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In the matter of: Digital Performance Right in Sound Recording and Ephemeral Recording

Docket No. 2000-9
CARP DTRA 1 & 2

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

Friday, October 19, 2001

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

BEFORE
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THE HONORABLE JEFFREY S. GULIN Arbitrator
THE HONORABLE CURTIS E. von KANN Arbitrator
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WITNESS

David Fagin
By Mr. Cohen 12112
By Mr. Levine 12124
By Ms. Woods 12133
Jonathan Zittrain
By Mr. Cohen 12144
By Mr. Katz 12157
By Ms. Woods 12165
Richard Seltzer
By Mr. Jacoby 12221
Adam Jaffe
By Mr. Katz 12310
By Mr. Garrett 12463

EXHIBIT

DESCRIPTION

MARK RECD

RIAA

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

SERV Rebuttal

4 Work Paper 12239
5 List of Variables 12240
6 1999 Sales Data 12240
7 RESL 73/74 12240
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1. you to return to your students.
2. We will reconvene at 2:00, at which point
3. we'll be hearing from Dr. Jaffe. And I gather we have
4. an updated schedule here.
5. (Whereupon, the foregoing matter went off
6. the record at 1:01 p.m. and went back on
7. the record at 1:01 p.m.)
8. CHAIRMAN VAN LOON: Message?
9. MR. JACOBY: Yes. I'd like to offer
10. Service rebuttal Exhibits 4, 5, 6, 7 were
11. received for evidence.
12. MR. SCHECHTER: No objection.
13. CHAIRMAN VAN LOON: No objection?
14. [Whereupon, Service rebuttal Exhibits 4, 5, 6, 7 were
15. received for evidence]
17. (Whereupon, the proceedings went off the
18. record from 1:02 p.m. until 2:07 p.m.)
19. CHAIRMAN VAN LOON: Good afternoon,
20. everyone.
21. Welcome back, Mr. Rich. Glad to see you.

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

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

Page 12310

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

53 (Pages 12307 to 12310)
is that correct?

A Yes, that's maybe correct.

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

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

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

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

THE WITNESS: Okay. Well, we talked about this quite a bit the first time I was here. I did try in the rebuttal testimony to carefully lay out the whole argument in one place so that it would be there. And because it is there, I'm not going to regurgitate the whole thing now, but just to kind of set up the discussion.

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

BY MR. RICH:

Q Now, an aspect of this analysis is that there is a zero incremental cost of the right being transferred; is that correct?

A Yes.

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

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

Q So for this purpose, the purpose of that observation is to bolster the view that the value of the respective rights, namely the sound recording performing right and the musical work right, from the standpoint of the willing buyer/willing seller perspective should be comparable. Is that the essence of it?

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

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

A Yes.

Q Now, there has been submitted rebuttal testimony on behalf of the copyright owners by Professor Wildman and Dr. Schink taking issue with this aspect of your analysis. Have you had occasion to review that rebuttal testimony?
Q. And would you provide the panel with your response to their own critique of your approach?

ARBITRATOR VON KANN: Sur rebuttal?

MR. RICH: Sur rebuttal.

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

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

But even at the theoretical level I do want to correct what I think are either misunderstandings or mischaracterizations of what my theory was, or is, that appear in those testimonies.

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

And I think that what they would like to have you take away is that somehow the sound recording itself and the right to perform it on the Internet are like sheep -- sorry, are like wool and mutton. There are two things which are inextricably produced at the same time by some production process. In that case it would be growing sheep. And that to say the wool is incremental to the mutton or the mutton is incremental to the wool would be just arbitrary; that you can't make that distinction. But I think that that characterization of the two things as being jointly produced in a sort of symmetric and even way just doesn't fit the situation we happen to be talking about.

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

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

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

A Yes.

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

A Have you had occasion to review that testimony?

Q Yes. I think this is where Professor Wildman may not have understood what I was saying, because it was essential to my argument that the inputs we're talking about have this property that there's no cost of providing them in this particular context. And that just wouldn't be true of cream and sugar. Both cream and sugar have a cost. And they reason they have a cost is because if you don't put it in the ice cream, you can use it for something else and get a value out of it. And so I was very specific that the circumstance I was talking about was one in which the input is coming to this incremental use in such a way that there's nothing saved by not using it here. And that doesn't apply to cream and sugar, and it doesn't apply to the actor and producer in making a movie. If an actor doesn't make a given movie, he can go make some other movie or she can go make some other movie. So there's a cost associated with the actor's time in making a given movie. And in that case, that cost is going to weigh heavily on the market price for their services in that context. So I don't think his examples fit my conceptual framework.

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

A Correct.

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

A Correct.

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

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

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

So what we have here are in both cases, again -- and this is what's crucial -- conceptually the same situation that I've been analyzing. We have an existing sound recording, we have an existing
musical work. The costs of creating both are sunk. There's substantial revenues that have typically already been collected toward both. And now we have this incremental use. Someone wants to make a movie; someone wants to make a TV show, and they would like to incorporate this particular performance of this particular song into this movie or into this TV show.

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

So, once again, even though it's not a performance right, it is a circumstance that conceptually, exactly fits the circumstance that I've been talking about, in which you have these parallel negotiations to acquire a previously created right whose costs are sunk, and where you need both, and you can't put the song sung by that artist into the movie unless you get both. So the circumstance we're talking about from an economic perspective has exactly the same structure as the licensing for performance purposes of the musical work and the sound recording.

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

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

Q Let me interrupt you to ask you, under the Wildman and Schink thesis what would you expect to observe in the data?

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

Now, as I've said, for any one song there could be reasons why one is worth more than the other. We'll see our data in a minute. There's an occurrence in our data where "Auld Lang Syne" is put into a movie, and the composer gets more than the songwriter.

ARBITRATOR VON KANN Well the composer was Scottish so he was very tough negotiator.

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

Q And I take it, despite your conceptual
differences, Professor Wildman himself says the proof of the pudding would be in the empirical data, and would agree; is that correct?

A Yes. We'll get to that, yes.

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

I don't think that argument's right as a matter of concept, and that's explained in that footnote. And further, if it were right, it has the clear implication that you should see a different pattern in movies than in television, because this difference which occurs in movies simply does not exist on the TV side. And what we'll see in a minute when we look at the data is that not only is there this very clear pattern of equality, there's no evidence of any difference between movies and television. So I just think there's no issue there with respect to this complication of how the rights are conveyed.

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

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

(Whereupon, at 2:33 p.m. the proceedings went into Closed Session.)
Q. Now in sum, Professor Jaffe, what do these studio data which you've now reviewed tell you about the validity of your conceptual analysis about the relative value of the sound recording performing right and the musical work performing right?

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

MR. RICH: I think we can, yes.

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

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

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

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

ARBITRATOR GULIN: So it would be?

THE WITNESS: Sorry?

ARBITRATOR GULIN: Would you guess there would be?

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

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

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

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

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

THE WITNESS: Correct.

ARBITRATOR GULIN: Correct? Now if that's the case, and that's happening here, and the absolute values of master-use rights and synch rights were truly equal, would not one expect that the record companies would accept less for the master-use right than the PROs for the synch right? Because they're making it up in promotional value. And that was the same analysis you did with respect -- that's why you had a downward adjustment in your rate.

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

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

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

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

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

BY MR. RICH:

Q Professor Jaffe, just following on Judge
Gulin's questions, looking at the other side of the equation, that is with respect to the musical works and possible other royalty opportunities, any thoughts what a successful exploitation of that product might do with respect to boosting other sources of income to the music publisher.

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

There's another phenomenon which is also going to go on, which is if that movie is a success, and presumably there's not going to be much promotional value for CDs if it's not a success, it's also going to end up on television later. And when the movie is shown on television, the musical work commands a performance royalty but the sound recording does not. So that there is an offsetting factor with respect to movies, in terms of promotional value, connected to the additional performance royalties that the composer will get when the movie is on TV that the sound recording doesn't get, which would tend to offset -- if they really are thinking this far down the road about these sort of subsequent royalty implications, that would tend to offset the CD sales, and it would imply that we ought to see something different between movies and television because with respect to television we have a different situation with the rights.

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

Q Now, if you'd look at the bottom of Page 23 of your prepared testimony, you have a summary section dealing with what you term the fundamental symmetry of sound recording and musical work performing right valuations.

A Yes.

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

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

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

A That's correct.

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

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

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

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

So all I've done here is to sort of redefine the way I talk about my model to show as clearly as possible how to compare it to the RIAA model. So what I did was instead of starting from a listener hour and then deriving from that a listener
song, what I have now done is to say, okay, I'll start
from a listener song and, you know what, I'll even
call it a performance since that's what RIAA calls it
so we can just agree on that terminology.
So I'll start by constructing a
competitive market value for a performance in the same
way I did before, so it's the same conceptual
approach. And I will derive the listener hour version
of the model from that so that it's totally parallel
to the RIAA presentation.
(Whereupon, at 2:57 p.m., the proceedings
got into Closed Session.)
MR. GARRETT: Mr. Chairman, let me have that portion of the transcript --
THE WITNESS: Oh, I'm sorry. Yes, I apologize.
CHAIRMAN VAN LOON: Yes. We'll need to go back, please, John, and mark it restricted. Thank you.
COURT REPORTER: Before Mandelbrot?
CHAIRMAN VAN LOON: Yes.
THE WITNESS: Yes.
CHAIRMAN VAN LOON: Should I continue?
THE WITNESS: Yes. I mean it's completely appropriate, we just need to be mindful of what's public information and what's not for the purposes of the public.
THE WITNESS: And now that I've been reminded that these agreements are in fact restricted, I'll try to keep that in mind. I'd forgotten about that.
CHAIRMAN VAN LOON: If it's necessary or helpful to make the point, it's completely appropriate for us to do it in closed session so that we have full understanding.

THE WITNESS: Yes, and all I meant was
I'll try to remember to say I'm about to say something restricted rather than just launching into it. If I can remember, I'll try to do that.
MR. GARRETT: Don't worry, I'll remind you.
(Laughter.)
THE WITNESS: Okay. So the point I was making was that it's the same model. What I've tried to do is to now set it up in a way that makes it very easy to compare to the RIAA's -- what they've called their performance model.

BY MR. RICH:
Q How don't we, using Figure 3, walk the Panel through the figures as they now exist, benefitting from both the recasting and the updating of data? So if you could describe what Figure 3 depicts, please.
A Yes. Figure 3 is analogous to a figure that was in my direct testimony. It was called Exhibit B-2 in my direct testimony. And the numbers that were in Exhibit B-2 are shown in the right hand column of Figure 3. And I won't test your memory, but in B-2 the listener hour model came first, and then the per performance, or listener song, model came second. So I've just reversed the order.
And then I've recalculated, as is indicated, in the first column the actual numbers.
Now, the first thing to observe in the first two rows is that the numbers are exactly the same of 0.0002 dollars or 0.02 cents per performance. This is now in over-the-air radio. We haven't yet brought it over to the Internet context. And 0.22 cents per hour, per listener hour. And that's the same in both cases -- to two decimal places those are the same numbers I had before.
Now, let me just briefly describe the updated data. When we did this before, which was in the spring of this year, what we had were for the year 2000 actual amounts paid by the licensees on an estimated basis to ASCAP, BMI and SESAC for the year 2000. They had not yet reconciled and produced final numbers or final reports and final payments to the ASCAP, BMI and SESAC, so I based my calculation on those estimates. I suggested at the time that there was no reason to believe that the final numbers would vary systematically one direction or the other.
Those final numbers were produced between the spring and the end of the summer, so I went ahead and recalculated using the final numbers. I also -- there were a few stations for which we didn't have complete data the first time around, and with the additional time, we now had complete data, so you'll see there's a few more stations in the recalculated numbers.

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

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

A Correct.

Q Okay. Now, if we could turn next to Figure 4, which is the application of that metric in the context of webcasters and broadcast streamers and rebroadcasters, could you please describe how the proposed fee, as set forth in the first row going across, indicating webcasters fee per performance and fee per tuning hour were derived?

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

Then moving across to the fee per tuning hour, and are we still now on the restricted record?

COURT REPORTER: I never left it.

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

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

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

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

(Whereupon, at 3:05 p.m., the proceedings went into Closed Session.)
THE WITNESS: So I took the 0.014 cents per performance and said my reading of the record in this case, from the testimony of one of the webcasters, was that there were 50 songs per hour in webcasting. So I simply multiplied the 0.014 cents per performance for webcasters times 15 performances per hour to suggest that you could have a fee per tuning hour, which is what the webcasters really can measure, at least easily, of 0.21 cents per tuning hour, so that that number would be an appropriate to use for a webcaster, which is essentially broadcasting or webcasting sound recordings more or less all the time.

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

Q Let me ask you this: Does the recasting to calculate, first, the fee per performance and then
to move up, if you will, or multiply up to the fee per
tuning hour reflect any changed judgement on your part
from the time of your initial testimony, as to
desirability of calculating royalties, at the end of
the day, on the basis of aggregate tuning hours?
A No. I mean as I think I described the
first time around, there's a lot of benefit to both
sides in structuring these fees so that they're
reasonably easy to calculate. And I think the tuning
hours concept is very powerful and very helpful,
because this is something which is easily measurable
on the Internet. So it's beneficial to both sides to
have a fee that can be calculated on that basis.
My model, fundamentally, is derived from
the same performance concept that RIAA has used, but
what I'm suggesting is that it's important that there
be a per hour implementation of that performance
model, because it would be inefficient to require most
webcasters to actually go and count the specific songs
on an hour-by-hour basis.
Q Why don't you next walk the Panel through,
in a similar fashion, how you derived the proposed
fees for the broadcast streamers? That's the second row on this Figure 4. A  Okay. Once again, the starting point is the 0.02 cents per performance over the air that appears on Figure 3. What I've done with respect to the rebroadcasting is to recognize that there's a lot of testimony in the record from Mr. Mandelbrot and others about reasons why the market price for this right, with respect to simulcasting or rebroadcasting, is likely to be lower than the market price for webcasting. The simulcasting or rebroadcasting is inherently, on the user's side, competing with over-the-air radio where this right is free, and that is going to tend to have a downward pole on any market price for the right on the Internet. Many of the issues regarding displacement, which have been raised as least as concerns seem to be connected to features of the Internet that would not be present with respect to rebroadcasts of the same material as over-the-air. So I think there is a general agreement that a lower rate, in some sense, is appropriate for the rebroadcasting or simulcasting. I don't believe that there's anything in the record that really allows one to precisely quantify what that difference should be. So what I propose is, as I described in my original testimony, I think the evidence on promotional value, on market power of ASCAP and BMI, on the international comparisons of the ratio of sound recordings and musical works, if you take all that together, I judged a range of 40 percent to 70 percent would be anywhere in that range could be a reasonable fee for the Internet. I had conservatively chosen the upper end, 70 percent, for the webcasters. So what I'm now suggesting is that one could choose the lower end of the range, 40 percent, for the over-the-air rebroadcasting and simulcasting. So what I've done in Figure 4 is to take that same 0.02, which appears in Figure 3, and multiply it by 40 percent. That produces the 0.008 cents per performance that's in the lower lefthand corner. Then to get over to the righthand side we need to multiply that by songs per hour. I used 12 songs per hour. The average in my data for over-the-air music stations is 11.5, so I just rounded that up to 12 to keep the numbers relatively simple. And that 0.008 cents per performance times 12 gives you 0.01 cents per hour for the streaming -- the simulcast and rebroadcast streaming. Q And for what period of time do you propose that the fees set forth in Figure 4 apply? A As I explained last time, these numbers are calculated on the basis of data for the year 2000. So what I'd like to propose is I think a conservative and straightforward of then applying them for the entire period that is at issue in this proceeding. So I would submit for the year 2000 these are clearly appropriate fees, because they're based on the actual economic experience in the year 2000. With respect to the year 1999, the fundamental basis of this is fees, which are based on revenue, per performance. The data show clearly that revenues relative to audiences in over-the-air radio for 1999 were lower. So if I had done this same calculation based on 1999 data for over-the-air radio, I would have gotten slightly lower numbers. So what I would suggest, just to keep things simple, and because I haven't done the calculations in any precise way, is that these numbers could be applied for the entire first period; that is, from the end of October 1998 up through the end of 2000, these fees could be applied. That's actually slightly conservative, because the right numbers for 1999 are probably slightly lower. Going forward with respect to 2001 and 2002, we don't have any data yet. We don't know what the fees are going to be in the benchmark for 2001 and 2002. Given the way the economy is going, I think there is reason to believe they might actually fall again, but I don't know. So what I propose, just again to keep it simple, is to just increase them for an estimate of inflation. So what I would propose is take the numbers that appear in Figure 4, Increase them by three percent for the year 2001, which is basically the current best estimate of the inflation rate, and then to take that level and increase it by another three percent for the year 2002 in order to build in a small increment for inflation.
Q: I take it that with respect to ephemeral fees, your testimony and your recommendation remains that there be no increment ephemeral fee payable beyond the fees set forth and proposed in your model; is that correct?

A: That is correct.

Q: For the reasons that you have earlier testified to.

A: Yes.

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

A: Yes. I've given this a lot of thought, and I think it's important when you're asking yourself whether some difference in circumstances demands a difference in fees that you focus in on the question of whether the difference in circumstances leads you to believe that the value of a performance in different circumstances is actually different. It's very easy to have circumstances that are quite different in terms of important business aspects without having any reason to believe that the value of the performance itself is any different.

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

If you were doing this on the basis of a percent of revenue, you'd have to try to figure out how to adjust your percentage so that the value you attribute to the performance itself is correctly translated from one context to another. But if you valued the performance itself, the mere fact that over here there's additional things that generate more revenue just doesn't matter. You don't need to worry about it.

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

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

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

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

CHAIRMAN VAN LOON: Thirty-one.

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

BY MR. RICH:

Q. Can you summarize your analysis there, please.

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

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

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

A. That is correct.

Q. Okay.

A. And, therefore, I think that the $250 figure that I had previously suggested is at least in the right range.

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

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

MR. GARRETT: Good.

THE WITNESS: -- would be probably okay, and I think one of them is higher than $250, I forget, two sixty-eight.

CHAIRMAN VAN LOON: Thirty-one.

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

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

THE WITNESS: But the incremental cost of having somebody in your system is independent of the size of the repertoire. It's really the cost of mailing out an invoice, it's the cost of keeping track of this guy in your computer, it's the cost of the dunning them if they don't pay, and so I don't really see an argument for adding up three different organizations, each of which are incurring the same minimum cost.

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

THE WITNESS: Not that I know of.

CHAIRMAN VAN LOON: Is it possible that if the margin -- if 90 percent of the people that were paying paid royalties enough to cover the incremental costs, plus a lot more so that they had a good margin, that the minimum fee that's picked is just some convenient one that made it affordable for everybody but doesn't really reflect the actual admin cost.

Q. It's just a picked minimum because they've got enough margin with this to cover everybody.
THE WITNESS: So what you're saying is that they've made a conscious decision to set a fee knowing that they're going to get some licensee that they're actually losing money on, because this guy really costs $500 to service. I'm going to give him his license for $150 and make that up somewhere else, and they've made a conscious decision to do that in order to license as broadly as possible.

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

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

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

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

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

MR. RICH: An hour plus.

CHAIRMAN VAN LOON: An hour plus. Why don't we take a break then right now, it's about an hour and a half, and plan to come back at quarter till.

And the Panel, during this break, will look at the new lineup, and so you might alert Ms. Woods that at quarter of that's when you all can come into to look at that.

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

CHAIRMAN VAN LOON: -- discuss the possibility of moving the final arguments to Tuesday, December 11, giving the parties an additional weekend to prepare, and in lieu of the historical significance of that date. And now we're discussing a revised schedule for next week that would waive personal appearances by Coppola, Marcus, Hessinger and Price.

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

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

MR. GARRETT: And further matter. The Panel, as you know, had asked that we provide you with certain information concerning various agreements, such as the Artists Direct agreement, the radio agreement. We did put together a response to the Panel. We have shared it the other side a couple of days ago. We have not gotten a response back. I think I did at one time promise to have it filed with the Panel by the end of the day today, but we're still awaiting comment from the other side.

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

MR. GARRETT: That's fine with me.

CHAIRMAN VAN LOON: Any other --

MR. GARRETT: Yes, one other thing too.

CHAIRMAN VAN LOON: Another housekeeping item.

MR. GARRETT: We also have provided to Yahoo's counsel, Mr. Greenstein, a sanitized version or a resanitized version of the transcript of Mr. Mandelbrot and have asked that he get back to us and let us know whether or not it's okay with him and his client. I gather he's forwarded it on to his client. We obviously have not gotten a response back. I went over it, I believe, yesterday. And so we have not been able to provide a copy of it to RIAA yet, and...
also we don't have a summary of what it is that Mr.
Marks would be testifying to. But as soon as we get
this resolved with Mr. Greenstein, we'll provide that
summary as well.
CHAIRMAN VAN LOON: You have a few more
hours, if they're on the west coast, to try to reach
him by the end of the day.
ARBITRATOR VON KANN: Marks is now next
Wednesday.

MR. RICH: Can we also have sense of
location at this point? Is it logical at this point
to assume we would stay here for the duration? Do you
have any more information on Library of Congress
closure?
CHAIRMAN VAN LOON: The latest -- we get
what are called broadcast alerts, or something like
that, on voice mail, which we've been checking. The
latest that we had heard from them was that they were
closed till further notice. They thought that they
would reopen Tuesday, but that has not been confirmed,
and I guess part of the Library was used, the clinic,
for testing, anthrax testing of people which concluded
around eight o'clock last night.

ARBITRATOR VON KANN: Mostly over where
you guys were sitting think

Laughter

ARBITRATOR VON KANN: So if you're eager
to rush back there at this point --
CHAIRMAN VAN LOON: I suppose -- one thing
is we could look for the earliest possible opportunity
to return to our hallowed venue or we could simply say
for a last day or two why not stay here if Mr.
Garrett's willing to allow us to impose on his
hospitality still further. I don't know whether the
parties have a preference whether --

ARBITRATOR VON KANN: I guess you enjoyed
that move so much that you'd like to now do it again.

CHAIRMAN VAN LOON: Do you all have a
preference?
MR. JOSEPH: I would say that this side
has a preference, probably, but we --

CHAIRMAN VAN LOON: Could you reveal it?
MR. JOSEPH: We wouldn't want to impose on
Mr. Garrett's hospitality unless he's interested in

MR. GARRETT: Your bill's going to be the
same regardless.
MR. RICH: Regardless.
(Laughter.)
CHAIRMAN VAN LOON: So you all would
prefer just to stay here and not go through that
hassle. This may be a case of no good deed goes
unpunished. We're so happily ensconced and you made
a big mistake by having the brownies brought in.

CHAIRMAN VAN LOON: You have few more
hours if they're on the west coast to try to reach
him by the end of the day.

MR. GARRETT: We're happy to have you all.
CHAIRMAN VAN LOON: Perhaps we should just
say then that we'll plan to stay here unless something
comes up. I suppose if the General Counsel's Office
at the Library said -- were to say to us, no, it's
very important that for public policy reasons or
something they wanted us back, we could reopen this.

MR. JACOBY: Well, we'll get an injunction
against them.

Laughter

CHAIRMAN VAN LOON: The heart of the
litigator.

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against them.

Laughter

CHAIRMAN VAN LOON: The heart of the
litigator.
which you have presented to the Panel. Do you have a reaction to that criticism?

A Yes. I think --

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

MR. RICH: This is now surrebuttal.

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

ARBITRATOR VON KANN: Okay. I'm sorry.

This was on the notes.

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

CHAIRMAN VAN LOON: Shocked, shocked.

THE WITNESS: And the fundamental issue -- the first issue then is this question of the percent of revenue model. I think there's actually a quote which is in my testimony here somewhere from negotiations for these rights where Mr. Marks says, "We both know that it's not revenue that determines the value of performances." And I think that's true in over-the-air radio. I view a percentage of revenue as a convenient proxy for the value of the performances. There is nothing intrinsic that determines that it's right to value performances as a percentage of revenue.

And I think that point carries particular force when you're going to, in effect, use a benchmark and move from one context to another. It's one thing, for example, over time to say, "Let's agree today on a certain royalty and rather than having to renegotiate tomorrow and the next day between the same parties, we know my business may grow and therefore you'd be entitled, in some sense, to more revenue, let's just make it two percent of revenue, and that way it will naturally increase as my business grows."

And that's a convenient way of avoiding having to continue to revisit what's really worth. That makes a certain amount of sense.

But when you're going to use it as a benchmark to determine a fee in a slightly different context, I just think it's extremely problematic to take a percentage of revenue in one context and presume that the value of the performances is the same percentage of revenue in another context. There is no economic reason why that should be true. It goes back to my tires on the Toyota versus tires on the Mercedes example. The revenue is determined by many, many different things. And if those things that determine revenue are different in the two contexts, then the percentage of revenue that is reasonable and a market value in one context is not going to be the appropriate percentage in another context.

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

BY MR. RICH:

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

A Yes.

Q And do you have a response?

A Actually, I have two responses. First of all, what he does is he looks at, for example, different formats of radio stations or different markets, and he shows that if you calculate the per performance fee that's paid in these different formats or different markets, they vary somewhat. In fact, I found his appendix quite comforting, because what it showed to me is they really don't vary very much at all. I calculated the number as being about 0.2, and what he shows is, well, in some cases it's as low as
0.15, and in some cases I think it was as high as about 0.3 or so. But in fact it really doesn't vary all that much.

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

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

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

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

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

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

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

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

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

The other check I did requires restricted information.

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

And I think, as I summarize here, that the evidence is very clear that there is promotional value over the air. The evidence that we do have on the Internet in terms of quantitative data shows that there is also net promotional value on the Internet. And the evidence regarding displacement is essentially anecdotal and fears about the future, but there is no quantitative evidence in the record that I could find of the amount -- the extent to which displacement is
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diminishing the net promotional value now or by the end of 2002. And that was true when I wrote this written report, and I don't believe that anything in the RIAA's rebuttal filing changes that. They did not put in any quantitative data to demonstrate the magnitude of displacement relative to promotion in the relevant time period.

BY MR. RICH:

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

A  Yes. I think, conceptually, in order to analyze whether we have benchmarks there that we can use, there are three steps. The first step is, is the agreement, in its own context, on its own terms, likely to be evidence of a willing buyer/willing seller competitive market situation that was not distorted by the presence of the RIAA market power? And I discussed briefly in my direct testimony, what that really comes down to is did the buyer have good information and access as a realistic matter to the statutory license as a substitute for what RIAA was offering so that that substitute -- the availability of that substitute could discipline the market power of the RIAA? That's the first step, and I refer to that as the is it willing buyer/willing seller in its own context.

A second issue is does it really give us significant evidence of market conditions? Is it economically significant? Did they actually pay real money under this agreement? Is there evidence that this was a viable business transaction? Because otherwise it's not telling us about the market price. And then, finally, there's the question of even if it is economically significant and reasonable on its own terms, is it comparable to what we're trying to license here? Is it -- does it represent an economic situation that can be appropriately extrapolated to the current licensees? Because otherwise it's not an appropriate benchmark.

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

A  Yes.

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

A  Yes, I have.

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

A  Now, this exhibit is certainly restrictive.

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

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

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aside whether it was willing buyer/willing seller and comparable, is there really any economically significant evidence contained in that agreement?

MR. RICH: Perhaps now we should move to a restricted record.

CHAIRMAN VAN LOON: Yes, let's go to the restricted record.

MR. RICH: Thank you.

(Whereupon, at 4:23 p.m., the proceedings went into Closed Session.)
Chairman Van Loon: Excellent, let's continue.

By Mr. Rich:

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

Could you synopsize your analysis of that approach of Dr. Nagle?

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

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

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

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

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

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

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

And I must say I just find this argument -
I just don't understand where this argument comes
from. It seems to be based on a presumption, almost
a religious presumption that it's got to be true, that
the performance is the thing that is really valuable
in terms of what streaming is about. And therefore
that thing has to be getting a significant fraction of
the total.

Well, it seems to me if it was
performances that are really valuable, we would
observe somebody making money with them because they
are easy to get. You or I can get performances, the
right to make performances. All we have to do is file
with the Copyright Office in terms of the sound
recording and write a letter to ASCAP and BMI and
indicate your willingness to be bound by their license
and to and behold you've got that. You've got the
right to make performances. If that was the key to
Eldorado on the internet, then we would have seen
people making money on the internet and we haven't
really seen that. What that says to me is that if and
when anybody ever goes figure out how to make money on
the internet, it's going to be somehow bringing to
bear to that business something or some things that
are very important and significant other than the
performances themselves, because the performances are
available today to anyone who wants them. And if that
was the thing that creates value on the internet, then
value would have been created on the internet. So I
just think it's irrelevant to observe that if we apply
a market price-derived model, the result is going to
be a relatively small percentage of the costs or
revenues of these streamers are actually going for the
performances. Because my response to that is yeah,
and that makes a whole lot of sense. It should be a
small percentage because it's pretty darn clear that
the right to make performances is far from what you
need to make money on the internet. You must need a
whole bunch of other stuff.

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

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

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

Q The footnote is correct as stated?

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

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

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

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

(Off the record.)

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

MR. GARRETT: 9.

CHAIRMAN VAN LOON: Please proceed.

MR. GARRETT: Thank you.

CROSS EXAMINATION

BY MR. GARRETT:

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

12 A Good afternoon.

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

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

CHAIRMAN VAN LOON: Absolutely, please.

We’ll need to call on your erasure skills first.

MR. GARRETT: I think I can handle that.

BY MR. GARRETT:

7 Q Dr. Jaffe, I’d like you to imagine for a moment a continuum, two poles, sort of the extent of my talent. And on the one hand we have a benchmark that if it were proposed in this proceeding and there were record evidence supporting it would be in your view outcome determinative. It is so close to what the real rate ought to be here that you would say go for it. Okay? That’s on one end of the extreme. We’ll call this the outcome determinative benchmark. The other end of the continuum here, I’d like you to think of a benchmark that if it were proposed by any party, it would be totally unreasonable. No reasonable person would rely on that benchmark, okay? We’ll just call it unreasonable. If the Panel adopted it, they would certainly be acting arbitrarily, okay?

Do you understand what I’ve done so far?

A I suppose, yes.

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

A I have great difficulty thinking about that as a one dimensional question and let me explain why. I think there’s sort of two issues. One is how good a benchmark is it and there’s a separate issue which is how precisely does it pin down exactly what the number is and those are two different issues. I think in terms of a good benchmark that can be relied on, my model is outcome determinative. I would be the first to admit though that it doesn’t give you an extremely precise number. There is some estimation that is involved in it, so that it’s outcome determinative with a range.

Now I don’t know how to represent that on your one dimension.

Q Let’s make it -- let’s just take the top continuum as being the concept, okay?

A Okay.

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

A Correct.

Q Why don’t we just stick with the concept for a moment then?

A Okay, fine.

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

A Fair, yes.

Q We’ll just label the radio PRO payments, okay?

A Okay.

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

A I think they’re unreasonable. They don’t tell me anything about the willing buyer/willing seller rate.
Okay, so we've got a little space to make up between the two of us, I guess.

ARBITRATOR VON KANN: We noticed that too.

BY MR. GARRETT:

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

A: I don't know.

Q: Why not?

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

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

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

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

correct?

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

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

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

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

A: Have put forward, yes.

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

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

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

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

A: That's fine. Well, again, I have another issue that I have difficulty fitting in one dimension which is to me there's a difference between how I would think about a benchmark if that was all I had and I were viewing it in isolation and how I might think about that same benchmark and is it useful to me when used in conjunction with other benchmarks in terms of reinforcing or confirming what is shown by other benchmarks.

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

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

A: Yes.

Q: And you know what the ASCAP forms and BMI forms -- they're actually form agreements provide,
correct?

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

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

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

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

A No, I'm not.

Q Is your view that those rates and terms that is those in the ASCAP and BMI form internet agreements would not be a good benchmark to set the royalty in this proceeding, correct?

A That is correct. We've done the commercial radio analysis, correct?

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

A Not per se, no.

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

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

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

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

THE WITNESS: I think it would be a mistake for this Panel to choose as its result a 3.5 percent of royalty formula. I do think that your question was wouldn't I think that was a good outcome and I'm saying no, I don't think that was a good outcome. At the same time do think that it would be perfectly reasonable for this Panel in weighing all of the different evidence before it and I have no particular illusion that they're going to adopt hook, line and sinker every number and every plus sign and minus sign and multiplication sign in my model.

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

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

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

MR. GARRETT: Form agreements.

MR. RICH: Internet license --

MR. GARRETT: Yes. Internet form agreements.

MR. RICH: Thank you.

THE WITNESS: Yes, that is correct. We've
glossed over that. The form agreements that are
offered by ASCAP and BMI have a number of different
options, including options that are not based on a
straight percent of revenue.

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

Q And the other alternatives generally
consist of higher percent of revenues applied to a
smaller base of revenue and it's either the higher of
that percent of revenues or something that is based
upon the number of page impressions, correct?

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

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

A Yes, I'm familiar with those.

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

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

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

ARBITRATOR GULIN: Can I just interrupt?

How about agreements between record labels and
services that are DMCA compliant?

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

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

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

(Laughter.)

They give us a --

Q I'll take what I can get.

A This is quite serious and this is an
important principle that you learn in chemistry majors
and undergraduates, they teach you this in science
classes. There's a difference between accuracy and
precision. Accuracy is the matter of are you right or
not? Precision is how precisely have you measured,
how narrowly have you measured whatever you've
measured. And you can be very precise and be wrong.
And you can be pretty accurate and be imprecise. And so what I would say is with respect to revenue and expenses, the RIAA agreements are quite precise. They tell us the number is 15 percent because virtually all of the percent of revenue agreements are 15 percent, percent of expenses is little less so, some of them are higher, but certainly in terms of -- there are none lower than 5 percent. So they're precise, even if they're wrong.

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

MR. STEINThAL: In the public service, I would like to point out that should probably be restricted.

BY MR. GARRETT:

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

A. Yes.

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

A. Yes.

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

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

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

THE WITNESS: No, that's not what I'm talking about. I'm talking about is how precise is the judgment I've given you. So I think the over the air model, based on musical works with the confirmation that we have on equality and with the other things that we've talked about is air tight as an argument as to how to approach this, but I've been pretty up front of saying, for example, when I look at the appropriate discount, it's somewhere between 40 and 70 percent, so I really haven't given you an exact number. I've told you a range that I think would be reasonable and then I've picked a number within that range, but I think I've been pretty up front about saying that that involves some judgment.

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

BY MR. GARRETT:

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

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

CHAIRMAN VAN LOON: 8.

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

BY MR. GARRETT:

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

A. Yes.

Q. All right, any other potential benchmarks you think we ought to put up on any of these continua here?

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

Q. That's the idea.

(Laughter.)

I was just going to give you an opportunity if you thought I'd not fully covered all the potential benchmarks that you think the Panel
A  I have not proposed any other benchmarks.
Q  Okay. Now when you were here the last time, I believe you had said something to the effect that you thought there might be some issues with the 26 RIAA agreements, but that you were still in the process of looking at the facts surrounding those agreements more closely, correct?
A  I think that's correct, yes.
Q  And you said you thought there were some problems, but you really weren't sure?
A  Yes.
Q  Because you hadn't done the requisite analysis yet, correct?
A  I think what I said is I had identified categories of problems, but I hadn't yet figured out to what extent they applied to each of the 26 different agreements.
Q  And you have now made that determination as to what the problems are with respect to each of those 26 agreements, correct?
A  I certainly enumerated some of the problems I found in the record with respect to the 26 agreements, yes.
Q  You think there might be more?
A  Yes.
Q  I guess I shouldn't have asked that question, huh?
(Laughter.)
ARBITRATOR VON KANN: Didn't they teach you anything in law school?
MR. GARRETT: Yeah, they told me not to be in this position at 6 o'clock on Friday night.
(Laughter.)
BY MR. GARRETT:
Q  You, in your written testimony, have focused your discussion of these agreements and the problems with these agreements by looking at just the record of this case here, correct?
A  Certainly that's the vast majority of the evidence, yes.
Q  Well, that was not a good question. The question really is exactly what is it that you have looked at here to determine the specific problems with respect to the RIAA agreements?
A  I've looked at the documents that were produced primarily these negotiating documents, e-mails and so forth and the testimony of the various witnesses in the proceeding.
Q  Have you spoken with any of the 26 RIAA licensees?
A  Yes, I have.
Q  And who have you spoken with?
A  I knew that was going to be the next question.
Q  I'm pretty predictable.
(Pause.)
A  I'm afraid as I sit here, I can't remember these names, all sort of sound the same to me and I get confused as to which is which. There were two, I believe, individuals that I spoke with from two different licensees, but as I sit here, I can't tell you which ones they were.
Q  Do you recall the names of the individuals?
A  No.
Q  You don't recall the specific licensee either, do you?
A  Correct.
Q  When did you have those conversations?
A  Those conversations were back in the time frame actually before -- between the written direct and my oral direct testimony when I was starting to think conceptually about what are the issues that might have arisen and I was trying to formulate my thinking about that.
Q  Did you make any notes of those conversations?
A  Not that I still have, no.
Q  Do you remember what issues you discussed with them?
A  Some of them, yes.
Q  Would you tell us?
A  One of them dealt with sort of this information issue and the question of whether the individual at the time that he was dealing with the RIAA, understood what the statutory license could do...
for him and whether he made the decision knowing that the presence of the statutory license meant that he could stream without signing with the RIAA. And that helped me to think about things. I'm not relying on that representation. I mean there's not an X in my chart that is supported by that particular conversation.

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

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

ARBITRATOR VON KANN: Which version do you have?

MR. GARRETT: The later version.

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

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

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

I have a list of citations either to specific documents or transcript references which is the basis for every X on that chart.

ARBITRATOR VON KANN: Okay.

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

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

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

THE WITNESS: As it were.

BY MR. GARRETT:

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

A. Yes.

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

A. Yes.

Q. Now potentially all webcasters could participate in CARP proceedings and therefore incur the cost of litigation, correct?

A. They could, yes.

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

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

Some of these licensees, I think a reasonable presumption is that if they had not signed a voluntary license and had relied on the statutory, they would not necessarily have participated in this proceeding and incurred significant litigation costs.
And in the case of Soundbreak, for example, you reached the conclusion that you did based upon a newspaper article that was put in the record here, correct?

A Yes, I think that is correct.

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

Page 65 of your written testimony?

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

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

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

Q So would it be your view that whenever you had an agreement where one of the negotiators said to the other negotiators, hey, you ought to settle this and avoid some litigation costs, that in and of itself would be enough to warrant a little checkmark here on your chart?

A I don't know.

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

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

BY MR. GARRETT:

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

A Correct.

Q I want to go back again though, so we're
clear here. Is it your statement by one of the negotiators that you ought to settle because you're going to avoid a lot of litigation cost. Is that in and of itself enough to render a particular agreement an inappropriate benchmark?

A Not necessarily, no.

Q What more do you need to know?

A Well, again, it's not a 0-1 thing of appropriate or inappropriate. I think it's a cumulative effect of evidence. I think the threshold question is what evidence do you need to think that this particular issue in this case, litigation costs is a concern and we talked about that. I think whether or not litigation costs being a concern would lead you to really not rely on the agreement at all or to perhaps just give it less weight, would depend on the facts. And in the case of Yahoo! we have some pretty specific facts. In the case of these others there are other factors beside the litigation costs which are also contributing to the conclusion that we can't learn much from these agreements about a reasonable fee. So it's not a matter of you know, it's not like pregnancy, you're either pregnant or not. It's a matter or cumulative evidence regarding the concerns about this proposed benchmark.

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

A And SESAC, yes.

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

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

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

A Yes, I think I did. That was discussed in my direct testimony as to what was the effect on that agreement of the fact that both ASCAP and the Radio Music Licensing Committee were doing that knowing that if they didn't reach that agreement, there would be litigation in rate court. So yes, I did consider that and made a determination that on balance, the effect of that determination is that the rate is probably high, if anything, but that it's the best indication we have of a competitive market rate.

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

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

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

A That's not correct. I'm not involved in
that litigation.

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

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

(Pause.)

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

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

What I've done is I have said if I see evidence that they did not understand that the statutory license was available to them, that the existence of the statutory license meant that they could begin streaming from the day they filed the appropriate papers whether the RIAA wanted them to or not, or that they didn't know whether or not what they were doing was compliant with the statutory license and if I see that affirmative evidence of that lack of information, then I would have put an X here.

Q. Is there anything else that would have caused you to put an X here?

A. I don't think so.

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

A. Yes.

Q. And what else did they need to know?

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

There really are only a handful of information Xs, all of which are licensees that had other problems as well. So I haven't made a huge deal out of this information issue, but there is some evidence.

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

A. Certainly not.

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

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

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

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

Q. If we, the RIAA, were to enter into agreements with any of the parties that they're litigating with on these personalized services, would that fact by itself mean that there are agreements on statutory licensing rates, would be -- would not provide a good benchmark for setting a royalty rate in this proceeding?

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

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

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

Q. So for example, if you were to enter into a settlement with a webcaster such as MTV who we are litigating against, that agreement would not be a good benchmark for setting a royalty rate in this
proceeding?
A I would certainly have significant concerns about using that agreement as a benchmark, yes.
Q And when you say significant concerns, does that mean that you're holding out the possibility that it still might be a valid benchmark?
A Well, what I've said is you know, I don't think validity of a benchmark is a yes/no thing. It's a matter of degree and cumulative evidence. I would -- and you're giving me a hypothetical where I sort of don't know any of the other aspects and I guess what I'm saying is I'm not going to sit here and say that based only on what you've told me I would throw it out the window and pay no attention to it. Based on what you've told me I would have significant concerns and I'd be inclined not to give it a lot of weight and if there were other reasons to be concerned, I might well give it no weight, but I don't know.

Let me ask you about the column that you've marked bundling with statutory right. You've reviewed the 26 agreements themselves?
A You mean the actual license documents?
Q That's correct.
A I have not reviewed all 26 of the actual license documents, no.
Q In this section you're not suggesting that there's anything in those agreements that gives the licensee something beyond the statutory license rights here, are you?
A Not in general, no.
Q When you say not in general?
A There may be one or two cases where there's actually something in the agreement. I don't remember.
Q All right, so what you're referring to in your testimony here is something beyond those written agreements, correct?
A Generally, that's true, yes.
Q Now for example, you say here on your demonstrative that one of the things that some of the licensees were getting was received enhancement relationships with label community to improve ability

to secure non-statutory licenses, correct?
A Yes.
Q Is it again your view that the mere fact that some company, some webcaster wanted to obtain an interactive license or have a certain kind of relationship with other record labels, that mere fact alone mean that you could not look at any agreement that RIAA entered into with them?
A No, that is not my position.
Q So for example, there are a number of these webcasters here in this proceeding who have indicated that they would like or they have other relationships with record labels. Are you aware of that?
A Yes.
Q And the fact that they have those relationships or want those relationships is not per se disqualifying their agreements with RIAA or any agreement with RIAA as a benchmark in this proceeding?
A No, I don't think the test is that the licensee wanted something more. The test is did the licensee perceive, is there evidence that the licensee perceived that they were, in fact, getting something more and that's what I've looked for and as we've seen, although I agree with you, it's not part of the agreement. Mr. Marks' own behavior suggests that it was not unreasonable for these licensees to perceive that they were getting something more.
Q So if Mr. Marks sends out an e-mail to all of the labels and said this is a good guy, you ought to help him out with what they're looking for, that fact --
A He did more than that. He said --
Q I'm not asking it. I was asking you if that's all, all right. If he simply sends out --
A I'm sorry, I interrupted you. I apologize.
Q It's all right. If all he does is sends out an e-mail saying that this is a good guy. He's one of our licensees. He's looking for some -- the ability to deal with the rest of you, would that fact in itself mean that you can't look at the license agreement any more?
A First of all, I never said that any one of
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<td>these says you can’t look at the license agreement.</td>
<td>can’t necessarily conclude that what you’re seeing</td>
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<td>I said that these things are sources of concern. I</td>
<td>here is a competitive market transaction that tells us</td>
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<td>think if I had an e-mail from the licensee saying I’m</td>
<td>the competitive market price for the statutory right.</td>
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<td>doing this because I really want to be on good terms</td>
<td>Q Would you agree, would you not, though</td>
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<td>with the record industry and then they sign the</td>
<td>that there would be probably a lot of webcasters out</td>
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<td>license and I saw an e-mail from Marks saying this guy</td>
<td>there who would like to maintain good relationships</td>
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<td>has just signed a license, I think we should be nice</td>
<td>with the individual record labels?</td>
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<td>to him. I think yes, that would be a source of</td>
<td>A Sure, although many of them decided that</td>
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<td>concern, that that’s what the parties perceived was</td>
<td>however much they might like to have that, they</td>
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<td>going on. I never said it in and of itself</td>
<td>weren’t going to sign with the RIAA. I don’t take</td>
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<td>disqualified the thing, but I think it would be a</td>
<td>that as evidence that it was unreasonable any more</td>
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<td>source of concern.</td>
<td>than I take it in and of itself as somehow</td>
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<td>Q Do you think that in your competitive</td>
<td>unreasonable that people wanted to do that. I think</td>
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<td>market that there would be a number of webcasters, who</td>
<td>you have to analyze what does it tell you about the</td>
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<td>would believe that if they entered into some sort of</td>
<td>market prices.</td>
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<td>statutory or entered into some sort of licensing</td>
<td>Q I guess my only question here is whether</td>
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<td>arrangement with RIAA, that that would help them in</td>
<td>you thought that by having – the webcaster who had</td>
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<td>the relationships with the individual record labels?</td>
<td>that view and wanted to maintain good relationships</td>
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<td>A Perhaps.</td>
<td>with individual record labels was somehow atypical of</td>
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<td>Q And the notion that if you’re a webcaster</td>
<td>the rest of the webcasters?</td>
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<td>entering into a deal with RIAA would help you with the</td>
<td>A Well, we already said that wanting to</td>
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<td>individual labels, would you consider that to be</td>
<td>maintain good relationships is not what caused concern</td>
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<td>something that is uncommon in the industry itself?</td>
<td>for me.</td>
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<td>A No.</td>
<td>Q You talk about another concern here that</td>
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<td>Q But in your view it would raise concerns</td>
<td>there are certain licensees who thought that by</td>
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<td>as to whether any agreement they entered into could be</td>
<td>entering into a license would enhance their ability to</td>
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<td>used as a benchmark for purposes of this proceeding?</td>
<td>be serviced, correct?</td>
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<td>A Yes, and to be clear I’m not saying</td>
<td>A Yes.</td>
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<td>there’s anything nefarious or anything inherently</td>
<td>Q And the notion of wanting to be serviced</td>
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<td>non-business-like of being these other considerations.</td>
<td>again is probably not atypical of the marketplace</td>
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<td>The question I’m putting to myself is</td>
<td>whether, right?</td>
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<td>we have the RIAA who is a monopolist who is putting</td>
<td>A No, it’s not.</td>
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<td>out a price and hoping people will take it and the</td>
<td>Q And your concern is that they thought that</td>
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<td>question I’m asking myself is can we draw an</td>
<td>by entering into an agreement with RIAA that would</td>
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<td>inference, an affirmative inference from the fact that</td>
<td>help them be serviced?</td>
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<td>certain people have chosen to take it, that that is,</td>
<td>A It wasn’t just that they thought it, it’s</td>
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<td>in fact, the competitive price. You’re asking us to</td>
<td>that it appears to be have been true.</td>
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<td>draw an affirmative inference from their acceptance of</td>
<td>Q There’s evidence that you’ve seen here</td>
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<td>that price, that it is not a monopoly price, it’s a</td>
<td>that once they enter into those agreements, they then</td>
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<td>competitive price. What I’m saying is some of these</td>
<td>begin to get serviced?</td>
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<td>other considerations as common as they may be, as</td>
<td>A I should say that differently. There is</td>
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<td>human nature as they may be, as natural as they may</td>
<td>evidence that they seem to have tried to get serviced</td>
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<td>be, nonetheless, when you think them through</td>
<td>and were told if you want to get serviced, go get a</td>
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<td>analytically, leads you to the conclusion that you</td>
<td>license and then we’ll talk about being serviced. I</td>
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don't actually know what then -- I'm not sure I know what then happened.

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

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

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

A Not that I recall.

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

A Yes.

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

A Yes.

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

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

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

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

MR. GARRETT: I thought I did.

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

(Pause.)

CHAIRMAN VAN LOON: Could I ask, related to that, Mr. Garrett, I know we made a pledge that our normal time would be to go through ballpark 6:30 which is what is fast approaching.

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

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

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

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

ARBITRATOR VON KANN: All of us will be.

(Laughter.)

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

(Laughter.)

CHAIRMAN VAN LOON: It does raise a question about whether anyone thinks it would be wise at all to start a little earlier tomorrow morning, 8:30 or whether that's a fate worse than death.

MR. GARRETT: Not a groundswell there.

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

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

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

ARBITRATOR VON KANN: Okay.

MR. GARRETT: Including myself.

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

Whereupon, at 6:25 p.m., the hearing.
recessed, to reconvene tomorrow, Saturday, October 20, 2001 at 9:00 a.m.)
In the matter of: Digital Performance Right in Sound Recording and Ephemeral Recording

Docket No. 2000-9 CARP DTRA 1 & 2

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

Saturday,
October 20, 2001

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

BEFORE
THE HONORABLE ERIC E. VAN LOON Chairman
THE HONORABLE JEFFREY S. GULIN Arbitrator
THE HONORABLE CURTIS E. von KANN Arbitrator
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Corporation; Radioactive Media Partners, Inc.;
RadioRave.com, Inc.; Entercom Communications
Corporation; Spinaker Networks, Inc.; Susquehanna Radio
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EXHIBIT DESCRIPTION MARK RECD
RIAA
116 RPX Jaffe Demonstrative 12611
001 RPX Song List 12660 12660
SERV Rebuttal
10 Disney Movie Log 12652 12663
11 Disney TV Log 12652 12663
request for
VAN LOON: Welcome back.

WITNESS: Thank you.

AIRMAN VAN LOON: We're glad you're taking part of the weekend well.

ADM JAFFE:

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

CROSS EXAMINATION CONTINUED BY MR. GARRETT:

Good morning Dr. Jaffe.

Good morning.

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

Q: When did you do that study?

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

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

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

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

A: Yes.

Q: So you got the first batch of data about 10 days before the rebuttal cases were filed, correct?

A: That's my recollection.

Q: Do you have any of those documents with you?

A: Yes.

WHEREUPON, ADAM JAFFE

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

CROSS EXAMINATION (CONTINUED) BY MR. GARRETT:

Q: Good morning, Dr. Jaffe.

A: Good morning.

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

A: Okay.
BY MR. GARRETT:

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

A. No.

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

A. No.

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

(Pause.)

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

MR. GARRETT: You noticed the difference?

ARBITRATOR VON KANN: Yes, I noticed the difference.

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

(Laughter.)

BY MR. GARRETT:

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

A. Yes.

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

A. Yes.

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

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

MR. RICH: Exactly what your hypothetical would be there, Mr. Garrett?
sound recording and what did it cost to make the
musical work when you are figuring out for this
incremental use their relative values, but rather that
because they're coming to this symmetrically, they
would get likely equal values and I was just making
the observation that when Congress faced the question
of splitting up the sound recording portion of it
between the record companies and the artists, Congress
didn't say you split that up in proportion to somehow
how much it cost each of them to -- what was their
relative original contribution to that sound
recording. They just said divide it in half. And
that's not the basis for my view because I don't know
why Congress did that. I'm just making the
observation that that is conceptually analogous to the
way I've looked at the sound recording versus the
musical work.

Q Are you familiar with the Audio Home
Recording Act?

A No.

Q Are you aware of the fact that the
royalties paid pursuant to the Audio Home Recording
Act are split two thirds to record labels and one
two third to publishers?

A No.

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

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

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

A Yes.

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

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

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

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

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

BY MR. GARRETT:

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

A I haven't focused on them, no.

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

(Pause.)

COURT REPORTER: Will be going into public
record now?

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

CHAIRMAN VAN LOON: Let's certainly go
back on the public record now and I guess the question
is whether we could go back to the beginning of that,
your theoretical questions when you were asking about
whether the three groups, the record companies, the
publisher and the background artists had shared
equally and then the question about the four, you
added in featured as well as background.

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

CHAIRMAN VAN LOON: That's easier to find.

(Pause.)

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

So let's continue in open session.

BY MR. GARRETT:

Q You are on page 17, Dr. Jaffe?

A Yes.

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

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

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

ARBITRATOR VON KANN: Before that.

MR. GARRETT: The very paragraph before
that.
THE WITNESS: Okay, well, this is a section that I didn't discuss orally yesterday because I think it's very much second order. I've explained why I think theoretically and why I think the data show empirically that the relative cost contributions in the sound recording of the recording company and the artists on the one hand and the publisher and the composer on the other hand are irrelevant because it's an incremental use. In this section, what I do is I say well not withstanding the fact that it's irrelevant, I don't think that the evidence necessarily supports the recording side is, in fact, greater. And I'm dealing here with an issue that came up in the direct which was the suggestion that well since the revenues that are earned from the sale of a CD by the sound recording owners are greater than the revenues that are earned by the musical work owners, doesn't that show that their contribution to the creation of that CD must have been greater? And the point that I'm making here is that that doesn't necessarily follow and there are two reasons. One is the statutory limitation on the mechanical royalty which is part of that, but even putting aside the statutory limitation of mechanical royalty, since we know that composers earn very significant revenues from performance rights in radio, which they can't get unless their song is on a CD, they might well have an incentive to lower the price that they charge for putting it on the CD in order to get access to those performance royalties in over the air radio and that's the point on page 17.

Q  Could it be the other way around? That they would actually take a lower performance royalty in order to generate higher mechanical fees? A  Well, that wouldn't make sense in the face of the statutory limitation on the mechanical royalty. The market, they can't get a market rate for their mechanical royalty, so it wouldn't make sense for them to somehow try to raise that, plus I don't really see how it would work because there are different parties, how would an agreement to charge less to radio stations per performance royalty help them in getting a higher mechanical?
revenue model, there is an additional issue which is
the concern that you could be making a lot of
performances and not paying for them and to me, the
solution to that problem is a per performance model,
but if you didn't achieve that solution, I would agree
that you might want to think about some other kind of
solution. I don't know what it would be.

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

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

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

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

Q Right. The BMI fee, you've listed as 259
which indeed the smallest minimum fee. But is it not
the case that BMI has three different minimum fees?

A  I don't recall.

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

A  Well, if it escalates depending on revenues, then the minimum is the minimum. I mean, the idea of a minimum fee is what you would pay if otherwise you would pay nothing because a model generates a smaller fee. So if you have a quote minimum fee that escalates with revenue, then the minimum fee is the lowest number that that formula produces, presumably that is what they believe they need to get to cover their incremental costs for a licensee that has de minimum revenue.

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

A  No, I do not.

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

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

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

Q And that goes to $517, right?

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

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

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

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

(Pause.)

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

ARBITRATOR VON KANN: Will this be the
restricted session or not?

MR. GARRETT: I believe so, yes.

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

MR. GARRETT: That's fine.

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

(Off the record.)

**********CLOSED SESSION**********
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Are we in restricted session?

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

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

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

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

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

MR. GARRETT: Okay.

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

MR. GARRETT: We're okay.

BY MR. GARRETT:

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

A Yes.

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

A Yes.

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

Is that right?

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

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

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

Q So even though they may have started out under some misapprehension of how the statutory license works, as long as they got it right before they signed on the dotted line, then we're okay.

Page 12616

A I think that would be right.

Q Have you reviewed the information that the DIMA has put on its website concerning the operation of the statutory license?

A Yes.

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

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

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

A Yes.

Q Do you have an opinion as to whether, if someone read and understood what was said on the RIAA website on this issue, whether that person would have a clear understanding of how the statutory license works?
I mean you could define understood it as
knew everything they needed to know, in which case
your question is a tautology. If we define
"understood it" to just mean they read those sentences
and they saw what was there and on some level they
absorbed it, I don't know that what's there is really
sufficient to make them understand what their options
were.
I think the fact that that website was
there the whole time and various licensees are writing
emails that clearly indicate that they don't
understand, suggests that it is not sufficient.
Let me go back to this RIAA Exhibit 116
RPX, and just number three there. I will try to
reverse the context here. If you found that a
licensee had a desire for rapid licensing for purposes
of satisfying potential investors, that I take it
would raise a concern to you?
A Yes.
Q Now when you say "for rapid licensing"
what do you mean by that?
A They felt that they needed to be licensed
to be licensed. I'm sorry. They
felt that they needed to have a license with license
terms faster than they would be able to get by relying
on the statutory license and this proceeding.
The whole issue with that is that RIAA has
market power unless the statutory license provides a
reasonable alternative. If I have a customer that I
can't make a deal with or an investor that I can't
make a deal with unless I have got the completed
license in hand with its terms, then the statutory
license isn't going to be a substitute for a voluntary
license unless it's going to be available in the
timeframe that I need to make a deal with that
investor or that customer.
Q Incidentally, I take it that the concerns
that you have raised here largely point in the
direction that the royalty rates to which RIAA
licensees agreed were too high. Is that a fair
statement?
A Yes, because of the market power of RIAA.
Q Are there any circumstances that you can
conceive of here that would suggest that the royalty
rates to which any of the licensees agreed to were too
low?
A No.
Q In going back to this number three here,
dealing with rapid licensing, is it relevant to look
at the amount of time that the parties engaged in
negotiation or discussion of a license here in
determining whether or not this particular concern is
present?
A I don't think so, no.
Q I take it that the mere fact that one of
the licensees was trying to obtain investors, that
fact in and of itself would not raise a concern
in your mind, would it, Dr. Jaffe?
A No, not absent some indication that the
licensee perceived that the lack of a license was a
problem in that regard.
Q On number four, I take it that the mere
fact that the licensee was out trying to obtain
additional customers, that fact in and of itself would
not suggest that there was a concern there. Correct?
A Again, not in the absence of some
indication that the licensee felt that he needed to
deal with this customer.
Q One other thing. Number 10 here, your
note three about press releases. Is the fact that a
licensee, the mere fact that the licensee after the
signing a deal with RIAA issues a press release, does
that in and of itself raise some concern in your mind?
A No.
Q What additional factors would you need to
consider besides that they simply issued a press
release?
A Some indication that the publicity they
were getting by becoming licensed was an important
consideration as to why they were doing it.
Q I take it with all of the various concerns
that you have raised here, you have concluded that
there is no way to adjust for any of them. Is that
right?
A As I suggested in my report, the only one
that I can think conceptually of how you would adjust
for would be the cost of litigation one. But in the
cases where it applies, it appears to be so large that
it's not -- I mean if you did the adjustment, it would imply a zero royalty, and I am not proposing that.

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

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

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

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

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

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

THE WITNESS: You've got it right.

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

THE WITNESS: Correct.

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

Perhaps with your example from the sheep salesman or the sheep farmer, if the sheep farmer is in a neighborhood where a lot of the kids coming to the petting zoo would be the children of powerful ranchers, they might want to have a big liability policy just to cover himself. Right?

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

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

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

To the extent that you believe there is evidence that there is an incremental risk for the sound recording owners associated with this use, which is different from risks that are faced by the benchmark situation, the musical works licensors in over-the-air radio, and you believe that you can quantify the magnitude of that risk, I think that that would result in an upward adjustment of the market royalty relative to that parity point for exactly the reason you have articulated, that is an incremental cost. That is not sunk. That is associated with the going forward activity.

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

CHAIRMAN VAN LOON: Okay. Let's assume for the purposes of the discussion that there is no quantified evidence. In a couple different places in your testimony, you say well, one place is the reference to Nagle, you say we'll go forward. There's going to be a negotiation. You talk about maybe this is a part of an upper bound or a lower bound, but you
are not offering a suggestion of where in the spectrum two negotiators might end up with on the price point. That it could be negotiation skills. Even at one point, you say bladder control, whatever.

The witness: They tried to make me take that part out.

Mr. Garrett: They should have succeeded.

Mr. Jacoby: Can we take a break now?

(Laughter.)

Chairman Van Loon: in any event, I mean you make the point. I think it's accurate. There is a negotiation going on. There is a question of, on the one hand, skills, and on the other hand, perceived issues. There certainly can be economic circumstances in which apart from the pure value, the perception or the circumstances of the negotiator may drive a deal more in the favor of one or the other.

I am thinking, for example, we go in to buy a car. There is some range. It may make a difference on the car salesman side if it's the last day of the month and he's got a quota to fill and he's willing to take a tiny margin or he's got a huge inventory and they have got to clear that out because it's this time of year, the old model year to get in another. So that might be something that would induce the car seller to accept a lower price. Similarly though, if I am coming in and my other car has just died or wrecked or whatever, and I have got to be on the road tomorrow, I may have an incentive -- I may have to make a deal even if I am going to accept more than I otherwise would.

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

The witness: I understand. That is a good distinction. I think my first answer didn't make that distinction. So I now understand what you are saying.

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

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

That again, is going to be -- you know, I guess what you are saying is it might affect that negotiation even if it can't be quantified. But of course for you to incorporate it in your decision, you are going to have to quantify it somehow in terms of how much impact you think it might have, which I think would be hard.

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

I don't know how to answer that question. I mean I think as an economist, what I would say is when I think about the market price, I would like to think about the market price in a market in which people are acting based on reality. But I won't deny that in real markets, they are sometimes affected by
irrationality. So in a sense, you could say that that is the market price, even if it is inconsistent with what the evidence shows about what is actually happening during the relevant time period.

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

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

So am wondering whether --

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

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

CHAIRMAN VAN LOON: The one other thing that you touched on that we keep wrestling with is the idea of the time period. There's certainly a strong argument, hey, we have got it easy. We are only looking at four years, and we're already through three of them, and we don't have to worry about what might happen ten years from now. I mean that's one whole way to look at it.

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

THE WITNESS: So what you are saying is that in putting aside whether what you decide would be a precedent for future, which is I think a separate issue, what you are saying is that in a hypothetical business negotiation, if two parties are negotiating a license for a fixed time period of a couple years, they are going to recognize and take into account and be affected by the fact that when they go to negotiate the subsequent period, what they agreed in this period will somehow influence that negotiation.

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

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

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

(Whereupon, at 11:49 a.m., the proceedings went into Closed Session.)
ARBITRATOR VON KANN: Does that last answer depend a little bit on how much the transaction costs are involved in revisiting this every couple of years? What if yes, sure, this is only for a short term, we can do another CARP, but it costs $5 million each time you convene a CARP or whatever it is. It's a very, very expensive exercise. Does that have some impact on the perception of the parties that when they start their very first go-round, we really need to look at this a little bit more than just two or four years because yes, of course we could do it all over again, but god, it's going to be expensive.

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

I think the very fact that there is nothing that compels in private negotiations parties to decide on one year, or two years, or anything else, to make the initial agreement precisely on the basis of a tradeoff between on the one hand, if we make it long, we minimize transactions costs, but we increase the chances that it is going to extend into a period where what we have agreed to no longer really seems to be the appropriate economics. So they balance that. One of the reasons they may choose a short term is precisely because they recognize that hey, this is a very rapidly changing situation and I don't want to promise anything now about what I am going to be willing to do in three years or five years.

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

CHAIRMAN VAN LOON: With that particular one.

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

CHAIRMAN VAN LOON: Sure.

ARBITRATOR VON KANN: This is on this issue of the it's all sunk cost business. When you were discussing that in direct yesterday, you made the point really in sort of responding to Dr. Schink and Wildman, the sheep farmer business. Then you said something which I made a note of, I think pretty close to verbatim, which was this. We could sometimes get to the point where the record companies would look at sound recordings as being produced for streaming as well as sales. At that point, they probably would look to start recovering some of their original production costs from the royalties for streaming because that is the way they are now looking at this product. It is not just a product for selling CDs. This is also a product for streaming, as I understood your testimony. Correct?

THE WITNESS: Yes. I think that is correct.

ARBITRATOR VON KANN: Why are we not there? In October 1998, the U.S. Congress said this stuff will be available to streamers. If you can't work out a deal, tough, the CARP will set it. It is now, it's out there. The streamers have got it. There is a forced -- you don't have a choice of whether you want it. It is now forced on you that you are producing sound recordings not just for CD sales, but for people to stream on the Web.

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

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

ARBITRATOR VON KANN: As whoever it was,
Everett Dirksen said a billion here, a billion there, pretty soon you are talking real money. I mean even under, I think even under your model, because webcasters did submit a chart, you add it all up, I can't remember exactly, but it's a seven figure number of royalties for all collectively.

**THE WITNESS:** The entire universe.

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

**THE WITNESS:** Again, I am not saying the royalty should be zero. What I'm saying is the magnitude of the costs that we're incurring, which is billions of dollars against billions of dollars of revenue on the CD side, is that magnitude of costs going to come to bear in thinking about how to price this incremental use where what's at stake is potentially millions of dollars, which is you know, less than one percent.

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

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

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

**CHAIRMAN VAN LOON:** Mr. Rich?

**MR. RICH:** Very brief redirect.

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

**REDIRECT EXAMINATION**

**BY MR. RICH:**

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

**A.** Okay.

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

**A.** Yes.

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

**A.** Yes.

**Q.** And my question to you is, when you present this data to the panel as result of your own methodology, what weight do you believe the panel should ascribe to these fees and how representative do you believe they are of the fees that a hypothetical competitive market would generate?

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

There's a difference between saying, if I observed, for example, MyPlay having negotiated a license with RIAA for $809, and that was all I knew, was that MyPlay had negotiated this license with RIAA for $809, would I be able to conclude from that deal alone that that represents a reasonable market fee.

And I believe I answered to Mr. Garret that, no, not necessarily if that's all you knew because there's not enough money there to know that you're seeing significant market transactions.

That's a very different proposition from the question, if I have a model which is based on other data that has a very sound and complete economic basis, and I then bring it to bear on MyPlay, and the
answer It produces is $809, is there any reason to
believe that that would be unreasonable; I think the
answer is no.

MR. RICH: That concludes my redirect. I
would want to offer at this point, since Mr. Garrett's
cross-examination utilized the so-called Disney movie
log, we're proposing to offer that in evidence at this
point, and for the sake of completeness to offer the
corresponding Disney television log, which would give
then the complete pic which has been previously
produced in this case to the other side.
But let me actually ask the witness -- if
we don't have multiple copies, I apologize for this.
But I want to show the witness a document labeled XJAJ
Rebuttal 0414 for identification purposes.
Professor Jaffe, do you recognize this
document?
THE WITNESS: Yes. This is the so-called
Disney TV log. The pages are actually labeled Music
Licensing Review. And in the same way discussed
with respect to the movie log, based on my discussions
with the individual at Disney, this is a course of
business record from Disney where they keep track of
the licensing of songs and television shows.

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

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

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

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

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

MR. STEINTHAL: Yes.

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

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

Mr. Garrett?

MR. GARRETT: I have no objection, at
least on the condition that I could ask some
additional questions so that we're all certain exactly
what's in this document.

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

Mr. Garrett: Sure.

RECROSS-EXAMINATION

BY MR. GARRETT:

Q Dr. Jaffe, let me ask you to turn to the
Disney movie documents you have there.
Dr. Jaffe, let's just go to that column
again that is marked as S/TRK and ADV and Royalty; do
you see that?

A Yes.
do that in a symmetric way.

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

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

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

A Correct.

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

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

Q Are you aware of any evidence from Sound Data as to the number of people who identify TV films, as a major reason for their purchase of sound recordings?

A I do not, no.

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

A No, I don't think that's correct. I mean, I think what we've said is that there is a right that is at issue in these data, which is including it in the movie for the purpose of showing in theaters. And that is a well-defined right that has a well-defined value that I have calculated in a well-defined way. And I don't think anything that we've been talking about for the last few minutes ought to be added into that. There are subsequent values that one can hypothesize, come about when it is included in the movie. And I've discussed at great length why I think in general they are small and uncertain and don't affect this decision. And in any event, they affect different songs differently. And the fact that we can just exclude the groups that are affected and get the same answer suggests that, in fact, none of that stuff makes any difference.

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

A That is correct.

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

A In that particular case, yes.

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

A Perhaps. And if you're worried about that, what I would do would be to exclude the songs that are sound tracks, and just say those may be your tainted; let's look at the ones that aren't.

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

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

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

A That could be.

Q And probably true for the publisher as well, correct?
That could be. And to really figure out what this deal is worth to a particular record label, one needs more data than the data that's simply here in this exhibit. I don't think that's true. Okay. Also, as we look at this exhibit, we see in the first column the song and the artist, correct?

And I guess it would be fair to say just looking at this exhibit alone we're not going to be able to determine whether the artist in each case is in fact the artist with which the public might be most familiar correct? If there were multiple versions of a sound recording, I'm not even sure that's well-defined concept. The artist the public is most familiar but certainly there's nothing in this document that tells you anything about that.

Well, we discussed before about how in negotiations between the record label and the motion picture company the motion picture company might say, look we'd like to have your particular version of the sound recording. But we really don't need it because we can go out and get version two or version three. Maybe they're not quite as well known, but they'll serve our creative purposes, right? And that happens in negotiations as you understand it.

I'm not even sure that's a well-defined concept. The artist the public is most familiar, but certainly there's nothing in this document that tells you anything about that.

Well, we discussed before about how, in negotiations between the record label and the motion picture company, the motion picture company might say, look, we'd like to have your particular version of the sound recording. But we really don't need it because we can go out and get version two or version three. Maybe they're not quite as well known, but they'll serve our creative purposes, right? And that happens in negotiations as you understand it.

Yes, that happens. But we don't know whether or not, without looking at additional information, whether the particular sound recording that has been licensed here is, in fact, the one that may have generated the most sales, for example.

That's correct. Also, in the sake of completeness, what we would like to have included in the record is an additional document that shows the specific songs that were excluded from Dr. Jaffe's analysis here.

Do you have a document already which indicates that?

Yes. It was one of the documents that they provided.

Is that the document that indicates the reasons for exclusion as well?

Yes.

May we see a copy?

It has both the ones that are excluded and included in this study.

We have on objection.

If there were multiple versions of a sound recording, I think it's the only restricted exhibit that we've offered in cross-examination.

I see. Then that will be admitted as well.

Just to be clear the first three pages are what are excluded and the rest of the document is what is included.

Let me just ask if you will questions about it.

I gave you documents marked RIM Exhibit 001 RRX. And let me direct your attention to the first three pages of that.

Okay.

Can you identify what those three pages are?

This is printout of spreadsheet that we produced indicating the songs that we had some kind of information on from one of the three studios but which were not used in the study. And it includes the reason why they weren't use, which in the vast majority of cases is simply because the information was incomplete. And then there a few in which there are other reasons why we concluded that we couldn't use it -- that we shouldn't use it.

Can you identify what those three pages are?

Yes. This is a printout of a spreadsheet that we produced indicating the songs that we had some kind of information on from one of the three studios, but which were not used in the study. And it includes the reason why they weren't use, which in the vast majority of cases is simply because the information was incomplete. And then there a few in which there are other reasons why we concluded that we couldn't use it -- that we shouldn't use it.

And then turning your attention to the remainder of the document, could you identify that?

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

Q. The one thing that's not on here, that's
probably going to be helpful for the record here, is
the titles of the different movies.

A. Okay. No, I'm sorry.

Q. Yes. That is the column entitled, Title.

A. That's why I missed it.

Q. I think this is clear on the record,

Dr. Jaffe, but you had indicated that the other
documents that you reviewed here did not have any
information on which movies generated sound tracks,
correct?

A. That's not quite correct. With respect to
the other studios, the basic information that I was
provided did not give that indication. With respect
to one of the other two studios, someone from my staff
actually spent some time in their offices reviewing
further information beyond that basic printout, which
I believe would have allowed looking at some other
information. But I just don't recall as I sit here
exactly how that was tabulated.

MR. GARRETT: All right. With that, I'd
say I have no objection to their including the movie
document into the record

CHAIRMAN VAN LOON: Okay. So all three of
them will be admitted.

[Whereupon, SERV Rebuttal
Exhibits 10 and 11 were
received for evidence]

MR. RICH: Mr. Chairman, if I may ask a
question or two on 001 RRX?

CHAIRMAN VAN LOON: Please.

REDIRECT EXAMINATION

BY MR. RICH:

Q. Professor Jaffe, I believe you may have
tested to this earlier. Putting to one's side

those transactions where there do not exist both sync
and master-use data, and therefore, where the
comparison could not be made, what impact on your
analysis and on the outcome of that analysis of
comparability occurs where you do add back in the
other transactions that were excluded; that is where
there were sync and master-use rights data but, which
for reasons you explain in your rebuttal testimony,
you chose to exclude from the analysis?

A. If you put them back in, I believe it
reduces very slightly the ratio of the sound recording
to musical works ratio, but qualitatively it's
essentially the same result.

MR. RICH: Thank you. I have nothing
further.

CHAIRMAN VAN LOON: Mr. Harding, are the
sandwiches that you had mentioned here?

MR. HARDING: Yes, they're I believe
upstairs. You would have to take an elevator upstairs
to eat.

MR. GARRETT: They're in the building.

CHAIRMAN VAN LOON: I see. We were
thinking about sort of a very short recess where
people will just grab a sandwich and bring it in, so
we can get through this last part quickly. But it
sounds like it may be more of a deal and we shouldn't
bring any food back here.

MR. GARRETT: No, it's not a big deal at
all. You can go upstairs and get them, bring them
back down, then we can continue. It's not a problem.

ARBITRATOR VON KANN: I guess I would like
to say to the parties, I feel very much of a culprit
here. It is a gorgeous Saturday afternoon, and
everybody, including me, would like to get out of
here. But I must say that I in reading the 80 pages
of Dr. Jaffe wrote a number of questions, some of
which have been answered but some of which haven't.
And I really do feel the need to spend a little time
with him dealing with that. I hope it won't take too
long. So maybe the sensible thing is grab the
sandwich, and come back in, and we can keep rolling.
And that will get us all out of here earlier. Is that
okay?

CHAIRMAN VAN LOON: Why don't we think of
it as 20 minutes that we'll hope everybody's got a
sandwich and ready to continue at quarter past.
(Whereupon, the foregoing matter went off
the record at 12:53 p.m. and went back on
the record at 1:19 p.m.)
CHAIRMAN VAN LOON: We hope you enjoyed
your lunch, Dr. Jaffe.
THE WITNESS: Thank you, Mr. Garrett.
CHAIRMAN VAN LOON: The panel has a few
questions for you.
ARBITRATOR VON IKANN: Let me say that I
found both your direct testimony and your rebuttal
testimony very thought-provoking and I have been
thinking about a lot of the issues raised there and
trying to work my way through them, make sure that I
understand them. And I have questions in several
areas where I want to make sure that I understand your
argument or your thesis, so I can, obviously, think
about it.
One of the first areas that I'd like to go
to is something we did talk about a moment ago. And
in my version this is the discussion that appears sort
of on pages 5 to 7, or 8, I guess, about the willing
buyer/willing seller. And, in particular, the notion
that with respect to musical works and sound
recordings, as we've said several times, the main
production costs are sunk. We're now dealing with
this new use that comes along of the Internet.
You say on page 5 that buyers need both
the sound recording and the musical work rights in
order to make public performances. And because of
that symmetry and mutual necessity, as you describe
it, the buyer's willingness to pay for each right will
be derived in the same way from the value that the
buyers expect to derive from making the performances.
Hence, there's no difference in the buyer's
willingness to pay for the musical work performance
right and the sound recording right. Going into
negotiations over either right, the buyers will be in
the same position.
Why isn't that equally true of the
position with respect to negotiations over the royalty
rates for the software that streamers will need to
operate their service? We've been told by several
witnesses here that virtually all of the services in
order to do what they do have to have software. And
that some of them developed themselves and a number of
them went out and obtained it from Microsoft or other
software suppliers, and they are paying a royalty for
the use of that software.
And it seems to me that Microsoft, or
whoever it is, their costs are sunk. They've
developed their software, and it's ready to go, and
along comes this new use, Internet streamers. Hey,
great. We never knew we'd have customers there, but
terrific; there they are.
So therein it seems to me a somewhat
similar position to the holders of musical works and
sound recording rights; that is, they don't have to
recover their original costs. They're looking at this
as a new incremental use. The buyer of the service
needs to have this software to operate. They can't
get up and running and put the music out, apparently,
without appropriate software. They need it
just as
much as they need the musical works and the sound
recordings, I think.

So from the point of view that they need
both the sound recording and the musical work rights
in order to make public performances, you could take
out musical work rights and put in software.
Why wouldn't the royalty rate for these
sound recordings be equivalent to or determined by
what the services have to pay to get this other
necessary input, which is being offered as sort of an
incremental additional use by the software developer?
I guess I don't see how the software license is any
different than the musical works license?
THE WITNESS: Okay. Well, I think there
are some similarities. I think there are also a
couple of important differences, though. One
difference is that the -- whatever is the value of the
software, it's not linked -- in terms of the aggregate
business of the streamer, I think I would agree with
you that the software is essential, the musical
performing rights are essential, the sound recording
performance rights are essential. There is not quite
the same degree of symmetry, though, because the
software is not linked to the individual performance
in the same way. In other words, every time they play a song, they make one performance, they are bringing to bear in a very symmetric way the sound recording performance right and the musical work performance right; whereas, the software is more of an overhead kind of input to the business operating. So that's one difference.

The other difference is -- and I don't know the details of the nature of this software. But it seems to me there's sort of two possibilities. One is that this isn't incremental; that, basically, this software was developed for the purpose of streaming on the Internet, and that's really what it is. And if that's what it is, then it's not incremental. And although for any one user, it would in a sense be incremental because they've incurred the cost of creating it. From the body of the Internet streamers they have to recover the cost of developing that specialized Internet streaming software because that's really what it was developed for. So that's one possibility.

The other possibility, as you indicated -- and as I say, I'm not sure what the facts are -- that this is more like an application of software that was previously developed for other uses, which is now being adopted in the streaming context. And in that case it's true that it's incremental, but it's also true, probably, that there is in some sense, and already established market price now. If what we're talking about is kind of the server equivalent of Windows -- this is basically just a big operating system that Net Radio uses and Arnold & Porter uses, there probably is an established market price for that; it's probably not being established by the streamers.

So it seems to me whichever of those two cases applies -- either it's not incremental because they really did develop it for this use; or in a way it's incremental but it's still just another use of the same thing as distinct from a CD, which is a physical product that is sold as a physical product, and then the right to perform that CD later, which is an incremental, non-tangible good that you're selling based on that physical product.

So I think while you're right, at some high level there are some similarities to software, I think there are also some important differences.

ARBITRATOR VON KANN: I think there may well be differences, because I don't know the details of this software-- was it developed just for this use. I can't remember, frankly, if any of the witnesses that we've heard have dealt with that. That would be primarily, I think, on the seller's side of the equation.

On the buyer's side for the moment, trying to understand the rationale of what you have here, which is, I think, to put out every song, I need musical works and sound recording. Let's assume that to put out every song I also need the software. Every single time I play a song, I need --

THE WITNESS: No, I would agree with you.

If you limit it to the buyer's side, then I think there would be a greater degree of similarity. But looking only at the buyer's side doesn't tell you anything. You need to put the two together in order to say something about market price. But I agree with you. Purely from the buyer's side there is quite a bit of similarity.

ARBITRATOR VON KANN: A little bit farther on in this discussion, at what's on page 8 of my version of your rebuttal, you have a paragraph that begins, *Note that this analysis does not in any way suggest that the zero incremental cost of the right being transferred would lead to a zero royalty. Quite the opposite. Intellectual property with zero incremental cost is routinely licensed at positive royalty rates.*

With respect to both musical works and sound recording, as we have a buyer, potential licensee, some maximum willingness to pay as derived from the value to the buyer of the performances, and we have the seller with a minimum willingness to accept equal to the zero incremental cost.

The economics of bargaining, as well as common sense, suggests that the parties will reach agreement at some point in between. Economics cannot really tell us where in the interval, between the buyer's maximum royalty and the seller's minimum royalty rates.
royalty the parties will come out. It will depend on
the stubbornness, negotiating skill, and, perhaps,
bladder control of the parties.*

Now, if I understand that, I think what
you are saying is that economic theory can get us only
so far in this exercise and perhaps establishing the
range. But one cannot sit here and sort of reason a
priori as a matter of pure economic theory where in
that range the parties will ultimately come out. Is
that correct?

THE WITNESS: I think it's correct for one
level of the analysis. I think that what I'm arguing
here -- or what I'm trying to think about here is this
conceptual proposition of the relationship between the
sound recording and the musical work. And what I'm
saying there is that in each case there's a range.
And the ranges in each case, if you accept the
premises of this section, are the same. And we don't
know where in that range each would come out, but
there's no reason to believe that it would go
systematically one way or the other, so that there is
an equivalence of position of the two. And in that
sense, I'm not using this section of the analysis to
try to pick a number; I'm just trying to think about
this equivalence issue.

When I actually implement this, what I do
is go to a very specific context where there has been
a lot of negotiation and a lot of back and forth over
the years and the presence of a rate court, and that
does produce a number. Now, that could have produced
a different number if there had been a different
sequence of negotiations or a different sequence of
history in that industry. But, nonetheless, it has
produced a number, and I believe it's the best
indication we have as a value, in that case for the
musical work. And my argument is, while it's true
that the number for the sound recording, if we were
really having this hypothetical negotiation, could be
somewhere in this range, a good benchmark for where
we're likely to be would be the number that has been
arrived at in this parallel musical works framework.

ARBITRATOR VON KANN: But does that
indicate -- it seems to me what you're saying is that
one could not work oneself through to a -- one could

not say, I can tell you, this is what the fair market
rate for this particular item is, purely as a matter
of economic theory without ever having looked at what
has happened in the real world. At some point, one
has to get some real-world data.

THE WITNESS: Absolutely. I couldn't
agree with that more.

ARBITRATOR VON KANN: Now, let me ask you
why I shouldn't, therefore, have some concern in
looking at your model from the following point of
view.

The 26 RIAA agreements clearly need to be
viewed with considerable caution in a number of
respects. They can't just be blindly applied. And
there are all kinds of reasons, some of which you'd
talked about, maybe even some others. But for better
or worse, those are instances in which some number of
buyers and sellers in the marketplace that we have to
try to replicate did sign on the dotted line to some
numbers.

If I'm correct, nobody in the real world
has agreed to the numbers that you have proposed in

Figure 4. There is no agreement anywhere that
reflects those rates. They are derived by you from a
different market with certain extrapolations applied
for which you've explained the rationale. But there
isn't a single real-world agreement that reflects
those rates. True?

THE WITNESS: Not for the sound recording
performance right; that's correct.

ARBITRATOR VON KANN: Let me ask about
something a little farther along here in your
testimony.

CHAIRMAN VAN LOON: Is it also related to
this same point?

ARBITRATOR VON KANN: No, it's moving on.

CHAIRMAN VAN LOON: Let me ask you a
related sort of question that I've been thinking
about.

Have you done some consulting work for
business people?

THE WITNESS: Yes.

CHAIRMAN VAN LOON: And have you noticed
a difference between the way economists think and

41 (Pages 12674 to 12677)
business people think?

THE WITNESS: Sometimes.

CHAIRMAN VAN LOON: Sometimes. How would you characterize part of that difference?

THE WITNESS: Well, business people tend to be less interested in the theoretical framework and more interested in the practical outcome. And also, business people tend to not care about broader public policy objectives, and they only care about making money, typically; whereas, as an economist you're coming from a broader perspective. So, sure, there are differences.

CHAIRMAN VAN LOON: And especially they tend to be more interested in making money, right?

THE WITNESS: Well, as an economist I think that's good. I mean, I'm not -- I don't mean to imply that there's something bad about them wanting to make money; that's their job.

CHAIRMAN VAN LOON: But my question is to emphasize that there may be a fundamental difference.

THE WITNESS: My analysis is predicated upon the assumption that all of the people involved -- the record labels, the webcasters, the streamers, the over-the-air radio stations that agree to the over-the-air licenses, and the performing rights organizations and the composers and publishers they represent -- are all interesting in making money. I mean that's a fundamental premise of my analysis. So I don't think that I'm somehow not taking that into account.

CHAIRMAN VAN LOON: Well, I don't mean to suggest that you're not, but I presume that that translates into then when we're doing our analysis and trying to figure out working willing buyer/willing seller, we should be thinking in terms of willing business buyer and willing business seller and with an acute sense that each one of them is going to be trying to maximize their profits, to the extent they can get away with it.

THE WITNESS: I agree with that.

ARBITRATOR VON KANN: And to sort of follow that a little bit, I guess an example of what might be different is I could imagine an economist, perhaps you, saying to the record industry folks, "Your costs are sunk. You don't have any need to recover these costs in this new arena." And I can imagine somebody from the record label saying, "Yes, but godammit we're going to try. We're going to go out there and get the best rate we can, and why shouldn't we try to recover a little bit of our costs in this new arena? These people are going to launch a new business and they want to make a lot of money, and if it succeeds, maybe I don't have to, as a matter of economic theory, but I'm going to sure try."

I guess, to some extent, I'm thinking --

I can't speak for my colleagues -- that wouldn't there be a substantial component of this which is, for lack of a better word, real politik? How much can we, in a straight face, go into a room and ask for and let's see what we can get? And how much -- on the other side, how much can we, with a straight face, go in and try -- I mean why isn't there going to be a substantial element of that?

THE WITNESS: There is and I'm not suggesting for a minute that they're not going to try to get as much as money as they can. That's the fundamental premise of this. The owners of the musical work performance rights try to get as much money as they can. And the question is, is the outcome of that tussle back and forth between them and the licensee who wants to pay as little as they possibly can going to be different in these two different contexts? And I guess what I'm suggesting is they may try to recover some of their costs but at the end of the day they are sunk. And, again, I come back to we do have data from this movie arena, which I think is -- everything we've been saying applies there as well, and we see what happens. And what we see if fundamental equality.

So I'm not for a minute suggesting that the record companies are bad business people who would not, in this hypothetical negotiation, be trying to get as much as they possibly can in negotiation for their rights. All I'm saying is that the outcome of that is going to be negotiated, and theory suggests it would be no different than for the musical work, and the data confirms in a situation where the same
principles apply that that's in fact what happens.

ARBITRATOR VON KANN: Let me ask you a
little bit about something a bit farther in your
rebuttal, and, again, on my pages it's at 42 and 43.
I think it might be --

THE WITNESS: I've been doing pretty well.

ARBITRATOR VON KANN: You've been
guessing? It's right preceding Section G, which is
called, "Services Proposed Royalty Rate."

THE WITNESS: Yes, I see it.

ARBITRATOR VON KANN: And you talk a
little bit here about the beginning, "I do not
believe," you talk about having developed the range in
your direct testimony, included that a sound recording
performance royalty in a range of 40 to 70 percent of
the musical works rate would be reasonable and so on.
You said, "I then propose a fee model based on the
absolute upper limit of this range." And at the top
of the next page you say, "Given the factors discussed
above, I believe it would be reasonable for the
rebroadcaster rate instead of being at the upper end
of the 40 to 70 range to fall in the lower end of the
range. What has changed since your direct testimony
last month that causes you to move from the top of the
range to the bottom of the range?

THE WITNESS: Well, with respect to the
webcasters, I've stayed at the top of the range. In
my direct testimony, with respect to the broadcasters,
rebroadcasters, what I had done last time was just use
that same upper end of the range but then to make a
deduction or proposed that the Services would be
permitted to make a deduction for users who they could
demonstrate were within 150 miles. And I kind of
justified that on the basis of the overall 150-mile
exemption that is in the law if everybody was within
150 miles.

And on thinking about it some more,
frankly, as a result, partially, of some questions
that Judge Gulin asked, I decided that that was really
not an overall consistent way to deal with what is
fundamentally the same issue, which is that there is
this competition with another medium in which it's
free, that tying it to the 150 miles and saying it
ought to be zero within the 150 miles just wasn't a
very good way to do that.

So what I've done, in effect, is to
discard any exclusion for people within 150 miles and
instead to just use the lower end of the range to
begin with, which has a somewhat similar magnitude.

And the motivations for doing it are basically the
same as the ones I had before, but I think it's just
a more straightforward way of dealing with that set of
issues.

ARBITRATOR VON KANN: Okay. Thank you.

Then a question on Page 43 to 44, and here may well
be misunderstanding what you're saying, so I just want
to get this clarified. But you talk in here a little
bit about the ADH data.

THE WITNESS: Okay.

ARBITRATOR VON KANN: And part of this has
to do with preparing the chart that we asked you to
prepare. But it appears, and maybe this is where
maybe I'm misunderstanding, but at the bottom of that
page there's a sentence that says, "When a licensee
instead calculates its fees, it will have the option
to base its calculation on the industry average or on
a reasonably reliable estimate specific to that
licensee, songs per hour times tuning hours."

And I may well be misunderstanding, but if
the Panel were to adopt a rate based on a per
performance model, why do we have to get into
estimates at all? Can't we -- this is the Digital
Age. There are, I would have thought, fairly easy
ways to have data that will tell us exactly what songs
were performed and how many hits or how many people
are listening. And maybe I'm wrong about that, but I
guess I just don't quite understand why we have to do
this, in any extent, on the basis of estimates.

Is it -- and maybe I should have got this
out of Zittrain when he was here -- but is it your
understanding that it is not possible to have actual,
precise counts of how many listeners tuned in to
listen to our service play this particular song last
night?

THE WITNESS: Okay. My understanding is
that it is possible to keep track of how many
listeners are listening for what period of time, and
this is basically the aggregate tuning hours. The number of songs, certainly, on the rebroadcast simulcast side where what they're doing is they're taking an audio signal that was produced for their over-the-air broadcasting and then just feeding it over to the Internet side, my understanding is it is not practical for them to keep track of how many songs that were played, because what comes over to the Internet side is just a continuous signal that was generated in the analog world of over-the-air radio. So that's part of the concern.

With respect to the webcasters, I would suspect, but I don't know for sure, that there is more ability, although there still are a lot of complicated issues, like what do you do -- how do you keep track of people who listen to a song but then their modem went bad and they got knocked off and then come back on and so forth? And so my understanding is although there's more ability there, that it's not as trivial as you might think, and it does seem to me it's in everyone's interests to keep this reasonably simple. Nobody loses by having an estimate which is not biased, which both parties can agree is reasonable, so that, on average, you're getting the right number of songs per hour times some measure of the listening audience.

ARBITRATOR VON KANN: Okay. I'd just say to the parties, we're getting down to the point where we don't have too many more witnesses coming, but at least this one Panel member is still not -- does not have a super command on what is technologically possible and not possible in this area and would welcome any clarification and help I could get. And I realize I probably should have asked more of Zittrain a couple of days ago and I'm sorry. And maybe it's already in the record, and I have -- it's just gone past me. And that was helpful too, Professor Jaffe.

On Page 51 of my version, you begin a section to talk about the RIAA benchmarks, and we've had quite a bit of discussion of that already today. I don't want to retrace that, but I do want to ask a couple of things in that area. At the top of my Page 52, you have a paragraph that says, "If the first of these questions cannot be answered in the affirmative, then we cannot conclude that the contract at issue represents reasonable rates and terms even if it's own context. Buyers who did not have good information about their alternatives cannot be considered willing buyers in the sense of replicating competitive market outcomes."

And I guess my question about that is this: I would have thought that in any market where there's a significant number of buyers and sellers there are going to be some substantial variations in the extent of information that any particular buyer has in relation to some others. Some of them will have done a due diligence like you wouldn't believe, and they'll know everything there is to know about the product that they're considering buying. Others will be more, I don't know what, they are entrepreneurs who go by their gut and they don't do all that stuff. They go in and size it up quickly, and they march into the table and they -- there's a tremendous range, I would have assumed, in the extent of information, knowledge, research, sophistication, understanding in any competitive market. And I guess I wonder a little bit how do we grade, how do we assign -- you know, you've got 97.2 percent and you're okay, but you've only got 87.

How do we decide how much knowledge is enough that we could -- I mean I would have thought that it all contributes to what the marketplace is doing. There may be some number of people who are not doing nearly as much research as they should, but they're in the market bidding, and they're signing deals. There are others who are extraordinarily knowledgeable. Doesn't this all, in a sense, get sorted out by where the center of the gravity of that market ends up being?

THE WITNESS: Well, it's certainly true that in any real market, as you say, there's going to be this variation. If the market is a well-functioning competitive market, which I would submit is your benchmark here, so I'm not talking about -- and you may have read that the Nobel Prize in economics for the last year went to three economists essentially for information economics. And what they
have made a career doing is studying particularly problematic markets that don't work very well, because there are information problems. And, certainly, in that case, the market outcome is very much affected by the fact that some people don't have good information. But we tend to think of that as a problem, as an exception to the norm that reasonably well-functioning competitive market has at least pretty good information.

And in a reasonably well-functioning competitive market, there's still going to be some people who, as you say, don't do any research or don't know what they're doing, but they're not going to determine the competitive price. The competitive price is going to be determined at the margin by the people who are reasonably well informed, and in some sense the people who are not well informed are going to ride along on that if the market really is competitive and working well.

Now, still it's not a matter of they've got to have -- you know, be able to pass a multiple choice test on the copyright law. I mean I'm not saying that have to absolutely know everything you could imagine they need to know. The idea that I was trying to get across is what we're looking for here is was the statutory license a reasonable alternative to them just accepting what the RIAA offered if hypothetically, the RIAA were to attempt to extract monopoly prices?

So what I'm looking for is evidence that they don't seem to have really understood that they had that option, that in order to begin streaming all they needed to do was do some paperwork. They could stream without ever talking to the RIAA, let alone signing something with them. And at the end of the day, you know, if you look at my demonstrative, there are really only a small number of cases where I've said that really seems to be a concern.

**ARBITRATOR VON KANN:** Okay. In a sort of a comparable way, I want to ask you about something that appears a few pages later. Again, on my version it's Page 56, and it's in a section, "Concerns About Timing and Uncertainty." Several licensees demonstrated a sense of urgency because of a variety of other business matters that were affected by the RIAA negotiations, including a need on the licensees' part to procure an RIAA license as a predicate to concluding a webcast radio syndication agreement with a third party or in some cases to secure investors.

Again, I would have thought that those are fairly typical things that happen to buyers and marketplaces. There's some number of them that are under pressures of one sort or another, whether it's they got a really great deal they want to secure over here and wrapping up this thing with the RIAA will help them, or they've got some Nervous Nellie investor who says, "I want to know." That just strikes me as, I would have thought, fairly garden variety stuff that happens in the marketplace.

**THE WITNESS:** But, again, it's the same issue. I'm not saying there's something anti-competitive about them being in a hurry. What I'm saying is we're not for a statutory license, we would presume that a deal with the RIAA is a monopoly deal, because they're the only one who can offer it. The only reason we might think that these voluntary agreements are representative of competitive markets is because the licensees had recourse to the compulsory license. And it happens to be the case that the compulsory license is not something you can get quickly.

And so we need that availability of the alternative to inoculate the transaction against the presumed market power of the RIAA. And while you're right, urgency in other context is often just part of life, in this particular context, the consequence it has is that it takes away our protection against the market power of the RIAA.

**ARBITRATOR VON KANN:** I guess -- and I don't want to belabor this too much -- but it strikes me that if one were to really try to run this to ground, it would be a more complex analysis than that, because it would seem to me that the presence of the compulsory license is a very substantial offset to the greatest power that a seller has, which is to withhold his product. And if you've got a bunch of buyers who are very eager to get your product and you have the capacity -- I guess this is another way of saying...
monopoly power -- you have the capacity to withhold it, the fact that there is this license which says, "You can start using it right away and you don't have to pay us for three or four years until the CARP gets around to it," is a very potent offset.

And it would seem to me that if you were really going to try to deal with that factor, you would have to not only look at the licensees who may not have been able to fully take advantage of that because they have Nervous Nellie investors, then you'd also have to factor in on the other side the licensees who used it to the hilt and may have been able to bargain the price down because of that availability.

I mean it would seem to me it could have offsets on both sides, and it would be a tremendously difficult exercise to figure, well, in this particular licensee, because he was under pressure from some investors, couldn't use the compulsory license factor too effectively. This one over here was able to use it extremely effectively. And that that would -- there would ultimately be almost a very tricky offsetting exercise that you'd have to go through one by one. I don't know how you do it.

THE WITNESS: Well, I disagree. I think if the standard is the competitive market, then there isn't any such offset. What you want is that fully, totally potent, as you put it, statutory license as the offset to the market power of the RIAA. And any limitation on that moves you away from the competitive benchmark. RIAA was under no compulsion to sign any of these licenses, and although I normally try not to put myself in the heads of negotiators, I doubt that the $500 or the couple thousand dollars they were getting from some of these licensees were the primary reason why they wanted to get those licenses signed.

I think that they wanted to get a number of those licenses precisely because they were trying to generate precedent for this proceeding. And if a licensee said, "You can't charge that. I've got the option of a statutory license," RIAA could say, "Okay, I'll see you in court." And they had no -- there's nothing that could -- they were not in any way compelled to sign on to a below competitive market price.

ARBITER VON KANN: On that point about trying to develop precedent for this proceeding, certainly that's an issue that's been raised. Mr. Marks and perhaps other RIAA witnesses have indicated, in essence, I think, "Yes, we were trying to establish precedent but precedent in the sense of trying to get the market and get all these other folks to line up, "Ah, we heard Yahoo struck a deal. Let's all go over and sit down with Marks and strike deals."

It doesn't -- and I guess I'd like your comment on this -- it doesn't strike me that I could imagine a situation in which RIAA was signing up these agreements for both purposes. If we can get everybody in the market to sign up at about this level, great, we don't have to worry about the CARP. If it falls through, we've got these agreements for the -- those don't strike me as mutually exclusive objectives.

THE WITNESS: Yes. And I wasn't suggesting, and I don't suggest in my testimony, that I'm relying in any way on an assumption that what RIAA was doing was creating precedent. I really don't care what RIAA was trying to do. I'm looking at this from the perspective of a licensee. I made the comment about RIAA only in the context of your observation that there seemed to be this sort of symmetric difficulty derived from the statutory license.

ARBITER VON KANN: Okay. Just one more. In the -- I guess two more. Again, my version it's Page 80. It's in your Section, "Nine Consequences of the RIAA Fee Proposal." There's a discussion here in a paragraph beginning, "More fundamentally, this is the cage of the Golden Goose --"

THE WITNESS: Yes.

ARBITER VON KANN: -- and the sheep, the bladder and the Golden Goose." And the notion here is that if the sound recordings were the key, these folks should be making money hand over fist, because they've had the use of those from the get-go for free. It seems to me that what -- and this is a little bit of an issue that I haven't quite figured out in my own mind, but that your testimony here sort of highlights it -- the problem, it appears, from the evidence that we've heard, the reason that very few, perhaps none, of the services have been able to be
profitable has nothing to do with the expense side of the ledger. It has to do with the revenue side of the ledger.

There is no evidence before me that would permit a rational conclusion that if we adopted your rate, these services would become profitable. Because at this point, the evidence is fairly overwhelming that there's been very little capacity to generate revenue to pay any of the expenses, to pay bandwidth, to pay software, to pay employees, to pay whatever. There's a big revenue problem here, clearly.

And so it doesn't seem to me that, frankly, the fact they aren't making money says very much about the value of the sound recording versus the musical works versus anything else. What it says is there's no revenue flowing in here, and unless some revenue starts coming from somewhere, nobody's going to make money regardless of what royalty you geniuses set.

So I guess my reaction to this was this doesn't really establish -- say much about the issue we're having to deal with. What it speaks to is the difficulty that apparently the advertising industry has not been convinced that this is worth putting very much money into.

THE WITNESS: Well, let me explain what I was trying to do in this paragraph, because it was just addressing a fairly minor point. And I don't disagree with anything you said. I certainly don't think that the key to profitability in this industry is that you adopt my model in this proceeding. I've said repeatedly that I don't care whether this industry is ever profitable or not; that's not the point. And I don't think -- and I agree with you that the reason they're not profitable is primarily the revenue side.

What I was trying to address was the notion that if somehow they ever did become profitable by which I mean they managed to generate real revenue, and under my model they would be generating significant revenue and making money, and darn it, the sound recording performance owners would be getting under my model only a relatively small portion of that, and there's something wrong with that, because somehow the sound recording is the essence of what they're doing, and therefore if they do ever figure out how to generate significant revenue, a significant chunk of that revenue should go to the sound recordings. That was the argument -- specific argument I was addressing.

And my point was just I see no reason why that's true. I don't see how a priori you can say the sound recordings are what ought to get a big chunk of that revenue. And, in fact, on the contrary, if all it took to generate a lot of revenue was that you had the sound recording performance right, we should see people having revenue because they've got that. So if anyone is ever going to generate revenue, it's going to be because they figure out how to do something else. And, therefore, there's no reason why, if that does happen, any particular percentage of that ought to go to sound recordings.

ARBTRATOR VON KANN: Last question I had has to do with your Section 10 on ephemeral issues.

THE WITNESS: The ephemeral section?

ARBTRATOR VON KANN: The ephemeral section. And I think I understand your thesis here that, in essence, the only reason to get these ephemeral copies is to do the performances. And if you're going to pay a royalty for the performances, that ought to be able to cover this in a single place. If you want to, you could divide it up and put a little over here on ephemerals and a little on performance. But once you've fixed out the fair rate for performance, it doesn't make any sense to have to pay additional for ephemeral.

Putting the aside for the moment, in the context of webcasters, that doesn't answer the question of the background music services who do not pay the performance royalty, right?

THE WITNESS: That is correct.

ARBTRATOR VON KANN: And have I missed where you address that in here?

THE WITNESS: That is not addressed in here. I did address it in my direct testimony, and I didn't have anything more really to say on the subject, which is why I think there really isn't anything more in that area.
ARBITRATOR VON KANN: So whatever you said in direct testimony is -- that's still what you say about this subject; is that --

THE WITNESS: Yes.

ARBITRATOR VON KANN: Okay. All right.

Nothing further for me.

CHAIRMAN VAN LOON had a couple of areas, but it will be more brief. And picking up right here in the ephemeral part, you say there's nothing from an economic perspective that justifies an additional fee. If we're back in the old willing buyer/willing seller but it's a businessman and not an economist, can't you be 100 percent right that there's nothing from sort of pure economic theory that justifies that, but where from the business side it's something, it's a service, it's another piece, and if they can get an additional charge for it, that that is the way the market would work regardless of sort of theory?

THE WITNESS: Well, guess the difficulty I have with trying to figure out where that takes you is then, in some sense, I'm not sure I have any analytical framework. I mean if I concede to you, which I do, that business people are kind of practical and don't worry about the theory too much and do what sort of makes sense to them, and they may do things that make sense, even if my theory says that that's not what would happen in a market, then, in some sense, we've now said anything could happen, and I can't, on some fundamental level rule that out. But I guess I would go back to the way I would approach your task, if I were in your shoes, which is to think of it as fulfilling a public policy objective.

And I guess I think of the market test as being there for a reason. I mean it's not because the market, as it occurs on the corner of 12th Street and E Street, has some particular moral or philosophical glory to it. I think that the reason we make reference to market tests is because we believe that in general well-functioning, competitive markets do a good job of pricing things. And so the thing we're making reference to really is, in some sense, my theoretical concept of the market, not a businessman's what might happen in a particular market on a particular day. But that's just my take on it.

CHAIRMAN VAN LOON: Well, just on that one, I mean isn't it -- aren't we charged in fact with the task of willing buyer/willing seller as opposed to the test of fair and reasonable? And wouldn't fair and reasonable be more of the public policy we weigh all the considerations but we've been told that the statute and a number of other things tell us, no, we've got to go to the market, to willing buyer/willing seller?

THE WITNESS: But then it's a question of what does that actually mean, I think. And, again, I wasn't there, I'm not a congressional scholar, I'm not going to pretend to be inside the heads of the Congress people, but I think that -- and I'm not suggesting fair and reasonable as an alternative, I'm suggesting willing buyer/willing seller meaning competitive market. And in my first testimony, actually, I talked about why I think that that's what it means. And I think that that ought to be interpreted in the context of why the competitive market is a good benchmark, rather than just in some literal sense saying, "Oh, well, they set the market. Let's try to figure out what happens in some specific market, given the business people might do this or might do that."

CHAIRMAN VAN LOON: Let me take that one then to maybe the easier example -- minimum fee. You say there's really no economic rationale for charging more than what would be essentially the administrative cost of setting up and running each incremental account at the margin. Now, again, if I'm a business person, though, am I going to do that? Am I going to provide that service at cost or doesn't the willing seller say, "I've got to have some margin. It might be that I'd like to have a huge margin. It might be that I'd have to settle for a modest margin." But if we knew, and we don't have any clear evidence of what's the actual cost, but wouldn't we, in fairness, have to have some margin there?

THE WITNESS: Well, I think you might, but, again, there, actually, I think that's easier because we have actual evidence. We know what ASCAP and BMI and SESAC have decided they want, and they've
concluded that what they want is somewhere in the range of a few hundred dollars. And I would think that they want to make money as much as anybody else, so to the extent that you're looking for what would business people in the real world do, as opposed to my economic theory, I don't think you need my economic theory. You can just look at what we actually observe in the world, which are minimum fees for a similar kind of service that are on the order of a few hundred dollars.

CHAIRMAN VAN LOON: Well, I agree. I mean that's the practical world answer, but I want to stick now for a minute --

THE WITNESS: Okay.

CHAIRMAN VAN LOON: -- on the opposite side. And what I'm understanding you to say is you would agree that if we knew what the actual cost was, it would be fair to add on a margin.

THE WITNESS: Well, as an economist, I don't know what fair means. I mean that's not a word that I use very much.

CHAIRMAN VAN LOON: What we knew what the actual cost was.

THE WITNESS: I think if you knew what the actual cost was, if you said to me, "We're going to do actual cost plus some margin, because we think that's what a business person would do," I don't think I could argue with that, if the margin was modest. I mean I don't know what business people would really do, so that could happen.

CHAIRMAN VAN LOON: Let me ask you about another aspect of it.

ARBITRATOR VON KANN: Are you done with the ASCAP, BMI part, because I've got -- could I ask a follow-up if you're to --

CHAIRMAN VAN LOON: Well, let me stick with the minimum for a minute --

ARBITRATOR VON KANN: All right. Go ahead.

CHAIRMAN VAN LOON: -- and then go back. The other thing, your argument is that assuming we're on a per performance model, then essentially the administrative costs of having the account sort of should be the measure. But isn't there a separate economic value to having the availability, having access, having the right? Each one of my credit cards I pay an annual fee. It's to have that convenience. I might never use it a single time during the year and never pay any extra fees. Or if I used it a lot, I might pay a lot more. But there's that sort of convenience fact or right factor, and wouldn't it be economically logical or justifiable that a minimum could -- that an appropriate basis for having a minimum could also be sort of the right to exercise, to play?

THE WITNESS: Yes, I think there's something to that. I think what I would say would be the magnitude of such a consideration, to take your credit card example, would be a fee that is quite small relative to what people typically pay for actually using it. So in your credit card example, the average credit card user, between late payments and the implicit fees that they pay when they pay a store and the store is charged, pays probably thousands of dollars a year for the use of the credit card. And the fee for just having it is typically $20 to $50, which I actually think, from the credit card companies' point of view, is tied to their view of the incremental cost of having a credit card account for you. So I actually think that your credit card example is quite consistent with my theory.

But if you did want to sort of have this notion of a fee sort of for the right, even if you don't use it, I don't think I could rule that out. But, again, I think it would be on the order of hundreds of dollars, not thousands of dollars, given the fact that we've already discussed many of the licensees who make use of this license, even on a royalty basis, are going to be paying on the order of thousands of dollars. And so to have a minimum that -- to have a fee for just the right to do it which was as big as most people would be paying for actually using it doesn't strike me as a good concept of a minimum fee.

ARBITRATOR VON KANN: One question related to the ASCAP, BMI, SESAC thing, and I confess I haven't quite figured out where this leads, but it seems to me that looking at those minimum fees is only
useful if we have comparability, if what ASCAP, BMI and SESAC are doing is comparable to what the licensor here. And it seems to me they aren't for a couple of reasons. First of all, the performing rights organizations, as I understand it, what they're doing is applying a percentage of revenue model. We don't have to keep track of what songs we're playing, we don't have to keep track of how many people listen to them, we don't have to keep track of anything except what was your revenue, and take out a calculator and multiply a percentage. And the minimum fees come along because there was hardly enough revenue to argue about. So what they're doing is an extremely de minimis operation.

Now, with respect to -- if we were to adopt a per performance model that has something to do with how many songs are played and how many people listen to the song, we do get into some more complex calculations, I would have thought -- data keeping and analysis -- that is quite different than what the performing rights organizations do. Perhaps because it's minimum, there isn't very much of that to do, but it's still different. And so I don't know that what it is the fair charge to figure out, "Hey, Charlie, they only made $1.75, they don't owe us much," is a little different to say, "Well, they made -- let's see here, they had 17 performances, and I've got to check how many listeners that is." It is a different exercise, isn't it?

THE WITNESS: I guess I see two parts of that, one part where I don't think there's any difference and one part where there might be. In terms of just recording the tuning hours or whatever that's going to be the basis of the model, presumably is going to be done by computerized systems that are set up to deal with everybody, and I don't think there's going to be a significant incremental cost associated with just kind of receiving the data just because it's perhaps somewhat more complicated data.

Now, I suppose there might be an issue if someone's paying the minimum fee of some minimal auditing to ensure that they qualify for the minimum fee; and I guess I could see an argument maybe that that auditing, to make sure that they qualify for the minimum fee, might be conceivably somewhat more complex. Although, frankly, having looked at the data, you know, for many of these stations it's very, very clear that their activity is de minimis. There are very few people listening, and I actually don't think there's a significant cost associated with sort of confirming that whatever the minimum fee is going to be this guy is in the minimum category.

CHAIRMAN VAN LOON: There are a few more questions, both from myself and from Judge Gulin, but we're going to need to have a very brief, we'll call it, six minutes restroom break.

THE WITNESS: I appreciate that as well.

CHAIRMAN VAN LOON: Be back in our chairs at 2:30.

(Whereupon, the foregoing matter went off the record at 2:22 p.m. and went back on the record at 2:31 p.m.)

CHAIRMAN VAN LOON: I have only two other areas, one, I think, very short and only because I'm lazy. But Page 52 in your testimony you're going through a bunch of bullet points summarizing things.

And in the third one, sort of in passing, you say, "The value of promotion to musical works is less than for sound recordings."

PARTICIPANT: I'm sorry, which number?

CHAIRMAN VAN LOON: This is the third bullet on Page 52. Starts off "Royalty rates for Internet performance ASCAP, BMI do not appear to be significantly higher.

PARTICIPANT: That's not matching at my --

THE WITNESS: It's the fifth bullet in the overall list --

CHAIRMAN VAN LOON: Right.

THE WITNESS: -- which begins with "Putting aside anecdotal evidence," if that helps anybody.

CHAIRMAN VAN LOON: No, no.

THE WITNESS: Oh, am I in the wrong place?

CHAIRMAN VAN LOON: I think you are.

THE WITNESS: Okay. Tell me again then, I'm sorry.

CHAIRMAN VAN LOON: Fifty-two.

THE WITNESS: Well, see we have this page
problem. Tell me what section.

CHAIRMAN VAN LOON: For me, it's the fifth bullet --
ARBITRATOR VON KANN: "There's no evidence of displacement"?
CHAIRMAN VAN LOON: One, two, three, four, five. It starts out, "Royalty rates --
THE WITNESS: Yes, I have that.
CHAIRMAN VAN LOON: -- for Internet performance."
THE WITNESS: Okay, I have that.
CHAIRMAN VAN LOON: Yes. Okay. And I'm going to the next sentence, "The value of promotion to the musical works is less than to sound recordings."
although it is and then you go on.
THE WITNESS: Right.
CHAIRMAN VAN LOON: And I wanted to ask you to sort of crystallize the way and the why the value of promotion --
THE WITNESS: Okay. This goes back to some stuff that was discussed at more length in my direct and not really in here. In other words, when a CD is sold, I think the evidence shows that the value of that -- both sides benefit. The sound recording owners benefit, and the composers and the publishers benefit, but per CD the benefit is greater to the sound recording. So that's sort of --
CHAIRMAN VAN LOON: That's all you mean.
THE WITNESS: That's all I was saying.
CHAIRMAN VAN LOON: The dollar amount that the record company and the artists get --
THE WITNESS: Right.
CHAIRMAN VAN LOON: -- is bigger than the dollar amount --
THE WITNESS: Exactly.
CHAIRMAN VAN LOON: Okay.
THE WITNESS: But there is still something to the musical works owner so that if it were true that there's promotion in the over-the-air but no promotion on the Internet and if ASCAP and BMI understood that, which I would think they -- or I would hope that they would, they would be demanding significantly higher fees on the Internet for that sort of low cost promotion value, and we don't observe --