
8 extent they are free would be compliant
9 services that this is good evidence of that.
10 Q You would expect the respondents
11 to the survey to understand the meaning of the
12 survey in light of the examples given,
13 wouldn't you?
14 A It would help give meaning to the
15 questions, yes.
16 Q In fact, you thought it would give
17 powerful help in interpreting the questions.
18 Correct.
19 A I believe it does.
20 Q Now it's true, is it not, that
21 nothing on this survey expressly asks about
22 listening to simulcasts of terrestrial radio

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1 transmissions? Isn't it?
2 A That's correct.
3 Q And in fact, the examples that
4 provide a powerful indication of the meaning
5 of streamed music from a free website don't
6 include radio station simulcast, do they?
7 A That's correct. They do not
8 include simulcast radio stations.
9 Q So a person taking this survey
10 would have to decide for themselves whether
11 streamed music from a free website included
12 listening to a radio station simulcast.
13 Correct?
14 A Correct.
15 Q Did you do any analysis of how
16 persons taking the survey treated radio
17 station simulcasts?
18 A I had no information on that and
19 conducted no analysis on that.
20 Q In addition another item on the
21 list was listen to terrestrial radio. Do you
22 see that?

1 A Yes.
2 Q And in preparing your testimony,
3 you didn't perform any analysis of the
4 response "listen to terrestrial radio," did
5 you?
6 A I did not.
7 Q Now to get the numbers of
8 purchases that you reported or that you used
9 from this survey, the respondent had to give
10 an answer in December 2005, first of all, how
11 much they bought in 2005. Correct?
12 A That's correct.
13 Q And then they had to give an
14 answer for how many they bought in the 12
15 months before 2005. Correct?
16 A That's correct.
17 Q And all of those answers were
18 given in December of 2005. Correct?
19 A That's correct.
20 Q By the way, do you happen to know
21 whether the questions relating to purchases in
22 the last 12 months and purchases in the 12

1 months before the last 12 months were rotated
2 or where they always presented in the order
3 shown here?
4 A I believe this is the order they
5 were asked in and my basis for that is where
6 they alter the order they seem to indicate
7 that. For example on the second page there's
8 an indication of a randomized which would
9 imply that they randomized what order they
10 asked those questions.
11 Q So the person to your
12 understanding was always asked what they
13 purchased in the last 12 months, in other
14 words, 2005 before they were asked what they
15 purchased in 2004. Correct?
16 A That's correct.
17 Q Now do you have an understanding
18 of what determined outlier means?
19 A A general understanding of what it
20 means, yes.
21 Q And what's your general
22 understanding of what it means?

1 A Well, my familiarity would be
2 mostly that in econometrics if you are an
3 analysis of data and you have a pool of data
4 and you're trying to understand what explained
5 the data if there is some data that seems very
6 far off the mark and can't be explained in
7 other ways, there might be reason to believe
8 it essentially should be removed or not really
9 explainable through the regression.
10 Q Do you have an understanding of
11 the term in the context of surveys?
12 A I've not seen the term used in
13 surveys, no.
14 Q You've not seen it with reference
15 to a respondent that gives an answer that
16 significantly deviates from the main?
17 A I've not seen that and I don't
18 know specifically how NPD would handle what
19 might appear to be an outlier. It's obviously
20 something that they I would expect would pay
21 attention to in the course of conducting their
22 analysis.

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1 Q And especially where the sample is
2 small, is it not true that an outlier will
3 increase the variability of the survey and
4 decrease the confidence that you have in the
5 survey?
6 A Everything else being equal, yes.
7 JUDGE WISNIEWSKI: What type of
8 distribution, Mr. Joseph?
9 MR. JOSEPH: My question wasn't
10 dependent on a type of distribution, Your
11 Honor.
12 JUDGE WISNIEWSKI: It wasn't.
13 Okay.
14 By MR. JOSEPH:
15 Q Now, Dr. Pelcovits, did you do
16 anything to adjust the data that you were
17 given from NPD for outliers or apparent
18 outliers?
19 A I did not.
20 Q Let's look at your data for Group
21 A for a second which is Services Rebuttal
22 Exhibit 30. Do you see there on about halfway

1 down the first page under "Bought music three
2 to five years ago," a single individual who
3 reported 25 CD purchases in 2005?
4 A Yes.
5 Q And do you see another on the next
6 page who reported purchasing 25.9 CDs in 2005?
7 A Yes, I see that.
8 Q How do you get 25.9 in what should
9 be average number of full length CDs for a
10 single purchasers?
11 A I would assume that's a reflection
12 of some of the weighting that they do. So
13 there might have been a respondent and because
14 that respondent was less than fully
15 representative of something in the population
16 that that's the adjustment that takes place.
17 But I don't know how they calculated these.
18 Q Sure. You don't know where that
19 number came from.
20 A I don't know exactly how they came
21 up with it, no.
22 Q So it's possible that it was

1 somebody who bought fewer than 29 or 25 CDs.
2 A Again, I don't have the raw data.
3 I have what they report based on their
4 techniques that they use in the normal course
5 of their business and this is the data they
6 gave me and this is what I relied on.
7 Q And do you see another individual
8 who said that he or she purchased 25.9 CDs in
9 2005?
10 A Yes, I do.
11 Q By the way, did you notice that
12 the person who said he or she bought 25 CDs in
13 2005 also said he or she bought exactly 25 CDs
14 in 2004? You won't find it on these sheets.
15 A But that would not surprise me.
16 No.
17 Q Do you remember noticing that?
18 A I don't recall that, no.
19 Q Do you remember noticing the
20 person who he or she bought 25.9 CDs in 2005
21 also said he or she bought exactly 25.9 CDs in
22 2004?

1 A I don't recall that.
2 Q Would you have looked for
3 something like that?
4 A Not necessarily, no. I was given
5 this data by NPD. There was a limited amount
6 of analysis I could do with it. That's what
7 I did. That's what I provided. I looked at
8 the data in different possible groupings to
9 see whether there was any tendency in the data
10 here that I was overlooking and did not find
11 that to be the case. In other words, the
12 results I report are the basic story told by
13 the data. They are not something that I
14 created and generate through some significant
15 adjustments or exclusion of data.
16 MR. JOSEPH: Let's do this one as
17 -- What are we up to now? Thirty-two?
18 PARTICIPANT: Thirty-four.
19 (Whereupon, the document
20 referred to was marked
21 as Services Rebuttal
22 Exhibit No. 34 for

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1 identification.)
2 BY MR. JOSEPH:
3 Q Dr. Pelcovits, just quickly to see
4 if this refreshes your recollection, I've
5 handed you Services Rebuttal Exhibit 34 which
6 are pages SX REV 3099 and 3100 which purport
7 to be Group A material, Group A responses,
8 coming from the NPD spreadsheet. Is that
9 accurate?
10 A Yes.
11 Q Do you see that the person -- And
12 Exhibit 34 where you see it says "Twelve
13 months prior," questions 3B and 3D, that would
14 be for answers for 2004. Correct?
15 A Correct.
16 Q And Exhibit 30 which we started
17 with reflects questions 3A and 3C, that would
18 be 2005. Correct?
19 A That's correct.
20 Q And you see where you have an
21 individual who claimed to have, in the group
22 of 60, bought music downloads three to five

1 years ago. There was one such individual and
2 that same individual purchased 25 full length
3 CDs in 2005 and 25 full length CDs in 2006.
4 Correct?
5 A Yes.
6 Q And do you see on the next page
7 the person who bought or owned a portable
8 digital music player for five years or longer
9 and in both 2004 and 2005 purchased 25.9 CDs?
10 Correct?
11 A Yes, I see that.
12 Q Did you do anything to test the
13 accuracy of individual recall of how much
14 music a person purchased between 13 and 24
15 months ago?
16 A I did not do such a test.
17 Q Did you do anything to test for
18 the possibility that the answer for 13 to 24
19 months ago would be influenced by the
20 immediately preceding answer?
21 A I would think that they would
22 indeed be affected by what they said about the

1 previous 12 months and to the extent it's very
2 helpful because it would seem that the
3 customer would answer by relating one year to
4 the other and to the extent that that customer
5 for example had substituted away from CD
6 purchases you would expect that same customer
7 would recognize that he was buying
8 significantly fewer CDs now than before.
9 MR. JOSEPH: Move to strike, Your
10 Honor. The question was did you do anything
11 to test for the possibility that the answer
12 would be influenced. I think that admits a
13 very simple yes or no.
14 CHIEF JUDGE SLEDGE: I would not
15 respond to that question with a yes or no.
16 Overruled or denied.
17 BY MR. JOSEPH:
18 Q Now, Dr. Pelcovits, if you turn
19 back to Services Rebuttal Exhibit 32, the
20 questionnaire, did each respondent answer with
21 respect to all of these activities, bought a
22 commercially released CD, downloaded music

1 from a free file sharing service, bought music
2 from a digital music store, subscribed or
3 listened to a digital music service, etc.?
4 A I'm sorry. Your question was did
5 each person respond to each question.
6 Q Yes sir.
7 A They were asked each question. I
8 don't know what happens if a customer skips
9 over a question.
10 Q But they either answer it or have
11 the opportunity to answer each question is
12 your understanding.
13 A That's my understanding, yes.
14 Q Did you do anything to control
15 your results for the other activities that
16 were asked about including free downloads,
17 purchased downloads, ownership of a portable
18 digital music player, listening to satellite
19 radio?
20 A When you use the term "to control
21 for" what do you have in mind?
22 Q Did you perform any analysis that

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1 used the responses to those questions?
2 A No.
3 Q Dr. Pelcovits, on page 28 in the
4 last paragraph, you say that "evidence in the
5 market shows that record companies regularly
6 receive percentages of revenue that are a
7 certain percentage or even higher." It's
8 true, is it not, that that sentence refers
9 only to music videos and master tones?
10 Correct?
11 A Yes. I believe you mean master
12 ring tones. Yes.
13 MR. JOSEPH: Can I have a moment,
14 Your Honor?
15 (Pause.)
16 MR. JOSEPH: Your Honor, I have no
17 further questions.
18 CHIEF JUDGE SLEDGE: Are there
19 questions from NPR?
20 MR. TAYLOR: No, Your Honor.
21 CHIEF JUDGE SLEDGE: Mr. Handzo.
22 MR. HANDZO: Thank you, Your

1 Honor.
2 REDIRECT EXAMINATION
3 BY MR. HANDZO:
4 Q Dr. Pelcovits, when you were
5 questioned by Mr. Steinthal, you were asked
6 some questions about whether in the ring tone
7 markets the sound recording owners sometimes
8 pay the musical works fee. Do you recall
9 that?
10 A Yes.
11 Q And then I believe your answer was
12 that sometimes they do.
13 A That was my answer.
14 Q And do you know how that came
15 about?
16 A I understand that came about
17 through agreements between the record
18 companies and the music publishers.
19 Q And what did those agreements
20 involve?
21 A They involved securing the musical
22 work right for purposes of being able to sell

1 this ring tone that includes both rights.
2 Q In other words, the sound
3 recording owners acquire the musical works
4 right.
5 A Yes.
6 Q Now you were also asked some
7 questions by Mr. Steinthal about your
8 testimony on page 3 that musical works can be
9 viewed as an input to the sound recording sold
10 to consumers. Do you recall that?
11 A I do.
12 Q And does the fact that sound
13 recording owners may buy the rights to the
14 musical works so that they can sell a bundled
15 product, is that relevant to your testimony
16 about it being an input?
17 A Well, it's certainly an example
18 where that takes place explicitly. I believe
19 that it's fair to characterize musical works
20 as an input from a more general sense of
21 recognizing how the services and goods are
22 sold in the marketplace.

1 Q And does scenario where the owners
2 of the sound recording purchased the musical
3 work right, does that have any impact on your
4 opinion about how this market would function
5 in the future if the owners of the musical
6 work were holding for a higher price?
7 A Well, it is certainly an example
8 of a contractual arrangement that particularly
9 if it were entered into at the time the sound
10 recording was made, it would be a way to get
11 around any problem of what we call "hold-up"
12 where the musical work copyright holder would
13 prevent anything from going forward unless
14 they were to get the same payment as the sound
15 recording copyright holder.
16 Q Now switching to your testimony
17 about NPD.
18 A Yes.
19 Q You indicated in response to one
20 of Mr. Joseph's questions that in the survey
21 or with surveys generally you may have some
22 concerns about the absolute numbers of

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1 purchases that consumers report having made.
2 Do you recall that?
3 A Yes.
4 Q Does that affect your view about
5 whether it's appropriate to look at those
6 numbers to see relative changes over time?
7 A No and I think if I reflect back
8 to something I said in my direct testimony, I
9 did say that I thought consumers were not
10 particularly good at knowing or identifying
11 how much they bought of something. But I
12 think the reason this survey is particularly
13 useful is because it asks the same person what
14 did you buy this year versus what did you buy
15 last year. And although the customer might
16 not get it exactly right and might in fact
17 overstate the amount of CDs he bought in 2005
18 I do believe that it is reasonable to think
19 that the customer when he says I bought the
20 same number in 2004 or something very close
21 that we're seeing evidence of whether or not
22 there is an effect of something like

1 webcasting or use of an on-demand music
2 service.
3 Q Now you were also asked some
4 questions I think about whether the results
5 that you report in your testimony for
6 interactive webcasters included people who
7 said they didn't know how much they paid. Do
8 you recall that?
9 A Yes, I do.
10 Q Did you look separately at a group
11 of people who knew how much they paid and paid
12 more than $4.99 a month?
13 A I did.
14 Q And based on your looking at that
15 group separately, did you see any reason to
16 believe that your numbers were being biased by
17 the fact that you included people who said
18 they didn't know?
19 A No and I think we already have
20 discussed that. The Group F were those that
21 knew and said how much they paid and they paid
22 more than $4.99 and it shows the same type of

1 results. In other words, if you break this
2 down within my ability to do so, you tend to
3 get the same types of results which is looking
4 at it through one way or another way,
5 breaking it down one way or another way.
6 There is no evidence of any significant
7 difference in substitution from one group of
8 customers who used webcasting and those that
9 used digital music service.
10 Q Would the same be true for example
11 with looking at people who only used a digital
12 music service versus people who used both the
13 digital music service and a free webcasting
14 service?
15 A I believe that's true, although I
16 think quite frankly it really doesn't matter
17 because we're looking at the effect of using
18 digital music service and whether that or not
19 that leads to substitution and if there is a
20 substitution effect that should be taken
21 account of in the way I did my benchmarking
22 analysis, it doesn't matter whether those

1 customers are also using a free webcasting
2 service.
3 MR. HANDZO: Thank you. That's
4 all I have.
5 CHIEF JUDGE SLEDGE: Mr.
6 Steinthal.
7 RECROSS EXAMINATION
8 MR. STEINTHAL: Just one thing.
9 RECROSS EXAMINATION
10 BY MR. STEINTHAL:
11 Q Just one thing, Dr. Pelcovits.
12 You were just asked about the hypothetical of
13 the publisher hold-ups being taken care by
14 including it in the price all in for musical
15 good. Right?
16 A Yes.
17 Q There's really no concern about
18 publishers holding up whether it be record
19 companies or music distribution companies when
20 their rates are subject to either a compulsory
21 license on the one hand or rate court
22 constraint on the other, is there?

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1 A I can't say that that's true. I
2 think that the fact that the agreements in Dr.
3 Jaffe's example of his market and his whole
4 theory is itself based on some concept of
5 holdup and I'm saying that the holdup concept
6 can be gotten around through a contract such
7 as the ones I refer to earlier.
8 Q Are you saying Dr. Jaffe's theory
9 is based on a holdup concept?
10 A Absolutely.
11 MR. STEINTHAL: I have no further
12 questions.
13 CHIEF JUDGE SLEDGE: Mr. Joseph.
14 MR. JOSEPH: May I have a moment,
15 Your Honor? I'm thinking about one of his
16 answers.
17 (Pause.)
18 MR. JOSEPH: No further questions,
19 Your Honor.
20 CHIEF JUDGE SLEDGE: Mr. Handover,
21 do you have anything further?
22 MR. HANDZO: No, Your Honor.

1 CHIEF JUDGE SLEDGE: Any questions
2 from the bench?
3 JUDGE WISNIEWSKI: Perhaps just
4 one. Dr. Pelcovits, we've been talking a lot
5 in this proceeding about "market rates" and
6 the like and been offered a number of
7 suggestions as to how those markets ought to
8 be constructed and how we ought to look at
9 them and so on and so forth. We haven't had
10 much said about the time period, however,
11 which we ought to be looking at with respect
12 to those markets. Do you have any thoughts
13 about that?
14 THE WITNESS: I have to make sure
15 I have the right reference for the question,
16 Your Honor. Could you give me a little more
17 there?
18 JUDGE WISNIEWSKI: Basically, what
19 I'm trying to get at here is are we looking at
20 a short term analysis of the markets or are we
21 looking at a long term market equilibrium
22 price? What is it we're really trying to

1 focus on here?
2 THE WITNESS: I think we are
3 looking and should look at this from on
4 balance a more long run approach and
5 particularly it should be looking at if we
6 were talking about this as an actual market
7 the nature of the arrangements that the
8 parties would enter into for something going
9 forward, for something which was not
10 constrained by some prior agreements such as
11 the whole issue of as we've been talking about
12 the publishing right being a separate right.
13 I think it should look at the market from a
14 broader sense than that and how the market,
15 what are the marketplace forces, what would
16 you expect in a market to be negotiated given
17 enough flexibility and fluidity in the market
18 and taking into consideration by the record
19 companies of future sound recordings of where
20 they would have the flexibility and how to go
21 about making those and where the copyrights
22 would be granted and given in the types of

1 contractual arrangements that could be entered
2 into.
3 JUDGE WISNIEWSKI: So more of a
4 dynamic analysis than a steady one.
5 THE WITNESS: I think that's
6 right. Markets are very dynamic and I think
7 you can't just -- If you take a snapshot, you
8 very often are influenced by the arrangements
9 and the prices that have developed in response
10 to particular institutional structures. But
11 if we're looking at how markets actually work
12 over time, they tend to work themselves around
13 various institutional considerations.
14 JUDGE WISNIEWSKI: Thank you.
15 CHIEF JUDGE SLEDGE: Any
16 questions?
17 JUDGE ROBERTS: Yes. Dr.
18 Pelcovits, if you could turn to the last
19 paragraph on page 2 of your testimony. Here
20 you're talking about Dr. Jaffe's testimony and
21 his assertion that essentially webcasting
22 revenues are economically irrelevant and

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1 therefore should be treated so in the
2 marketplace. Your assertion is that going to
3 the top of page 3 that that is not true. "A
4 rational business will consider each
5 opportunity to increase revenues to cover a
6 portion of its costs as worthwhile in its own
7 right." Is this a discussion on your part
8 about market segmentation?
9 THE WITNESS: No, it's not
10 intended to be that. It's simply trying to
11 respond to a claim by Dr. Jaffe where he says
12 that a market's very small and therefore you
13 don't have to be concerned about how much of
14 your cost you're recovering there. It happens
15 that they are segmented this way, but in fact
16 all that means is that you're going to try to
17 maximize your profits in each segment
18 individually or to the extent to which there
19 is some crossover effect or substitution from
20 one to the other.
21 JUDGE ROBERTS: So if there is a
22 small sliver of the pie, so to speak, to be

1 recovered you say that a rational decision
2 maker in a business would seek to move to
3 recover that portion. Correct?
4 THE WITNESS: Or seek to recover
5 what it could from that portion. It's not
6 going to underprice it simply because it's not
7 a big market. If that were true, then you
8 would expect a record company to be, let's
9 say, indifferent with how much CDs sell for in
10 Montana because it's a small state. But
11 obviously they would be.
12 JUDGE ROBERTS: Just in the
13 example that you used with respect to Montana,
14 I would suspect that the cost of the CD in
15 Montana is not as much as the cost of a CD in
16 New York City necessarily.
17 THE WITNESS: Well, I would -- I
18 don't know if that's true. It might be true
19 because of retailing costs, although now with
20 internet shopping it probably doesn't matter
21 at all. But I would have to agree that in
22 different markets you're going to get

1 different markups if they are really segmented
2 and if demand conditions are different in the
3 two markets. But each market in its own right
4 it's still important and it's still one where
5 you would expect the normal marketplace
6 forces, namely essentially all the dynamics we
7 were talking about to still play a role.
8 JUDGE ROBERTS: And from the
9 seller's perspective the seller would move or
10 take necessary action to again as you point
11 out to maximize that. What kind of
12 considerations would go into the seller's
13 evaluation of these so-called smaller markets?
14 Would they adjust price to recover that amount
15 or how would they do that?
16 THE WITNESS: I think they
17 certainly sort of a starting would look to all
18 the markets to recover a certain portion of
19 their costs of development and certainly any
20 distribution costs and there would be no
21 fundamental difference from how they would
22 approach a small or large market just because

1 one market is small and the other one is
2 large. In some sense to say that the
3 webcasting is the sort of market that doesn't
4 matter because it's never going to tip a
5 decision one way or the other, you could say
6 that about every single sale.
7 So I think each market is
8 important. Each market is one where the
9 seller as a business would consider what it
10 costs, what's gone into the product and try to
11 recover as much as it can subject to the
12 demand for the product in the market and where
13 you would expect to see a different cost
14 recovery or a different revenue recovery would
15 be based on differences and substitutes and
16 those two markets demand elasticities and
17 factors like that.
18 JUDGE ROBERTS: We've heard some
19 testimony in this proceeding about at least
20 offering by certain services, broadcasters in
21 particular, that their webcasting amounts to
22 very, very few people in actually streaming

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1 music, but if I hear correctly you say that a
2 rational seller would nevertheless move to try
3 to capture or do what they could to try to
4 capture that sliver even though it's very few
5 people receiving the service.
6 THE WITNESS: I think they still
7 would. It's still a substantial amount of
8 money. The webcasting, even under current
9 rates, the webcast payments to Sound Exchange
10 are millions of dollars and in every
11 expectation that's going to grow. So they are
12 certainly worth the attention of the
13 businessmen. I think businessmen make
14 decisions where they consider something of
15 several million dollars worth attention. The
16 only case where you would say it doesn't
17 matter would be whether the time and attention
18 necessary to deal with it are not sort of paid
19 for by the revenues in that market. It's such
20 a small, small market that it's not even worth
21 spending ten hours of someone's time on it.
22 JUDGE ROBERTS: Okay. Thank you.

1 CHIEF JUDGE SLEDGE: Any followup
2 questions from the bench?
3 MR. HANDZO: No, Your Honor.
4 MR. STEINTHAL: No, Your Honor.
5 MR. JOSEPH: No, Your Honor.
6 CHIEF JUDGE SLEDGE: All right.
7 Thank you. That completes your testimony.
8 (Witness excused.)
9 CHIEF JUDGE SLEDGE: You gents,
10 have anything to present before we adjourn?
11 MR. HANDZO: No, Your Honor.
12 We'll begin tomorrow morning with Ms. Kessler.
13 MR. TAYLOR: Your Honor, one
14 housekeeping matter. Today we filed a Notice
15 of Appearance of Gil Rosenstein who may join
16 us later this week to appear on behalf of DiMA
17 and we'll be giving you a courtesy copy
18 tomorrow morning in light of the --
19 MR. JOSEPH: Your Honor, since
20 we're talking about notices of appearances we
21 also filed a Notice of Appearance last week
22 for one of my partners, Tom Kirby, who

1 unfortunately or fortunately my colleague, Meg
2 Ryan, has received an appointment and is not
3 available to assist. So Mr. Kirby will be
4 filling and helping me. We have filed that
5 notice of appearance for Mr. Kirby. He will
6 not be here tomorrow, but he will be here on
7 Wednesday.
8 CHIEF JUDGE SLEDGE: I think
9 parties would reasonablely expect the Court
10 will take a careful approach new attorneys
11 coming on who are not familiar with our
12 proceedings and to the extent that they will
13 be able to participate.
14 MR. STEINTHAL: Your Honor, Mr.
15 Rosenstein came in during the rebuttal phase
16 and did some of the discovery. So she is
17 familiar with the case. Of course, she hasn't
18 appeared here before but in particular because
19 of my travel back and forth, I thought it was
20 important to get another partner in my firm
21 available. So she is familiar with the case
22 and I have briefed her on the surrounding and

1 the procedures of this hearing.
2 CHIEF JUDGE SLEDGE: We expect her
3 to be able to demonstrate that.
4 MR. STEINTHAL: Yes.
5 JUDGE ROBERTS: Are you planning
6 to be here the rest of the week, Mr.
7 Steinthal?
8 MR. STEINTHAL: I'm going to be
9 back and forth, Judge Roberts. I'm doing the
10 best I can.
11 CHIEF JUDGE SLEDGE: We recess
12 until 9:30 a.m. Off the record.
13 (Whereupon, at 5:28 p.m., the
14 above-entitled matter recessed to reconvene at
15 9:30 a.m. the next day, November 28, 2006.)
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