

PUBLIC VERSION

SoundExchange's Written Rebuttal

Volume V: Designated Testimony from Docket No. 2006-1 CRB DSTR

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WRITTEN REBUTTAL TESTIMONY OF CHARLES CIONGOLI

Background and Qualifications

I am Executive Vice President and Chief Financial Officer for Universal Music Group North America (“UMG”), a position I have held since 2003. I am responsible for the financial activities of UMG’s North American operations, which include nine United States record label groups, as well as music publishing, selling, and distribution operations. In my capacity as Executive Vice President and Chief Financial Officer, I have knowledge of and regularly review the finances of both UMG’s U.S. record label and the music publishing operations of Universal Music Publishing Group (“Universal Publishing”).

I was previously Senior Vice President of Finance for UMG. Prior to that, I was employed as Vice President of Finance for MCA Records, and also served as Vice President and Group Controller for both MCA Records and MCA Music Publishing. I began my employment with MCA in 1990 as the Group Controller for the MCA Music Entertainment Group, which became UMG in 1996. Prior to joining MCA in 1990, I was a Senior Manager with the international accounting and consulting firm Price Waterhouse, where for ten years I provided a variety of audit, accounting and special services for Mergers and Acquisitions.

I received a Bachelor’s degree in Finance and Auditing from California State University at Northridge. I am a Certified Public Accountant (CPA) in the State of California, and I am a member of the American Institute of Certified Public Accountants and the California State Society of CPAs.

Universal Music Group and Universal Music Publishing

UMG is the largest record company in the world with over a 31% share of the domestic recorded music market in 2006. It consists of numerous acclaimed and popular record labels, including Motown Records, Universal Records, Geffen Records, Interscope Records, MCA Nashville, Island Records, and Def Jam Music Records.

Universal Publishing recently completed the acquisition of BMG Music Publishing which, as a result, has made Universal Publishing the largest publishing operation in the United States and the world, with a combined U.S. market share of approximately 20-24%.

Overview

I am submitting this testimony to provide the Copyright Royalty Judges with information concerning the sound recording and music publishing businesses, which operate separately at UMG but which each report their finances through me.¹ As part of this testimony, I am providing comparative financial data on UMG's U.S. record label and Universal Publishing's music publishing operations. For purposes of this comparison, I have excluded all BMG Music Publishing financial data, as it is not applicable for 2006 and prior years. To assist the Judges, I have attached copies of UMG's Consolidated U.S. Record Label Income Statements for 1999 through 2006 (SX Ex. 213 RR) and Universal Publishing's U.S. Music Publishing Income Statement (SX Ex. 214 RR) as exhibits to this written testimony. I have reviewed these documents in preparing this testimony, and I regularly review such materials in the ordinary course of my professional responsibilities.

¹ I understand that in Docket No. 2006-1 CRB DSTRA and Docket No. 2005-5 CRB DTNSRA, XM Satellite Radio Inc., Sirius Satellite Radio Inc. and MTV Networks (collectively, "the Services") have proposed benchmarks based on the royalty rates for musical works paid to performance rights organizations such as ASCAP, BMI and SESAC. I submit this testimony to rebut the Services' testimony proposing those benchmarks.

As discussed in more detail below, there are fundamental differences between the sound recording and music publishing businesses. They play very different roles in the sale of music and also vary greatly in terms of the magnitude of the investments required and the level of risk associated with those investments.

There is little consumer market for musical works by themselves (e.g., as sheet music). The actual products that consumers buy and to which they listen are sound recordings, and musical works are one component of sound recordings. The sound recording is created, marketed, and distributed by the record company. While music publishers earn royalties from the sale of sound recordings (e.g., on CD and as digital downloads and mastertones) and music videos, they invest very little. Although they do have to pay advances against royalties to songwriters (or their publishing designees), music publishers are able, to a large degree, to ride the coattails of the record companies. Unlike record companies, music publishers do not incur significant recording, marketing, promotion, sales, distribution, creative services, video, new technology, or personnel costs. Rather, it is the record companies that expend enormous sums to create and promote their products to consumers. The publishers are the beneficiaries of the record companies' work and investment.

It is therefore unsurprising that the risks and rewards -- and the levels of compensation -- for sound recordings and musical works differ greatly in markets where music is disseminated. I have frequently heard the sound recording business described as being like the stock market -- high risk, high reward -- and the music publishing business described as being like the bond market -- low risk, consistent but lower returns. I agree with that characterization.

The sound recording business is risky and speculative. A record company invests large sums of money before a final product is created. Once created, the record company must then

undertake great expense and effort to market and promote the sound recordings, with the hope that it can earn back its substantial upfront investment. In reality, the vast majority of sound recordings are not profitable for record companies; for each record that earns a profit for a record company, there are approximately nine others that do not.

The music publishing business, by contrast, is much less risky. Unlike the sound recording business, the music publishing business is not fundamentally about creating a product. To a certain extent, then, the music publishing business resembles a bank. When music publishers invest in the acquisition of catalogs of musical works, their decision to invest is based on the catalog's proven value. In general, the music publisher knows what the catalog has earned in the past, and is investing in an income stream for the future based on past performance, primarily from sales of CDs or downloads and performances on over-the-air broadcasts, and use in motion pictures and television advertising. Music publishers may also invest in musical works that do not have a proven track record, but generally do so only where a record company previously has signed the recording artist/songwriter to a recording agreement and has made clear that it will be spending significant sums to develop, promote, and market sound recordings by that recording artist/songwriter, all of which will help to ensure revenue from those musical works. Thus, a music publisher will give a significant advance to a new singer-songwriter only if it knows that a record company is going to spend far greater sums to promote that artist.

For all of these reasons, the music publishing business is materially different in character from the sound recording business.

Comparison of Investment, Risks, and Operations of Sound Recording and Music Publishing Businesses

As I discuss below, UMG's record label operations are characterized by a greater level of investment and risk than Universal Publishing's music publishing operations. Record labels

engage in a very risky business that requires substantial expenditures for recording costs, overhead, marketing, promoting, manufacturing and distributing sound recordings. For most sound recordings, the majority of the costs are incurred before a single unit is sold. By contrast, the publishing business involves less risk and less cost. Universal Publishing spends little or nothing to create, market, promote, manufacture and distribute copyrighted musical works. Moreover, the music publishing business benefits from the record company's marketing, promotion and other efforts, which help generate mechanical royalties and public performance royalties that publishers and songwriters receive. Further, when a record company makes a sound recording a hit, music publishers are able to garner significant license fees for synchronization uses of the sound recording. The greater costs and upfront investments make the recorded music business less profitable and much riskier than the music publishing business. These differences in investment characteristics also reflect one of the reasons for the greater return generally provided to sound recording copyright owners than musical works copyright owners.

Before I discuss the different types of investment, I must note that the distinct and interrelated finance and accounting concepts of costs, expenses, investments and cash expenditures are often conflated in general discussion. For present purposes, the technical distinctions among those terms are not instructive. Accordingly, my testimony uses the term "cost" broadly to give the Judges an instructive sense of the financial scope of UMG's and Universal Publishing's businesses.

A. Artist and Repertoire ("A&R") Investment

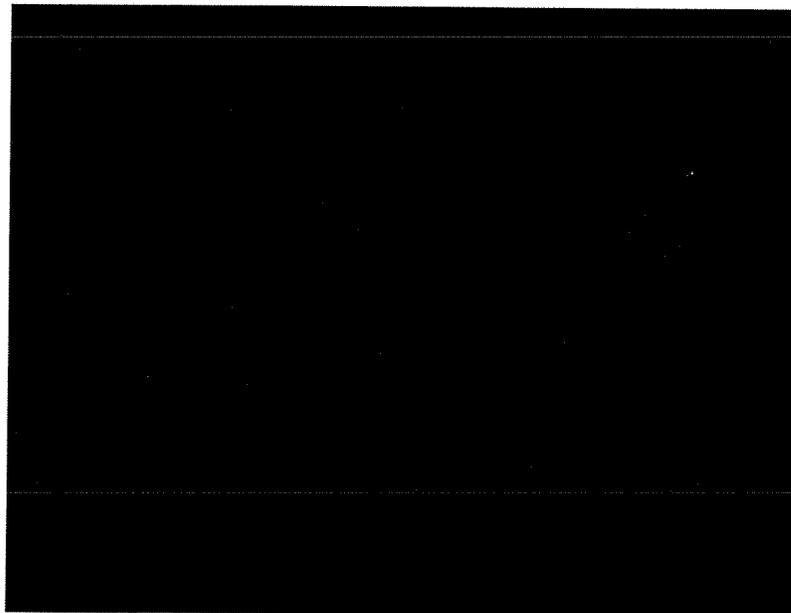
The creation or acquisition of copyrighted works that generate income requires both the recorded music and music publishing operations to incur expenses in acquiring the services of

artists and songwriters. Record companies and music publishers both pay advances, which they hope to recoup from future earnings. Despite these apparent similarities, however, expenditures on A&R are vastly different in the sound recording and music publishing businesses. Record company investments in A&R include all of the work that goes into finding and developing talented artists and bringing the product (i.e., the sound recording with its underlying musical work) to market, including paying for advances and recording costs. Record companies advance large amounts of money to artists and pay for all of the recording, producing, mixing, mastering and other expenses involved in creating a sound recording. Some expenditures are not recoupable at all because with a large percentage of artists, record companies never recoup the given advance.

In contrast, music publishers spend little to create the product that is sold to consumers. They do provide advances to songwriters, but those advances are generally smaller and are wholly recoupable by the publishers. Moreover, music publishers often pay advances to songwriters who already have revenue in the pipeline either from sales of proven catalog tracks or recently released albums that have sold but for which royalties have not yet been paid. Overall, then, the risk of investment falls almost completely on the record company.

The dramatic difference in the two businesses can be seen by looking at the data regarding their investment in A&R. Gross A&R expenditures for UMG's record labels and Universal Publishing show that the sound recording business requires a significantly greater investment (and thus a significantly greater return to make it profitable) than the music publishing business. In 2006, UMG's record labels had gross A&R expenditures of [REDACTED]. In marked contrast, Universal Publishing's gross A&R expenditures were [REDACTED] for the same time period.

On UMG's income statements for both the record label and music publishing operations, we report a line item for total A&R costs. This line item reflects net A&R investment and therefore refers to the amount of unrecouped advances and recording costs to artists and songwriters paid or expensed in the relevant period. As shown in SX Ex. 213 RR and SX Ex. 214 RR, the net A&R expense for UMG's record labels in 2006 vastly exceeded Universal Publishing's net A&R expense for the same time period. As shown in Figure 1 below, UMG's record labels had net A&R expense of [REDACTED], or [REDACTED] of our labels' FY 2006 total net revenue. The comparable data for our music publishing operations are a net positive of [REDACTED] of net revenue for FY 2006.

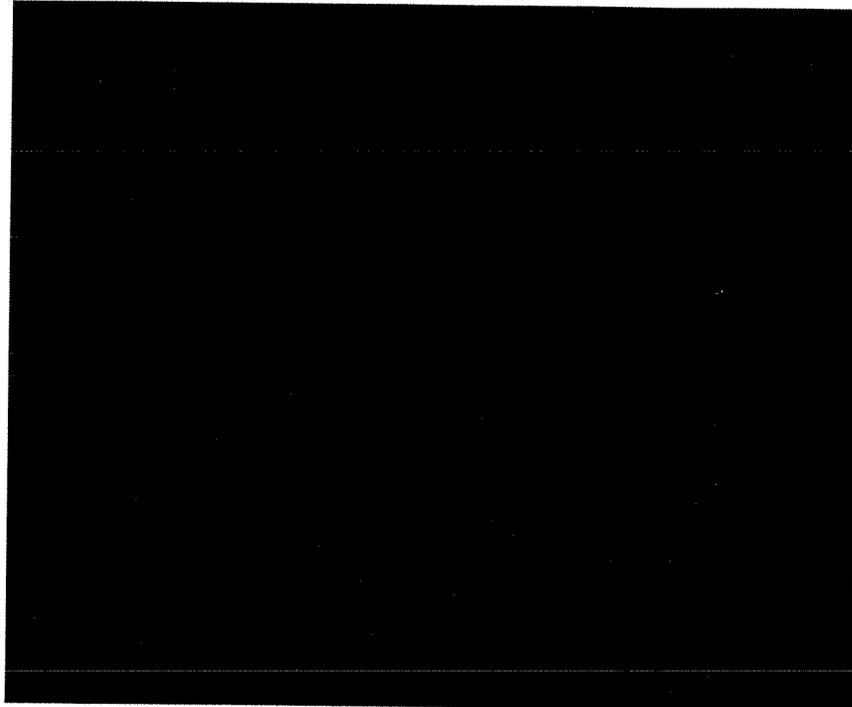


Note that these figures do not include overhead -- i.e., the cost of personnel to engage in A&R activities. The A&R staffs of record companies are much larger than those of music publishers and significantly more expensive. These A&R overhead expenses are included in the "overhead" category discussed below.

B. Marketing Costs

UMG's record labels market and promote their new albums and artists to consumers in order to achieve sales. The investment in marketing includes the cost of music videos, print advertisements, television advertisements, point of purchase advertising materials, co-op advertising, radio advertising, Internet advertising, promotional merchandise, and a host of other expenses. Most of these marketing costs are incurred up front, before the record company is able to generate any revenue from the music that is being marketed. These expenditures -- if successful -- benefit both record companies and music publishers, who each earn revenues when a particular artist, song, or album becomes popular.

By contrast, Universal Publishing generally does not have to undertake much in the way of marketing efforts. It simply relies on the record company to do the bulk of the marketing. Accordingly, the marketing costs incurred by the recorded music businesses are substantially higher than the marketing costs incurred by the music publishing operations. As SX Ex. 213 RR demonstrates, in FY 2006, UMG record labels spent a total of [REDACTED] of their total net sales, on marketing. Universal Publishing, on the other hand, does not even have a separate line item for marketing. If, however, one totaled all of the publicity, promotion, and travel and entertainment expenses, it would total [REDACTED] of its total publishing income in FY 2006. See SX Ex. 214 RR. Figure 2 below shows the comparison.

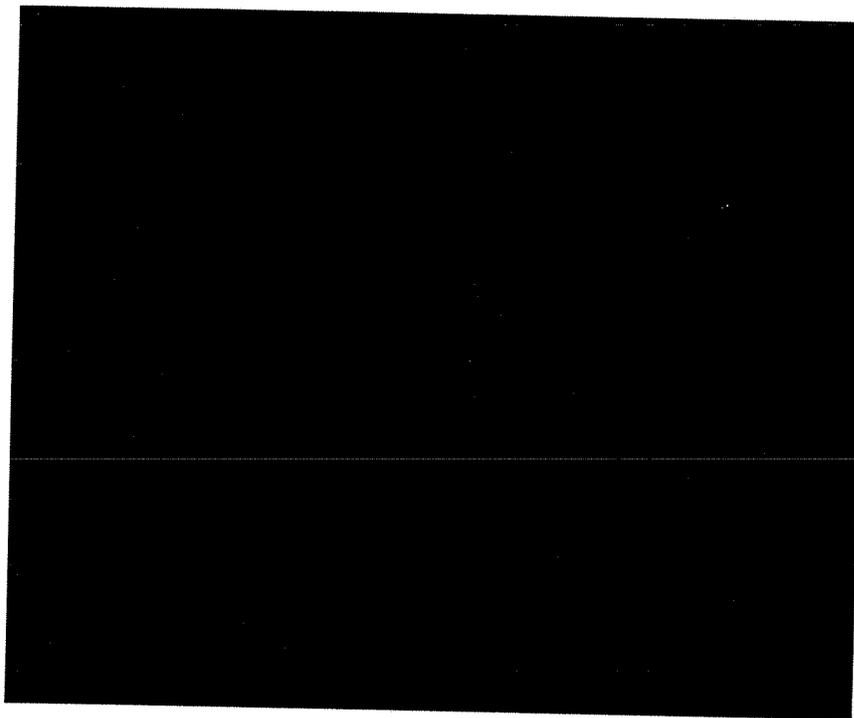


Once again, none of these figures includes overhead, discussed below, which is vastly greater in the recorded music business because of the personnel required to conduct all of the marketing and other promotional activities that form no part of the music publishing business.

C. Overhead

UMG's record labels have much larger overhead expenses than Universal Publishing because, as I have discussed above, the labels must undertake many more activities. Overhead expenses include, for example, salary and benefits, office space, supplies, utilities, office equipment, furniture, and travel and entertainment costs. The extent of these costs is largely driven by the number of personnel involved in an operation. Because UMG's recorded music operations have a greater need for personnel than Universal Publishing, UMG incurs greater overhead expenses. UMG requires personnel to do all of the work in finding, developing, promoting, and marketing sound recordings -- work from which music publishers benefit without cost. As SX Ex. 213 RR shows, UMG's record labels had overhead expenses (excluding

overhead for selling and distribution, discussed below) in FY 2006 of [REDACTED] of net sales. By comparison, Universal Publishing had overhead costs of [REDACTED] of total revenues for FY 2006. *See* SX Ex. 214 RR.

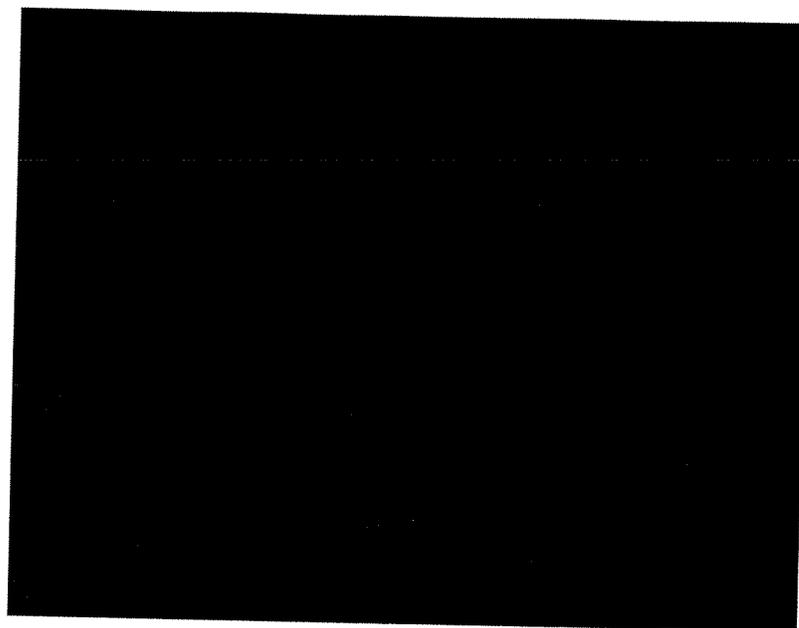


D. Manufacturing and Distribution Costs

UMG's record labels also must pay significant manufacturing costs in order to produce the physical product that is sold to the customer. Manufacturing costs are incurred before sales are made to customers, and with no guarantee that they will be recovered from sales. In FY 2006, UMG's record labels incurred [REDACTED] in manufacturing and inventory related costs. *See* SX Ex. 213 RR. Another substantial expense incurred by UMG's record labels is the cost of distributing their sound recordings to retailers and consumers. In FY 2006, UMG's record labels spent [REDACTED] on distribution and selling expenses (including overhead). *See* SX Ex. 213 RR.

The transition to more digital distribution of sound recordings does not mean that record companies' manufacturing and distribution costs have disappeared. Rather, record companies must maintain two separate (and expensive) chains of distribution -- incurring all of the costs of digitizing sound recordings, collecting and updating metadata, building and operating systems for distribution, and actually distributing digital versions of sound recordings to retailers and other outlets. These costs include the investment in IT for system development, the cost of labor related to the housing of data and other digital assets, and other expenditures. In addition, record companies must maintain all of the relationships with the ever-growing number of outlets selling digital and mobile music in various forms. All of these expenses are encompassed within distribution expenses or overhead expenses. All told, UMG's manufacturing and distribution costs for 2006 were [REDACTED] of net sales. See Figure 4.

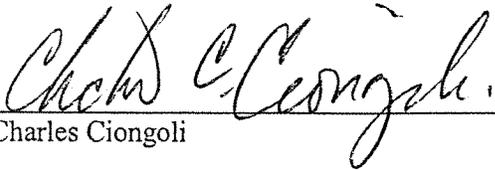
Music publishers, in most cases, need not undertake any of these activities because they are not providing a product directly to retailers or consumers. Universal Publishing earns revenue from licensing its musical works. It does not manufacture physical products and thus incurs no manufacturing costs at all. Universal Publishing therefore has no budget line item for this cost category and takes none of the risks associated with producing a physical product. Similarly, Universal Publishing does not incur distribution costs and thus has no line item for those costs, nor does it incur separate expenses for digital and mobile activities.



Conclusion

As the foregoing discussion and data make clear, the character of the sound recording business is markedly different from the music publishing business. UMG's record labels incur much greater cost in creating sound recordings than Universal Publishing incurs in creating musical works. Music publishers, including Universal Music Publishing Group, benefit from the creation of sound recordings by record companies and earn revenues from the efforts of record companies without having to engage in the same type of investments. At the same time, there is substantially more risk associated with UMG's recorded music operations than with Universal Publishing's music publishing operations.

I declare under penalty of perjury that the foregoing testimony is true and correct to the best of my knowledge and belief.


Charles Ciongoli

Date: July 24, 2007

Exhibits Sponsored by Charles Ciongoli

**Restricted exhibits, which are identified by the suffix "RR," are not included
in the Public Version of SoundExchange's Rebuttal Case**

Exhibit No.	Description
SX Exhibit 213 RR	Universal Music Group US Only Income Statement, 1999-2006 Actuals
SX Exhibit 214 RR	Universal Music Publishing Group, US - Publishing, Full Year Historical Results and Historical Overhead Expense, 1999-2006

Transcript of:

Date: August 23, 2007

Volume: XXII

Case: Adjustment of Rates for Pre-Existing Subscriptions

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Phone: 202-234-4433
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Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

|-----+
In the matter of:

Adjustment of Rates and
Terms for Preexisting
Subscriptions Services,

Docket No. 2006-1
CRB DSTRA

and
Satellite Digital Audio
Radio Services
|-----+

Room LM-408
Library of Congress
First and Independence Avenue, S.E.
Washington, D.C. 20540

Thursday,

August 23, 2007

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

BEFORE:

THE HONORABLE JAMES SLEDGE, Chief Judge

THE HONORABLE WILLIAM J. ROBERTS, JR., Judge

THE HONORABLE STAN WISNIEWSKI, Judge

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1 P R O C E E D I N G S
 2 9:35 a.m.
 3 CHIEF JUDGE SLEDGE: Good morning,
 4 we'll come to order.
 5 Mr. Rich?
 6 MR. RICH: Good morning, Your
 7 Honor. As our next and final witness on the
 8 rebuttal cases of XM and Sirius, we call Dr.
 9 John Woodbury to the stand.
 10 (Pause.)
 11 CHIEF JUDGE SLEDGE: Mr. Woodbury,
 12 will you raise your right hand?
 13 WHEREUPON,
 14 JOHN WOODBURY
 15 WAS CALLED FOR EXAMINATION BY COUNSEL FOR THE
 16 SERVICES AND, HAVING FIRST BEEN DULY SWORN,
 17 WAS EXAMINED AND TESTIFIED AS FOLLOWS:
 18 CHIEF JUDGE SLEDGE: Thank you.
 19 Please be seated.
 20 (Pause.)
 21 CHIEF JUDGE SLEDGE: All right,
 22 with Dr. Woodbury's testimony we have

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1 THE WITNESS: Thank you.
2 (Whereupon, the witness was
3 excused.)
4 CHIEF JUDGE SLEDGE: Mr. Rich?
5 MR. RICH: Your Honor, that
6 concludes XM's rebuttal case.
7 CHIEF JUDGE SLEDGE: We will
8 recess five minutes.
9 (Whereupon, the proceedings in the
10 foregoing matter went off the
11 record at 2:32 p.m. and went back
12 on the record at 2:37 p.m.)
13 CHIEF JUDGE SLEDGE:
14 SoundExchange?
15 MR. DeSANCTIS: Thank you, Your
16 Honor. At this time, SoundExchange would like
17 to call its first witness, Mr. Charles
18 Ciongoli.
19 CHIEF JUDGE SLEDGE: Mr. Ciongoli,
20 please raise your right hand.
21 WHEREUPON,
22 CHARLES CIONGOLI

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1 was called as a witness by Counsel for
2 SoundExchange and, having been first duly
3 sworn, assumed the witness stand, was examined
4 and testified as follows:
5 CHIEF JUDGE SLEDGE: Mr.
6 DeSanctis?
7 DIRECT EXAMINATION
8 BY MR. DeSANCTIS:
9 Q Good afternoon. Please state your
10 name for the record.
11 A Charles Ciongoli.
12 Q And have you testified in this
13 proceeding previously?
14 A Yes, I have.
15 Q Okay. And could you just very
16 briefly remind us with whom you are employed
17 and what your title is?
18 A I work for the Universal Music
19 Group. I am Executive Vice President and
20 Chief Financial Officer for UMG in North
21 America.
22 Q And in that capacity, do you

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1 oversee the finances of Universal's sound
2 recording operations in the United States?
3 A Yes, I do.
4 Q And do you also oversee
5 Universal's music publishing operations in the
6 United States?
7 A Yes, it reports up through me.
8 Q By "oversee," I meant oversee the
9 finances of.
10 A That is correct.
11 Q Okay. Mr. Ciongoli, I'd like to
12 direct your attention to SoundExchange Trial
13 Exhibit 118. If you could open it and look at
14 it. Do you recognize this?
15 (Whereupon, the above-
16 referred to document was
17 marked as SX Exhibit
18 No. 118 for
19 identification.)
20 A Yes, I do.
21 Q What is it?
22 A It is my rebuttal testimony to the

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1 matter that we're discussing today.
2 Q Would you please turn to page 13.
3 Is that your signature?
4 A Yes, it is.
5 MR. DeSANCTIS: Okay. Your Honor,
6 at this time, I would like to move for the
7 admission of SoundExchange Trial Exhibit 118.
8 CHIEF JUDGE SLEDGE: Any objection
9 to Exhibit 118?
10 MR. REED: No, Your Honor.
11 CHIEF JUDGE SLEDGE: Without
12 objection, it is admitted.
13 (Whereupon, the above-
14 referred to document,
15 previously marked as SX
16 Exhibit No. 118 for
17 identification, was
18 admitted into evidence.)
19 MR. DeSANCTIS: Thank you, Your
20 Honor. I would also like to move at this time
21 that certain portions, as marked in the
22 written testimony, be treated as restricted

50 (Pages 194 to 197)

1 under the Court's protective order, in
2 addition to the two exhibits.

3 We've been very conservative in
4 marking restricted information in this
5 testimony. It is limited solely to the
6 numerical figures, both whole dollars and
7 percentages, that are expressed in text and in
8 the graphs. These are confidential financial
9 -- this is confidential financial information
10 at a level of specificity that is not shared
11 with competitors or with the general public in
12 any way.

13 Moreover, these are -- the numbers
14 come in two sets. One is with -- one set of
15 numbers is with respect to Universal's sound
16 recording operations. Those numbers have
17 already come in and were treated as restricted
18 in the direct case. The other set of numbers
19 is the analogous numbers from the publishing
20 side of the business. Those also are not
21 shared with the public and would be
22 competitively sensitive and harmful if

1 released to competitors.

2 So we asked for the -- that the
3 portions marked in the text be treated as
4 restricted, and that each of the two exhibits
5 be treated as restricted.

6 CHIEF JUDGE SLEDGE: Insufficient.

7 MR. DeSANCTIS: Can I give you
8 page numbers, Your Honor, and walk you through
9 it?

10 CHIEF JUDGE SLEDGE: You'll have
11 to.

12 MR. DeSANCTIS: Okay. The first
13 portions appear at the bottom of page 6.
14 These are two specific expenditure figures
15 that are not released to the public, more
16 shared with competitors and would be harmful
17 if -- would be competitively harmful if
18 released to competitors.

19 The next numbers are on page 7.
20 There are three figures in the first paragraph
21 of text and two in the graph. These also are
22 specific financial figures from both

1 Universal's recording operations and
2 Universal's publishing operations at a level
3 of specificity that are never released to the
4 public or to competitors.

5 The next figures are on page 8.
6 Similarly, these are specific marketing costs
7 of both Universal's sound recording operations
8 and Universal's publishing operations that are
9 not shared with the public or with
10 competitors.

11 Those same figures are
12 demonstrated graphically in the graph at the
13 top of page 9, which is labeled Figure 2.
14 These are, again, percentage figures that are
15 not shared with competitors or with the
16 public, and that could give competitors a
17 competitive advantage if it were released to
18 them.

19 The next figures are on page 10.
20 Similarly, these are confidential overhead
21 figures that are not shared with the public or
22 with competitors. That is overhead for

1 Universal sound recording operations and their
2 publishing operations, and the two figures
3 that are in the text at the top of page 10 are
4 represented graphically in Figure 3. Again,
5 these are specific figures that are never
6 released to the public or to competitors, and
7 that are competitively sensitive and could
8 give competitors an unfair advantage.

9 The same is true for the two
10 figures at the bottom of page 10 and the one
11 on page 11. And, finally, those are
12 represented graphically in Figure 4.

13 CHIEF JUDGE SLEDGE: Any
14 objection?

15 MR. REED: No, Your Honor.

16 CHIEF JUDGE SLEDGE: Without
17 objection, the motion is granted.

18 MR. DeSANCTIS: Thank you, Your
19 Honor. I would like to, similarly, move for
20 restricted treatment of the two exhibits, or
21 was Your Honor's ruling to those as well?

22 CHIEF JUDGE SLEDGE: I thought you

1 were through with your motion.
 2 MR. DeSANCTIS: Oh. I'm sorry,
 3 Your Honor. The two exhibits are simply the
 4 financial documents from which all those
 5 numbers come that we were just discussing.
 6 Again, these are internal financial documents
 7 that are not shared with the public and are
 8 never released to competitors, and contain all
 9 of the financial data plus more that we had
 10 just been discussing.

11 Portions of Exhibit 213 have
 12 already been admitted in the direct phase
 13 pursuant to the restrictive order -- the
 14 Court's protective order, and Exhibit 214 is
 15 simply the analog to Exhibit 213 for UMG's
 16 publishing business.

17 CHIEF JUDGE SLEDGE: Are you
 18 through now with your motion?

19 MR. DeSANCTIS: I am, Your Honor.

20 CHIEF JUDGE SLEDGE: Any objection
 21 to the Exhibits 213 and 214?

22 MR. REED: No, Your Honor.

1 CHIEF JUDGE SLEDGE: Without
 2 objection, the motion is granted.

3 MR. DeSANCTIS: Thank you, Your
 4 Honor.

5 BY MR. DeSANCTIS:

6 Q Mr. Ciongoli, your written
 7 testimony discusses various costs, risks, and
 8 investment in the sound recording operations
 9 and publishing operations of Universal Music.
 10 Do you recall that testimony?

11 A Yes, I do.

12 Q We'll talk about specifics in a
 13 minute, but, in general for now, how do the
 14 costs, investment, and risks in the sound
 15 recording business compare to those in the
 16 music publishing business?

17 A Well, there are some small -- I
 18 wouldn't say small, but there are some
 19 similarities, but by and large they are vastly
 20 different. On the recorded music side,
 21 clearly, there are advances that you make to
 22 an artist or to a songwriter, but then there

1 is actually the procurement, the making of the
 2 sound recording, and then the attendant
 3 marketing and promotion costs to go along with
 4 it, whereas in the music publishing business
 5 there really is no creation, if you will, of
 6 the sound recording, and there is no attendant
 7 marketing cost or attendant promotion cost,
 8 distribution cost, things of that nature.

9 Q Okay. Beginning on page 5 of your
 10 written testimony, which has been marked as --
 11 which is SoundExchange Trial Exhibit 118, you
 12 discuss cost, investment, and risk with
 13 respect to artist repertoire. And I'd like to
 14 direct your attention to the numbers at the
 15 bottom of page 6 of your testimony. Without
 16 discussing the actual figures there, can you
 17 tell us what those figures represent?

18 A Yes. The first figure, you can
 19 see -- or from the description, it is in the
 20 hundreds of millions of dollar area, and that
 21 is the gross -- what we call gross A&R
 22 expenditure or the gross amount of advances

1 plus recording costs made in the 2006 year for
 2 sound recordings, as compared to the smaller
 3 figure in the tens of millions of dollars
 4 relative to the gross A&R investment that the
 5 music publishing company made.

6 Q And if I can direct your attention
 7 to Figure 1 on page 7, can you explain what is
 8 represented in this graph in Figure 1?

9 A Yes. Just to -- it's really more
 10 to depict relative size. The percentage on
 11 the left side is the amount or the percentage
 12 of the A&R -- what we call the net A&R spend.
 13 There is -- the figure we just were looking at
 14 was a -- was the gross number. And then, in
 15 any given year, there is what we call the net
 16 A&R number or the amount that is written off
 17 that is not deemed to be recovered. And that
 18 is expressed as a percentage of the net sales.

19 So the figure on the left is the
 20 amount or the percentage of net sales relative
 21 to the net A&R cost in 2006. Conversely --

22 Q For which entity?

1 A For the music -- sorry, for the
2 recorded music company. And then, the figure
3 on the right, which actually is a negative
4 number, is the amount of -- percentage against
5 the publishing revenues in terms of their net
6 investment. And in this case, because it's
7 negative, they actually had a recovery,
8 meaning that they had previously written off
9 costs in a prior period or a prior year for
10 which they were actually recovered in the
11 current year.

12 Q Your testimony next discusses the
13 relative cost, investment, and risks in
14 marketing, as between the sound recording
15 business and the music publishing business.
16 I'd like to direct your attention to Figure 2
17 on page 9 and ask you to please explain what
18 this graph represents.

19 A The graph -- again, the graph
20 represents -- again, expressed in terms of a
21 percentage of net sales relative to the sound
22 recording business -- the amount of marketing

1 monies spent in that year versus, if you will,
2 there is actually no monies spent on the -- in
3 the music publishing business relative to
4 marketing, promotion, what have you.

5 The small percentage that is
6 actually shown here would be the amount of
7 money if you were able to pull out of the
8 overhead, I believe, the travel and
9 entertainment and the small amounts of money
10 that they use for advertising -- you know,
11 small ads within some of the trade magazines.
12 And you can see that it's a relatively small
13 percentage, less than a quarter -- quarter of
14 a point.

15 Q Okay. The next topic you discuss
16 is overhead, and you make the same comparison
17 as between the sound recording business and
18 publishing business. I'd like to direct your
19 attention to Figure 3 and ask you to explain
20 what this represents.

21 A Again, it is the percentage or the
22 overhead expressed as a percentage of net

1 sales to the record company on the left, and
2 the percentage of overhead relative to the
3 music publishing total revenues on the right.
4 And, again, you can see I believe from the
5 numbers at the top of the page, one is in the
6 hundreds of millions of dollars versus the
7 other is in the tens of millions.

8 And, again, the contrast there is
9 because the record company has so many
10 different services that they provide, whether
11 it's marketing, creative services, video,
12 production, all of the various, you know,
13 marketing-related activities where none of
14 that is incurred on the music publishing side.

15 Q Your testimony next discusses
16 manufacturing and distribution costs. I'd
17 like to direct your attention to Figure 4 on
18 page 12 of your testimony. Can you please
19 describe what this figure is representing?

20 A Again, on the left side, it's a
21 percentage -- or it's the cost previously, I
22 believe on page -- on page 10. It is the

1 amount of cost expressed as a percentage,
2 again, relative to the net sales for the
3 recorded music.

4 Obviously, the music publishing
5 company does not sell sound recordings.
6 Therefore, they would not incur this cost at
7 all.

8 Q And this is costs for?

9 A This is manufacturing and
10 distribution costs.

11 MR. DeSANCTIS: Okay. I have no
12 further questions, Your Honor.

13 CHIEF JUDGE SLEDGE: Any cross
14 examination?

15 MR. REED: Yes, Your Honor.

16 CROSS EXAMINATION

17 BY MR. REED:

18 Q Good afternoon, Mr. Ciongoli. How
19 are you?

20 A Good.

21 Q I'm going to talk to you a little
22 bit about your written rebuttal statement,

1 SoundExchange Exhibit 118. I believe it's
2 still in front of you there.

3 JUDGE ROBERTS: Counselor, what is
4 your name again?

5 MR. REED: My name is Ben Reed,
6 Your Honor.

7 JUDGE ROBERTS: Thank you.

8 BY MR. REED:

9 Q And if I could direct your
10 attention to page 2 of that testimony. In the
11 very first paragraph, you say that UMG has a
12 31 percent share of the domestic recorded
13 music market in 2006, is that correct?

14 A Yes.

15 Q And then, in the second paragraph
16 you say that Universal Publishing recently
17 completed acquisition of BMG Music Publishing,
18 is that correct?

19 A Yes, it is.

20 Q And the combined entity has a U.S.
21 market share of approximately 20 to 24
22 percent, is that right?

1 A Yes, it is.

2 Q But the share of the market that
3 Universal Publishing had before that
4 acquisition was lower, was it not?

5 A Yes, it was.

6 Q And it was about 10 to 12 percent,
7 is that right?

8 A That's correct.

9 Q Okay. And in the next paragraph
10 under the overview, you say that for purposes
11 of your comparison you have excluded BMG Music
12 Publishing financial data, is that right?

13 A Yes, I have.

14 Q So when you're comparing the cost
15 operations, you're comparing UMG music
16 recording with Universal Music Publishing
17 without the BMG numbers included, correct?

18 A Yes, I am.

19 Q So you're comparing the expenses
20 of a company with almost a third of the total
21 market with the expenses of a company that has
22 around 10 percent of the total market, is that

1 right?

2 A Yes, that's correct.

3 Q And you didn't weight any of your
4 numbers later on in your testimony to account
5 for the relative market share, did you?

6 A Well, I think that's not
7 necessarily the direction that I was given in
8 terms of what my testimony was about.
9 Universal Music Group did not have -- was not
10 entitled to any of the activity of BMG
11 Publishing, which I believe we finished the
12 acquisition in May of this year.

13 My statement was submitted, and
14 things that we were required to -- or I was
15 asked to prepare was for the full fiscal year
16 of 2006. So in terms of the numbers, they are
17 what UMG has, they are in my control, and
18 these are things that are -- you know, I am
19 responsible for.

20 Q Sure. And all I'm asking is is
21 that you didn't take any weighting of the 31
22 percent market share that UMG has versus the

1 10 percent share that Universal Publishing had
2 in presenting the comparative numbers, did
3 you?

4 A Well, I'm not necessarily sure
5 that would -- that's relevant or not, because
6 I think whether I included or excluded some
7 weighting, I think overall the percentage is
8 based upon my knowledge of the publishing
9 business and our business, and the recorded
10 music business and our business.

11 I think the percentages overall,
12 whether you weight it or not, would come out
13 about the same.

14 Q Let's talk about the music
15 publishing business for a minute. On page 3
16 of your written rebuttal testimony, in the
17 first paragraph you say, "There are
18 fundamental differences between the sound
19 recording and music publishing businesses."
20 Do you see that?

21 A Yes, I do.

22 Q And as an example, at the bottom

1 of page 3 you say that -- in that paragraph
2 right there at the end of the page, you say
3 that record companies invest large sums of
4 money before the final product is created, is
5 that right? Do you see that? It's at the
6 very bottom of page 3.

7 A Yes, I do.

8 Q And then, going on to page 4, in
9 the middle of that first full paragraph, the
10 sentence beginning, "In general," do you see
11 that?

12 A Yes, I do.

13 Q You say that music publishers are
14 investing in an income stream for the future
15 based on past performance.

16 A Yes, I see that.

17 Q Are you aware there's a proceeding
18 pending before this Tribunal to set the
19 mechanical and digital phono record delivery
20 royalty rate?

21 A I'm not necessarily aware of the
22 -- all of that. I have heard of it, but I'm

1 not necessarily familiar with all of the
2 details of the case.

3 Q But you're aware there is -- that
4 proceeding is pending.

5 A I believe so.

6 Q And that proceeding will include
7 the royalty that record companies pay to music
8 publishers, is that right?

9 A I believe so.

10 Q And you understand that, like this
11 proceeding, there will have been testimony
12 submitted from both the music publishing
13 industry and the recording industry in that
14 case?

15 A I presume so.

16 MR. REED: Sorry, Your Honor, for
17 the pause with the switching of sides. I have
18 to communicate across the room.

19 BY MR. REED:

20 Q Mr. Ciongoli, I've shown you what
21 has been marked as SDARS Exhibit 82. And on
22 the first page of that, do you see there at

1 the top it says, "Before the Copyright Royalty
2 Judges," do you see that?

3 (Whereupon, the above-
4 referred to document was
5 marked as SDARS Exhibit
6 No. 82 for
7 identification.)

8 A Yes, I do.

9 Q And do you see there there's a
10 caption that says, "In the matter of
11 Mechanical and Digital Phono Record Delivery
12 Rate Adjustment Proceeding," do you see that?

13 A Yes.

14 Q And that's the proceeding we were
15 just talking about, is it not?

16 A Okay.

17 Q And do you see that it says this
18 is the witness statement of Ralph Peer?

19 A Yes.

20 Q And so this appears to be
21 testimony that Mr. Peer submitted in this
22 proceeding, right?

1 A I assume so.

2 Q Okay. Do you know who Mr. Peer
3 is?

4 A I've heard of Ralph Peer, yes.

5 Q He's the CEO of Peer Music?

6 A I don't know what his current
7 title is.

8 Q But he is with Peer Music, to your
9 understanding?

10 A I believe that he is one of the
11 owners of Peer Music.

12 Q And Peer Music is a music
13 publishing business?

14 A Yes, it is.

15 MR. REED: Your Honors, at this
16 time I would like to move the admission of
17 SDARS Exhibit 82.

18 CHIEF JUDGE SLEDGE: On what
19 basis?

20 MR. REED: Your Honor, I intend to
21 -- this witness has testified in his written
22 testimony about the --

<p style="text-align: right;">Page 218</p> <p>1 CHIEF JUDGE SLEDGE: You didn't 2 understand my question. On what basis are you 3 offering it? 4 MR. REED: To impeach him. 5 CHIEF JUDGE SLEDGE: To impeach 6 his testimony. 7 MR. REED: Yes. 8 CHIEF JUDGE SLEDGE: With the 9 testimony of Ralph Peer in another proceeding. 10 MR. REED: Yes, Your Honor. Ralph 11 Peer is a music publisher. 12 CHIEF JUDGE SLEDGE: Any 13 objection? 14 MR. DeSANCTIS: Yes, Your Honor, 15 objection to -- lack of foundation. This 16 witness was never even asked if he is familiar 17 with this document. 18 CHIEF JUDGE SLEDGE: Any response? 19 MR. REED: Your Honor, this 20 witness is purporting to testify as to music 21 publishers, and this is testimony from another 22 proceeding from a music publisher.</p>	<p style="text-align: right;">Page 220</p> <p>1 A Yes, I do. 2 Q Mr. Ciangoli, I have handed you 3 what has been marked as SDARS Exhibit 83. Do 4 you have that document in front of you? 5 (Whereupon, the above- 6 referred to document was 7 marked as SDARS Exhibit 8 No. 83 for 9 identification.) 10 A Yes. 11 Q And, again, on the first page it 12 says, "Before the Copyright Royalty Judges," 13 do you see that? 14 A Yes, I do. 15 Q And, again, the caption says, "In 16 the matter of Mechanical and Digital Phono 17 Record Delivery Rate Adjustment Proceeding," 18 do you see that? 19 A Yes. 20 Q And the title of that document is 21 "Witness Statement of Nicholas Firth." Do you 22 see that?</p>
<p style="text-align: right;">Page 219</p> <p>1 CHIEF JUDGE SLEDGE: How do you 2 know that? 3 MR. REED: Because that is what it 4 is on the -- 5 CHIEF JUDGE SLEDGE: That doesn't 6 make it so. Objection sustained. 7 BY MR. REED: 8 Q Mr. Ciongoli, are you aware of 9 what Mr. Peer has testified to in this 10 document? 11 A No, I am not. 12 Q Well, going back to your written 13 rebuttal testimony, on page 4, you say that -- 14 right there in that same long paragraph, the 15 sentence beginning, "Music publishers may also 16 invest," do you see that? 17 A Okay. 18 Q And you're saying that they may 19 invest in musical works that don't have a 20 proven track record, but only where a record 21 company has previously signed a recording 22 artist or songwriter, do you see that?</p>	<p style="text-align: right;">Page 221</p> <p>1 A Yes. 2 Q And in that first paragraph, 3 number 1, it indicates that Nicholas Firth is 4 Chairman and Chief Executive Officer of BMG 5 Music Publishing worldwide, do you see that? 6 MR. DeSANCTIS: Objection. Now 7 counsel is reading from a document that is not 8 in evidence. 9 CHIEF JUDGE SLEDGE: Overruled. 10 BY MR. REED: 11 Q And I believe you testified 12 earlier that Universal Music Publishing has 13 purchased BMG Music Publishing, is that 14 correct? 15 A They purchased it effective May 16 15th of this year, 2007. 17 Q That was the date that the 18 European Union gave approval of that purchase, 19 is that correct? 20 A That was when the transaction was 21 consulted. 22 Q When was the deal actually signed?</p>

56 (Pages 218 to 221)

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1 A I don't recall the exact date.
2 Q Mr. Ciongoli, Universal Music
3 Publishing's parent company is Vivendi, is
4 that correct?
5 A Universal Music Publishing -- no,
6 that's not correct.
7 Q Is Universal Music Group's parent
8 company Vivendi?
9 A Yes, it is.
10 Q Okay. And Universal Music
11 Publishing is part of Universal Music Group?
12 A Yes, it is.
13 Q You have in front of you what has
14 been marked as SDARS Exhibit 84. Is this
15 document a -- what's the date of this
16 document, do you see that there? The second
17 line.
18 (Whereupon, the above-
19 referred to document was
20 marked as SDARS Exhibit
21 No. 84 for
22 identification.)

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1 A It appears to have September 6,
2 2006.
3 Q And what is the title of that?
4 A "Vivendi to Purchase BMG Music
5 Publishing." To purchase.
6 Q And what does the first paragraph
7 say?
8 A Do you want me to read it aloud?
9 Q Please.
10 MR. DeSANCTIS: Your Honor, I
11 would object again to asking the witness to
12 read from a document not in evidence.
13 CHIEF JUDGE SLEDGE: Mr. Reed?
14 MR. REED: Your Honor, I'm just
15 trying to establish the foundation that this
16 is -- I'm sorry. Strike that. I'd like to
17 move the admission of this document.
18 CHIEF JUDGE SLEDGE: Any objection
19 to Exhibit 84?
20 MR. DeSANCTIS: Yes, for lack of
21 foundation, Your Honor.
22 CHIEF JUDGE SLEDGE: Any response?

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1 MR. REED: Your Honor, he has
2 testified that Vivendi is the parent company
3 of the company that he represents, and this is
4 a press release that Vivendi issued. So the
5 witness has, I believe, the ability to testify
6 about this document.
7 CHIEF JUDGE SLEDGE: Objection
8 sustained.
9 BY MR. REED:
10 Q Mr. Ciongoli, does this refresh --
11 does this document refresh your recollection
12 as to the date that the deal between Vivendi
13 and Bertelsman for the purchase of BMG Music
14 Group was signed?
15 A I respectfully disagree with your
16 connotation of "the deal signed." It was a
17 very complicated transaction. There was a lot
18 of regulatory approval. So to the extent that
19 your reference to "the deal signed," I don't
20 believe that it was signed or at least it was
21 completely consulted at this time.
22 Q But the parties had reached

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1 agreement in principle at that time, hadn't
2 they?
3 A Yes. However, though, the
4 management of the company and the way in which
5 the transaction was structured, Universal
6 could not manage BMG until closing.
7 Q Since the time that the
8 transaction closed, which was in May of 2007,
9 is that correct?
10 A That's correct.
11 Q Has Universal taken any action to
12 withdraw the testimony of Mr. Firth?
13 A I have no knowledge of that.
14 Q All right. You don't know if
15 they've tried to correct that testimony?
16 A I have no knowledge of that.
17 MR. REED: Your Honor, I'd like to
18 move the admission of SDARS Exhibit 83.
19 CHIEF JUDGE SLEDGE: Any
20 objection?
21 MR. DeSANCTIS: Objection to
22 foundation, Your Honor.

57 (Pages 222 to 225)

<p style="text-align: right;">Page 226</p> <p>1 CHIEF JUDGE SLEDGE: Any response?</p> <p>2 MR. REED: Your Honor, this is a</p> <p>3 document that has been submitted by an officer</p> <p>4 of a company that Mr. Ciongoli's company has</p> <p>5 acquired.</p> <p>6 CHIEF JUDGE SLEDGE: How do you</p> <p>7 know that?</p> <p>8 MR. REED: He testified that the</p> <p>9 -- that this company has been acquired, that</p> <p>10 BMG Music Publishing has been acquired by his</p> <p>11 company.</p> <p>12 CHIEF JUDGE SLEDGE: Objection</p> <p>13 sustained.</p> <p>14 BY MR. REED:</p> <p>15 Q Mr. Ciongoli, in your written</p> <p>16 rebuttal testimony, you talk about various</p> <p>17 costs incurred by Universal Music Group,</p> <p>18 right?</p> <p>19 A Yes, I do.</p> <p>20 Q Does Universal Music Group do</p> <p>21 business planning regarding its costs and</p> <p>22 sales and revenues?</p>	<p style="text-align: right;">Page 228</p> <p>1 A I'm not sure all of the costs are</p> <p>2 broken out with respect to each revenue</p> <p>3 stream, but there are costs and expenses.</p> <p>4 Q And you would see those plans as</p> <p>5 the CFO of Universal Music Group?</p> <p>6 A For the U.S. operations, or for</p> <p>7 what I'm responsible for, that would be</p> <p>8 correct.</p> <p>9 Q Can I ask you to look at</p> <p>10 SoundExchange Exhibit 213 there in your</p> <p>11 binder? This is Universal Music Group's 2006</p> <p>12 income statement, is that correct?</p> <p>13 A For the United States, that is</p> <p>14 correct.</p> <p>15 Q For the United States. Now, in</p> <p>16 your written rebuttal testimony, on page 4, in</p> <p>17 that carryover paragraph at the top of the</p> <p>18 page, do you see that sentence that says, "In</p> <p>19 reality"?</p> <p>20 A Yes.</p> <p>21 Q "In reality, the vast majority of</p> <p>22 sound recordings are not profitable for record</p>
<p style="text-align: right;">Page 227</p> <p>1 A I'm sorry. Can you repeat the</p> <p>2 question?</p> <p>3 Q Does Universal Music Group do</p> <p>4 business planning with regards to its sales,</p> <p>5 revenues, and costs?</p> <p>6 A Yes.</p> <p>7 Q And are those plans in documents?</p> <p>8 A There is various documents that we</p> <p>9 prepare, like any normal business does, in</p> <p>10 terms of annual plans.</p> <p>11 Q Okay. And do those plans forecast</p> <p>12 sales and revenues and costs in future years?</p> <p>13 A Generally, it's just the next</p> <p>14 operating cycle.</p> <p>15 Q And those would include</p> <p>16 projections of physical and digital sales?</p> <p>17 A Yes.</p> <p>18 Q And revenues from physical and</p> <p>19 digital sales?</p> <p>20 A Yes.</p> <p>21 Q And costs associated with physical</p> <p>22 and digital sales?</p>	<p style="text-align: right;">Page 229</p> <p>1 companies." Is that your testimony?</p> <p>2 A Yes, it is.</p> <p>3 Q But you're not saying that</p> <p>4 Universal Music Group isn't profitable, are</p> <p>5 you?</p> <p>6 A No, I'm not saying that at all.</p> <p>7 Q Universal Music Group has been</p> <p>8 profitable since 1999 at least, hasn't it?</p> <p>9 A Yes, it has.</p> <p>10 Q And in your rebuttal statement, on</p> <p>11 page 5, the next-to-the-last sentence of that</p> <p>12 carryover paragraph starts, "The greater costs</p> <p>13 and upfront investments," do you see that, the</p> <p>14 next-to-the-last sentence of the carryover</p> <p>15 paragraph?</p> <p>16 A On page 5? I'm sorry.</p> <p>17 Q Yes, page 5, the carryover</p> <p>18 paragraph, the next-to-the-last sentence</p> <p>19 beginning, "The greater cost and upfront</p> <p>20 investments."</p> <p>21 A Okay.</p> <p>22 Q You say that the recorded music</p>

1 business is less profitable and much riskier
 2 than the music publishing business.
 3 A Yes.
 4 Q Okay. But looking at SDARS
 5 Exhibit 213, if you look at the line item
 6 called EBIT, do you see that in the middle of
 7 the page?
 8 A Yes.
 9 Q What is that number?
 10 A I'm sorry. Which number?
 11 Q The EBIT number.
 12 A EBIT. The 387,596?
 13 Q Yes. Is that million?
 14 A Yes.
 15 Q Okay. And that's earning before
 16 interest and taxes?
 17 A Yes, it is.
 18 Q And then, if you look at SDARS
 19 Exhibit 214, and there is also a line called
 20 EBIT on that document, correct?
 21 A Yes.
 22 Q And what is that number for 2006?

1 MR. DeSANCTIS: Your Honor, before
 2 the witness answers, I would ask for his
 3 answer to be treated subject to the restricted
 4 -- subject to the protective order, unless we
 5 can dispense with requiring the witness to
 6 articulate the actual dollar figure.
 7 CHIEF JUDGE SLEDGE: Since the
 8 exhibit is in evidence, is that answer
 9 required?
 10 MR. REED: I think I can get to it
 11 without the direct answer, Your Honor.
 12 CHIEF JUDGE SLEDGE: All right.
 13 Thank you.
 14 BY MR. REED:
 15 Q Mr. Ciongoli, is that number
 16 approximately five times the number -- the
 17 contract number for Universal Music Group's
 18 recording business?
 19 A In terms of gross numbers, yes,
 20 that's correct.
 21 Q Mr. Ciongoli, would you turn to
 22 page 6 of your written rebuttal testimony.

1 JUDGE WISNIEWSKI: When you say
 2 "in terms of gross numbers" here, do you mean
 3 in terms of the absolute numbers?
 4 THE WITNESS: Yes, the absolute
 5 numbers.
 6 BY MR. REED:
 7 Q And in that carryover paragraph,
 8 the last sentence on page 6, you say that
 9 "Some expenditures are not recoupable at all,
 10 because" --
 11 A I'm sorry. Where are you reading
 12 from?
 13 Q The last sentence of the carryover
 14 paragraph on page 6.
 15 A Yes.
 16 Q And you say that record companies
 17 never recoup a given advance, is that right?
 18 A That is correct.
 19 Q But you're not saying that the
 20 costs of producing a record are never recouped
 21 by the company at all, are you?
 22 A Yes, I am.

1 Q So on every record that is
 2 produced there is never a profit?
 3 A I didn't say there wasn't a
 4 profit. You asked were they recouped.
 5 Q So from revenues of the record
 6 sales, those costs end up being covered.
 7 A Sometimes they are and sometimes
 8 they are not.
 9 Q It's just that the percentage that
 10 the artist receives as their royalty isn't
 11 sufficient to recoup that investment, right?
 12 A Well, I think it's both.
 13 Q Okay. But that amount is about
 14 10 percent of the total revenues?
 15 A That's your number, not mine, but
 16 okay.
 17 Q But you're not saying that UMG
 18 never obtains a profit from the sales of CDs,
 19 right?
 20 A There are many projects that never
 21 make a dollar, whether the artist recoups or
 22 UMG recoups.

1 Q But overall UMG is profitable.
 2 A Overall UMG is profitable.
 3 Q Would you turn to page 11 of your
 4 written rebuttal testimony. And in that
 5 paragraph you're talking about record
 6 companies having to incur costs related to the
 7 digital distribution of sound recordings,
 8 right?
 9 A Yes.
 10 Q And you detail what those costs
 11 are, right?
 12 A Yes, I do.
 13 Q And Universal Music Group is
 14 incurring those costs in connection with
 15 offering basically new technology for
 16 delivering sound recordings to consumers,
 17 right?
 18 A Yes.
 19 Q And with respect to those costs,
 20 you don't pay music publishers more every time
 21 a new technology is developed, do you?
 22 A Well, again, I think we are --

1 with respect to digital, we are in a whole new
 2 environment. So to the extent that rules or
 3 regulations are put in place, we will pay them
 4 accordingly.
 5 Q But you're not paying music
 6 publishers more when the downloaded digital
 7 sound recording is to a portable device as
 8 opposed to when the download is to a fixed
 9 computer, are you?
 10 A Again, I guess I'm not quite sure
 11 I follow your question in terms of am I paying
 12 them more or not, publishers getting paid
 13 differently from a digital download versus a
 14 CD sale. So they are getting paid
 15 differently, and in some cases they are
 16 getting paid more than they historically used
 17 to be.
 18 Q Okay. But in the context of
 19 digital, you're not paying a music publisher
 20 with respect to a digital download more if the
 21 download is to a portable device as opposed to
 22 if the download is to a non-portable device,

1 right?
 2 MR. DeSANCTIS: Objection, Your
 3 Honor. I think at this point the line of
 4 questioning is entirely beyond the scope of
 5 the witness' direct testimony -- I'm sorry,
 6 the witness' written rebuttal testimony.
 7 CHIEF JUDGE SLEDGE: Hasn't that
 8 question already been answered?
 9 MR. REED: No, Your Honor, I don't
 10 believe it has.
 11 CHIEF JUDGE SLEDGE: I thought you
 12 just asked that the last time. You asked the
 13 same question again.
 14 MR. REED: I don't believe he
 15 answered my question.
 16 CHIEF JUDGE SLEDGE: Yes, he did
 17 answer your question.
 18 BY MR. REED:
 19 Q Mr. Ciongoli, if you'll look at
 20 page 3 of your written rebuttal testimony, in
 21 the -- that second full paragraph near the
 22 bottom, the sentence begins, "Unlike record

1 companies." Do you see that?
 2 A Yes, I do.
 3 Q You say, "Unlike record companies,
 4 music publishers do not incur certain costs --
 5 marketing, promotion, distribution,
 6 personnel," is that right? Among others?
 7 A Yes, that's correct.
 8 Q Okay. And then, you go on to say,
 9 "Instead, it's the record companies" -- and
 10 specifically UMG -- "that incurs those costs,"
 11 right?
 12 A Yes, I do say that, that the
 13 record companies expend enormous sums to
 14 create and promote the products to consumers.
 15 Q And you say that -- your testimony
 16 is that publishers are the beneficiaries of
 17 this work and investment, right?
 18 A Yes, that's correct.
 19 Q And your testimony is that this
 20 justifies the lower compensation that music
 21 publishers receive?
 22 A Yes, that's correct.

1 Q So in contrast to the music
2 publishers, the record companies are taking
3 the publishers' copyrighted work and making a
4 substantial investment and bearing substantial
5 risk to create a final product that's
6 distributed to the public?

7 A I don't -- I don't see it the way
8 you see it. I don't think we're taking the
9 music publishers' copyrighted works. I think
10 the -- there are artists that create the
11 musical work, which then ultimately becomes
12 the sound recording. That is the creation of
13 the work that is ultimately exploited.

14 I don't think somebody, to use
15 your -- somebody has taken something and
16 created something. I think it's a
17 collaborative effort from the artist and the
18 writer, to the extent that a writer does, in
19 fact, work on it. But, again, that's my view
20 of how things are exploited.

21 Q And despite that fact, the music
22 publisher is entitled to lower compensation,

1 right?

2 A Again, the music -- from my
3 perspective, from a financial perspective, the
4 music publishing company does not create, nor
5 if you will invest in the actual creation of
6 the copyrighted work. They are basically a
7 bank if you will.

8 I mean, at least our music
9 publishing company is, and many, many others
10 that I've seen, whereby they invest in
11 catalogs where they have -- as I think I have
12 explained in my testimony here, where there is
13 a catalog that has a projected cashflow, and
14 those cashflows are basically fronted monies
15 whereby a publisher gets a small return on
16 those.

17 Q And you're talking about your
18 music publishing business particularly,
19 correct?

20 A Well, I think it is by and large
21 the music publishing business in general.

22 Q So your testimony is that music

1 publishers don't invest in artists?

2 A I didn't say that they don't
3 invest in artists. Generally speaking, in the
4 country area, there is some investment in some
5 writers, they develop writers. But by and
6 large, those writers or those songs are then,
7 if you will, tried to be placed. But that's
8 a very, very small part of the overall music
9 publishing business.

10 MR. REED: Your Honor, if I may
11 have one moment.

12 CHIEF JUDGE SLEDGE: Yes, sir.
13 (Pause.)

14 BY MR. REED:

15 Q Mr. Ciongoli, when we were talking
16 about business plans earlier, you mentioned
17 operating cycles. Do you remember that?

18 A Yes.

19 Q What is an operating cycle?

20 A It's the next fiscal year. So,
21 for example, we are on a calendar year, so we
22 would make projections for the period January

1 through December of -- we are actually in the
2 process of making plans for the 2008 year. So
3 it's the next operating cycle, 12-month
4 period.

5 Q And does Universal Music Group do
6 any longer range forecasting?

7 A There are some very, very high-
8 level plans that are done, but they are --
9 they are -- you know, they are done at a very
10 macro level for all of UMG for all of Vivendi.

11 MR. REED: No further questions,
12 Your Honor.

13 CHIEF JUDGE SLEDGE: Is there any
14 redirect?

15 MR. DeSANCTIS: No, Your Honor.

16 CHIEF JUDGE SLEDGE: Any questions
17 from the bench?

18 (No response.)

19 Thank you, sir. That ends your
20 testimony.

21 THE WITNESS: Thank you.

22 (Whereupon, the witness was

1 excused.)
 2 CHIEF JUDGE SLEDGE: All right.
 3 We'll recess 10 minutes.
 4 (Whereupon, the proceedings in the
 5 foregoing matter went off the record at 3:24
 6 p.m. and went back on the record at 3:35 p.m.)
 7 CHIEF JUDGE SLEDGE: On the
 8 record. All right. We will come to order.
 9 MR. SCHNEIDER: SoundExchange
 10 calls Dr. Janusz Ordover.
 11 Whereupon,
 12 JANUSZ ORDOVER
 13 was recalled as a witness Counsel for
 14 SoundExchange, and having been first duly
 15 sworn, was examined and testified as follow:
 16 THE WITNESS: It's a pleasure to
 17 be here again.
 18 DIRECT EXAMINATION
 19 BY MR. SCHNEIDER:
 20 Q Dr. Ordover, could you state your
 21 name for the record?
 22 A Janusz Alexander Ordover.

1 Q And has any of your biographical
 2 information changed since you were here
 3 several months ago?
 4 A No, it has not.
 5 (Whereupon, the document
 6 referred to was marked
 7 as SX Exhibit No. 119
 8 for identification.)
 9 MR. SCHNEIDER: Let me show what's
 10 been marked as SoundExchange Exhibit 119.
 11 (Witness proffered document.)
 12 BY MR. SCHNEIDER:
 13 Q Looking at SoundExchange Exhibit
 14 119, can you identify this document?
 15 A Yes, I can.
 16 Q This document?
 17 A This one?
 18 Q Yes.
 19 A This is the rebuttal testimony
 20 which I prepared in this case.
 21 Q And turning to page 21, is that
 22 your signature?

1 A Yes, it is.
 2 MR. SCHNEIDER: And I would like
 3 to move SoundExchange 119 into evidence.
 4 CHIEF JUDGE SLEDGE: Any
 5 objection?
 6 MR. MEYER: Yes, Your Honor.
 7 CHIEF JUDGE SLEDGE: Go ahead.
 8 MR. MEYER: I have a number of
 9 objections both to the direct written
 10 testimony and the exhibits attached thereto.
 11 First of all, in paragraph 17 of the written
 12 testimony, Dr. Ordover, and in the chart that
 13 precedes that, Dr. Ordover presents what
 14 essentially an attempt to update and buttress
 15 a similar chart that he had in his original
 16 direct written testimony. As Your Honors may
 17 recall, the similar chart in the direct
 18 testimony, Dr. Ordover testified it was based
 19 solely on essentially double hearsay. He
 20 testified that his staff -- that Mr. Kenswil
 21 and Mr. Eisenberg had told his staff what the
 22 numbers were and the staff then told Dr.

1 Ordover.
 2 So here I think what Dr. Ordover
 3 purports to do is he says "This reflects an
 4 analysis of contracts" undertaken by his staff
 5 under his direction. So my objections are,
 6 first of all, that it's not proper rebuttal.
 7 Secondly, that the analysis was not done by
 8 Dr. Ordover but rather was done by his staff.
 9 And thirdly, that there's no foundation since
 10 the contracts that Dr. Ordover testifies were
 11 analyzed are not in any way identified.
 12 Secondly, Your Honor, and I move
 13 to strike the entire paragraph 17. I want to
 14 point out at the end of paragraph 17 Dr.
 15 Ordover talks about another set of research.
 16 CHIEF JUDGE SLEDGE: Mr. Meyer, I
 17 don't know what you mean by that last thing.
 18 Are you objecting only to paragraph 17?
 19 MR. MEYER: I'm going through my
 20 objections, but in the direct written
 21 testimony, I'm objecting to the chart and to
 22 paragraph 17 and then to another section which

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

In the Matter of)
)
)

ADJUSTMENT OF RATES AND TERMS FOR)
PREEXISTING SUBSCRIPTION SERVICES)
AND SATELLITE DIGITAL AUDIO RADIO)
SERVICES)
)
)

Docket No. 2006-1 CRB DSTRA

TESTIMONY OF

MARK EISENBERG

Executive Vice President, Business and Legal Affairs
Global Digital Business Group
SONY BMG MUSIC ENTERTAINMENT

PUBLIC VERSION

October 2006

DIRECT TESTIMONY OF MARK EISENBERG

I am submitting this testimony to discuss the types of contracts that owners of sound recording copyrights make in the unregulated marketplace and the value of sound recordings as reflected in those contracts. Such market data points have substantial probative value in setting the rates under 17 U.S.C. § 801(b)(1) for certain uses of sound recordings by the satellite radio companies, XM and Sirius (“SDARS”), and by the other “over-TV” services known as the pre-existing services (“PES”).

BACKGROUND AND QUALIFICATIONS

I am currently Executive Vice President, Business and Legal Affairs, Global Digital Business Group, at SONY BMG MUSIC ENTERTAINMENT (“SONY BMG”). SONY BMG is a joint venture that owns and controls the recorded music business formerly owned by Sony Music Entertainment Inc. (“Sony Music”) and Bertelsmann AG. I have held this position at SONY BMG since the formation of the joint venture between Sony Music and BMG in 2004. In this position, I oversee the worldwide distribution¹ and digital distribution activities of SONY BMG’s various music and other intellectual property assets across a wide array of digital distribution platforms and outlets. I am also directly involved in the formulation of SONY BMG’s policies and procedures regarding new technologies. I work closely with SoundExchange on a variety of issues, including the negotiation of rates and terms for statutory licenses under Sections 112 and 114 of the Copyright Act. I also work with trade organizations such as IFPI and RIAA in a variety of contexts, including new technologies, and interact with

¹ For convenience, I use the term “license” broadly, to include the distribution right for content regardless of business model (*e.g.*, whether the consumers are purchasing content on an “a la carte” basis through a download store or on an integrated listening experience basis through an “all you can eat” subscription service).

SONY BMG's marketing and online sales departments worldwide on myriad label and artist issues as they relate to digital distribution.

Prior to the formation of SONY BMG, I served as Senior Vice President, Business Affairs, New Technology and Business Development of Sony Music Entertainment Inc. From 2000 to 2001, I served as Senior Vice President and General Counsel, 550 Digital Media Ventures, a venture capital firm started by Sony Music to make strategic investments in companies engaged in technologies, services, and marketing related to digital platforms and media. From 1998 to 2000, I was Vice President, Business Affairs, New Technology and Business Development, Sony Music, and prior to that, from 1996 to 1998, I was Director, Business Affairs, Sony Music. I originally joined Sony Music in 1994 as Counsel in the Sony Music Law Department. I began my career in 1988 as an associate with Willkie Farr & Gallagher, subsequently moving to the entertainment law firm of Gold Farrell & Marks where I worked in copyright, music and litigation matters. I earned a Bachelor of Arts degree in 1985 from Brandeis University, graduating summa cum laude, Phi Beta Kappa. I earned a Juris Doctor degree from the New York University School of Law in 1988.

BACKGROUND ON SONY BMG

SONY BMG is a global recorded music joint venture that was formed in August, 2004. The joint venture is 50% owned by Bertelsmann AG and 50% owned by Sony Corporation of America. SONY BMG encompasses some of the most influential and successful record labels in the world, which are home to a wide array of both local and international artists, including Arista (Dido, Whitney Houston, Sarah McLachlan, and Santana); Columbia Records (Aerosmith, Tony Bennett, Beyonce, Bob Dylan, Destiny's Child, Dixie Chicks, John Mayer, Jessica Simpson, Bruce Springsteen, Barbra Streisand, System of a Down, and Train); Epic Records (Anastacia,

Good Charlotte, Incubus, Los Lonely Boys, Modest Mouse, and Jennifer Lopez); Jive (R. Kelly, Britney Spears, and Justin Timberlake); J Records (Alicia Keys, Annie Lennox, Maroon 5, and Rod Stewart); LaFace (OutKast, Pink, and Usher); RCA Records (Christina Aguilera, Dave Matthews Band, Avril Lavigne, and Velvet Revolver); RLG-Nashville (Kenny Chesney, Alan Jackson, and Martina McBride); Sony Music Nashville (Buddy Jewell, Montgomery Gentry, Travis Tritt, and Gretchen Wilson); Sony Classical (Yo-Yo Ma, Joshua Bell, composer John Williams, and Robert Downey, Jr.); BMG UK (Westlife, Will Young); BMG Japan (Kazumasa Oda); BMG Ricordi (Eros Ramazzotti); and Sony Music International (Adriano Celentano, Celine Dion, La Oreja de Van Gogh, George Michael, Sade, Shakira, Julio Iglesias, Leonard Cohen, Delta Goodrem, Bic Runga, and Jay Chou), among many others.

In addition, SONY BMG is the home of a broad variety of archival recordings, including masterworks from such all-time greats as Miles Davis, The Byrds, John Denver, Johnny Cash, Robert Johnson, Janis Joplin, Barry Manilow, Louis Armstrong, Dolly Parton, Elvis Presley, Mahalia Jackson, Vladimir Horowitz, Glenn Gould, Laura Nyro, Lou Reed, and Stevie Ray Vaughan.

DEVELOPMENT OF THE DIGITAL DISTRIBUTION MARKET

The recording industry today is experiencing an unprecedented transformation. We are quickly evolving from what used to be a packaged goods industry into a digital business, and the challenges associated with this fundamental change in the industry cannot be overstated. It is well known that the last several years have not been particularly good for the industry. The sales of our physical products (most particularly CDs) have languished, and while the digital business is now taking shape and delivering substantial revenues, our total sales are still down from 2000.

Historically, SONY BMG's revenues worldwide have principally derived from the sale and distribution of pre-manufactured physical products, such as vinyl LPs, cassette tapes, compact discs, VHS tapes, and DVDs. Unlike other copyright-based music businesses, such as music publishing, which has long enjoyed a performance right and the revenue stream flowing therefrom, the recorded music industry was historically entirely dependent on revenues derived from the sales of packaged goods.

In the late 1990s, music began to be distributed over the Internet -- in most cases illegally. In the years that followed, the record industry was faced with widespread digital piracy over file-sharing networks, such as Napster (no relation to the current licensed service of the same name), with other forms of piracy, such as physical piracy through the use of CD burning technology, and with new business challenges caused by the transformation of the legitimate marketplace from physical to digital. Since 2000, the shipments of physical products -- and consequently, SONY BMG's core source of revenues -- have declined, with industry wide shipments declining by more than 25%. And as the industry continues its transition to digital delivery, the traditional "brick and mortar" physical market will continue to contract in the years to come.

Eventually, however, legitimate digital distribution platforms began to take hold and now are promising sources of significant future revenue. iTunes, for example, began in 2003 and marked the beginning of a new stage in the development of digital distribution models, which are numerous and increasing with each passing day. The distribution platforms include satellite radio, cable and satellite television networks, the Internet, and private data-communications networks, including cellular telephone network operators. The products -- available on some or all of the above-mentioned distribution platforms -- range from single-track downloads to streaming music videos to ringtones. Consumer demand for experiencing music through these differentiated products and alternative distribution platforms is growing by leaps and bounds and has ripened into an increasingly important source of revenue for SONY BMG. In every market worldwide, digital revenues as a proportion of the company's overall revenues are increasing.

It is clear from the above that while our traditional physical products will still be an important part of our overall business for years to come, it is the digital exploitation of music where our future will be made or lost.

LICENSING AND DISTRIBUTION PRACTICES FOR DIGITAL MUSIC

Overview of Digital Licensing and Distribution Philosophy

SONY BMG owns or controls the digital distribution rights to an immense catalog of intellectual property across a wide array of functionalities and distribution platforms. These incorporate a wide range of business models, including, by way of illustration, satellite radio; services delivering music over cable and satellite television; online "on demand" subscription services; online permanent download services; interactive and non-interactive online and wireless "radio" services; services operated by "mobile" carriers and content aggregators selling myriad digital products and services online and/or "over the air" of a cell phone carrier's network (such as master ringtones, MIDI ringtones, ringback tones, full-length video downloads,

full length audio downloads and graphics); online streaming of “sound clips”; digital jukeboxes; and CD-burning kiosks. SONY BMG is constantly approached both by potential new entrants in the market exploring opportunities to provide digital music services, and by existing distribution partners seeking to extend, renew, and/or expand distribution arrangements that are already in place.

In deciding whether to make our catalog available for distribution in a particular circumstance, SONY BMG considers and balances a host of factors and considerations. Those include the value that consumers derive from the particular service or distribution platform, especially for services that offer “anytime, anywhere” access, such as wireless and satellite-delivered services and the possible substitution effect that one service may have on other paid uses of sound recordings. I discuss these in more detail below.

Impact of Portability and Wireless Devices

Although each of the above-listed factors and considerations plays a significant role in our “distribution” activities, in recent years, a key factor in shaping the economic terms for our potential digital distribution opportunities has been whether the proposed service can be accessed by end users “anytime, anywhere,” through lightweight, hand-held, “portable devices” (as contrasted with being accessible only within the more limiting environment of a fixed-line personal computer resident in the home). The ease and convenience of wireless-enabled cellular phones, which function as “portable” audio and audiovisual music players, combined with the ubiquity of wireless networks have resulted in significant value to consumers interested in listening to music, and thus to SONY BMG.

As the Board may already be aware, the legislative history of the DPRSRA and the DMCA are rife with references to the eventual development of a “celestial jukebox” -- a giant “server in the sky” where consumers can access the digital content that they want, whenever they

want it, wherever they are geographically. SONY BMG started selling master ringtones in the United States in July 2003, making it the first major record company to do so. Through its distribution arrangements, SONY BMG has made available more than a dozen different categories of mobile products for distribution, including master ringtones, voice ringers, ringback tones, full-length audio, music videos, mobile radio, mobile TV, artist images and music news. For SONY BMG, the long anticipated “celestial jukebox” is here and now.

As more fully laid out below, SONY BMG’s content as delivered via wireless networks yields healthy premiums compared to the revenues our content yields on tethered platforms (such as personal computers). For example, carriers and mobile content aggregators have offered us wholesale rates reflecting more than [REDACTED]² for single-track permanent downloads delivered OTA over a cell phone network, as compared with existing online wholesale pricing. In fact, even excerpts of our sound recordings known as “ringtones” -- which are not more than 30 seconds in length -- and “ringbacks” -- for which a purchaser’s rights are only temporary in nature (expiring as early as 3 months after the consumer’s purchase) -- [REDACTED]

[REDACTED]

The increased value of our sound recordings when delivered wirelessly and the resulting premium that our sound recordings command in negotiated marketplace agreements are particularly instructive for determining the statutory rate for satellite radio. Like the portable and wireless services discussed above, satellite radio can be received anytime, anywhere. Whether in the car with one of the many “plug-and-play” devices, or with the newer completely wireless handheld receivers, which allow subscribers to receive satellite radio transmissions anywhere

² The information in this testimony that has been marked as restricted is proprietary and commercially sensitive information that is not generally known to the public.

and without being tethered to a PC or anything else, consumers are enjoying satellite radio portably and wirelessly. It follows that SONY BMG is entitled to increased compensation for this added value through the statutory rate just as it would insist on and receive in the open market.

Concerns of Substitution Versus Promotion

As I mentioned above, one of the factors that weighs heavily in our decision about how we price our content in the digital marketplace is the extent to which the service at issue is likely to substitute for purchases of recorded music. With minor exceptions, virtually all digital services are substitutional to some extent. Simply put, they are ways in which consumers choose to receive, listen to and, in most instances, pay for music. A consumer's decision to receive his or her music from one or more digital services means, in most cases, that he or she will in turn purchase less music in traditional physical media. As a result, where a digital delivery service substitutes for other paid uses of recorded music (either for CDs or for other digital services from which we earn market-based royalties), it is imperative that the applicable royalty structure be sufficiently high so as to compensate for our otherwise resulting loss of income.

The flip side of substitution is promotion -- the notion that any one of these digital services might introduce consumers to more music and, in turn, actually cause consumers to purchase more CDs or downloads than they otherwise would. What matters at the end of the day, of course, is the net effect: whether a service on the whole is more substitutional than promotional or more promotional than substitutional. Two points, explained below, are critical to understand here. First, in the digital arena, our practice has been to charge a fair, undiscounted price for our music, even if a service might have *some* or even a net promotional effect. Second, I have seen no evidence that digital services, including satellite radio and the

other “over-TV” services at issue here, are net promotional. Rather, they appear to be deeply substitutional.

Fair Compensation for Promotional Uses

The evolution from a “packaged media” consumer experience (*i.e.*, manufactured CDs) to consumption by means of digital distribution has led to significant structural changes within SONY BMG. Through the creation of a new business unit -- the Global Digital Business Group -- SONY BMG has sought to maximize the company’s digital revenues for all its intellectual properties across all new media platforms.

In response to the changing marketplace, SONY BMG has changed how it views its traditional promotional and marketing activities. In the past, when recorded music revenues were derived almost entirely from physical product sales, SONY BMG relied on, among other things, giving away free, though limited, access to certain, specifically targeted new sound recordings, with the hope of increasing incremental sales of the company’s core product -- *i.e.*, a full-length album in the CD format or in other media. However, in the era of digital distribution, where full-length album sales are being cannibalized by other types of consumption including satellite radio, it has become increasingly important to transition away from the practice of providing “free” access to content in the digital space and to move towards ensuring that SONY BMG is compensated for each exploitation of its content, even if a particular exploitation could have the potential to indirectly generate incremental product sales for the artist concerned. Our digital media marketing and promotional activities are increasingly designed to accomplish these dual, complementary objectives of providing maximum exposure for our artists’ work and simultaneously monetizing each promotional opportunity.

The sum of these institutional changes within SONY BMG is that SONY BMG does not discount broad licenses to its entire catalog based on the potential for causing incremental sales

in another market. Rather, SONY BMG seeks a fair return (and under 17 U.S.C. § 801(1)(B) is, indeed, entitled to a fair return) in each and every market for each and every exploitation, instead of hoping for collateral, indirect sales under the guise of “promotion.” Indeed, even when SONY BMG licenses its catalog for use by a commercial distributor who does nothing other than provide clips of music to consumers when they are considering purchasing a CD or digital download -- a use that clearly promotes sales of sound recordings -- SONY BMG often is compensated in the range of [REDACTED] of the service’s revenues because these sound clip services have built their business on the commercial exploitation of our sound recordings.

The SDARS and PES Services Are Not Promotional

When it suits their immediate business interests, the satellite radio companies frequently compare themselves to terrestrial (AM/FM) radio and claim that their services drive consumers to purchase particular sound recordings or CDs. We have not yet seen any palpable evidence of that. Nor would I expect to. **Indeed, alleged customer testimonials that XM posts on its own website are strategically deployed to market just the opposite conclusion, “No more need to ever buy another CD.”**³ The fact is that there is an array of reasons why exposure on satellite radio substitutes for other types of consumption of music and is not an effective means of inducing sales of physical products, let alone digital music. In the following, I discuss briefly some of the reasons why this is so.

The claims of the satellite radio industry simply miss the point of the types of promotion record companies do with respect to terrestrial radio. The industry has learned from decades of experience that the playing of a sound recording on terrestrial radio (what we call a “spin”) does not by itself have significant promotional value. Rather, the value of radio promotion for a

³ See <http://testimonials.xmradio.com/> (last visited Oct. 27, 2006) (emphasis added), SX Ex. 006 DP.

particular recording is achieved when the spins in conjunction with other marketing efforts amount to a “call to action” or, in marketing terms, have an “impact” on the target demographic.

Experience has taught the industry that, when done in a particular way and only in a particular way, spins on terrestrial radio can be an effective part of a localized campaign to promote a particular new release and to turn it into a hit. First, to make an impact on the market, the spins must be part of what is called a “power rotation.” That is, the new release being promoted must be played over and over again at peak listening hours. Second, these power rotation spins must be coordinated with other aspects of a multi-faceted local marketing campaign. Such campaigns must include disc jockey (“DJ”) chatter where the local DJ, who has a relationship with the listeners, talks up the new release as something good that the listeners will like. In addition, these campaigns typically are coordinated with local appearances by the artist that are advertised on the radio, and with other promotional activities such as concert ticket and merchandise give-aways. Only in this way does terrestrial radio help create the necessary frenzy among the target audience to “break” a new release and turn it into a hit record. Third, a record company can only “promote” a small subset of its catalog at any one time. The idea that any distribution channel -- terrestrial radio, satellite radio, or any other -- can simultaneously promote sales of every artist and album at the same time is ludicrous. The reality is that the coordinated promotional efforts record companies undertake occur for a tiny fraction of sound recordings at any one time.

Satellite radio, by contrast, shares none of these characteristics. Except for the few dedicated “top hits” channels on XM and Sirius (which largely play the songs that already are at the top of the hit list and contribute little to getting them there in the first place) the SDARS pride themselves on having long playlists, *i.e.*, not playing the same song multiple times within a

day. These infrequent spins -- far from the proven "power rotation" model -- provide little or no promotional value to the record companies. In addition, the satellite services have far less DJ chatter that touts any new releases. And, though they might feature a particular artist in any number of ways, they rarely, if ever given their diffuse national audience, take part in any localized campaigns that are coordinated with local concert appearances or other promotional activities. The same, of course, is true of the pre-existing, "over-TV" services such as MusicChoice and Muzak. At bottom, we have seen no evidence of these services having any positive impact on sales of recorded music.

Rather, as discussed above, there is every indication that they are significantly substitutonal. Unlike terrestrial radio, which is free, a subscription to satellite radio costs between \$120 and \$155 a year, in addition to the cost of purchasing a proprietary XM or Sirius radio and paying to have it activated. Where consumers have decided to spend that kind of money to receive their music in a particular digital format, they obviously will have less money in their entertainment budgets to spend on CDs, digital downloads, or the many paid subscription services from which we earn respectable royalties.

Similarly, unlike terrestrial radio, satellite radio offers scores of channels in narrowly tailored genres that meet the tastes of virtually anyone who enjoys music. Enthusiastic fans of a particular song or artist will of course continue to buy recorded music so that they can hear their favorite songs over and over again. But for millions of music listeners, the listening experience is less specific. They simply want to have a variety of music playing in the car, for example, or at the office or during dinner. Or they have a range of tastes and might prefer one genre such as country, but at times, might also be in the mood for classical, jazz, blues or light rock and roll -- things that are not always easy to find on terrestrial radio in a given location. For these people

(who already are spending significant sums of money to receive satellite radio in the car, in their homes, or with them where ever they go) satellite radio is the perfect substitute for many of the CDs they otherwise might buy.

As I have described, where all evidence and logic (not to mention the service's own website) point to a service as having a pronounced substitutional effect, we take that effect into account very seriously when negotiating a fair price for our content in the open market.

Recognizing Value in Marketplace Agreements Beyond the Monetary Royalty

In addition to the rates themselves (discussed below), there are many other terms in SONY BMG's marketplace agreements that augment the agreements' value to SONY BMG and that are critical to measuring the value of our content in the marketplace. Because these terms, or "deal points," as they often are called, are not always contained in statutory licenses, it is important to understand that, absent such deal points, looking only to the rates obtained in the marketplace would significantly *undervalue* our content. Accordingly, to the extent that marketplace rates are considered, as they should be, in determining the rates in this proceeding under 17 U.S.C. § 801(b)(1), it is essential to bear in mind that the rates themselves reflect only a portion of the value reflected by any one agreement as a whole. Without these additional deal points in our agreements, we unquestionably would demand higher rates in our marketplace agreements.

Such deal points include the following:

- (a) **Available repertoire; Windowing; Holdbacks.** SONY BMG would exercise discretion over the titles of repertoire that may be made available on a distributor-by-distributor basis, and with respect to the repertoire that is made available, exercise discretion over the timing that those titles may be made available by those distributors and through specific channels.
- (b) **Syndication and Sublicensing.** SONY BMG would restrict the ability of the distributor to syndicate the service under branding or trademarks owned or controlled by yet other third parties, whether on a "private label," "co-brand" or other basis.

- (c) **Distribution Channels.** SONY BMG would restrict the distribution channels (*e.g.*, restricting distribution solely to Internet, OTA, cable, or public facilities, etc.) through which the service is made available to end users.
- (d) **Electronics Devices.** SONY BMG would specify the particular types of electronics devices (or service eligibility criteria) through which the service may be accessed via a particular distribution channel.
- (e) **Marketing and Promotional Opportunities.** SONY BMG would require the distributor to undertake a number of commitments that are designed to be of mutual benefit to SONY BMG and the distributor.
- (f) **Security.** SONY BMG would retain approval rights over the end-to-end security of a given distribution platform to avoid a wide variety of types of unlawful reproduction and distribution.
- (g) **Financial Audit Rights/Accounting Standards.** SONY BMG would maintain the right to examine the relevant books and records of the distributor for purposes of verifying the accuracy of accountings.
- (h) **Technical Audit Rights.** SONY BMG would maintain the right to conduct on-site examinations of the distributor's systems, servers and server logs for purposes of observing and verifying the security of SONY BMG's intellectual property and the accuracy of the service's transaction data and reports sent to SONY BMG.
- (i) **Electronic Reporting.** In order to facilitate the cooperation and development of specific marketing initiatives with SONY BMG's labels, artists and products, SONY BMG would require the distributor to deliver weekly information reports in conformity with an electronic reporting specification and monthly royalty reporting. Such reports can be automatically uploaded into SONY BMG's internal systems without labor-intensive manual compilations, restatements and adjustments.
- (j) **Remedies.** SONY BMG would retain the right to terminate the license and seek damages in the event of a material breach of the distributor's obligations to SONY BMG.

In virtually every one of its marketplace agreements, SONY BMG receives either a significant non-refundable but recoupable advance payment or, alternatively, a significant non-refundable but recoupable minimum monthly revenue guarantee.

Over the last year, we have seen an explosion in the number of requests for catalog licenses to digitally distribute our intellectual property. Given the number of requests and

limited resources we have to do deals, SONY BMG is committed to pursuing only deals that offer substantial economic upside and a reasonable chance of success in the marketplace.

Examples of SONY BMG New Media Agreements

Set forth below are the principal economic terms contained in a number of representative non-statutory agreements for the digital distribution of SONY BMG products. These terms, we believe, are quite instructive in gauging the fair value of our music.

Online “On Demand” Streaming and Conditional Download Services for Audio Materials

SONY BMG has several commercial distribution arrangements with services that provide online, “on demand” streaming and conditional download services. Large webcasters such as AOL, Yahoo!, and Real Networks provide such on demand services, either directly or through third-party “white label” distributors.

Pursuant to these deals, end users can select particular tracks from SONY BMG’s audio catalog for “on demand” playback in one of three (3) basic forms: (a) on demand streams; (b) non-portable conditional downloads (*i.e.*, downloads that are “tethered” to a PC and expire or “time out” at the end of the consumer’s subscription to the service); and (c) portable conditional downloads (*i.e.*, conditional downloads that are transferable from a PC to portable devices that are compatible with commercially available software).

With each of these basic forms, the resulting programming that is delivered to the end user consists of the particular tracks that are specifically requested by that user for playback. Users can construct their own “playlists” around these tracks, and generally create a music experience tailored to suit the specific preferences of the user. Many on demand services recognize that users frequently do not know the identities of the exact sound recordings that may satisfy a particular desire, mood or preference at a given moment, so rather than rely on the user

to “pull” those specific tracks, the services “push” suggested playlists to the user based on general user inputs and preferences.

Generally speaking, these on demand subscription services bifurcate into two distinct consumer offerings: (i) a “tethered” on demand subscription service offering, which consists of on demand streams and non-portable conditional downloads that are playable only on a PC (*i.e.*, the music is “tethered” to the PC, and therefore largely restricted to the home or work environment), and (ii) a “portable” on demand subscription offering, which consists of each of the individual components of the “tethered” offering, plus the added functionality of portable conditional downloads that can be rendered for playback on secure, lightweight portable devices “on the go” (*i.e.*, the music can be enjoyed “anytime, anywhere” whether inside the home or outside, by means of a portable device, such as portable MP3-type digital audio players).

For these and other types of subscription services, SONY BMG typically has structured the license fees payable for online on demand subscription services as the greater of the following calculations:

[REDACTED]

[REDACTED]

⁴ For technological reasons, a per play or “per performance” rate would not make sense in the context of the current proceeding because the services at issue do not, and may not be able to, track the number of times that their many transmissions are received by a subscriber. That, however, in no way limits the importance of a greater-of rate structure in the proceedings.

[REDACTED]

[REDACTED]

The purpose of this greater-of-three royalty calculation is to make certain that SONY BMG is fairly compensated, no matter how the distributor may choose to exploit SONY BMG's sound recordings.

SONY BMG's recent deals (either new service launches or renewals of existing deals) with online on-demand music subscription services are representative of how these rates are applied in practice. In its most recent deals, SONY BMG receives monthly accountings for royalties determined and computed as follows:

(a) **For "tethered" subscription offerings.** [REDACTED]

[REDACTED]

(b) **For "portable" subscription offerings (which include "tethered" access to SONY BMG repertoire).** [REDACTED]

[REDACTED]

Wireless Services

The market for music services that can be received directly over a wireless device such as a cell phone, without a fixed-line computer, is evolving. This market is already generating considerable revenue, as consumers are willing to pay a premium for the ability to access content from anywhere via wireless devices. A similar phenomenon can be seen with satellite radio, where people are willing to pay substantial subscription fees for preprogrammed radio (some but not all of which is commercial free) that is accessible in the car and, with recently available devices, anywhere by means of a handheld portable device.

We already have evidence of the greater value of music in this distribution channel in the market for ringtones. Ringtones are short clips of music that can be used as cell phone ringers. Mastertones refer to ringtones that are clips of actual sound recordings, whose copyrights are owned by SONY BMG and other record labels. Consumers are willing to pay approximately \$2.50 for mastertones -- much more than they will pay for downloads of entire songs (a single track being about \$0.99 on iTunes).

SONY BMG treats the market for wireless music services completely differently from other distribution channels, with different pricing and royalty agreements. [REDACTED]
[REDACTED]. SONY BMG charges [REDACTED] for “ringback” tones, which allow users to cause a particular sound recording clip to play on another’s cell phone instead of a conventional “ring” sound when placing a call.

While the market for wireless full-length audio downloads is just beginning, SONY BMG has recently entered into agreements in this area. With a wireless download service, a consumer can, over a high-speed data network, download a full track directly to the handset, thus

truly making music available anytime, anywhere. SONY BMG has required distributors to pay

[REDACTED]
[REDACTED]. That represents a more than [REDACTED] premium over the price that SONY BMG receives for downloads to personal computers delivered via the Internet. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Video Streaming

SONY BMG has entered into such agreements for video streaming services that offer videos selected by viewers (so-called “on demand” or “pulled” streams) as well as pre-programmed plays (so-called “pushed” streams). Because audiovisual exhibitions are not subject to a statutory license, the content providers and distributors negotiate rates for both interactive and non-interactive video streaming. [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Although music videos are viewed by some as “promotional” for the sale of recorded music product (CDs, DVDs and downloads), the marketplace has recognized the intrinsic value of the audiovisual content itself, both for generating lucrative ad dollars and in creating “stickiness” for visitors of a given website. Thus, in addition to the promotional value that a given video might bring for a particular release, SONY BMG has negotiated substantial multimillion dollar deals for online exhibition rights to its video catalog. SONY BMG has already entered into agreements that guarantee, in the aggregate, [REDACTED]

[REDACTED] The advances are merely a down payment, recoupable against a recurring revenue share generated from each video play, ranging from the pro rata share of an introductory rate of 30% to the current standard of 50% of the advertising and sponsorship revenues generated.

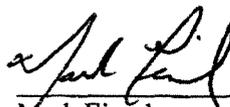
In addition, SONY BMG's video agreements provide additional non-monetary consideration. We receive guaranteed promotional consideration (separate and apart from any intrinsic promotional value which may be associated with simply having the video streamed) and preserve holdback rights for purposes of pursuing "windowing" strategies. Moreover, in recognition of the premium that consumers pay -- and services receive -- for wireless functionality, SONY BMG expressly prohibits services from streaming its videos to mobile or cellular networks absent a separately negotiated video agreement which expressly grants rights in such a distribution channel (for which additional consideration would be required).

Online Distribution of Permanent Audio Downloads

SONY BMG's general approach to distributing permanent downloads is to sell them on a "wholesale" sales model, similar in many respects to the way physical goods such as CDs and DVDs are sold for distribution through normal retail channels. [REDACTED]

[REDACTED] In general, SONY BMG's revenue splits for digital download service providers are between [REDACTED] and [REDACTED]

I declare under penalty of perjury that the foregoing testimony is true and correct to the best of my knowledge and belief.



Mark Eisenberg

Date: 10/29/06

Exhibits Sponsored by Mark Eisenberg

Exhibit No.	Description
SX Ex. 006 DP	XM Radio.com Testimonials Page
SX Ex. 104 DR	[Redacted]
SX Ex. 107 DR	[Redacted]

Transcript of:

Date: June 18, 2007

Volume: IX

Case: Adjustment of Rates for Pre-Existing Subscriptions

Neal R. Gross & Co., Inc.
Phone: 202-234-4433
Fax: 202-387-7330
Email: info@nealrgross.com
Internet: www.nealrgross.com

Page 1

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

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In the matter of:
 -----+

Adjustment of Rates and Terms for Preexisting Subscriptions Services, and Satellite Digital Audio Radio Services	Docket No. 2006-1 CRB DSTR
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**Room LM-408
 Library of Congress
 First and Independence Avenue, S.E.
 Washington, D.C. 20540
 Monday,
 June 18, 2007**

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

BEFORE:
THE HONORABLE JAMES SLEDGE, Chief Judge
THE HONORABLE WILLIAM J. ROBERTS, JR., Judge

THE HONORABLE STAN WISNIEWSKI, Judge

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1 P-R-O-C-E-E-D-I-N-G-S
 2 9:30 a.m.
 3 CHIEF JUDGE SLEDGE: Thank you.
 4 We'll come to order.
 5 Mr. Meyer, were you still in your
 6 examination?
 7 MR. MEYER: Yes, Your Honor,
 8 although I've concluded and pass the time to
 9 Mr. Sturm for Sirius.
 10 CHIEF JUDGE SLEDGE: Mr. Sturm.
 11 MR. STURM: Thank you.
 12 WHEREUPON,
 13 YORAM WIND
 14 HAVING BEEN PREVIOUSLY SWORN, WAS RECALLED AND
 15 TESTIFIED AS FOLLOWS:
 16 CROSS EXAMINATION
 17 BY MR. STURM:
 18 Q Good morning, Dr. Wind.
 19 A Good morning.
 20 MR. STURM: I pass up this
 21 exhibit, Your Honor.
 22 (Whereupon, the above-

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1 And my response at the time was
 2 that the markets are heterogeneous, that there
 3 are different segments that will have
 4 different relationships and that I believe
 5 there will be a positive association between
 6 the two.
 7 I did one over the weekend, the
 8 regressions, actually, usage against
 9 importance and found --
 10 MR. MEYER: Your Honor, I hate to
 11 interrupt again. This is new analysis and
 12 he's not testified that he's done. We
 13 haven't seen it. It wasn't part of his direct
 14 report, and it may be something he can do in
 15 rebuttal, but at this point I would say it's
 16 premature.
 17 CHIEF JUDGE SLEDGE: You have made
 18 your point.
 19 JUDGE ROBERTS: I don't hear him
 20 offering any numbers. Please continue.
 21 THE WITNESS: The point, what I
 22 suggested is there is a strong association

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1 THE WITNESS: All from the
 2 consumer point of view.
 3 That's basically the essence of
 4 marketing. Marketing really tries to
 5 understand what are the perceptions and
 6 preferences of consumers, this is important to
 7 making business decisions.
 8 JUDGE ROBERTS: Thank you, Dr.
 9 Wind.
 10 (Pause.)
 11 CHIEF JUDGE SLEDGE: All right,
 12 any follow-up questions?
 13 MR. HANDZO: No, Your Honor.
 14 MR. MEYER: No, Your Honor.
 15 MR. STURM: No, Your Honor.
 16 CHIEF JUDGE SLEDGE: Thank you,
 17 sir.
 18 THE WITNESS: Thank you.
 19 CHIEF JUDGE SLEDGE: Mr. Handzo,
 20 anything before we take a recess?
 21 MR. HANDZO: No thank you, Your
 22 Honor.

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1 between the usage and importance is very fine.
 2 So and to the extent that you want to, I'd be
 3 delighted to share with the question the
 4 results of these studies.
 5 So I think that going back it's
 6 from a marketing point of view the study that
 7 I preferred has done has identified a number
 8 of dimensions that was summarized in figure 1
 9 and present the results on a common base in
 10 terms of comparing the structure of music,
 11 compared to the best second programming
 12 feature.
 13 And to me, there is the strength
 14 of the study, the convergence validity we have
 15 here, that all of these measures are
 16 consistent, all of them showing the three
 17 eminence of music compared to the others in
 18 dealing with attraction, in cancellation, in
 19 importance, in any one of the measures that we
 20 have here.
 21 JUDGE ROBERTS: And all from the
 22 consumer point of view?

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1 CHIEF JUDGE SLEDGE: We'll recess
 2 ten minutes.
 3 (Off the record.)
 4 CHIEF JUDGE SLEDGE: We will come
 5 back to order. You are going to be our next
 6 presenter?
 7 MR. DeSANCTIS: I am, Your Honor.
 8 CHIEF JUDGE SLEDGE: All right,
 9 Mr. DeSanctis.
 10 MR. DeSANCTIS: I would like to
 11 call Mark Eisenberg.
 12 CHIEF JUDGE SLEDGE: Mr.
 13 Eisenberg, please raise your right hand.
 14 Whereupon,
 15 MARK EISENBERG
 16 was called as a witness by counsel for
 17 SoundExchange and, having been first duly
 18 sworn, was examined and testified as follows:
 19 CHIEF JUDGE SLEDGE: Please be
 20 seated.
 21 MR. DeSANCTIS: Good morning.
 22 DIRECT EXAMINATION

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1 BY MR. DeSANCTIS:
 2 Q Please state your name for the
 3 record.
 4 A Mark Eisenberg.
 5 Q And, Mr. Eisenberg, where are you
 6 currently employed?
 7 A Sony BMG Music Entertainment.
 8 Q What is your position there?
 9 A I am Executive Vice President for
 10 the Global Digital Business Group for Business
 11 and Legal Affairs.
 12 Q And what are your primary
 13 responsibilities in that capacity?
 14 A I oversee the negotiations and
 15 contract work for our digital business. So
 16 this would be for digital distribution
 17 agreements and licensing arrangements for our
 18 catalog and new releases.
 19 Q Mr. Eisenberg, I would like to
 20 show you what has been marked as SoundExchange
 21 Trial Exhibit 53.
 22 (Whereupon, the

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1 admission of SoundExchange Trial Exhibit 53.
 2 CHIEF JUDGE SLEDGE: Any objection
 3 to exhibit 53?
 4 MR. WYSS: No objection, Your
 5 Honor.
 6 CHIEF JUDGE SLEDGE: Without
 7 objection, exhibit 53 is admitted.
 8 (Whereupon, the
 9 aforementioned document,
 10 having previously been
 11 marked for
 12 identification as
 13 SoundExchange Exhibit
 14 Number 53, was received
 15 in evidence.)
 16 MR. DeSANCTIS: Your Honor, at
 17 this time I also would like to move for three
 18 of the four parts to be admitted pursuant to
 19 the Court's proactive order; that is, certain
 20 parts of the written direct testimony and to
 21 the exhibits.
 22 We are actually marking less of it

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1 aforementioned document
 2 was marked for
 3 identification as
 4 SoundExchange Trial
 5 Exhibit Number SX-53.)
 6 BY MR. DeSANCTIS:
 7 Q Do you have that in front of you?
 8 A Yes, I do.
 9 Q Do you recognize this?
 10 A Yes. This is my written testimony
 11 for these proceedings.
 12 Q And let me turn your attention to
 13 page 22 of your written testimony. Is that
 14 your signature there?
 15 A Yes.
 16 Q Can you please also look at each
 17 of the three exhibits and tell us if these are
 18 the exhibits that were attached to your
 19 written direct testimony?
 20 A Yes. Yes, it is.
 21 MR. DeSANCTIS: Your Honor, at
 22 this time I would like to move for the

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1 restricted than what was originally marked as
 2 "Restricted." I would be happy to walk the
 3 Court through what we are asking to be
 4 considered restricted to that.
 5 Most of the testimony is not
 6 restricted. The first piece of restricted
 7 information is on page 7 of the written
 8 testimony. We are asking for only the figure
 9 that is in the middle of the paragraph to
 10 remain restricted on that page. This
 11 reflected a comparison of rates that Sony BMG
 12 currently obtains in the marketplace.
 13 CHIEF JUDGE SLEDGE: Okay.
 14 MR. DeSANCTIS: The next number is
 15 on page 10, Your Honor. Again, this number
 16 reflects the current rates that Sony BMG
 17 obtains entirely negotiated confidential
 18 agreements in the marketplace. It is
 19 competitively sensitive vis-a-vis Sony BMG's
 20 competitors and the services' competitors.
 21 The next information, Your Honor,
 22 begins at the bottom of page 16. There's two

<p style="text-align: right;">Page 97</p> <p>1 paragraphs here that start with i, ii, and 2 iii, continuing on page 17. We are not 3 marking this restricted in an effort to be as 4 conservative as possible with our restricted 5 designations. And I will be happy to submit 6 a revised list to the Court. 7 On 17 through the end, each of the 8 restricted markings in this section shows 9 actual numbers of actual contracts that are 10 competitively sensitive vis-a-vis some of 11 BMG's competitors and vis-a-vis the services' 12 competitors for various types of digital 13 agreements negotiated, confidential agreements 14 negotiated, in the marketplace. 15 And we would ask for the remainder 16 of what is marked as confidential to remain so 17 at the door, restricted under the Court's 18 protective order. 19 CHIEF JUDGE SLEDGE: Explain the 20 middle of page 19. 21 MR. DeSANCTIS: This is data that 22 Sony BMG is in possession of reflecting the</p>	<p style="text-align: right;">Page 98</p> <p>1 use of a particular kind of service. We think 2 this information is not in the public domain. 3 However, it does not reflect rates 4 in agreements. And, therefore, if Your Honor 5 does not wish to deem that sentence 6 restricted, SoundExchange would not object. 7 CHIEF JUDGE SLEDGE: Any response? 8 MR. WYSS: Your Honor, we don't 9 object. However, perhaps we can have one 10 point of clarification on page 7. I think the 11 representation was made or maybe I misheard 12 that this is rates currently in effect while 13 the written statement itself merely says that 14 people have offered that certain number. And 15 I don't know whether that is, the 16 representation is, consistent with the 17 testimony itself. 18 CHIEF JUDGE SLEDGE: The motion is 19 granted excluding the designated part in the 20 middle of page 19. 21 MR. RICH: Your Honor, if I might 22 be heard?</p>
<p style="text-align: right;">Page 99</p> <p>1 CHIEF JUDGE SLEDGE: Mr. Rich? 2 I'm sorry. 3 MR. RICH: Thank you very much. 4 Your Honor, I have no objection 5 per se on behalf of XM, but I do have a 6 consistency concern Your Honors may recall 7 that when we designated portions of Dr. 8 Woodbury's joint response to testimony, there 9 was some question and reservation by the Court 10 about whether data which were proffered in a 11 report sponsored by a joint expert might 12 vitiate the individual confidential nature of 13 respectively XM and Sirius data. 14 The Court reserved on that. And, 15 to my knowledge, we haven't had a ruling. You 16 will recall Mr. Handzo flagged the similar 17 circumstance we are now seeing in respect to 18 the SoundExchange case, namely that data 19 propriety, for example, to Sony BMG finds its 20 way into the jointly sponsored expert 21 submissions, which you will be hearing from 22 one or more of the experts, like Dr. Ordovery,</p>	<p style="text-align: right;">Page 100</p> <p>1 who relies on this. 2 And all I'm urging the Court is 3 that, again, while we have no objection to the 4 confidential treatment here, that we afforded 5 the equal status; that is, with respect to 6 confidential materials in Dr. Woodbury's 7 report, which we identified, that that 8 material be treated similarly. 9 CHIEF JUDGE SLEDGE: The motion is 10 granted excluding the designated portion in 11 the middle of page 19. 12 MR. DeSANCTIS: Thank you, Your 13 Honor. 14 Finally, the two exhibits to the 15 testimony, which are marked as SoundExchange 16 exhibit 104DP and SoundExchange exhibit 107DR. 17 These are confidential agreements that Sony 18 has negotiated in the marketplace. 19 They are current. They remain in 20 effect. And they reflect the current rates 21 and terms governing the relationship between 22 Sony BMG and the licensee. They are</p>

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1 confidential and competitively sensitive
 2 vis-a-vis Sony BMG's competitors and also
 3 vis-a-vis the services' competitors. And we
 4 ask that these be admitted as restricted under
 5 the Court's protective order.
 6 CHIEF JUDGE SLEDGE: Any
 7 objection?
 8 MR. WYSS: No objection, Your
 9 Honor.
 10 CHIEF JUDGE SLEDGE: Without
 11 objection, the motion is granted.
 12 MR. DeSANCTIS: Thank you, Your
 13 Honor.
 14 BY MR. DeSANCTIS:
 15 Q Mr. Eisenberg, you testified that
 16 you are currently employed by Sony BMG. Just
 17 very briefly, what is Sony BMG?
 18 A Sony BMG is a joint venture. It
 19 is a combination of two recording music
 20 companies, Sony Music Entertainment and
 21 Bertelsmann Music Group, back in August of
 22 2004. And it's one of the four major record

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1 operating unit, just focusing on the digital
 2 side of the business. And we have executives
 3 and professionals and staff that are focused
 4 on the me generation and deal-making for our
 5 catalog and for our new releases in digital
 6 formats.
 7 Q And where did you work prior to
 8 the formation of Sony BMG in 2004?
 9 A I was a Senior Vice President for
 10 Business Affairs for Sony Music Entertainment
 11 in the new technology and business development
 12 area, which was a similar role that I
 13 currently play at Sony BMG.
 14 Q And so that was one of the
 15 predecessor companies that became Sony BMG?
 16 A Yes.
 17 Q So, Mr. Eisenberg, how long have
 18 you been working in the area of the digital
 19 distribution of music?
 20 A Since about 1998. I was a
 21 business affairs executive at the company.
 22 And we were just starting to explore our

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1 companies.
 2 Q Can you give us a little a little
 3 flavor of some of the artists in the Sony BMG
 4 catalog, say, in the rock and roll genre?
 5 A Bob Dylan, Bruce Springsteen,
 6 Aerosmith, the Foo Fighters, Dave Matthews
 7 Band, Pearl Jam. Those are some of the
 8 high-profile artists in --
 9 Q How about in the country genre?
 10 A Carrie Underwood, Dolly Parton,
 11 Alan Jackson, Martina McBride. Those are some
 12 highlights.
 13 Q And are there classical artists in
 14 the Sony BMG catalog?
 15 A Yes. Yo-Yo Ma, Joshua Bell, the
 16 works of Leonard Bernstein, Vladimir Horowitz.
 17 Q You said that you work in the
 18 Global Music Group at Sony BMG. Can you just
 19 briefly describe what that is?
 20 A Yes. It's Global Digital Business
 21 Group. The way that we have structured our
 22 digital business is that we are under one

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1 digital media in 1998. There was a need for
 2 a specialty for business affairs in that area
 3 for negotiating new deals and exploring new
 4 business models. So I was asked to focus on
 5 that area. And I've done that since 1998.
 6 Q Is 1998 when you started with Sony
 7 Music?
 8 A No. Prior to that time. So 1994
 9 is when I joined the company, Sony Music
 10 Entertainment, as a lawyer in the Law
 11 Department. I focused at that time on artist
 12 recording agreements and general corporate
 13 matters of the company.
 14 In 1996, I was promoted to
 15 business affairs, again focusing on artist
 16 contracts and traditional business
 17 structuring. I did that for two years and
 18 then became more focused or specialized in
 19 digital media and in new technology.
 20 Q You said you began in 1994 with
 21 Sony. At that time, what was the physical
 22 medium in which most music was sold?

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1 A It was typically the compact disc,
 2 the CD. We were probably seeing some units of
 3 the set still being sold at the time, but the
 4 cassette was sort of being phased out of the
 5 marketplace, particularly in the United
 6 States, with compact disc being the
 7 predominant format. Some vinyl records were
 8 still being sold in specialty markets, but the
 9 predominant form was the CD.
 10 Q And has that changed at all since
 11 you have been with Sony BMG?
 12 A Quite dramatically, yes.
 13 Q How so?
 14 A Well, with the advent of digital
 15 media, we have seen a shift from an album
 16 configuration and a sell-through model. And
 17 by that, I mean a piece of product that we
 18 put, a physical piece of product that we put,
 19 into the marketplace, into a merchant, like a
 20 Tower Records or a Best Buy or Sam Goody's.
 21 And that would be our -- that was
 22 our predominant product at the time. You make

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1 too. The four major carriers, the telephone
 2 companies, have now -- now represent -- there
 3 are 4 of our top 11 accounts in the first half
 4 of this year. So the rise in Sprint-Nextel,
 5 T-Mobile, and -- they won out -- Spring,
 6 Verizon, T-Mobile, and AT&T Cingular. Those
 7 are some of our biggest accounts.
 8 And some of the traditional
 9 retailers, like Tower, have gone out of
 10 business; Amazon, which is known as an online
 11 retailer, hasn't cracked our top ten the first
 12 half of this year.
 13 Transworld, which has the Sam
 14 Goody's chain and Coconuts chain, is not in
 15 our top ten the first half of this year. Nor
 16 is Circuit City, which, again, had been a very
 17 big retailer of ours for many, many years.
 18 Q How about Tower Records?
 19 A Tower Records went bankrupt and
 20 are no longer operating their stores. So
 21 you're seeing a lot of digital outlets now
 22 that didn't exist. Obviously the Apple store,

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1 an album. You might have 10 or 12 tracks on
 2 that record. And that would be the way that
 3 you recouped your investment in the artist.
 4 Now you were seeing digital media
 5 proliferate the number of products in the
 6 marketplace. So you're selling tracks, not
 7 necessarily albums. You are selling different
 8 configurations. You are selling listens. You
 9 are selling downloads. You are selling
 10 streams. You are selling ring tones on the
 11 mobile phone, on the handset. You're selling
 12 ring backs, which is another way to listen to
 13 music on the telephone handset. You're
 14 selling video, both streams or listens or
 15 views, rather, as well as downloads.
 16 And you're selling a whole
 17 proliferation of -- profliery of products that
 18 didn't exist back when I joined the company in
 19 1994.
 20 Q And today what are some of your
 21 biggest retail accounts?
 22 A That actually has changed a lot,

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1 iTunes, is a very, very big account of ours;
 2 like I said, the telephone companies. And
 3 then you have some digital services, like a
 4 Napster or Real Rhapsody or even Yahoo! Music
 5 now ascending their way up the rankings of our
 6 top accounts.
 7 Q Can you approximate the size of
 8 the decline in physical CD sales since 1999?
 9 A It's been about -- I think, about
 10 2000 to 2006, there's been about a 29 percent
 11 decline according to Sound Scan, which is the
 12 body that tracks sales, over-the-counter
 13 sales. Those are in the physical album units.
 14 That's just by the end of calendar year 2006.
 15 We have actually experienced a
 16 precipitous decline the first half of this
 17 year, where sales, physical album units have
 18 declined by another 23 percent industry-wide.
 19 Q And do you see anything in the
 20 industry that would suggest that this trend is
 21 going to reverse itself?
 22 A No. Unfortunately, we're in a

<p style="text-align: right;">Page 109</p> <p>1 spiraling market downward in terms of the 2 physical configuration. The accounts that we 3 have are putting a lot of pressure on us in 4 terms of even maintaining the status quo. 5 You have accounts like Transworld, 6 which is looking at taking away our floor 7 space and giving it to video games. You have 8 stores like Wal-Mart, which this first half of 9 this year made an extraordinary return to the 10 industry of about \$60 million worth of 11 inventory. So they're shrinking the floor 12 space for physical product and selling other 13 types of goods in the marketplace other than 14 music. 15 Q So as the physical sales have been 16 falling, I think you mentioned that digital 17 sales have been rising over this time? 18 A Yes, they have. 19 Q Is the rise in digital sales in 20 terms of revenue enough to make up for the 21 decline in physical sales? 22 A No, not at all. What we have seen</p>	<p style="text-align: right;">Page 110</p> <p>1 is about -- the digital revenues making up for 2 just about half of the shortfall, the physical 3 decline. And we don't see that ever really 4 making up the difference, certainly in the 5 near term, as the physical units and the 6 albums decline precipitously and the digital 7 units just make up for a short -- for a small 8 portion of that shortfall. 9 Q Has this decline in revenue 10 affected the type or amount of music that Sony 11 makes every year? 12 A Oh, absolutely. The number of 13 releases that we put out; that is, the number 14 of albums and tracks that we put out from new 15 artists, has shrunk. It has caused us to 16 narrow the focus of our research development, 17 or A&R, as we call it, in the music industry. 18 So, instead of experimenting with 19 new sounds and new artists and new music, you 20 tend to focus on what you hope to be sure 21 things so that you can recoup your investment. 22 So it actually has a detrimental</p>
<p style="text-align: right;">Page 111</p> <p>1 impact on the music consumer at large because 2 there's less of a diverse body of music that 3 we're able to put out. 4 Q Now, are XM and Sirius one of 5 these new digital outlets for music? 6 A Yes. 7 Q In terms of the number of 8 subscribers or subscriber revenue, how do XM 9 and Sirius compare to other subscription 10 services in the digital marketplace? 11 A Relatively they have done 12 phenomenally well. For example, you know, I 13 think last time I looked, they had about 14 14 million subscribers between them or combined. 15 And if you look at the other 16 on-demand services, like a Napster or Real or 17 Yahoo!, combined that on-demand pay 18 subscription service pool is about two million 19 users. 20 So we're talking about 14 million 21 on the XM and Sirius front versus about 2 22 million in the other digital services that</p>	<p style="text-align: right;">Page 112</p> <p>1 we're offering. And in terms of revenues, I 2 believe that XM and Sirius had about \$1.5 3 billion of revenue this past year. And in the 4 other digital services, we're talking probably 5 about \$200 million or so. So, again, 6 relatively it seems like it did quite well. 7 Q Given their size compared to the 8 market, does Sony BMG need the performance 9 royalty payments from XM and Sirius that we're 10 litigating here? 11 A We need performance royalties from 12 everyone. Certainly XM and Sirius we rely on. 13 We're moving from, as I said, a physical 14 format into a listen or performance 15 environment or paradigm. And so listens are 16 very, very important. 17 And monetizing or commercial, 18 making -- commercializing the listening 19 experience is very important because that is 20 taking away from our other types of sales, 21 whether it be sale through physical product or 22 sale through downloads or sales through</p>

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1 albums.

2 So whether it be Sirius, XM, or

3 any other digital media company, those

4 performances and listens are extremely

5 important.

6 Q You just mentioned that one of the

7 new ways that you sell your music is by

8 selling listens. By that, are you referring

9 to streaming services?

10 A Yes.

11 Q Can you just describe a little bit

12 in a little bit more detail what you mean by

13 that, selling listens?

14 A Well, there are different models

15 for providing music to consumers. One is what

16 I would call a self-remodel, which is you go

17 to an online store or digital store. It could

18 be on your cell phone. And you buy a track or

19 an album or a bundle of tracks. And you pay

20 a retail price. A merchant pays us a

21 wholesale price. And the user gets to keep

22 that download or that track for permanent

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1 listening experience, which is different from

2 a subscription environment, which is

3 oftentimes commercial-free.

4 Q And are the satellite radio

5 companies, XM and Sirius, a form of streaming

6 in which people pay for these listens, as you

7 call them?

8 A Yes.

9 Q Has the advent of paid streaming

10 services changed the manner in which Sony BMG

11 markets its music?

12 A Yes. You know, when we used to

13 sell albums or what I would call big bundles

14 of tracks, you would be able to promote a

15 track or promote an album by giving a teaser

16 or either a listener, sometimes a permanent

17 ownership for a low-cost or sometimes no-cost

18 because it was a loss leader, so to speak, to

19 sell the bigger configuration, the bigger

20 product.

21 So, for example, if you were

22 selling an album and it had 12 tracks on it,

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1 ownership.

2 Then there is a listening

3 experience, which is something different. It

4 is not necessarily about permanent ownership.

5 But it is the ability to listen to tracks or

6 the ability to listen to a program for a

7 period of time. The period of time could be

8 based on a subscription. So you pay a monthly

9 fee, and you get access to a certain portion

10 of the catalog or perhaps the whole catalog.

11 And you can listen 24/7 if that is what the

12 service provides.

13 There are also ad-supported

14 models, where the listening is interrupted by

15 what I would call speed bumps, almost like

16 terrestrial radio, which there needs to be

17 station IDs or commercial breaks in between.

18 And that is what underwrites essentially the

19 user's experience.

20 So the content owner gets paid by

21 part of the advertising or from the

22 advertising dollars. And the user gets a

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1 you might sell a single, physical single, into

2 retail at 49 and 99 cents because you're going

3 to sell the 10 or 11 or \$12 wholesale album,

4 you know, off the heels of that teaser or

5 listen.

6 You might give streaming -- make

7 streaming available on the internet in a way

8 that you can't do now because now you have to

9 make money on every individual listen or every

10 individual stream.

11 CHIEF JUDGE SLEDGE: Yes, sir?

12 MR. WYSS: Your Honor, I believe

13 this is outside the scope of anything in his

14 written direct. We didn't have anything about

15 streaming and tracks and teasers, I don't

16 believe.

17 CHIEF JUDGE SLEDGE: Mr.

18 DeSanctis?

19 MR. DeSANCTIS: Your Honor, I am

20 not sure if the word "teaser" is used, but on

21 page 4 of the written direct testimony,

22 certainly through page 6 and then again pages

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1 8 through 10, there's extensive discussion on
 2 this change in the digital marketplace and
 3 change in the company's marketing practices.
 4 CHIEF JUDGE SLEDGE: Motion is
 5 granted. I should say the objection is
 6 sustained.
 7 BY MR. DeSANCTIS:
 8 Q Mr. Eisenberg, when you negotiate
 9 a license with a digital service, do you ever
 10 consider whether the service might promote the
 11 sale of CDs?
 12 A When I license for digital
 13 purposes?
 14 Q Right.
 15 A There are really two separate
 16 silos, so to speak. My job at the company is
 17 to maximize our digital revenue. There may be
 18 incidental effects that some of our products
 19 and services might have in other parts of the
 20 business, but my charge is to maximize our
 21 digital revenues. So it's important that I
 22 look at that.

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1 or the digital download or the track that we
 2 may be offering for sale or for a license,
 3 they will also market and promote additional
 4 products and services, either that artist's or
 5 like artist's.
 6 Q How do they do that? Can you
 7 explain what you mean?
 8 A Well, you have a Web site, an
 9 online service. There's a lot of digital and
 10 pictorial elements on that page. So you may
 11 be promoting or may be offering for sale a
 12 particular track. And then around it, there's
 13 pictures of the artists, and there's links to
 14 other products or services that can be
 15 purchased as well.
 16 There are also marketing
 17 activities that we do to stimulate additional
 18 interest in our artists. For example, there
 19 have been maybe contests that we have run.
 20 And those contests will enable us to collect
 21 e-mail names, for example, from some of their
 22 users. And then we can direct market to those

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1 So whether or not something may
 2 have an incidental promotional effect really
 3 doesn't affect my business judgment or my
 4 deal-making on the digital side of the
 5 business.
 6 Q When you're structuring a deal
 7 with a digital licensee, do you ever require
 8 that they take certain steps to make their
 9 service more promotional otherwise?
 10 A Well, as part of the
 11 consideration, there are what we call
 12 marketing considerations that we will require
 13 a service to make. Some of those
 14 considerations include actually profiling our
 15 plays or profiling our listens because for
 16 every listen, for every consumed unit, we're
 17 making money. So by them to give us more
 18 listens and more plays, we're actually
 19 maximizing our digital revenues.
 20 There are other things that we ask
 21 for in terms of contextual marketing and
 22 promotion so that, in addition to the listen

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1 users for additional products from that
 2 particular artist.
 3 So there are marketing campaigns
 4 or elements to the individual items we are
 5 offering for sale or for listens as a part of
 6 the contextual environment.
 7 Q And are any of these sort of
 8 promotional elements, like the Web site,
 9 visuals, and pictorials, or anything else you
 10 mentioned, available on satellite radio?
 11 A Well, satellite radio has a
 12 different user interface. For example, if
 13 you're listening to music on a device, on an
 14 LCD screen, you're not seeing the same context
 15 or the same pictorial elements. You also
 16 don't have the linking ability to go outside
 17 to a different Web site to make an impulse
 18 buy, for example, of a particular track.
 19 In internet radio, for example, if
 20 you're listening to webcasting on the
 21 internet, you can actually click on the
 22 internet site and download the track

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1 instantaneously. You don't have that on
 2 satellite radio. It's a much more two-step,
 3 three-step, four-step process to buy
 4 additional products or services.
 5 Q So based on those differences, if
 6 XM and Sirius said to you that they would like
 7 to pay less than they otherwise might because
 8 they're streaming the music without these
 9 features and people, nevertheless, will hear
 10 the music, how would you respond?
 11 MR. WYSS: Objection, Your Honor.
 12 Hypothetical question. He is a fact witness.
 13 CHIEF JUDGE SLEDGE: Sustained.
 14 Also sustain it as the question is not based
 15 on any evidence he has given. He said that
 16 they have different promotional tools than
 17 internet, but he didn't say that they don't
 18 have promotional tools, satellite radio.
 19 MR. DeSANCTIS: Thank you, Your
 20 Honor.
 21 BY MR. DeSANCTIS:
 22 Q Following up on that, Mr.

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1 that seemed to follow directly from his prior
 2 answers.
 3 CHIEF JUDGE SLEDGE: I think you
 4 are right. He began this whole area in
 5 response to your question saying that
 6 promotion is not part of his business and not
 7 part of his considerations, but all of his
 8 answers since that time have been in direct
 9 conflict with that.
 10 So in light of his testimony, the
 11 objection is overruled.
 12 MR. DeSANCTIS: And, thank you,
 13 Your Honor. I would like to clear up the
 14 potential conflict that Your Honor just
 15 highlighted.
 16 BY MR. DeSANCTIS:
 17 Q Mr. Eisenberg, when you testified
 18 earlier that -- I don't want to characterize
 19 it or mischaracterize it but that you're not
 20 in the promotion business, yet you have been
 21 telling us about how promotion works over the
 22 internet, can you please --

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1 Eisenberg, based on your experience dealing
 2 with a wide range of digital services, is it
 3 your opinion that XM and Sirius promote the
 4 sale of CDs?
 5 MR. WYSS: Objection, Your Honor.
 6 That's asking for an opinion without laying a
 7 proper foundation.
 8 CHIEF JUDGE SLEDGE: Mr.
 9 DeSanctis?
 10 MR. DeSANCTIS: Actually, I think
 11 we have been laying a foundation for the past
 12 five minutes. Mr. Eisenberg's business is
 13 negotiating licenses with all forms of digital
 14 services. He testified that one of the things
 15 they take into account is whether a service
 16 can help promote CD sales and exactly how it
 17 will do that.
 18 I asked him based on that
 19 experience in terms of what works in the
 20 digital marketplace, which is his business,
 21 whether he thought given the attributes of XM
 22 and Sirius that they would promote CD sales

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1 CHIEF JUDGE SLEDGE: How promotion
 2 works in his contracting and licensing
 3 business.
 4 MR. DeSANCTIS: That is right.
 5 Thank you, Your Honor.
 6 BY MR. DeSANCTIS:
 7 Q Could you please explain to us why
 8 you began by saying that you are not in
 9 promotion?
 10 A As I said, tried to say, before,
 11 my job is to maximize our sales base. Some
 12 things that you might do to maximize sales may
 13 include motion of your additional tracks,
 14 additional products. So if I have a digital
 15 download to sell, I may promote that sale
 16 through a listen or a stream.
 17 I get paid on that stream or the
 18 company gets paid on that stream. In
 19 addition, we promote an upsell. The upsell
 20 might be to a digital download product for the
 21 track. An additional upsell might be for a
 22 video stream. An additional upsell might be

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1 for a video download. An additional upsell
 2 might be for an album download. Another
 3 upsell might be for a ring tone on the cell
 4 phone. Another upsell might be for a ring
 5 back on the cell phone.

6 There are a litany of products
 7 that we have. And we try to leverage one off
 8 of the other through a sale that listens. So
 9 we try to maximize the totality of our sales.
 10 And if we have an artist or a user that has
 11 certain synergies in respect to our multiple
 12 products, we try to leverage one off the other
 13 and create multiple sales off the single dale
 14 that we consummated.

15 Q And you deal with this in the
 16 business environment of negotiating licenses
 17 with digital licensees?

18 A Yes.

19 Q Not as the member of a promotion
 20 department?

21 A No. These are revenue-generating
 22 or sales initiatives.

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1 interest in the local market by having the
 2 artists talk about an appearance, for example,
 3 at a local record store, where he or she may
 4 be signing a CD.

5 So there's very targeted marketing
 6 efforts done by a local station to generate a
 7 buzz, so to speak, within a local market,
 8 which then hopefully radiates out further and
 9 further and further as the artist tours
 10 nationwide.

11 Q And do any of those things exist
 12 on satellite radio?

13 A Well, satellite radio has a
 14 national footprint or a national scope. So
 15 you can't do the targeted promotions that you
 16 do in terrestrial radio because it's not a
 17 local market service.

18 And also the user experience is
 19 very, very different. On satellite radio,
 20 they're touting themselves as commercial-free.
 21 It isn't seamless -- or, rather, it is
 22 seamless. It isn't interrupted by DJ banter

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1 Q So is it fair to say, then, as
 2 part of your business negotiating licenses,
 3 you routinely consider the value of any
 4 promotional upsell or benefit that a
 5 particular digital service might have?

6 A Yes. We try to connect the dots,
 7 so to speak, between a marketing effort or a
 8 promotional effort and a call to action or a
 9 sale or a listen or another revenue-generating
 10 exercise.

11 Q So in your experience valuing the
 12 different potential promotional benefits of
 13 different services, have you learned lessons
 14 from terrestrial radio?

15 A Well, terrestrial radio has a very
 16 targeted focus. They do a lot of repetition.
 17 They have a lot of what we call DJ banter in
 18 the booth, where the DJs interrupt the flow of
 19 music and they talk about an artist.

20 Sometimes they have artists come
 21 in and they promote a particular tour that
 22 they're doing in a local venue. They get

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1 and speed bumps because consumers have said
 2 that they don't want that kind of experience.
 3 They want more of a shuffle play, a CD shuffle
 4 play listening experience. And they're paying
 5 money for that on a monthly basis.

6 So, as I mentioned before in my
 7 testimony, there's two kinds of models.
 8 There's an ad-supported model in some
 9 respects. And there's a consumer pay model in
 10 other respects.

11 And in an advertising-supported
 12 model in many cases, you're going to have
 13 interruptions, which kind of modulate the
 14 consumer experience; whereas, in a satellite
 15 radio experience, it is seamless, endless
 16 music. So even there, you don't have the
 17 ability to promote in a market that you do in
 18 some of the other digital media or terrestrial
 19 radio.

20 Q You mentioned concentration
 21 rotations as one of the ways in which
 22 terrestrial radio might be promotional. Are

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1 you familiar with XM's channel 20 on 20?
 2 A Yes.
 3 Q Have you listened to it before?
 4 A Yes.
 5 Q Is that an example of these
 6 concentrated play times that may be
 7 promotional or is that something different?
 8 A No. It's a different experience.
 9 Twenty on 20, as I am aware of it, is an XM
 10 radio station. And they have eight different
 11 times during the say where they play the top
 12 20 hits. And they play them end to end. So
 13 they may have a short intro or outro that says
 14 the name of the track or the artist, but
 15 there's no commercial interruptions.
 16 So it's basically like taking your
 17 iPod with you and listening to your CDs or
 18 your tracks end to end. And the universe is
 19 only 20 tracks. So in that regard, it's a
 20 limited universe, but it's a very, very
 21 satisfying consumer experience because they
 22 aren't really promoting tracks. They're just

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1 not maximizing our revenues, it's really going
 2 to hit the bottom line quite substantially.
 3 It's not just, you know, those tracks that are
 4 lost but essentially the pool of our income
 5 that we derive from those tracks.
 6 Q I'm sorry. I just wanted to be
 7 clear. Is the top 20 hits genre the most --
 8 was your testimony that that is the most
 9 lucrative genre of music?
 10 MR. WYSS: Objection, Your Honor.
 11 There's nothing about this in the written
 12 statement at all.
 13 CHIEF JUDGE SLEDGE: Mr.
 14 DeSanctis?
 15 MR. DeSANCTIS: If I could have
 16 just a minute, Your Honor?
 17 (Pause.)
 18 MR. DeSANCTIS: Your Honor, this
 19 is discussed, obviously in somewhat different
 20 words, beginning at the bottom of -- actually,
 21 beginning at the first full paragraph on page
 22 11 of the testimony.

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1 giving you the top hits.
 2 In fact, if you looked at the top
 3 digital downloads that are being sold in the
 4 iTunes music store, they match up very well
 5 with the top 20 tracks that they're offering
 6 on the radio, on XM and Sirius.
 7 So one would question, why would
 8 you have to buy those tracks at the iTunes
 9 store if eight times a day you can listen to
 10 them end to end on XM and Sirius?
 11 I mean, it's not the same 20
 12 tracks necessarily that track the iTunes top
 13 20, but it's very, very similar.
 14 Q And is that, the top 20 genre, a
 15 genre that's valuable to Sony BMG?
 16 A In the music business, people say
 17 it's 90/10, 80/20, somewhere in that spectrum,
 18 meaning that our top 10 percent of our tracks
 19 or so are going to account for 90 percent of
 20 our revenues.
 21 So if you siphon off our top hits
 22 and offer those in an environment where we're

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1 At the bottom, he begins to
 2 discuss the top hits channels. The top hits
 3 channels on XM and Sirius are discussed at the
 4 bottom of page 11. And their potential
 5 substitutional effects are discussed on page
 6 12.
 7 CHIEF JUDGE SLEDGE: Overruled.
 8 BY MR. DeSANCTIS:
 9 Q Mr. Eisenberg, XM and Sirius
 10 frequently discuss deep playlists. Can you
 11 describe what that means and whether that has
 12 an effect on the extent to which their
 13 services might promote CD sales?
 14 A Yes. First of all, they have
 15 many, many music channels, so about 70, I
 16 think, on average between each of the
 17 services, about 69 or 73, so let's say, on
 18 average, 70 music channels. So that's a very,
 19 very diverse grouping of music that they can
 20 choose from.
 21 On top of that, it's
 22 commercial-free. So they're offering a

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1 seamless music experience. And they are also
 2 playing tracks that are deeper catalog tracks,
 3 which aren't being focused on, let's say, by
 4 traditional radio in regards to sales. So we
 5 are not -- we sell catalog. And it's very
 6 important, a very important business for us.
 7 In fact, the Sony-BMG merger was
 8 premised in large part upon the very large
 9 catalog that Sony Music Entertainment had. If
 10 you play catalog or deep tracks on a radio
 11 service, particularly if it's commercial-free,
 12 that substitutes for someone's appetite to
 13 purchase those tracks, whether they be in
 14 physical form or digital form and particularly
 15 where it's an endless music experience without
 16 interruption.
 17 So you add those elements together
 18 and it's a very satisfying experience for the
 19 end user and one that could be very
 20 substitutional for our efforts in both digital
 21 and physical.
 22 Q Are there other reasons why XM and

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1 music."
 2 The other issue that I just
 3 alluded to was for time, your free time. The
 4 more you listen to radio, XM and Sirius radio,
 5 the less time you have to spend to your other
 6 forms of music.
 7 So if I have two hours of drive
 8 time during the day, let's say one hour to the
 9 office and one hour home, I have a choice
 10 whether to dial up my XM and/or Sirius radio
 11 receiver or to take my iPod and listen to the
 12 tracks that I purchased online for a dollar
 13 apiece.
 14 So there is an endless amount of
 15 consumer spend. There is an endless amount of
 16 time. And we were all competing in these end
 17 user for both of those elements. So in that
 18 regard, it's very substitutional.
 19 And it's fine if we're making
 20 money in each of those formats. We just have
 21 to make sure that we're maximizing our sales
 22 or our listens or our licensing income so that

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1 Sirius might actually substitute for CD sales?
 2 A There's also a -- I think there
 3 are two issues, really. There's a pocketbook
 4 issue, and there is a consumer time issue.
 5 Q Can you explain what you mean by
 6 the pocketbook issue?
 7 A Sure. Users have only so much
 8 money to spend on entertainment and music. If
 9 you're paying \$13 a month for a satellite
 10 radio service, it's likely that that will put
 11 a -- some pressure on your ability or your
 12 willingness to pay for music in other forms
 13 and other formats because you -- a) you want
 14 to justify your spend on XM and satellite and
 15 the music experience that they have to offer.
 16 So it's very logical for a user to
 17 say, "Well, I have spent \$13 on my music this
 18 month. I'm not going to buy that album. I'm
 19 not going to buy these digital tracks" or "I
 20 am not going to sign up for an on-demand
 21 subscription service or an interactive radio
 22 service because I have everything I need for

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1 one doesn't displace the other at an unfair
 2 rate.
 3 Q Are you aware of the satellite
 4 radio services themselves ever admitting or
 5 advertising publicly this substitutional
 6 effect that you're speaking of?
 7 A Yes. I have seen a -- I think
 8 they call it a testimonial from XM on their
 9 Web site.
 10 Q Is that one of the exhibits to
 11 your testimony?
 12 A Yes.
 13 Q Could I refer your attention to
 14 SoundExchange's exhibit 6 to your written
 15 testimony? Is this what you were referring to
 16 a minute ago?
 17 A This is the -- it says page 1 of
 18 3, XM at the top?
 19 Q Yes.
 20 A Yes. So there's -- at the bottom
 21 of the page, there's a quote from a user.
 22 This is from the XM Web site. Mike asks from

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1 Simi Valley, California. He states, "Thank
 2 you. Thank you. Thank you. Since I
 3 activated my service two weeks ago, I have yet
 4 to listen to anything other than the XM
 5 format, unbelievable sound quality, content,
 6 and selection, no more need to ever buy
 7 another CD. Your service is a bargain at
 8 twice the price."
 9 Q Staying with this theme, Mr.
 10 Eisenberg, does the fact that a device or a
 11 service may be available portably affect or
 12 impact the substitutional effect that it might
 13 have?
 14 A Absolutely. There are, I guess,
 15 two ways to listen to music. One is what I
 16 would call within a tethered environment or a
 17 fixed line environment or a home theatre
 18 environment. That is, you put on your stereo
 19 or you put on your computer, and music is
 20 streamed or played through your speakers. But
 21 you're essentially immobile because you're
 22 listening within the four walls of your home

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1 are promotional, maybe on a case-by-case
 2 basis, they may be promoting, marketing a
 3 particular track.
 4 I'm not saying that it's never
 5 promotional, but on a net basis, it's very
 6 substitutional for other forms of music that
 7 we're trying to sell, whether it be a physical
 8 album, a digital album, a digital track, or
 9 even a listen, streaming listen, on an
 10 internet site, all of which we are paid for.
 11 So I believe it is net-substitutional because
 12 of the ubiquitous effect and the experience
 13 for the end user.
 14 The other thing to add is that the
 15 sound quality for XM and Sirius is quite high.
 16 It's not a tinny AM listen with low bandwidth.
 17 It's CD-quality.
 18 Again, they use the word "CD" to
 19 mirror the value, the end value, to the
 20 consumer. In that regard, it's very
 21 substitutional and reality and then in the
 22 consumer's eyes.

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1 or your room.
 2 The other way to listen to music
 3 is portable, which is to take that music on
 4 some type of storage media. That could be the
 5 CD. It could be a Walkman. It could be an
 6 iPod. And it now can be a satellite receiver.
 7 And you take it with you on the go.
 8 And then there's another element
 9 of portability which is in the car. So
 10 obviously XM and Sirius are available on the
 11 go in the car. So you are always with your
 12 music. So that has a very high value to the
 13 end user because he doesn't have to be tied to
 14 his home to listen to it.
 15 Q So in your licensing work, Mr.
 16 Eisenberg, are these attributes of XM and
 17 Sirius that we have been discussing this
 18 morning the kind that would lead you to
 19 conclude that a service is net-promotional or
 20 net-substitutional?
 21 A Well, these services I believe are
 22 net-substitutional. To the extent that they

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1 Q And how would that conclusion
 2 affect your licensing strategies vis-a-vis a
 3 digital service?
 4 A It just means that we have to get
 5 paid a fair return for the listens or for the
 6 licensing. We like to license our music.
 7 We're in the business of licensing and selling
 8 our catalog and our new releases to maximize
 9 our revenues for the company.
 10 We just have to do so in a way
 11 that enables us to maximize our sales across
 12 many, many different types of service
 13 offerings that we have in the marketplace,
 14 whether they be digital or physical.
 15 CHIEF JUDGE SLEDGE: Is satellite
 16 radio the only mobile transmission means that
 17 has high-quality sound?
 18 THE WITNESS: I have to answer
 19 that in two parts. Satellite radio is in what
 20 I would call real time. Take a listen to it,
 21 broadcast as it's coming from the tower or
 22 satellite, right?

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1 If you listen to your iPod music
 2 on the go, that is high-quality as well, but
 3 obviously you have downloaded it before you
 4 have taken it on the road.
 5 So in terms of the sound quality,
 6 it may be similar. But they're both portable
 7 experiences. The cell phone companies as well
 8 offer mobile listens and mobile downloads.
 9 And, again, the sound quality may
 10 differ depending on the type of service.
 11 Currently the cell phone services don't offer
 12 as high quality for real time transmissions as
 13 the satellite radio companies do.
 14 CHIEF JUDGE SLEDGE: So satellite
 15 radio is the only mobile service of streaming
 16 that offers high quality, contrasted to a
 17 source that the listener owns?
 18 THE WITNESS: For portability,
 19 yes. There is higher-quality streaming on Web
 20 sites, where you are tied to your computer.
 21 But if you want to be portable, I think XM and
 22 Sirius are superior to the services that are

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1 JUDGE ROBERTS: Quality,
 2 portability.
 3 THE WITNESS: Right now the base
 4 for HD Radio is very, very small. You know,
 5 it's nowhere near the 14 million of XM and
 6 Sirius. And the breadth of offerings is much
 7 fewer, much smaller. They don't have 70
 8 stations. The side channels are very
 9 restrictive in terms of what was allocate to
 10 each of the terrestrial radio companies to
 11 broadcast.
 12 So it is different, but in terms
 13 of the sound quality, it probably is a very
 14 good sound quality and comparable to that of
 15 XM and Sirius.
 16 JUDGE WISNIEWSKI: We are
 17 certainly in a period of where there are all
 18 sorts of technological developments that are
 19 going on with respect to this issue.
 20 THE WITNESS: We are definitely in
 21 a technology upwards spiral, which is a good
 22 thing.

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1 out there.
 2 JUDGE WISNIEWSKI: Well, if you
 3 are getting it on your computer, could you get
 4 it from iPod and that's portable?
 5 THE WITNESS: If you are in a hot
 6 spot, but it's very restricted in terms of
 7 where you are, yes. There are also the
 8 on-demand services, which offer conditional
 9 downloads.
 10 So you can -- for example, with a
 11 Napster to Go account, you can download it
 12 from the computer onto a device and then take
 13 that device with you and listen to the tracks
 14 on the go.
 15 And that's not a permanent
 16 download because you have to be a subscriber
 17 to listen, but you're not streaming it in real
 18 time.
 19 JUDGE ROBERTS: Mr. Eisenberg,
 20 what about HD Radio?
 21 THE WITNESS: In terms of the
 22 sound quality?

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1 JUDGE WISNIEWSKI: So we may see
 2 all sorts in the next few months here.
 3 THE WITNESS: We are still
 4 restrained with regard to bandwidth. So until
 5 we have what I think people envision as WiMax,
 6 which is available on a portable basis
 7 throughout a whole community at large, you are
 8 somewhat limited in terms of your streaming,
 9 real-time streaming activity, by technology
 10 constraints.
 11 MR. DeSANCTIS: Your Honor, it is
 12 12:20-something. I can't quite see the clock.
 13 It's a good place for me to break before I
 14 broach sort of the second half of Mr.
 15 Eisenberg's testimony or I would be happy to
 16 continue, whatever Your Honors wish.
 17 CHIEF JUDGE SLEDGE: All right.
 18 We will recess now. And we won't resume until
 19 1:45
 20 (Whereupon, a luncheon recess was
 21 taken at 12:22 p.m. until 1:45
 22 p.m.)

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1 CHIEF JUDGE SLEDGE: Mr.
 2 DeSanctis?
 3 MR. DeSANCTIS: Thank you. We
 4 call Mr. Eisenberg to the stand.
 5 CHIEF JUDGE SLEDGE: Yes, sir.
 6 MR. DeSANCTIS: Your Honor, for
 7 the next part of the testimony I'd like to
 8 show the witness and the Court SoundExchange
 9 Trial Exhibit 54, which is simply a
 10 demonstrative that has been provided
 11 previously to the other side.
 12 (Whereupon, the above-
 13 referred to document was
 14 marked as SX Exhibit
 15 No. 54 for
 16 identification.)
 17 As noted at the bottom of this
 18 demonstrative, it is taken from the figures
 19 provided at pages 17 to 21 of Mr. Eisenberg's
 20 testimony. And for the same reason that those
 21 pages have been admitted subject to the
 22 Court's protective order as restricted, I

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1 Sony BMG, are you familiar with the voluntary
 2 deals for digital distribution that Sony BMG
 3 has made in recent years?
 4 A Yes.
 5 Q Do you personally negotiate them?
 6 A Yes, I either negotiate them
 7 personally or people on my staff negotiate the
 8 deals and we compare and I approve the deals
 9 that they enter into.
 10 Q And do you personally negotiate
 11 licenses with -- for only one particular kind
 12 of digital service or a broad array of digital
 13 services?
 14 A All different kinds of digital
 15 services on the mobile platform through
 16 telephone lines, the internet platform,
 17 satellite radio, streaming services, download
 18 services, the whole -- the whole gamut.
 19 Q And does Sony BMG get paid the
 20 same for its music from all different types of
 21 digital music services, or does it get paid
 22 differently for different types of services?

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1 would ask that, although I'm not seeking the
 2 admission of this exhibit, I would ask that it
 3 be treated as restricted under the Court's
 4 protective order for the same reasons.
 5 CHIEF JUDGE SLEDGE: That's
 6 denied. We've gone as far as we've gone in
 7 dealing with how we treat admitted evidence,
 8 and I'm not going to accept responsibility for
 9 exhibits that are not offered.
 10 MR. DeSANCTIS: Okay, Your Honor.
 11 JUDGE ROBERTS: Mr. DeSanctis, are
 12 you seeking to invoke the protective order
 13 when the witness mentions a number or speaks
 14 of --
 15 MR. DeSANCTIS: Yes, we're going
 16 to be getting to proprietary testimony.
 17 JUDGE ROBERTS: I suggest you
 18 refine your request.
 19 MR. DeSANCTIS: I will do -- I
 20 will do that, Your Honor.
 21 BY MR. DeSANCTIS:
 22 Q Mr. Eisenberg, in your work at

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1 A It varies depending on the type of
 2 service and the functionality that is being
 3 offered in a given service and how they're
 4 using our music.
 5 Q What are the primary factors that
 6 affect the rate that Sony will receive for a
 7 particular type of service?
 8 A We look at the cost of making the
 9 music and producing the music, the R&D or A&R
 10 process, what we need as a fair rate of return
 11 for our investment. We look at the value that
 12 the music has in a given service to the end
 13 user or the consumer. The more value that the
 14 music has to the user the more we're going to
 15 charge or the -- you know, the higher the rate
 16 we're going to charge, because of the
 17 beneficial -- the benefits that are bestowed
 18 on that user.
 19 Q Okay. And what are the primary
 20 factors, would you say, that affect value to
 21 the consumer?
 22 A I mean, there's really I guess two

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1 -- two elements we look at. One is the --
 2 whether it's portable or not. We talked a
 3 little bit before in my testimony about the
 4 higher value that's ascribed to portability.
 5 The other is the quality of the listening
 6 experience to the user.
 7 The higher the quality, whether it
 8 be fidelity or seamless music, the higher the
 9 value that we place on our music. And those
 10 two elements really are corollaries of the
 11 substitutional impact that we look at when we
 12 value our music. If music in a given service
 13 offering to a consumer is substituting for
 14 other types of products or services that we
 15 may also sell to the user, we have to take
 16 that into account in pricing the product in a
 17 given service.
 18 Q Okay. So if the quality of the
 19 listening experience is high, what does that
 20 do to the rate that Sony BMG receives for this
 21 service?
 22 A The higher the listening quality

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1 And those listens are tethered to
 2 the computer, meaning it's non-portable. It's
 3 streaming off of the PC in what I would call
 4 the four-wall environment of the home or the
 5 office on a portable computer or Mac, if it's
 6 offered on the Mac.
 7 Q But does that mean you can't --
 8 when a stream is received to the computer, you
 9 can't then transfer it off of that computer?
 10 A You cannot, the only caveat being
 11 if you're in a WiFi hot spot, as we've talked
 12 about before, and you happen to have a laptop
 13 with you and you're carrying your laptop. If
 14 you're in a WiFi-enhanced area, you will be
 15 able to receive the stream, because at that
 16 point you are connected to the internet, but
 17 most connections in the -- to the internet are
 18 via a wireline or fixed line.
 19 Q You also describe in your
 20 testimony that these -- that in your licenses
 21 for non-portable subscription streaming
 22 services Sony BMG typically puts in place a

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1 and the more -- or whether it's portable or
 2 not means the higher the rates we'll ascribe
 3 on a wholesale basis for our music.
 4 Q And is that what you seek in terms
 5 of a higher rate, or is it in fact what you
 6 obtain in the marketplace?
 7 A That's what we negotiate for, and
 8 that's what we obtain in the free marketplace.
 9 Q Okay. And one of the services
 10 that you describe in your written testimony is
 11 non-portable subscription streaming. Can you
 12 very briefly describe what is non-portable
 13 subscription streaming?
 14 A This is the type of monthly
 15 service that a service like Napster or
 16 Rhapsody or Yahoo might offer their user,
 17 where you would have a catalog offering on an
 18 all-you-can-eat basis, meaning the user can
 19 stream as many tracks per month as he or she
 20 wants to that's in the catalog as many times
 21 as he or she wants to for a single flat price
 22 to the end user.

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1 three-part rate structure. Could you describe
 2 what that three-part structure is?
 3 A Yes. There's a -- what we refer
 4 to as a "greater of" formula. So there's
 5 three -- there are three prongs. There's a
 6 revenue share that is the revenues or -- the
 7 revenues that a service receives from the
 8 consumer, or from the use of the music. So it
 9 could be advertising, it could be consumer
 10 receipts, whatever monies are derived by --
 11 from the service, we get a percentage of that.
 12 That's the first prong.
 13 The second prong is a per
 14 subscriber minimum. So if a service is
 15 charging a monthly fee to the consumer, we had
 16 a wholesale minimum that we assess in respect
 17 of each consumer. So if the service, for
 18 example, were to give away the service free to
 19 the end user, that end user still has a deemed
 20 value and that is the per subscriber minimum.
 21 And the third prong is a usage
 22 metric. It's a per play model. So for every

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1 play, for every unit consumed, there's an
 2 additional fee. And at the end of each month,
 3 you calculate your royalties in respect of
 4 each of those three prongs, and the greater of
 5 those three prongs prevails, and that's how
 6 the service pays us for that month concern.
 7 Q Why is there this three-part
 8 structure instead of just one of the three?
 9 A Well, we look at the end value to
 10 the consumer. If the consumer is using a lot
 11 of music, they pay more. There's also a
 12 minimum value to the music, offering the full
 13 catalog to the end user, and that is reflected
 14 in either a percentage of the revenue derived
 15 by the service provider or in the subscriber
 16 minimum per user. So it's consumption-based
 17 and it's also value-based to the end user.
 18 Q Now, turning to the -- let's say
 19 an average of your current agreements that are
 20 currently in effect, turning to the first of
 21 the three --
 22 JUDGE WISNIEWSKI: Well, before we

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1 revenue share that Sony BMG typically receives
 2 for non-portable subscription streaming?
 3 But before you answer that
 4 question, I would ask that we go into
 5 restricted session for the next several
 6 answers, as we work through this.
 7 CHIEF JUDGE SLEDGE: Any objection
 8 to applying the protective order to the
 9 question about the rates applied?
 10 MR. WYSS: No, Your Honor.
 11 CHIEF JUDGE SLEDGE: Without
 12 objection, the motion is granted.
 13 MR. DeSANCTIS: Thank you, Your
 14 Honor.
 15 (Whereupon, the proceedings went
 16 into Closed Session.)
 17
 18
 19
 20
 21
 22

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1 get to that, Mr. DeSanctis, I'm not quite sure
 2 I follow your last answer, because you -- when
 3 you were talking about value to the consumer,
 4 you just described it in terms of access to
 5 the full catalog, whereas in your prior
 6 testimony when you were talking about value to
 7 the consumer you said it really depends on two
 8 characteristics -- portability and quality of
 9 the sound.
 10 THE WITNESS: Audio of the
 11 listening experience. Sound is one aspect,
 12 and then the full --
 13 JUDGE WISNIEWSKI: I must have
 14 missed that.
 15 THE WITNESS: I'm sorry.
 16 JUDGE WISNIEWSKI: Thank you.
 17 BY MR. DeSANCTIS:
 18 Q Mr. Eisenberg, let's talk about
 19 the -- your existing contracts currently in
 20 effect for non-portable subscription
 21 streaming, taking each of the three parts in
 22 turn. What is the percent of revenue or the

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1 CROSS EXAMINATION
 2 BY MR. WYSS:
 3 Q Good afternoon, Mr. Eisenberg.
 4 I'm sorry, Your Honor. May I go
 5 ahead?
 6 CHIEF JUDGE SLEDGE: Please.
 7 BY MR. WYSS:
 8 Q Good afternoon, Mr. Eisenberg. I
 9 think you remember me from your deposition,
 10 correct?
 11 A Yes.
 12 Q Okay. Now, you are a lawyer,
 13 right?
 14 A Yes, sir.
 15 Q And you graduated from New York
 16 Law School in 1988.
 17 A New York University Law School.
 18 Q I'm sorry, New York University Law
 19 School. You went into private practice for
 20 about six years, correct?
 21 A Yes.
 22 Q And that also included time as an

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1 attorney at Wilkie Farr & Gallagher in New
 2 York, correct?
 3 A Yes.
 4 Q You then moved to Sony in 1994.
 5 A Yes.
 6 Q And while at Sony, originally you
 7 were in the Legal Department, correct?
 8 A For Sony Music.
 9 Q Okay. And am I correct that Sony
 10 BMG has a number of individual label groups
 11 that actually produce and make the individual
 12 sound recordings, correct?
 13 A We have two primary label groups
 14 -- the Sony Music Entertainment -- or Sony
 15 music label group and the BMG label group, and
 16 then there are labels or imprints within each
 17 grouping. So it's a complicated answer to
 18 what don't think you intend to be a
 19 complicated question. But there are multiple
 20 labels.
 21 We have maybe 20 different labels
 22 within the Sony BMG family, roughly split

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1 level, those are the people who are actually
 2 doing the promotion, trying to go to radio and
 3 convince them to play your music, correct?
 4 A We have promotion staffs at the
 5 labels who are charged with trying to get
 6 exposure for artists.
 7 Q Okay. And as part of their
 8 budgets, they have tens of millions of
 9 dollars, if not hundreds of millions of
 10 dollars that they spend at the label level on
 11 promotion, correct?
 12 A I don't know how much they spend.
 13 Q Okay. Because you've never worked
 14 at a label, right?
 15 A I worked for a record company,
 16 Sony BMG, and then formerly Sony Music.
 17 Q Yes. But you never worked at the
 18 actual label level where they're making the
 19 decisions how much to invest in promotion, how
 20 much to spend on radio, how much to spend in
 21 newspapers. You haven't worked at that level,
 22 correct?

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1 between two label groups, the Sony music label
 2 group and the BMG label group. We actually
 3 have a Nashville country label group as well.
 4 Q Okay. And it's the little groups
 5 that actually make the music sound recordings,
 6 correct?
 7 A I'm not sure what you mean by
 8 "make the sound recordings."
 9 Q Sign the artists, put them out,
 10 sell the records.
 11 A The A&R staffs are at the label
 12 level. The sales are coordinated within the
 13 Sony BMG company. So we have one sales group
 14 that goes to our accounts that services all of
 15 the labels.
 16 Q Okay. But the labels have their
 17 own budgets, correct?
 18 A Yes.
 19 Q And they have their own profit and
 20 loss statements, correct?
 21 A Yes.
 22 Q Okay. And the people at the label

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1 A I haven't been part of a label
 2 entity. I've been part of a company that
 3 employs those people.
 4 Q And you haven't personally been
 5 involved in any of the promotional activities,
 6 how records are promoted to the radio industry
 7 and to the public, correct?
 8 A Well, part of my job is to liaise
 9 with the marketing and promotional staffs for
 10 online uses of our music. So in that regard
 11 we do speak and communicate strategies in
 12 terms of maximizing our sales.
 13 Q I'm talking about your personal
 14 involvement in the day-to-day activities of
 15 promoting records to the radio industry and to
 16 the public. That's not part of your job, is
 17 it?
 18 A To the extent we're promoting or
 19 marketing in the online channels, it is part
 20 of my job to coordinate with the marketing
 21 staffs of the labels with whom I meet on a
 22 regular basis.

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1 Q But you don't get involved in how
 2 much money we're going to actually spend going
 3 to radio on a particular album, correct?
 4 A No, I don't.
 5 Q Now, in addition to being a lawyer
 6 at Sony, you also serve on various committees
 7 of the RIAA, correct?
 8 A Yes.
 9 Q And the RIAA is a trade
 10 association for the record industry?
 11 A Yes.
 12 Q And you serve on various
 13 committees that develop strategies concerning
 14 copyright licensing proceedings, do you not?
 15 A I'm on a SoundExchange licensing
 16 committee, which is not an RIAA licensing
 17 committee. So the strategies are with respect
 18 to SoundExchange, on that committee not the
 19 RIAA.
 20 Q Okay. But you are on committees
 21 at RIAA that also are involved with developing
 22 strategies for other copyright licensing

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1 A Yes.
 2 Q And you participated with the
 3 SoundExchange lawyers in developing the
 4 strategy for this case, correct?
 5 MR. DeSANCTIS: Objection, Your
 6 Honor, to the extent that it calls for
 7 privileged communications with lawyers.
 8 CHIEF JUDGE SLEDGE: How would you
 9 be able to make that objection? You don't
 10 represent Sony.
 11 MR. DeSANCTIS: I think he was
 12 talking about SoundExchange. I apologize if
 13 I misheard the question.
 14 CHIEF JUDGE SLEDGE: Why don't you
 15 restate it, so I can make sure I understood it
 16 correctly.
 17 MR. WYSS: All right. I wasn't
 18 asking him to reveal any substance of any
 19 conversations. I just wanted to know, did he
 20 participate with the SoundExchange lawyers in
 21 developing the litigation strategy for this
 22 case? It's a yes or no.

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1 proceedings, correct?
 2 A I don't know if there is an RIAA
 3 licensing committee as such. When
 4 SoundExchange was formed, that task was
 5 removed I believe from the RIAA, and a
 6 separate SoundExchange committee was formed.
 7 Q Okay. But you are a part of the
 8 SoundExchange committee.
 9 A Yes.
 10 Q Okay. And that's the committee
 11 that's charged with developing and negotiating
 12 strategies of, and litigation for, copyright
 13 licenses, correct?
 14 A These are compulsory licenses, not
 15 -- obviously not voluntary deals. We don't
 16 talk about them.
 17 Q Right, the compulsory licenses.
 18 A For 114, Section 114, sometimes we
 19 talk about strategies for negotiating the
 20 rates.
 21 Q Okay. And that's the license that
 22 is at issue right in this proceeding, correct?

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1 CHIEF JUDGE SLEDGE: Okay. Mr.
 2 DeSanctis?
 3 MR. DeSANCTIS: I suppose I would
 4 just restate my -- phrased as yes or no, and
 5 limited as such, I would withdraw my
 6 objection.
 7 CHIEF JUDGE SLEDGE: All right.
 8 THE WITNESS: Yes.
 9 BY MR. WYSS:
 10 Q Now, at pages 4 to 5 of your
 11 written direct testimony, you discuss the
 12 various financial woes of the record industry,
 13 correct, particularly the languishing CD
 14 sales?
 15 A The testimony speaks to the
 16 decline of the physical market, if that was
 17 your question.
 18 Q Right. And that's something you
 19 addressed here earlier today, that there's a
 20 decline in CD sales, and I think you even said
 21 this morning that that impacts the type of
 22 music you make, correct?

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1 A Yes.

2 Q Okay. Now, you were not trying to

3 suggest that somehow satellite radio is

4 primarily responsible for the decline of that

5 sales, are you?

6 A In my testimony this morning my

7 focus was not on a "but for." It was about

8 the importance of licensing income. Because

9 we're in a declining physical market, it's

10 very, very important for us to maximize all of

11 our revenues, however derived, from the sale

12 of our -- or licensing of our sound

13 recordings.

14 Q Let me reask my question. It's

15 not your testimony today to suggest that

16 satellite radio itself is primarily

17 responsible for the decline in the CD sales.

18 A I believe it's a --

19 CHIEF JUDGE SLEDGE: That was

20 answered. Is that a little different question

21 than what he has already answered?

22 MR. WYSS: I think it was the same

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1 record, correct, back in the '50s and '60s?

2 A I'm sorry. I don't quite

3 understand the question.

4 Q Am I --

5 JUDGE WISNIEWSKI: Mr. Eisenberg

6 wasn't around then.

7 (Laughter.)

8 BY MR. WYSS:

9 Q Am I correct that back in the '50s

10 and the '60s the record companies were

11 actually selling singles, or actually I think

12 the records typically had two sides for 45

13 play.

14 A A vinyl record.

15 Q Yes.

16 A Yes.

17 Q Okay. And then, in the '60s, and

18 certainly into the '70s and '80s, you shifted

19 away from the singles to the album sales,

20 correct?

21 A We actually still sold singles.

22 We had what was called CD3s and CD5s in the

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1 question. I don't think I got a direct answer

2 to it, Your Honor.

3 CHIEF JUDGE SLEDGE: I heard a

4 direct answer, but go ahead and repeat it, if

5 you'd like.

6 THE WITNESS: In this morning's

7 testimony, I was not making a "but for"

8 causation. If you're asking me a new

9 question, which is, do I believe that

10 satellite radio is somewhat responsible, my

11 answer to that is yes.

12 BY MR. WYSS:

13 Q That's not -- my question was,

14 were you making a "but for" cause, and I

15 believe your answer was no, correct?

16 CHIEF JUDGE SLEDGE: Twice.

17 MR. WYSS: Twice, okay.

18 BY MR. WYSS:

19 Q Now, CD albums -- I may be dating

20 myself -- I've been around long enough so I

21 can remember when you could buy a single, or

22 actually an A side and a B side on a 45

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1 marketplace. So they were not the full album,

2 but they were singles or tracks, sometimes

3 with remixes attached to them, and that was

4 actually sold in physical retail up until a

5 few years ago.

6 Q Okay. But that's something you

7 strictly controlled, which ones you would put

8 into a single, correct?

9 A Did we select the repertoire that

10 --

11 Q That you would allow to be sold as

12 single tracks.

13 A We -- that was our product, so we

14 put the product into the marketplace.

15 Q Right. And the vast majority of

16 your sales over the last 20 years have all

17 been CDs which have 8 to 10 songs or more,

18 correct?

19 A The vast majority has been albums,

20 and in the CD or compact disc configuration.

21 The number of tracks may vary. It may be

22 sometimes 8 or 7 tracks, it could be 13 or 14

<p style="text-align: right;">Page 195</p> <p>1 tracks. It depends.</p> <p>2 Q Okay. But in terms of the -- if a</p> <p>3 listener liked one song on the album, and you</p> <p>4 didn't allow that one to be sold as a single,</p> <p>5 their only choice was to buy the full album if</p> <p>6 they wanted that one song, correct?</p> <p>7 A If they wanted to get the song?</p> <p>8 Q Yes.</p> <p>9 A I suppose they could listen to a</p> <p>10 friend's CD if a friend loaned them their CD.</p> <p>11 I mean, they were either listening -- you can</p> <p>12 go to the library and listen to a song. But</p> <p>13 in terms of a purchase, a price -- or rather</p> <p>14 a skew that was sold at retail, we were</p> <p>15 selling it in an album configuration.</p> <p>16 Q Right. And then, iTunes came</p> <p>17 along in about 2003, correct?</p> <p>18 A iTunes launched in April of 2003.</p> <p>19 Q Okay. And all of a sudden</p> <p>20 individual songs were now available on an</p> <p>21 individual basis and consumers didn't have to</p> <p>22 buy those other eight or nine songs if they</p>	<p style="text-align: right;">Page 196</p> <p>1 only wanted one, correct?</p> <p>2 A It opened up the catalog to single</p> <p>3 track downloads, which wasn't prevalent in a</p> <p>4 physical world.</p> <p>5 Q Okay. And that occurred in 2003,</p> <p>6 correct?</p> <p>7 A The Apple Store launch on the Mac</p> <p>8 platform in April of 2003, and about six or</p> <p>9 eight months later it launched on the Windows</p> <p>10 platform. On the Mac platform, it wasn't a</p> <p>11 very significant store.</p> <p>12 Q Okay. Now, isn't it correct that</p> <p>13 in your own personal view you believe that the</p> <p>14 decline in the CD sales was the result of a</p> <p>15 confluence of a variety of factors, none of</p> <p>16 which you could prioritize, correct?</p> <p>17 A I don't know if I couldn't</p> <p>18 prioritize them. I mean, I think they were --</p> <p>19 are a confluence of factors. I think one of</p> <p>20 the main factors is there's a lot of different</p> <p>21 ways to listen to music and to acquire or</p> <p>22 enjoy music today that perhaps weren't</p>
<p style="text-align: right;">Page 197</p> <p>1 available many years ago before the advent of</p> <p>2 the digital world. Satellite radio is one</p> <p>3 such example. Internet radio is another.</p> <p>4 Single track downloads and streaming</p> <p>5 performances are yet another.</p> <p>6 Q Now, in terms of your question</p> <p>7 about some of the financial woes, you're not</p> <p>8 suggesting, are you, that your financial woes</p> <p>9 in recent years are caused directly by</p> <p>10 satellite radio, are you?</p> <p>11 A I think, as you said, a confluence</p> <p>12 of factors. So the ability to listen to music</p> <p>13 in a whole different -- in different types of</p> <p>14 services contribute to the decline, I believe,</p> <p>15 in sales, because you can enjoy music in a</p> <p>16 whole variety of different ways that you</p> <p>17 weren't able to in years past.</p> <p>18 Q Okay. Well, let's look at the</p> <p>19 financials, so we can help the Court</p> <p>20 understand the background of your financial</p> <p>21 situation. Am I correct that Sony BMG does</p> <p>22 not file any public information that would</p>	<p style="text-align: right;">Page 198</p> <p>1 allow us to verify your financial information?</p> <p>2 A Sony BMG is a private company, so</p> <p>3 I don't believe that we section out our</p> <p>4 financials from our parent companies.</p> <p>5 Q Okay. But you're aware that at</p> <p>6 the Court's request financials were prepared</p> <p>7 for this case, correct?</p> <p>8 A I believe at the --</p> <p>9 MR. DeSANCTIS: Objection. It's</p> <p>10 completely unclear to me what he means by</p> <p>11 "financials were prepared for this case."</p> <p>12 MR. WYSS: Financials showing --</p> <p>13 MR. DeSANCTIS: That sounds like a</p> <p>14 question for a lawyer as opposed to a fact</p> <p>15 witness.</p> <p>16 MR. WYSS: Well, I'm going to ask</p> <p>17 --</p> <p>18 CHIEF JUDGE SLEDGE: I haven't</p> <p>19 heard an objection yet. Everybody is looking</p> <p>20 at me, but I haven't heard anything on which</p> <p>21 there is an objection.</p> <p>22 MR. DeSANCTIS: I will withdraw</p>

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1 the objection.

2 BY MR. WYSS:

3 Q I think you're aware, are you not,

4 that financials were prepared for this case

5 for Sony BMG U.S. only?

6 A I wasn't responsible in preparing

7 financials, so I'm not sure exactly what was

8 or wasn't prepared.

9 Q But you were aware that they were

10 prepared for this case, correct?

11 A I don't know for a fact what was

12 prepared. My assumption is that there must

13 have been some financial data that was

14 submitted, but I wasn't a party personally to

15 the creation or development of those

16 materials, so I don't know what was or wasn't.

17 Q Let me ask you to please look at a

18 document that is being marked as SDARS Exhibit

19 Number 14, please. And for the record, this

20 bears SoundExchange production numbers

21 0203204-5 and SE 0203062-6 on it.

22 (Whereupon, the above-

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1 testimony about declining sales and financial

2 woes.

3 He is the only Sony witness that

4 is being tendered in this case, and is the

5 only one that we have to use this exhibit

6 with.

7 CHIEF JUDGE SLEDGE: Now, why is

8 he the only one you have?

9 MR. WYSS: He is the only Sony

10 witness listed in this case.

11 CHIEF JUDGE SLEDGE: Produced by

12 SoundExchange.

13 MR. WYSS: Yes.

14 CHIEF JUDGE SLEDGE: But certainly

15 not the only Sony witness available to the

16 services to have for this trial.

17 MR. WYSS: Your Honor, he was also

18 the one I believe who was offered to testify

19 about finances as well in this case.

20 CHIEF JUDGE SLEDGE: What's the

21 basis of that?

22 MR. WYSS: If I could have one

Page 200

1 referred to document was

2 marked as SDARS Exhibit

3 No. 14 for

4 identification.)

5 And I will state for the record,

6 Your Honor, these were financial informations

7 produced to us just recently out of the

8 production by SoundExchange.

9 And, Mr. Eisenberg, do you

10 recognize SDARS Exhibit 14 as the financial

11 information that was prepared for Sony BMG

12 relating to its U.S. only operations in

13 connection with this case?

14 A No.

15 Q You don't recognize it at all?

16 A No.

17 MR. WYSS: All right. Your Honor,

18 we would offer SDARS Exhibit 14 as the

19 financial information from Sony, which was

20 produced in response to the Court's order by

21 SoundExchange, which is to respond to and to

22 put into context the witness' earlier

Page 202

1 moment, Your Honor. Again, he was offered to

2 testify about the declining physical sales and

3 how much they were and how much they're going

4 down. That was in his written direct

5 testimony. And it talks about -- when he

6 talks about fair compensation for promotional

7 uses at page 9 of his testimony.

8 CHIEF JUDGE SLEDGE: I guess

9 you're expecting me to read this whole thing,

10 since you're not pointing out any part of it?

11 MR. WYSS: I'm sorry, Your Honor.

12 It's page -- no, I don't want you to read the

13 whole thing, Your Honor. It's the -- it is

14 his testimony earlier today about the

15 declining CD sales and the impact financially

16 on the company. That's what I'm addressing

17 this to, that he was allowed to testify about

18 the financial impact of the declining CD

19 sales, and we would be offering SDARS 14 in

20 response to that to put that in context and

21 rebut it.

22 CHIEF JUDGE SLEDGE: Any response

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1 to the offer?

2 MR. DeSANCTIS: Yes, Your Honor.

3 I would object on at least a couple of

4 grounds. First, this -- the witness testified

5 that he didn't recognize the document, and,

6 therefore, certainly I would object on the

7 grounds of lack of adequate foundation.

8 This is not a witness who is in

9 Sony's financial department and necessarily

10 has any familiarity with this particular

11 document or documents like it. Moreover, the

12 testimony --

13 JUDGE ROBERTS: And Mr. DeSanctis

14 isn't making statements about the fact that

15 sales are not going well.

16 MR. DeSANCTIS: The testimony,

17 Your Honor -- thank you -- that he provided in

18 his written statement and today was primarily

19 on an industry -- sales on an industry-wide

20 basis. He talked about a decline in --

21 JUDGE ROBERTS: Something that he

22 was told maybe by someone else?

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1 -- as a basis for your objection, and yet he

2 is making these statements about finances and

3 costs.

4 MR. DeSANCTIS: I guess it's a

5 question of degree, Your Honor, for someone

6 who is senior in the company to know that

7 sales have been down year on end, and to know

8 the extent that sales have been down, versus

9 this kind of very detailed financial document.

10 And without his authentication, that would be

11 my objection to this particular document.

12 CHIEF JUDGE SLEDGE: Objection is

13 overruled. Exhibit 14 is admitted.

14 (Whereupon, the above-

15 referred to document,

16 previously marked as

17 SDARS Exhibit No. 14 for

18 identification, was

19 admitted into evidence.)

20 BY MR. WYSS:

21 Q Now, on Exhibit 14, you have --

22 MR. DeSANCTIS: Your Honor, if I

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1 JUDGE WISNIEWSKI: Mr. DeSanctis,

2 on page 4 of his testimony, it says, "Since

3 2000, the shipments of physical parts and,

4 consequently, Sony BMG's core source of

5 revenues have declined."

6 MR. DeSANCTIS: That's right, Your

7 Honor. He spoke primarily about the industry,

8 and he then did discuss --

9 JUDGE WISNIEWSKI: It sounded like

10 at Sony BMG.

11 MR. DeSANCTIS: And then, he did

12 discuss its effect on Sony BMG in terms of the

13 -- how it has affected Sony's decision to

14 create music. He did not get into the

15 specific numbers on this page.

16 JUDGE ROBERTS: Then, how does he

17 know?

18 MR. DeSANCTIS: I'm sorry?

19 JUDGE ROBERTS: How does he know

20 unless somebody told him, "Our sales are going

21 down"? You're telling us that he doesn't have

22 any exposure or expertise in finances on your

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1 may move for this to be restricted under the

2 Court's protective order. As Counsel for

3 Sirius mentioned at the outset, this is not

4 information that is publicly available or that

5 is publicly filed. This is internal to Sony

6 BMG and is at a level of detail that is never

7 shared with its competitors or with the

8 public.

9 CHIEF JUDGE SLEDGE: Ask your

10 witness. I'm interested in how you're going

11 to get that established with this witness,

12 based on what he has -- and you have said

13 about him.

14 MR. DeSANCTIS: Can I ask him,

15 Your Honor?

16 CHIEF JUDGE SLEDGE: Yes, sir.

17 MR. DeSANCTIS: Mr. Eisenberg, are

18 you familiar with the general types of

19 documents -- of financial documents that Sony

20 files publicly with the SEC or other public --

21 or in other public filings?

22 THE WITNESS: I'm not involved in

Page 207

1 the process -- in SEC filings. I do know that
 2 music companies' results are not separately
 3 broken out in the parents' filings.
 4 MR. DeSANCTIS: And if they're not
 5 separately broken out, do you know if they're
 6 shared otherwise with the public, or whether
 7 they're largely treated within Sony BMG as
 8 confidential through Sony BMG?
 9 THE WITNESS: I have never seen
 10 them disclosed to third parties.
 11 MR. DeSANCTIS: Your Honor, I
 12 renew my motion for SDARS Exhibit 14 to be
 13 treated as restricted.
 14 CHIEF JUDGE SLEDGE: Motion is
 15 denied.
 16 BY MR. WYSS:
 17 Q Looking at SDARS Exhibit 14, if
 18 you would, please, do you see the line net
 19 revenue? Is that where we sum up the various
 20 revenues each year?
 21 MR. DeSANCTIS: I would object to
 22 that question on foundation.

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1 Sony BMG U.S. only operation obtained during
 2 each of the years indicated?
 3 A The numbers listed here would
 4 reflect a ballpark -- what I would call --
 5 what I would think of as a ballpark number in
 6 terms of our revenues over this time, but I
 7 don't -- I didn't prepare this document, so I
 8 don't have any way to verify or validate, you
 9 know, the basis on which these numbers were
 10 developed.
 11 Q But you have seen financial
 12 statements at Sony where you take net revenues
 13 and you subtract from those the costs that are
 14 directly attributable to those revenues and
 15 you come up with something called variable
 16 contribution or gross profit, correct?
 17 A No. I don't do that at Sony BMG.
 18 Q You don't have any idea about
 19 that?
 20 A On a company-wide level, that is
 21 not my job, no.
 22 Q How about SG&A expenses? Do you

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1 CHIEF JUDGE SLEDGE: Please repeat
 2 it, Mr. Wyss.
 3 BY MR. WYSS:
 4 Q Looking at the line that -- do you
 5 remember in your deposition we looked at P&L
 6 like this and asked you some questions about
 7 it?
 8 A When you say "like this," was it
 9 this document? I don't recall this document.
 10 Q This one has been updated, because
 11 we didn't have the 2006 information. But do
 12 you recall at your deposition that we looked
 13 at a P&L that had these various categories on
 14 it?
 15 A I recall a document being placed
 16 in front of me at a deposition with numbers on
 17 it. I don't recall what the numbers were or
 18 what document that was in relation to.
 19 Q Okay. Well, looking at the SG&A
 20 line -- well, first of all, let me just -- the
 21 net revenues, you do not recognize the net
 22 revenues line as the total revenues that the

Page 210

1 know what SG&A expenses are?
 2 A I believe SG&A refers to sales,
 3 general, and administrative.
 4 Q Is that the extent of your
 5 knowledge about that?
 6 A I believe it's an overhead
 7 component.
 8 Q Okay. And I think you did mention
 9 that there are budgets prepared looking
 10 forward each year, correct, for the labels?
 11 A I believe each label group has a
 12 budget plan to submit to the CFO and our
 13 senior management team for approval. I'm not
 14 part of that process.
 15 Q Let me mark as SDARS Exhibit
 16 Number 15 a document produced in this case
 17 bearing SoundExchange Number 0203186 through
 18 3190.
 19 (Whereupon, the above-
 20 referred to document was
 21 marked as SDARS Exhibit
 22 No. 15 for

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1 identification.)
 2 And, Your Honor, I will represent
 3 this is a document that was produced by
 4 SoundExchange in this case in response to the
 5 Court's order for projections going forward at
 6 the label level of income and expenses
 7 produced very recently. And this was the one
 8 for Sony BMG.
 9 And do you recognize SDARS Exhibit
 10 15 as a copy of the 2007 budget for all of the
 11 U.S. labels, which are broken out on the
 12 second page but summarized on the first page
 13 under the major groupings?
 14 A No.
 15 Q You don't recognize it at all?
 16 A No.
 17 MR. WYSS: Okay. Your Honor, we
 18 would offer SDARS Exhibit 15.
 19 CHIEF JUDGE SLEDGE: On what
 20 basis?
 21 MR. WYSS: Your Honor, this is --
 22 shows us the projection. This is in response

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1 response to his testimony here earlier today.
 2 CHIEF JUDGE SLEDGE: Still, what's
 3 the tie to this exhibit?
 4 MR. WYSS: Sorry?
 5 CHIEF JUDGE SLEDGE: What is the
 6 tie you're trying to make from that testimony
 7 and this exhibit?
 8 MR. WYSS: That their financial
 9 woes, which the witness testified about
 10 earlier today, are overstated, and that in
 11 2007 they expect to have very substantial
 12 operating income for the U.S. operations.
 13 CHIEF JUDGE SLEDGE: Response?
 14 MR. DeSANCTIS: Yes. Your Honor,
 15 similar to your own questioning, there is --
 16 he does not testify in his written statement
 17 about projections, nor did he testify today
 18 about projections. He testified about
 19 declining sales through 2006 and through the
 20 first half of 2007 as reported, and there was
 21 no further discussion that would make this
 22 exhibit relevant.

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1 to his testimony earlier today about the
 2 financial woes. This shows the projection of
 3 what they're expecting to do in 2007 quite
 4 well.
 5 CHIEF JUDGE SLEDGE: Where is that
 6 in his testimony? I don't recall him talking
 7 about projections.
 8 MR. WYSS: He did not talk about
 9 projections, but he talked about how bad
 10 things had been up to today this morning, and
 11 --
 12 CHIEF JUDGE SLEDGE: And what has
 13 that got to do with projections?
 14 MR. WYSS: Because they are now
 15 projecting to do very well next year.
 16 JUDGE ROBERTS: Where is he saying
 17 that?
 18 MR. WYSS: In his written direct,
 19 Your Honor?
 20 JUDGE ROBERTS: Yes.
 21 MR. WYSS: He does not say that in
 22 his written direct. It was part of the

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1 Therefore, I would object on it
 2 being beyond the scope of direct, and also it
 3 being -- lacking authentication and
 4 foundation.
 5 MR. WYSS: Could I add one further
 6 comment, Your Honor?
 7 CHIEF JUDGE SLEDGE: Yes, sir.
 8 MR. WYSS: In his written direct
 9 testimony at page 5, the witness does
 10 specifically address the question of it is the
 11 digital exploitation of music where our future
 12 would be made or lost. And this exhibit would
 13 be going towards that area opened by his
 14 written direct.
 15 CHIEF JUDGE SLEDGE: Objection
 16 sustained.
 17 BY MR. WYSS:
 18 Q Let me now ask you to please look
 19 at a document that I know you have seen
 20 before. This was an exhibit to your
 21 deposition, and we will mark it as SDARS
 22 Number 16.

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1 (Whereupon, the above-
 2 referred to document was
 3 marked as SDARS Exhibit
 4 No. 16 for
 5 identification.)
 6 And, Mr. Eisenberg, do you
 7 recognize SDARS Exhibit 16 as a breakdown of
 8 your digital revenues for 2005 and 2006?
 9 A Yes.
 10 Q Okay. And looking at the -- I
 11 guess it's about the third page in, 810 at the
 12 bottom, is that where the total digital
 13 revenues for 2005 and 2006 appear?
 14 A I'm sorry. Which page?
 15 Q 810 at the bottom, about the third
 16 page in. Do you see the line that says
 17 "total"?
 18 A Yes.
 19 Q Okay. And am I correct that there
 20 was a large increase, 50 percent increase,
 21 from 2005 to 2006?
 22 MR. DeSANCTIS: I want to object.

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1 MR. DeSANCTIS: Before that
 2 happens, Your Honor, I would like to make a
 3 motion that this document be treated as
 4 restricted under the Court's protective order.
 5 This is a level of detail of information -- of
 6 financial information that is never shared
 7 with Sony's competitors or with the
 8 competitors of the services that are listed
 9 here or with the public.
 10 CHIEF JUDGE SLEDGE: Motion is
 11 granted.
 12 MR. DeSANCTIS: Thank you, Your
 13 Honor.
 14 BY MR. WYSS:
 15 Q Am I correct looking at the
 16 approval figures on that page that there was
 17 a very substantial increase of about 50
 18 percent just from 2005 to 2006 in your digital
 19 revenues?
 20 A I don't have a calculator in front
 21 of me, but going from about \$227 million to
 22 \$345 million is about 50 percent.

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1 Before we read from documents -- I don't
 2 believe this got moved into evidence, and he
 3 is now reading from it. I would object to
 4 that line of questioning.
 5 CHIEF JUDGE SLEDGE: Mr. Wyss?
 6 MR. WYSS: Your Honor, I will move
 7 SDARS Exhibit Number 16 into evidence.
 8 CHIEF JUDGE SLEDGE: Any
 9 objection?
 10 MR. DeSANCTIS: No, Your Honor.
 11 The witness said he did recognize it.
 12 CHIEF JUDGE SLEDGE: Without
 13 objection, Exhibit 16 is admitted.
 14 (Whereupon, the above-
 15 referred to document,
 16 previously marked as
 17 SDARS Exhibit No. 16 for
 18 identification, was
 19 admitted into evidence.)
 20 THE WITNESS: Can you repeat the
 21 question?
 22 MR. WYSS: Certainly.

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1 Q Okay. And in terms of the overall
 2 significance to the company, am I correct that
 3 your revenues went from about 11 percent of
 4 your revenues -- excuse me, I'm going to start
 5 over again.
 6 Isn't it correct that your digital
 7 revenues went from about 11 percent of your
 8 net revenues up to 18 percent in just the
 9 space of that one year?
 10 A That sounds correct.
 11 Q Okay. Now, on the first page --
 12 well, just so I'm clear, though, the other
 13 82 percent even today is still physical CD
 14 sales, correct?
 15 A Roughly. There may be some
 16 licensing income that's from master use
 17 licenses for television and film, but minor.
 18 Q Okay. And looking at page 1 of
 19 SDARS Exhibit Number 16, the first category
 20 shown there, which is the online D-loads and
 21 subs, do you see that?
 22 A Yes.

<p style="text-align: right;">Page 219</p> <p>1 Q And as we get down -- we get down, 2 there's a total line about a third of the way 3 down? 4 A Yes. 5 Q Okay. And am I correct that that 6 category of digital revenues -- and I did the 7 math -- was about 54 percent of your total 8 digital revenues in 2006? 9 A You're comparing the 187 -- 10 \$187 million to the -- 11 Q To the -- 12 A So that's around 50 percent. 13 Q Okay. And then, the next one down 14 is the mobile category. Those are the cell 15 phone carriers primarily? 16 A Yes. 17 Q Okay. And, again I did the math 18 and got about 39 percent of your revenues in 19 2006, correct? 20 A Of the digital revenues. 21 Q Right. So am I correct that 22 digital revenues, when you add together the</p>	<p style="text-align: right;">Page 220</p> <p>1 online downloads and subs and the music -- 2 excuse me, the mobile, you've got about 90 3 percent plus accounts for your digital 4 revenues, correct? 5 A I would have to do the math, but 6 it's -- a substantial amount of our digital 7 revenues are derived from permanent downloads, 8 which is in that first category, and the 9 mobile income, which is in that second 10 category. 11 Q Okay. And just so the Court is 12 clear, there also is a further breakout down 13 at the bottom of page -- the first page, which 14 carries over to the second page. Am I correct 15 that the two categories that are discussed 16 there -- online subs only and downloads from 17 online subs -- those further breaks are 18 actually already included and added up in the 19 first category on page 1? 20 A I don't believe the online subs 21 only is in there, because that is the 22 subscription revenue that we get from</p>
<p style="text-align: right;">Page 221</p> <p>1 streaming activity. So to give you an 2 illustration, if Napster offers a monthly 3 subscription service for \$10 or \$15 a month, 4 those revenues would be reflected in the 5 online subs category. 6 The second category that you 7 referred to is downloads from online subs. I 8 believe that's part of the first category, 9 which talked about all online subs. 10 Q Okay. Well, let me look at the 11 subscription revenues for the subs only, which 12 appears on page 2. Am I correct that that's 13 the \$26 million figure, correct? 14 A Yes. 15 Q And that's about 8 percent of your 16 total digital revenues in 2006, correct? 17 A That sounds right. 18 Q And that's less than 1.5 percent 19 of the company's total revenues in 2006, 20 correct? 21 A I would have to do the arithmetic 22 on that.</p>	<p style="text-align: right;">Page 222</p> <p>1 Q Okay. Now, on the next page, the 2 third page of the exhibit, there is a category 3 called statutory licenses. What goes into 4 that category? Am I correct that includes all 5 statutory licenses, webcasting, satellite 6 radio, anybody else, correct? 7 A These are the DMCA royalties that 8 we receive from SoundExchange pursuant to 9 Section 114. So it would cover webcasting and 10 it would cover the satellite radio services. 11 Q And also Music Choice? 12 A Yes. 13 Q Then, the other category of radio, 14 what category is that? 15 A These are direct internet radio 16 deals that we have. 17 Q These are so-called customized 18 radio? 19 A I believe so. 20 Q Okay. And if you look at the 21 fourth page now, the 810 one again, do you see 22 that on the -- for 2006 there is an all other</p>

<p style="text-align: right;">Page 223</p> <p>1 charge of \$11 million? Do you remember me 2 asking you about that at your deposition? 3 A No. 4 Q Okay. Do you know what is 5 included in that \$11 million charge for 2006 6 for digital revenue? 7 A I don't know. 8 Q Okay. And am I correct that the 9 amount of charge that you don't know, that's 10 about three and a half times as large as all 11 of the SoundExchange revenue that you got in 12 2006, correct? 13 A It appears that \$11 million is 14 roughly three and half times \$2.9 million, if 15 that was your question. 16 Q Now, when one of the labels sits 17 down to negotiate a contract with an artist 18 who has made prior records for Sony, you 19 negotiate over the -- how much money you're 20 going to pay the artist, correct? 21 A I'm sorry. Can you repeat the 22 question?</p>	<p style="text-align: right;">Page 224</p> <p>1 Q When one of the labels sits down 2 to negotiate a new album deal with an artist 3 who has previously made albums for Sony, in 4 making those negotiations do the labels look 5 at the past sales of physical albums in 6 calculating how much money they are willing to 7 invest in a new album? 8 A Typically, when you sign an 9 artist, you are signing him for a series of 10 albums in advance. So if I'm signing an 11 artist today, I may get five or six albums 12 under that deal. So you would have 13 contractual rights to additional product that 14 hasn't been released yet. They're not -- each 15 album is not necessarily a separate 16 negotiation, because you have contractual 17 rights for features. 18 Q Let me try to come back to my 19 question. Isn't it true that on occasion you 20 will negotiate with an artist over a new album 21 deal who has got a past track record? 22 A There are instances in which an</p>
<p style="text-align: right;">Page 225</p> <p>1 artist may want to renegotiate a deal, and 2 they may provide additional value for you, and 3 that would be the subject matter of a new 4 negotiation. 5 Q Okay. And during that 6 negotiation, isn't it true that you will look 7 at the past sales of physical albums in 8 deciding how much money you are willing to 9 invest in making new music with that artist, 10 correct? 11 A It's one factor. 12 Q Isn't it also correct that another 13 factor you will look at is past revenue from 14 digital downloads, the permanent downloads, 15 correct? 16 A That is another factor. 17 Q Okay. And isn't it true that you 18 do not currently consider the money coming in 19 from subscription services, such as the 20 Napsters and that sort of thing, because they 21 are too small to make an impact on the 22 decision to sign an artist contract for a new</p>	<p style="text-align: right;">Page 226</p> <p>1 record, is that correct? 2 A No, that's not true. What you 3 look at is the entirety of the royalty flow 4 that an artist has received under a deal from 5 whatever sources you were able to exploit 6 their sound recordings. 7 So whether the money came from 8 licensing income or subscription income or 9 digital downloads or video royalties or 10 ringtones or ringbacks or the whole gamut of 11 products that we have, those are all royalty- 12 bearing products. And you look at the royalty 13 flow, the royalty earnings that the artist has 14 made over that period of time, and then you 15 assess what you can and can't afford to pay 16 them for future product. 17 Q Do you remember we took your 18 deposition -- 19 A Yes. 20 Q -- in this case? Okay. I would 21 ask you to please look at a copy of your 22 deposition, which we're going to mark as SDARS</p>

<p style="text-align: right;">Page 227</p> <p>1 Exhibit 17. And would you turn to page 71 of 2 your deposition? 3 (Whereupon, the above- 4 referred to document was 5 marked as SDARS Exhibit 6 No. 17 for 7 identification.) 8 MR. RICH: Your Honor, may I? 9 CHIEF JUDGE SLEDGE: Yes. 10 MR. RICH: May I inquire if we are 11 still under -- if we are still on a restricted 12 record, or whether our client can return to 13 the courtroom? 14 CHIEF JUDGE SLEDGE: It was never 15 a restricted record on testimony. There was 16 a motion on the exhibit being applied to the 17 protective order, but never a motion on any 18 testimony. 19 MR. RICH: So our client was 20 abundantly cautious and left when we received 21 that ruling. Thank you, Your Honor. 22 BY MR. WYSS:</p>	<p style="text-align: right;">Page 228</p> <p>1 Q Do you see on page 21 of your -- 2 excuse me, page 71 of your deposition we asked 3 you about what you considered when you looked 4 at -- in renegotiating one of these contracts, 5 and you indicated you look at CD sales, you 6 look at digital downloads. And do you see 7 where you were asked at the bottom of page 72, 8 "Question: Okay. And so would that include 9 income from subscription services as well?" 10 And do you recall that your answer 11 under oath at that time was, "I think at this 12 point the amount of monies that are coming in 13 from subscription services are probably too 14 small to make an impact on those calculations 15 as we sit here today." Is that your testimony 16 at your deposition under oath? 17 A Yes. 18 Q Okay. And do you recall you were 19 then asked, "And would the same be true about 20 the income from SoundExchange?" And do you 21 recall that your answer at that point was, 22 "Yes, the same would be true"?</p>
<p style="text-align: right;">Page 229</p> <p>1 A In regards to whether it would 2 make an impact, not whether we consider the 3 monies. Those are two separate questions. 4 Q Okay. And didn't you testify that 5 -- or isn't it true that the royalties that 6 you currently get from SoundExchange, for all 7 of the different compulsory licenses, are 8 really just a rounding error when compared to 9 the overall revenues of the company? 10 A I don't know if I would refer to 11 it as a rounding error. It's a relative 12 aspect of our company and something that we 13 take very seriously. It may not have a 14 particular impact on a case-by-case basis with 15 a superstar artist who derives most of his 16 revenues from physical product or digital 17 downloads, but it's certainly a factor that we 18 take and will take into account. 19 Q Let's now look or talk a little 20 bit about the -- your chart and some of the 21 other deals that you discussed on your direct 22 testimony.</p>	<p style="text-align: right;">Page 230</p> <p>1 CHIEF JUDGE SLEDGE: With a change 2 in area, it would be a good time to recess 3 10 minutes. 4 (Whereupon, the proceedings in the 5 foregoing matter went off the 6 record at 3:10 p.m. and went back 7 on the record at 3:25 p.m.) 8 CHIEF JUDGE SLEDGE: Thank you. 9 We'll come to order. 10 Mr. Wyss. 11 MR. WYSS: Thank you, Your Honor. 12 Before we go to other deals, I just want to 13 check one thing from the earlier testimony. 14 BY MR. WYSS: 15 Q I think you stated that you don't 16 recall using the term "rounding error" to 17 describe the significance of the SoundExchange 18 revenues to Sony. 19 A I don't have a specific 20 recollection of it. 21 Q Okay. Let me ask you this, try to 22 refresh your recollection. If you'd look at</p>

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1 your deposition, page 43 at line --

2 CHIEF JUDGE SLEDGE: How could

3 this possibly matter, Mr. Wyss, whether he

4 calls that number a rounding error or not?

5 MR. WYSS: It's his term, Your

6 Honor, but it was very, very small --

7 CHIEF JUDGE SLEDGE: How could it

8 possibly matter?

9 MR. WYSS: I think it would matter

10 to other expert witnesses.

11 CHIEF JUDGE SLEDGE: All right.

12 BY MR. WYSS:

13 Q Would you just look quickly at

14 page 43 of your deposition, that's SDARS 17,

15 and it carries over to line 5 on page 44. And

16 isn't it correct, Mr. Eisenberg, that it was

17 your term to describe what you called as a

18 very, very small amount, that the

19 SoundExchange licensing revenues were

20 essentially a rounding error to the overall

21 component?

22 A I think I was comparing a few

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1 MR. WYSS: For the purpose, Your

2 Honor, of showing the background of the deals

3 that were being talked about here, and how

4 internally those deals are analyzed at Sony.

5 CHIEF JUDGE SLEDGE: You're going

6 to tie an `03 to current?

7 MR. WYSS: Yes, Your Honor.

8 CHIEF JUDGE SLEDGE: Any objection

9 to Exhibit 18?

10 MR. DeSANCTIS: No, Your Honor.

11 CHIEF JUDGE SLEDGE: Without

12 objection, it's admitted.

13 (Whereupon, SDARS

14 Exhibit Nos. 18 was

15 admitted.)

16 BY MR. WYSS:

17 Q Did you recognize --

18 MR. DeSANCTIS: Your Honor, I

19 would like to move that it be treated as

20 restricted under the protective order as it

21 includes many, many numbers and dates --

22 CHIEF JUDGE SLEDGE: Why does that

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1 million to 1.7 billion. I don't have a

2 specific recollection of using the term

3 "rounding error", but I'm not going to dispute

4 that it's in my examination.

5 (Whereupon, SDARS

6 Exhibit No. 18 was

7 marked for

8 identification.)

9 Q Now let's talk about your deals,

10 the other deals you discussed, and let's talk

11 about -- let's go back to -- I'd like to show

12 the witness Exhibit SDARS 18, which was

13 Eisenberg Deposition Exhibit 11. And if you

14 recognize SDARS Exhibit 18 as a copy of a memo

15 prepared by Larry Kanusher, K-A-N-U-S-H-E-R,

16 to Phil Wiser that was circulated to you and

17 others back in June of 2003.

18 A Yes.

19 MR. WYSS: Your Honor, we would

20 offer SDARS Exhibit 18.

21 CHIEF JUDGE SLEDGE: For what

22 purpose?

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1 matter to 2007, or the future?

2 MR. DeSANCTIS: Well, I don't know

3 how many of these were carried forward, or

4 not. Often rates are carried forward, they

5 may have been, they may not have been. As I'm

6 looking at this now, I certainly can't say

7 that that's not the case. There's rates for

8 many different kinds of services in here. For

9 example, some of the per play rates do seem

10 the same as current rates.

11 CHIEF JUDGE SLEDGE: Motion is

12 granted.

13 BY MR. WYSS:

14 Q Mr. Eisenberg, Larry Kanusher, did

15 he work for you back at this time period?

16 A Yes.

17 Q Okay. And this is a memo going to

18 Phil Wiser, who was one of the top executives

19 at Sony at the time?

20 A He was head of our Digital

21 Business Development efforts at the time, and

22 our Chief Technology Officer.

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1 Q And this was a memo about your
 2 strategy for the deals you were going to
 3 negotiate in the future in the digital space.
 4 Correct?
 5 A It was a rough primer to kind of
 6 get him inculcated in the music licensing
 7 world.
 8 Q Am I correct, looking at the last
 9 bullet on the first page, that at least one of
 10 the factors that you were considering as you
 11 went forward to negotiate deals in the future
 12 was the desire to establish good precedence,
 13 particularly ones that could be "valuable in
 14 future Sony deals and rate setting proceedings
 15 for compulsory licenses." Is that a factor
 16 that was discussed internally at Sony as you
 17 went into this area?
 18 A Not really.
 19 Q And Mr. Kanusher certainly put it
 20 in his memo. Correct?
 21 A I think he was describing it seems
 22 to be more than a half a dozen bullets, it

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1 A What we've seen over the years,
 2 it's really a spectrum of substitutability.
 3 Whether it's promotional or not really isn't
 4 material. You have the spectrum of different
 5 services, of different service offerings. And
 6 you have different types of functionality,
 7 different types of consumer offerings. One
 8 may be more substitutational on other sales than
 9 another, but I wouldn't put the polar extremes
 10 as promotional on one end, and substitutational
 11 on the other. I think it's a continuum of
 12 substitutability, with certain elements of
 13 promotion, perhaps, at different parts of the
 14 spectrum, or within different types of
 15 services.
 16 (Whereupon, SDARS
 17 Exhibit No. 19 was
 18 marked for
 19 identification.)
 20 BY MR. WYSS:
 21 Q Let me ask you now to look at
 22 SDARS Exhibit 19. And do you recognize SDARS

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1 looks like it's the last one, so it wasn't
 2 something that we discussed at great length
 3 within the company.
 4 Q Now looking at the second page
 5 where he talks about evaluating functionality,
 6 do you see that section?
 7 A Yes.
 8 Q And would you agree that there is
 9 a spectrum of functionality for the various
 10 digital services that can go all the way from
 11 promotional at one end, to substitutational at
 12 the other end, particularly when you get to
 13 fully on-demand access to a catalogue.
 14 A Not -- looking at today's world, I
 15 think it's very much different from the way
 16 that we -- I thought the world was in June of
 17 2003.
 18 Q Okay. You no longer think that
 19 there is a spectrum of functionality from
 20 things that are promotional on one end of the
 21 spectrum, up to highly substitutational where
 22 you have on-demand access to catalogue?

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1 Exhibit 19 as a copy of a memo that you
 2 authored in July of 2003, and sent to various
 3 top executives within Sony Music?
 4 A Yes.
 5 Q Okay. And some of the people who
 6 it went to, Mr. Anthony, and Mr. Lack. Mr.
 7 Lack was CEO, and now Chairman. Correct?
 8 A At that time, yes, he was the
 9 incoming CEO of the company.
 10 Q And Mr. Anthony was the Executive
 11 Vice President of the company. Correct?
 12 A It's actually Michelle Anthony.
 13 Q I'm sorry.
 14 A It's a woman.
 15 Q Ms. Anthony, she was Executive
 16 Vice President of the company at that time.
 17 Correct?
 18 A For Sony -- this was before the
 19 merger, so the company in 2003 was Sony Music
 20 Entertainment, not the Bertelsmann piece of
 21 the company.
 22 Q Okay. Now this was a memorandum

<p style="text-align: right;">Page 239</p> <p>1 that you prepared for the top executives to 2 talk about your overall licensing philosophy 3 going after some of the new digital services. 4 Correct?</p> <p>5 A This was kind of a parallel piece 6 to Mr. Kanusher's memo, kind of providing a 7 primer on licensing overviews to executives 8 who perhaps weren't all that familiar with our 9 music licensing activities at the time they 10 joined the company.</p> <p>11 Q Okay. Let me focus you on the 12 section number two called "Webcasting 13 Spectrum." Do you see that?</p> <p>14 A Yes.</p> <p>15 Q And do you see where, at least in 16 your view at that time, was that should be 17 best analyzed along a functionality spectrum. 18 Correct?</p> <p>19 A I described it as a functionality 20 spectrum. Is that your question?</p> <p>21 Q Yes.</p> <p>22 A Yes.</p>	<p style="text-align: right;">Page 240</p> <p>1 Q And right below it, you have a 2 nice little diagram of your functionality 3 spectrum. Correct?</p> <p>4 A Yes.</p> <p>5 Q And at the far left pole is 6 traditional terrestrial FM broadcast simulcast 7 over the internet. Correct?</p> <p>8 A Yes.</p> <p>9 Q Okay. And then at the far right 10 pole, if we go over there, that's the on- 11 demand access to the full catalogue on a 12 track-by-track basis. Correct?</p> <p>13 A Yes.</p> <p>14 Q And then in-between you can have 15 different levels of interactivity and 16 demandness. Correct? And that sort of falls 17 in that middle range of the spectrum. 18 Correct?</p> <p>19 A It's in-between the two poles. 20 It's not -- I wouldn't say it's the absolute 21 midpoint. It was really for illustrative 22 purposes, so you have on-demand, you have</p>
<p style="text-align: right;">Page 241</p> <p>1 terrestrial radio, and then you have hybrids, 2 or various types of services in-between. And 3 the range -- they could be plotted out at all 4 different points along that functionality 5 spectrum.</p> <p>6 Q Okay. Let's go to the top of the 7 second page of the memo. And do you see where 8 you specifically talk about the simulcast, 9 which I believe you indicate "mirror 10 traditional radio as we know it." Do you see 11 that discussion?</p> <p>12 A Yes.</p> <p>13 Q And am I correct that in your memo 14 to the top executives, you actually underscore 15 the following sentence: "Thus, simulcast can 16 be considered complimentary to a record 17 company's effort in promoting new releases, 18 and familiarizing record buyers through 19 repetition." Correct?</p> <p>20 A I wrote that.</p> <p>21 Q And underscored it.</p> <p>22 A Yes.</p>	<p style="text-align: right;">Page 242</p> <p>1 Q Okay. Now when we get down to the 2 middle section, we get to the compulsory 3 licenses, the non-interactive versus voluntary 4 licenses interactive. Do you see that?</p> <p>5 A Yes.</p> <p>6 Q Okay. In the paragraph that 7 follows that, you discuss a series of very 8 specific functionality rules designed to keep 9 programming more tightly aligned to the left 10 pole, that's the terrestrial radio pole than 11 the right pole of the spectrum. Correct?</p> <p>12 A That's what I wrote.</p> <p>13 Q Okay. And what you're discussing 14 there are the so-called is it compliment 15 rules? I always get this confused, the rules 16 that are imposed upon satellite radio and 17 certain DCMA-compliant webcasters that limit 18 the number of tracks for a particular album or 19 artist that can be played, would prohibit 20 publishing play lists in advance, and which 21 requires those services to prominently display 22 the song title. Correct?</p>

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1 A I was describing the difference
 2 between a compulsory license under 114, and
 3 voluntary licenses that don't have those
 4 restrictions by virtue of statute.
 5 Q Okay. But those restrictions by
 6 virtue of statute, those are the ones that
 7 you're referring to as specific functionality
 8 rules designed to keep the programming more
 9 tightly aligned with the left pole of the
 10 terrestrial pool. Correct?
 11 A That's the intention of the
 12 restrictions in the statute, I believe.
 13 MR. WYSS: Okay. Your Honor, we
 14 would -- did I offer number 19 into evidence?
 15 CHIEF JUDGE SLEDGE: No, sir.
 16 MR. WYSS: Your Honor, I would
 17 offer SDARS Exhibit 19 into evidence.
 18 CHIEF JUDGE SLEDGE: Are you going
 19 to tie it to the present?
 20 MR. WYSS: I'm going to tie it --
 21 yes, I am. I'm going to take it right up
 22 through the functionality analysis as applied

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1 CHIEF JUDGE SLEDGE: Just like
 2 Exhibit 18, this without objection will be
 3 admitted, subject to tying it to the present.
 4 (Whereupon, SDARS
 5 Exhibit No. 19 was
 6 admitted.)
 7 BY MR. WYSS:
 8 Q Mr. Eisenberg, I'd now like to
 9 apply the functionality spectrum analysis that
 10 you described in SDARS Exhibit 19, and I'd
 11 like to start with terrestrial radio, if I
 12 could. Am I correct that terrestrial radio
 13 provides a music discovery service to its
 14 listeners?
 15 A I believe there's probably an
 16 element of music discovery to certain radio
 17 stations. It depends on how heavily they're
 18 targeting a particular track, and working with
 19 the record company to do so. There are other
 20 radio stations which don't provide that sort
 21 of targeted marketing effort, so I think it
 22 depends on what exactly they're doing to

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1 to this service, and the other competing
 2 services.
 3 CHIEF JUDGE SLEDGE: Any
 4 objection?
 5 MR. DeSANCTIS: Yes, Your Honor.
 6 There is information in this document
 7 referring to the current rate that XM and
 8 Sirius are paying, which XM and Sirius have
 9 agreed not to introduce into evidence in this,
 10 or any other proceeding. It's something that
 11 came up in the webcasting case, and I think it
 12 was honored there, and I would object to this,
 13 or at least that portion of this document
 14 going into evidence for that reason.
 15 CHIEF JUDGE SLEDGE: Mr. Wyss.
 16 MR. WYSS: I'm prepared to redact
 17 that out, Your Honor. I apologize. And we
 18 will prepare a redacted version that takes out
 19 the two lines that counsel is referring to.
 20 MR. DeSANCTIS: With that, I would
 21 withdraw my objection to the admissibility of
 22 the evidence.

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1 stimulate the sale of a particular artist's
 2 recording that we're trying to sell into the
 3 marketplace.
 4 Q Am I correct that terrestrial
 5 radio also helps promote the sale of new sound
 6 recordings?
 7 A I'm not sure on a generalized
 8 basis you can say that. I think there are
 9 certain things about terrestrial radio that
 10 may be promotional, and there are certain
 11 things that are substitutional, even with
 12 terrestrial radio. If you have a programming
 13 block on Sunday morning of acoustic
 14 performances by a particular artist with no
 15 commercial interruption, I would call that
 16 substitutional, and not promotional.
 17 Q Terrestrial radio is
 18 substitutional. Correct?
 19 A Terrestrial radio can be
 20 substitutional as well, yes.
 21 Q All right. And when you're
 22 talking about on the functionality spectrum,

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1 with respect to terrestrial radio, you don't
 2 know when a particular song or artist is
 3 coming up - correct - in general?
 4 A Sometimes they pre-announce
 5 certain artists or certain recordings that are
 6 going to be up in the next hour. They
 7 probably don't publish a play list in advance
 8 track-by-track, but they will give you a sense
 9 of what's coming up in their play list from
 10 time to time.
 11 Q Okay. In terms of interactivity,
 12 am I correct that terrestrial radio, putting
 13 side the call-in show if you're the 87th
 14 person who can get through, put that aside,
 15 there's no ability for the listener to control
 16 the sequence of the songs that he's going to
 17 hear on terrestrial radio. Correct?
 18 A Well, you can channel surf, if
 19 you're de facto interactivity, if you don't
 20 like the song, you go to the next channel.
 21 Q If I want to listen to a
 22 particular Linda Ronstadt song, there's no way

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1 THE WITNESS: It is. That is what
 2 I refer to still as a broadcast, so they're
 3 playing a song for -- that's requested by a
 4 single user, but everybody hears that song at
 5 the same time. It's not a one-to-one, what we
 6 call a unicast in internet terms. And I think
 7 what counsel was --
 8 CHIEF JUDGE SLEDGE: What is
 9 unicast?
 10 THE WITNESS: It's a type of
 11 interactivity.
 12 CHIEF JUDGE SLEDGE: That's not
 13 the question you asked. That's your
 14 interpretation of the question.
 15 THE WITNESS: Okay.
 16 CHIEF JUDGE SLEDGE: But the
 17 question he asked was, does terrestrial radio
 18 have on-demand play lists.
 19 THE WITNESS: Right.
 20 CHIEF JUDGE SLEDGE: Certainly,
 21 they often do.
 22 THE WITNESS: That is correct.

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1 I can go to terrestrial radio and channel
 2 surf, and guarantee I'm going to hear that
 3 song, is there?
 4 A Probably not a guarantee of a
 5 particular track.
 6 Q Okay. So there's no
 7 interactivity, certainly nothing like what we
 8 get with all these subscription services where
 9 you have on-demand access to the entire
 10 catalogue. Correct?
 11 A You cannot on terrestrial radio
 12 pick a particular track to listen to at a
 13 particular time.
 14 Q And when you're listening to --
 15 CHIEF JUDGE SLEDGE: That's a
 16 strange answer. I've certainly listened to an
 17 awful lot of terrestrial radio where the disc
 18 jockey takes calls over the telephone for
 19 requests, and plays those requests.
 20 THE WITNESS: Yes.
 21 CHIEF JUDGE SLEDGE: That's an on-
 22 demand playing of a song, isn't it?

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1 BY MR. WYSS:
 2 Q Now on terrestrial radio, as part
 3 of the normal service, you don't get a
 4 permanent copy of the sound recording when
 5 it's played. Correct? That's not built into
 6 the terrestrial radio. Right?
 7 A It might be in the device. The
 8 broadcaster doesn't offer that type of
 9 service, but the device may capture the sound
 10 recording.
 11 Q Okay. But the broadcaster doesn't
 12 offer that service.
 13 A I don't believe they do.
 14 Q Okay. And the broadcaster doesn't
 15 offer you a copy that you can access at a
 16 later time. Correct?
 17 A Well, they do if you tape it, but
 18 they're not -- it's really the electronic
 19 equipment that is responsible for capturing
 20 it, as opposed to the broadcaster who's
 21 providing you the service of capturing the
 22 track.

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1 Q And am I correct that terrestrial
 2 radio does not pay you any royalties for its
 3 playing of sound recordings?
 4 A In the United States, they do not.
 5 Q Okay. And is it also true that
 6 there's no exclusivity with respect to
 7 terrestrial radio; once you've released the
 8 song and they play it, they can play whatever
 9 they want. You can't negotiate exclusivity
 10 with terrestrial broadcasters.
 11 A We do not have a sound recording
 12 performance right in analog broadcasts in the
 13 United States, so there's no right to
 14 remuneration, nor is there any exclusivity by
 15 virtue of that.
 16 Q Okay. And terrestrial radio can
 17 be used portably and wirelessly. Correct?
 18 A Yes.
 19 Q You have it in your car. My wife
 20 once gave me an FM radio I could swim laps
 21 with. You can use it just about anywhere.
 22 Correct?

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1 station gets three extra channels. Right?
 2 A I believe so.
 3 Q Okay. And each one of those can
 4 program it however it wants. Right? Those
 5 three extra channels, so whatever the existing
 6 number of broadcast channels are, you multiply
 7 that by three, and you get the potential
 8 number of HD channels. Correct?
 9 A In a local market.
 10 Q Okay. Now let's look at satellite
 11 radio, and apply your spectrum functionality
 12 analysis. On satellite radio, you don't know
 13 when a particular song or artist is going to
 14 be played. Correct?
 15 A They have very specific genres, so
 16 you can have a good sense of which types of
 17 artists are going to be played. In XM, for
 18 example, they have that station called "20 on
 19 20", which are the top 20 hits. So, again,
 20 you have a sense of what the top 20 are by the
 21 previous days results, so you do have a sense
 22 within that hour or so on XM what's coming up.

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1 A Yes.
 2 Q All right. And in terms of the
 3 quality, the new HD radio services, that's
 4 digital quality. Correct?
 5 A I don't know if those receivers
 6 are the portable ones that you're describing
 7 in the swim lane. I mean, very few --
 8 Q No, that's not the one I was
 9 describing, but the new HD service is going to
 10 be a high quality service, commercial-free.
 11 Correct?
 12 A When you say "high quality",
 13 you're talking about fidelity?
 14 Q Yes.
 15 A The audio quality?
 16 Q Yes.
 17 A The audio quality will be better
 18 than AM or FM. The service offering will not
 19 be as broad, as let's say XM or Sirius,
 20 because they're not going to have as many
 21 channels on the spectrum.
 22 Q Well, each local terrestrial

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1 Q That's on the 20 by 20, but in
 2 terms of all the other ones with deep play
 3 list that you talked about, you said that - am
 4 I correct - that you just don't know when a
 5 particular artist or song is going to be
 6 played. Correct?
 7 A The artist you will have a sense,
 8 based upon the genre that is described in the
 9 station guide. You may not know what specific
 10 recording is coming up, but you know that
 11 Sheryl Crow is not going to be in the Hair
 12 Band's channel.
 13 Q Okay. But, in fact, is there not
 14 a specific prohibition on satellite radio to
 15 announce in advance what the next song is
 16 going to be?
 17 A The restrictions that you talked
 18 about before in terms of a published play
 19 list, that's published in advance applies to
 20 satellite radio.
 21 Q And that does not apply to
 22 terrestrial radio, does it?

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1 A Correct.

2 Q So in that sense, satellite radio

3 is less substitutional than terrestrial radio

4 in the sense that they can't publish a play

5 list in advance. Correct?

6 A It's different functionality. I'm

7 not sure it falls -- that's actually less

8 substitutional or more substitutional. It's

9 a different functionality, in determining

10 whether it's more or less substitutional, I

11 think you would look at a variety of factors.

12 Q Now in terms of interactivity,

13 satellite radio is no different than

14 terrestrial radio in terms of interactivity or

15 on-demand. There may be some call-in shows,

16 but there's no way that the majority of

17 listeners can control what they're going to

18 hear coming up in the future. Correct?

19 A You're not able to pick particular

20 tracks on-demand, except for the call-in shows

21 that you talked about. You do have narrowly

22 tailored channels, which kind of limit the

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1 of the sound recordings. Correct? The

2 service that's at issue in this proceeding.

3 A The services are not permitted to

4 provide end-users with a permanent copy.

5 Q And in terms of music discovery,

6 am I correct that satellite radio is even

7 better than terrestrial radio in that every

8 time they play a song down across the bottom

9 it tells you what the name of the song is, who

10 the artist is, and if you like it, you are now

11 armed with the information you would need to

12 go and log onto iTunes and purchase that song.

13 Correct?

14 A Under Section 114, there's a set

15 of requirements that are imposed upon

16 statutory licensees. One of those is to

17 display the name of the album and the artist.

18 Q And unlike terrestrial radio,

19 satellite radio does pay royalties to

20 SoundExchange. Correct?

21 A Yes.

22 Q Okay. And am I correct that every

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1 amount or the types of repertoire that you're

2 going to hear, but that is not the same as an

3 on-demand selection track-by-track, but it

4 still is substitutional, I believe.

5 Q Yes, but even the one I think you

6 mentioned, Sheryl Crow, you don't know when

7 Sheryl Crow is going to come up. You're going

8 to have to sit there and listen, and it might

9 be eight hours later. Correct?

10 A I don't think it's eight hours

11 later. I mean, I think they have very

12 narrowly tailored channels within satellite

13 radio, and you have a good hunch of - if

14 you're listening for a three-hour block and

15 you have a prominent artist, either a deep

16 catalogue high profiled artist or a new

17 released high profiled artist, you have a

18 sense that will come up.

19 Q In terms of getting a permanent

20 copy, satellite radio is the same as

21 terrestrial radio, in that as part of this

22 service, you don't get a permanent copy of any

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1 listener that satellite radio attracts away

2 from terrestrial radio is money that you

3 wouldn't otherwise have. Correct?

4 A To the extent there's some type of

5 royalty that's coming into SoundExchange by

6 virtue of the listen, that is correct.

7 Q Okay. And for satellite radio,

8 you've got to pay - unlike terrestrial radio,

9 you've got to pay for it. Right?

10 A There's a monthly fee that the

11 satellite radio companies charge their users

12 to subscribe to the service.

13 Q I think it's \$12.95 now, and for

14 that you get Howard Stern, sports, NFL, talk,

15 music program channels, all that is part of

16 the package. Correct?

17 A I think it depends on which

18 service. Each of the services offers about 70

19 channels of commercial-free music, and then

20 they have certain supplemental channels, as

21 well. But the basic package for each of these

22 services is about 70 channels of commercial-

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1 free music.

2 Q Okay. And if you don't want to

3 pay \$12.95, you could always flip back to your

4 car AM-FM radio, and get all the music that's

5 available there for free. Correct?

6 A Or you could buy a CD, or buy a

7 digital download, or sign up to Napster.

8 There's a lot of different choice that a

9 consumer has to acquire music.

10 Q Looking at the deals that you

11 talked about, am I correct that in all of the

12 different categories, your deals with iTunes

13 and with the major subscription services,

14 isn't it true that all of those companies

15 offer repertoire from all four of the major

16 record label companies?

17 A I'm sorry, which services are you

18 referring to?

19 Q All of them on your chart. And

20 let's talk - on the permanent downloads, the

21 Verizons, the cell phones, the wireless, the

22 various subscription services, all of the

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1 labels as part of what they're offering their

2 customers?

3 A Don't know what you mean by

4 "promote".

5 Q You can get all the music in the

6 world.

7 A Do they sell?

8 Q Yes.

9 A Again, the ones that we've

10 licensed or done deals with most likely have

11 in their catalogue music from all major

12 labels, but there may be exceptions.

13 Q Okay. Now Sony has the exclusive

14 rights to sound recordings for the Sony

15 artists - correct - that you mentioned, like

16 Bob Dylan, Bruce Springsteen, Dixie Chicks,

17 Justin Timberlake, Whitney Houston. You have

18 the exclusive rights to those sound

19 recordings. Correct?

20 CHIEF JUDGE SLEDGE: I'm not sure

21 in your question, are you referring to those

22 people you mentioned, or -- your first

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1 major ones offer repertoire from all four

2 labels. Correct?

3 A The major services, but there may

4 be services out there that don't offer all

5 four majors content. In fact, there was a

6 service, cell phone service by the name of

7 AMP, that --

8 Q I was only asking about the major

9 ones. Am I correct that all the major

10 services, the ones that generate the revenues

11 for you, offer repertoire from all four major

12 labels.

13 A Well, AMP was considered a major

14 aggregator, and it didn't have Sony-BMG

15 repertoire. All of the ones that we've

16 licensed to, or have done deals with, most

17 likely had repertoire from the other majors,

18 as well, but there are exceptions from time to

19 time.

20 Q And isn't it true that all of the

21 major services that you license promote the

22 wide availability of music from all four major

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1 question was all Sony artists.

2 MR. WYSS: Yes, in general, the

3 Sony artists who are signed with your label.

4 BY MR. WYSS:

5 Q When you make a sound recording,

6 you get the exclusive rights to their sound

7 recording. Correct?

8 A Generally speaking, that is the

9 case. There are exceptions, as to whether or

10 not we have digital rights with respect to all

11 of our artists, and there are certain artists

12 that have the ability to create their own, for

13 example, live versions of tracks, if they do

14 a show, and they create their own digital live

15 record. Some are permitted to do that under

16 our deals.

17 Q Okay. But for the ones where

18 you've got the exclusive rights to, if a

19 company like iTunes, or one of these

20 subscriptions, wants to get a license to carry

21 the Sony artist, they have to come to you to

22 get that license. Correct?

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1 A If iTunes wants a catalogue
 2 license, or iTunes is not a license, it's
 3 sales agreements, but if they want rights to
 4 sell our artists' recordings, they could come
 5 to us.
 6 Q Okay. And if they don't like your
 7 prices and terms, your 40 percent, 62 percent,
 8 they can't go to Universal or Warner and get
 9 the rights to those Sony artists, can they?
 10 MR. DeSANCTIS: Objection. Your
 11 Honor, I'm not sure where this is going, but
 12 certainly, there was nothing in the direct
 13 testimony, nor in his written testimony about
 14 exclusive contracts with artists, so I would
 15 object to this continuing line of questioning.
 16 CHIEF JUDGE SLEDGE: Mr. Wyss.
 17 MR. WYSS: Your Honor, just a
 18 simple point, that as we analyze these deals,
 19 these deals are presented to the potential
 20 subscriber as if you want this, you've got to
 21 take my deal. And that there's no competition
 22 among the labels on price, or any way else, in

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1 interactive. The customer gets to select
 2 precisely what he wants to buy when he
 3 purchases it. Correct?
 4 A Yes.
 5 Q And he gets a permanent copy.
 6 Correct?
 7 A Yes.
 8 Q And he can listen to it any time
 9 he wants. Correct?
 10 A If he changes computers more than
 11 three times, then perhaps they may not be able
 12 to listen to that in perpetuity. There are
 13 certain limitations based upon technology, so
 14 it may not be in perpetuity, unless he's
 15 continuing to use the same device or machine.
 16 Q As long as he continues to use the
 17 same device, he can use it. Right?
 18 A Yes.
 19 Q Okay. And isn't it correct that
 20 the download sales, these are at that far left
 21 - I'm sorry - the far right pole of your
 22 functionality analysis, that these are highly

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1 terms of whether they're going to negotiate a
 2 "market deal" for any particular terms.
 3 CHIEF JUDGE SLEDGE: That's far
 4 outside of any direct testimony. Objection
 5 sustained.
 6 BY MR. WYSS:
 7 Q Let's talk about your download
 8 sales category on your chart, if we could.
 9 And I want to look at the functionality
 10 spectrum, as discussed in your earlier memo
 11 for that. Isn't it correct that the download
 12 sales are a very, very large percentage of
 13 your digital revenues?
 14 A Which box are you referring to?
 15 Q Permanent audio downloads.
 16 A Right. It's about, probably about
 17 60 percent of our digit revenue last year.
 18 Q Okay. And a permanent audio
 19 download is really the purchase of the music.
 20 Correct?
 21 A Yes.
 22 Q Okay. And it is fully

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1 substitutional for the sales of CDs?
 2 A Yes.
 3 Q Okay. And that's about as far
 4 away from the terrestrial radio broadcast on
 5 your spectrum scale as you can get. Correct?
 6 A It's highly substitutional. As I
 7 said before, terrestrial radio, depending on
 8 the programming, could be highly
 9 substitutional, as well. It depends on what
 10 the programming is like. If you have
 11 commercial-free kind of archival recordings
 12 that are often offered to users or to
 13 listeners on Sunday morning broadcast, those
 14 are very, very substitutional for special
 15 packages that we create and sell either as
 16 downloads or as CDs, so it depends. The
 17 functionality spectrum isn't an all-or-nothing
 18 proposition, depending on which service you're
 19 in. It slides back and forth, depending on
 20 the type of programming that you're involved
 21 in at any given time.
 22 Q And you have to look at all the

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1 different factors, functionality factors that
 2 we've been talking about. Correct?
 3 A And other ones, as well.
 4 Q Okay. Now looking at your chart
 5 on the three blocks that are wireless full-
 6 length audio downloads, wireless ring tones,
 7 and wireless ring back tones. Correct? Do
 8 you see those?
 9 A Yes.
 10 Q Okay. In each case, is it not
 11 correct that the consumer is getting -- well,
 12 first of all, that it's fully interactive.
 13 The customer selects exactly what he wants to
 14 download, either as a full-length audio
 15 download, or as a ring tone, or a ring back
 16 tone. Correct?
 17 A Yes.
 18 Q And he gets either a permanent
 19 copy, or a copy for at least for several
 20 months or longer for when he makes any of
 21 those purchases. Correct?
 22 A Again, the caveat being permanent

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1 is the second largest hunk of your revenue,
 2 about 40 percent comes from these audio
 3 downloads, or ring tones, or ring backs from
 4 the cellular carriers. Correct?
 5 A We're at 100 percent if you take
 6 60 percent for permanent, so there's still
 7 some left over for video streaming, and for
 8 some other services, so I think that -- if you
 9 want to do it relatively, the permanent
 10 downloads are the highest percentage of our
 11 digital revenues, the wireless components that
 12 you described are probably second highest
 13 category or categories, and then you have on-
 14 demand subscription services, portable and
 15 non-portable video streaming, and various
 16 other types of digital activity rounding out
 17 to 100 percent.
 18 Q Let me just focus on the wireless
 19 full-length audios. Am I correct that that is
 20 a very, very small business for you?
 21 A It's a growing business.
 22 Q I'm sorry?

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1 on a cell phone that's bound by your -- the
 2 life span of that device, so if you download
 3 a permanent download to a Motorola handset,
 4 and 18 months later you discard that handset,
 5 you may not have access to that download any
 6 longer, the same ring tones, and with respect
 7 to ring backs, they all expire after a certain
 8 period of time, ranging from three months to
 9 12 months.
 10 Q But in terms of the ring tone
 11 downloads, am I correct, not only do you get
 12 the music, but also as part of the \$2.50, is
 13 that the retail price you quoted?
 14 A Yes.
 15 Q As part of that, not only do you
 16 get the music, but you get it integrated in so
 17 that it actually rings when you want it to
 18 ring, and everybody can hear it all over the
 19 place. Correct?
 20 A It's downloaded to your handset,
 21 and it plays when your phone rings.
 22 Q Okay. And am I correct that this

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1 A It's a growing business. These
 2 services have just launched.
 3 Q Right. But right now, it is a
 4 very, very small business for you.
 5 A Relative to our total digital
 6 revenue?
 7 Q Yes.
 8 A Yes.
 9 Q Now all of your wireless deals,
 10 the cell phone companies, they didn't build
 11 their networks strictly to deliver audio
 12 entertainment, did they?
 13 A I don't work for a wireless
 14 company. I don't know what their designs
 15 were.
 16 Q Well, you know they built their
 17 systems to deliver cell phone calls for
 18 people. That's how they sold their networks.
 19 Correct?
 20 A Well, they have voice systems, and
 21 they have what they call data systems. And
 22 data doesn't work on the same pipe, so to

<p style="text-align: right;">Page 271</p> <p>1 speak, as the voice.</p> <p>2 Q Right. And they added the data</p> <p>3 system so that you could get your email, and</p> <p>4 text messaging, and Blackberry. Correct?</p> <p>5 A And music, and other types of</p> <p>6 video services.</p> <p>7 Q Well, the music has only come just</p> <p>8 very, very recently. Correct? After they</p> <p>9 already had built it out for Blackberries and</p> <p>10 text messaging. Correct?</p> <p>11 A I don't know. I don't work for a</p> <p>12 phone company. I would imagine that they were</p> <p>13 envisioning music as part of that data package</p> <p>14 that they were going to sell to the consumers,</p> <p>15 and that it wasn't an after-thought after they</p> <p>16 built the pipes.</p> <p>17 Q But after they had built the pipes</p> <p>18 and had it all set up, then they came to you</p> <p>19 and said gee, we might add music as something</p> <p>20 that might attract people. Correct?</p> <p>21 A No. I mean, there's been dialogue</p> <p>22 with the companies over time about offering</p>	<p style="text-align: right;">Page 272</p> <p>1 music services throughout the years. And one</p> <p>2 of the challenges is penetration in the</p> <p>3 marketplace for 3G data services, and for</p> <p>4 handsets that are equipped to actually play</p> <p>5 the music, so you have to wait until there's</p> <p>6 a high enough penetration in the marketplace</p> <p>7 on the technology side before they can</p> <p>8 actually introduce these services.</p> <p>9 Q Are you aware that Sprint is now</p> <p>10 selling full downloads, single-track downloads</p> <p>11 for 99 cents over the cell phones?</p> <p>12 A Yes.</p> <p>13 Q Okay. And is that the exact same</p> <p>14 price that Apple charges for its tethered</p> <p>15 downloads?</p> <p>16 A Well, Apple's downloads are not</p> <p>17 tethered, they're -- in the sense -- I just</p> <p>18 want to use the terminology correctly. It's</p> <p>19 an on-line download which you then can use on</p> <p>20 a portable basis.</p> <p>21 Q Right.</p> <p>22 A But you're making a purchase</p>
<p style="text-align: right;">Page 273</p> <p>1 through the computer.</p> <p>2 Q Okay. But in any case, for buying</p> <p>3 a single-track download over Sprint for 99</p> <p>4 cents, that's the same thing you get for a</p> <p>5 single-track download from Apple or some of</p> <p>6 these other online stores. Correct?</p> <p>7 A Sprint has reduced their retail</p> <p>8 price from \$2.49 or so, \$2.49 or \$2.50 down to</p> <p>9 99 cents for a certain promotional campaign</p> <p>10 that they're running currently.</p> <p>11 Q Okay. And have the Sprint people</p> <p>12 told you that other major labels have dropped</p> <p>13 their mobile price from somewhere up around</p> <p>14 \$1.25 down to the 70 cent level, which is</p> <p>15 pretty standard for Apple in the business?</p> <p>16 A They tell us a lot of things to</p> <p>17 try to negotiate our prices downward. That's</p> <p>18 one of the things, they told us our prices are</p> <p>19 high, and they've asked for some relief on our</p> <p>20 wholesale price.</p> <p>21 Q Haven't they specifically told you</p> <p>22 that other labels have dropped their wholesale</p>	<p style="text-align: right;">Page 274</p> <p>1 price to 70 cents?</p> <p>2 A They haven't told me what the</p> <p>3 other labels are charging. They've asked us</p> <p>4 for relief on the wholesale price, and we're</p> <p>5 in discussions with them to potentially give</p> <p>6 them some relief in exchange for other</p> <p>7 financial considerations.</p> <p>8 Q Okay. And at your deposition, you</p> <p>9 were still in those discussions, you hadn't</p> <p>10 made a decision yet whether you were going to</p> <p>11 give them relief?</p> <p>12 A There are a bunch of trade-offs,</p> <p>13 or a series of trade-offs that we would make,</p> <p>14 if we gave them relief on a per-unit basis, or</p> <p>15 over-the-air downloads for a limited period of</p> <p>16 time, we would have to get something in</p> <p>17 return. And we're talking about financial</p> <p>18 guarantees beyond their current run rate, well</p> <p>19 in excess of their current run rate, for</p> <p>20 permanent download, we're talking about</p> <p>21 carriage of video services that we want to</p> <p>22 offer on their television application, on the</p>

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1 phone, we'd be offering long-form videos, pay-
 2 per-view videos, a streaming channel, and a
 3 series of other types of content that would
 4 essentially make up for the shortfall on the
 5 per-unit price.
 6 Q Okay. But at least at the time of
 7 this hearing, you haven't made a final
 8 decision yet whether you're going to drop it
 9 down so they can make money on their 99 cent
 10 sales. Correct?
 11 A They still might not make money on
 12 those 99 cents sales. We haven't locked into
 13 a price. It may be a lost leader for them,
 14 but maybe they won't lose as much on every
 15 download as they otherwise would if we were at
 16 \$1.25.
 17 JUDGE ROBERTS: Mr. Eisenberg,
 18 have you made a decision yet? I mean, has the
 19 company made a decision yet?
 20 THE WITNESS: If we get the
 21 concessions from them, we're willing to drop
 22 our price.

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1 chain.
 2 Q Now on your chart, the first two
 3 boxes where you talk about a non-portable and
 4 portable subscription, and you use the term
 5 "streaming" there. Correct?
 6 A Yes.
 7 Q Okay. Isn't it true that all of
 8 the major subscription services that you've
 9 included here on this box include an on-demand
 10 component, a fully interactive, on-demand
 11 component?
 12 A As one of the components that they
 13 offer? Yes.
 14 Q Okay. So it's not really fair to
 15 call it a subscription streaming service. It
 16 would probably be more accurate to call it a
 17 subscription service that includes a fully
 18 interactive on-demand service. Correct?
 19 A Well, they offer both kinds of
 20 functionality, what I would call a pre-
 21 programmed experience, which is a play list
 22 that may be selected by the service, or may be

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1 JUDGE ROBERTS: So the answer is
 2 no, right now.
 3 THE WITNESS: The answer is we
 4 don't have a final document reflecting an
 5 agreement.
 6 JUDGE ROBERTS: All right.
 7 BY MR. WYSS:
 8 Q Am I correct that for all of the
 9 downloads, that you, Sony, when you get money
 10 for one of these downloads, you still have to
 11 pay the mechanical fee for that. Correct?
 12 A For any type of permanent audio
 13 download? Yes.
 14 Q Right. So, in other words, the
 15 money you get from Apple or from Verizon for
 16 the permanent downloads, you don't get to keep
 17 all of that. You have to pay over to someone
 18 else a portion of that revenue for mechanical
 19 fees. Correct?
 20 A We pay artist royalties, we pay
 21 mechanicals, we pay the unions. There are
 22 several different participants in the revenue

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1 selected by the end-user, and an on-demand
 2 component, which allows the user to pay track-
 3 by-track. Each of these services offers both
 4 sets of functionality to the end-user, and
 5 end-users have different desires. Some may be
 6 more passive, and they want a play list
 7 functionality, or a programming decision to be
 8 made by a service, and others may want a more
 9 active participation.
 10 Q But the deals you're talking about
 11 here, every one of these deals includes an on-
 12 demand functionality. Correct? The major
 13 deals.
 14 A That is one component of the
 15 service, yes.
 16 Q And the subscriber using that can
 17 pick a song, any song he wants. Correct?
 18 A To the extent it's in the
 19 catalogue.
 20 Q Right. And he gets to pick what
 21 he wants to hear, when he wants to hear it, as
 22 part of those deals. Correct?

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1 A That is a component of the
 2 service.
 3 Q And as long as he continues the
 4 subscription, he can continue to listen on his
 5 portable device any time - and I say "he", it
 6 could be he or she, any time they want to call
 7 up a song, they can bring it right up. Right?
 8 A For the second tier, the portable
 9 subscription streaming you're talking about?
 10 Q Yes.
 11 A Yes, you could either select
 12 tracks on-demand, or have a pre-programmed
 13 play list that's generated.
 14 Q Okay. And as long as you continue
 15 to subscribe, the subscriber has this fully
 16 interactive capability, if he wants to invoke
 17 it. Correct?
 18 A Yes.
 19 Q And on your -- would you agree
 20 that if you can listen to a track whenever you
 21 want, it has a substitutional effect for the
 22 purchase of that track on a permanent basis?

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1 A About 2 million.
 2 Q Two million total?
 3 A Two million total.
 4 Q To Rhapsody and Napster, which are
 5 the two biggest.
 6 A Well, you're missing one. There's
 7 AOL service, which is called AOL Music Now.
 8 Those subscribers were actually purchased by
 9 Napster, and I have to look back at the
 10 exhibit to make sure I didn't leave anybody
 11 out, but the major on-demand subscription
 12 services have about 2 million subscribers, but
 13 only a portion of those are portable
 14 subscribers, about 350,000 of those are
 15 portable subscribers, and the remainder are
 16 non-portable subscribers.
 17 Q And isn't it true that the various
 18 on-demand subscription services that fit in
 19 those first two boxes up there haven't been
 20 very successful, in your view?
 21 A Well, they haven't garnered a lot
 22 of subscribers.

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1 A Among other things, yes.
 2 Q Okay. And so when we look on your
 3 spectrum of functionality, you have this on-
 4 demand capability, this is way over at the
 5 right pole of your spectrum where it can be
 6 substitutional for the purchase of music.
 7 Correct?
 8 A As one of the services, or one of
 9 the types of functionality that is on the
 10 right side of the pole.
 11 Q Now, by the way, how many
 12 subscribers do you currently have who
 13 subscribe to Napster and Rhapsody, which I
 14 think are your two biggest subscription
 15 services?
 16 A Yes. Sony-BMG does not operate
 17 the service. We're just a content provider,
 18 so Napster, and Rhapsody, and Yahoo!, they run
 19 their own services, but I believe the number,
 20 if you roll it all together, is about 2
 21 million subscribers to those services.
 22 Q About how many?

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1 Q And isn't it part of your view
 2 that they are still stagnating, that the 2
 3 million is a -- stagnating at that level.
 4 Correct?
 5 A Well, I wouldn't call it
 6 stagnating. They are growing. We would love
 7 to see it as -- to have as many subscribers as
 8 satellite radio, for example. If they had 14
 9 or 15 million subscribers, that would be
 10 terrific for us. Right now, they're not there
 11 yet.
 12 Q Okay. And they haven't been there
 13 for -- how long have they been in business
 14 now?
 15 A Probably in the early 2000 range,
 16 and then portability was really just as aspect
 17 of the market that just opened up over the
 18 last couple of years.
 19 Q On your chart, and I don't want to
 20 read it, there's a -- in your first box, the
 21 per-subscriber per month number on the top
 22 line. Do you see that?

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1 A Yes.

2 Q Does that include the Napster-Sony

3 agreement?

4 A Pre-merger? Are we in --

5 Q I'm sorry. Isn't it a fact that

6 there is an existing agreement that still is

7 out there that pays less than the range that

8 you have there on a per-subscriber per month

9 basis?

10 A I'm sorry.

11 THE WITNESS: Your Honor, I just

12 wanted to ask if we were in closed session at

13 this point?

14 CHIEF JUDGE SLEDGE: We are not,

15 have not been.

16 MR. DeSANCTIS: I would like to

17 move that we go into closed session, so that

18 Mr. Eisenberg can answer the questions fully

19 with numbers, if that's what Mr. Wyss is

20 looking for.

21 CHIEF JUDGE SLEDGE: He has not

22 asked that. Denied.

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1 MR. WYSS: Well, he put up a chart

2 that says - I won't read it, but he says from

3 one number to another number per-subscriber

4 per month. And I would like to get into the

5 record that there is a lower number that is

6 not reflected on his chart.

7 CHIEF JUDGE SLEDGE: Mr. Wyss, we

8 covered Exhibit 54 long ago. I'm not going to

9 close the courtroom for you to ask one

10 question that's pretty unrelated to your

11 questioning at this point, just to pull

12 something in. That motion is denied, and the

13 objection to that question is sustained.

14 BY MR. WYSS:

15 Q You mention your video deals on

16 the chart. Correct?

17 A Video streaming, yes.

18 Q And am I correct that all of the

19 video streaming deals include an on-demand

20 fully interactive component as part of the

21 deal?

22 A The deals cover both on-demand

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1 THE WITNESS: We have certain

2 minimums in the Sony Music agreement with

3 Napster, actually, the predecessor of Napster,

4 which was known as Press Play, and then there

5 are some mechanisms to ratchet up the per-

6 subscriber minimum based upon certain market

7 conditions.

8 BY MR. WYSS:

9 Q Okay. But the per-subscriber per

10 month number is substantially less than the

11 range that you show on that first box.

12 Correct?

13 A In one provision of the agreement,

14 that is the case, but there are certain

15 provisions in the agreement that allow us to

16 be paid on a market basis.

17 MR. WYSS: Okay. Your Honor, I

18 would like to get that number in the record,

19 if we could, for what the below the range

20 number that is currently in effect.

21 CHIEF JUDGE SLEDGE: Where is that

22 in cross or direct?

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1 streaming, and pre-programmed streaming, so

2 on-demand is one component of the overall

3 deal.

4 Q Okay. And so, the people who are

5 subscribing to those video services, they have

6 the ability to call up any video, any time,

7 anywhere they want, as part of that service.

8 Correct?

9 A Well, these are not portable

10 services, so it's not any time, anywhere.

11 It's when you're sitting in front of your

12 computer screen, if it's in the menu of

13 available videos, you can call it up, or you

14 can sit back and listen or view one of the

15 pre-programmed play lists.

16 Q Now there's one service that's not

17 mentioned on your chart, and that's the

18 customized radio service. Correct?

19 A Correct.

20 Q Okay. And that was discussed at

21 length in your testimony that you gave in the

22 webcasting proceeding. Correct?

<p style="text-align: right;">Page 287</p> <p>1 A I don't recall how much time we 2 talked about it for.</p> <p>3 Q Okay. But the customized radios 4 included negotiated deals that have a lower 5 revenue share, and lower per-sub per month 6 rates than anything shown on your chart. 7 Correct?</p> <p>8 A The revenue shares in some cases 9 are lower. The per-unit fees are, in some 10 cases, lower, and the per-subscriber varies 11 because they may be offered on an ad-supported 12 basis, in which case there may not be a per- 13 subscriber fee for those types of services.</p> <p>14 Q But in your Launchcast deal, what 15 is the percentage of subscriber revenue for 16 that deal?</p> <p>17 MR. DeSANCTIS: Your Honor, I 18 would ask that the answer to that be in 19 restricted session, if this is, indeed, a 20 current rate.</p> <p>21 CHIEF JUDGE SLEDGE: This refers 22 to which, please?</p>	<p style="text-align: right;">Page 288</p> <p>1 MR. WYSS: This refers to the 2 customized radio deals, Your Honor, which are 3 negotiated in the market, and have lower 4 rates. He didn't include those on the chart. 5 I'm trying to impeach him to show that there 6 was a whole other category of deals that have 7 not been included, that have substantially 8 lower rates.</p> <p>9 CHIEF JUDGE SLEDGE: The motion is 10 granted, and the earlier order denying the 11 motion as to the question in the Napster and 12 Rhapsody non-portable subscription streaming 13 is changed, and that motion to apply the 14 protective order for that question is granted, 15 and the question may be re-asked.</p> <p>16 MR. WYSS: Thank you, Your Honor. 17 (Whereupon, the proceedings went 18 into Closed Session.) 19 20 21 22</p>
<p style="text-align: right;">Page 299</p> <p>1 CHIEF JUDGE SLEDGE: Proceed. 2 MR. WYSS: Thank you, Your Honor. 3 BY MR. WYSS:</p> <p>4 Q In terms of, I think you mentioned 5 the one posting on the XM website, which I 6 think we saw with earlier witnesses. You 7 mentioned that - correct - on direct?</p> <p>8 A Yes.</p> <p>9 Q Okay. And you mentioned 10 competition for consumer spend. Correct?</p> <p>11 A For music, yes.</p> <p>12 Q Okay. But that competition would 13 also include the money that a consumer would 14 spend on video games, on DVDs, on ice cream 15 cones. Correct?</p> <p>16 A I believe there's a certain amount 17 of discretionary spend that a consumer has for 18 different elements of entertainment, music 19 being one, and some of the other items that 20 you mentioned being others.</p> <p>21 Q Okay. Now I want to put aside the 22 XM website, and I want to put aside consumer</p>	<p style="text-align: right;">Page 300</p> <p>1 spend, which might include DVDs, and video 2 games, and other stuff. I'd also like to put 3 aside your personal beliefs, and what I'd 4 really like to focus on - have you seen any 5 quantitative economic analysis that would 6 support a causal connection between listening 7 to satellite radio, and any specific decline 8 in the purchase of music, either digital, 9 physical, or any other?</p> <p>10 A I haven't focused on market 11 studies, if that's your question. I haven't 12 seen market studies.</p> <p>13 Q My question was, have you seen any 14 quantitative economic analysis that would 15 support a causal connection between listening 16 to satellite radio, and any specific decline 17 in the purchase of music, either digital, 18 physical, or other?</p> <p>19 A I haven't seen an analysis that 20 was conducted by a research firm that 21 certainly talked to many of our consumers, and 22 have asked them what their reactions are.</p>

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1 Q Well, what I'm focusing on is,
 2 say, an econometric study that was done for
 3 this proceeding to show whether or not there
 4 is any substitutional effect, at all.
 5 CHIEF JUDGE SLEDGE: Mr. Wyss,
 6 you've changed your question several times --
 7 MR. WYSS: Yes, I did.
 8 CHIEF JUDGE SLEDGE: -- in the way
 9 it's asked, so this is a new question.
 10 MR. WYSS: This is a new question,
 11 Your Honor.
 12 CHIEF JUDGE SLEDGE: That's not
 13 the way you phrased it, but as we understand
 14 it, this is a new question.
 15 MR. WYSS: Yes.
 16 THE WITNESS: I have not viewed an
 17 economic analysis.
 18 BY MR. WYSS:
 19 Q Okay. Have you seen any
 20 quantitative survey analysis that would
 21 support a causal connection between listening
 22 to satellite radio, and any specific decline

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1 A As I said, I have not looked at a
 2 study.
 3 Q Okay. Now you do surveys at Sony.
 4 Correct?
 5 A I do not, no.
 6 Q But Sony itself does surveys.
 7 Correct?
 8 A I would imagine that Sony-BMG does
 9 surveys in our marketing departments. I'm not
 10 part of those surveys.
 11 Q Okay. In your written direct
 12 testimony at page 12, one of the things you
 13 said is you distinguish terrestrial radio from
 14 satellite radio because they have different
 15 genres, like classical, jazz, light Rock `N
 16 Roll, they're not always easy to find on
 17 terrestrial radio. Do you recall that?
 18 A What page of the testimony?
 19 Q On page 12 of your written direct
 20 testimony.
 21 A This is the third paragraph you're
 22 referring to, or the second full paragraph?

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1 in the purchasing of music, whether digital,
 2 physical, or other?
 3 A I have not looked at survey data.
 4 Q Have you seen any third-party
 5 study of any type, whether survey, economic
 6 analysis, or anything else, that would support
 7 a causal connection between listening to
 8 satellite radio, and any specific decline in
 9 the purchase of music?
 10 A In our day-to-day activities at
 11 the company, we ask users what their listening
 12 habits are, and it comes up that satellite
 13 radio is one of the drivers that leads them to
 14 make certain purchase decisions, or not to
 15 make certain purchase decisions. So in those
 16 day-to-day activities, that is how I have
 17 become familiar with the concept of
 18 substitutionality.
 19 Q I think my question focused on any
 20 third-party study, whether survey, economic
 21 analysis, or otherwise, that would support
 22 that causal connection.

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1 Q I believe so. You see paragraph
 2 12, it's at the bottom of the page, "where
 3 they have a range of tastes that might prefer
 4 one genre, such as country, but at times may
 5 also be in the mood for classical, jazz,
 6 blues, light Rock `N Roll, things that are not
 7 always easy to find on terrestrial radio in a
 8 given location." Do you see that?
 9 A Yes.
 10 Q And do you remember at your
 11 deposition, I introduced you to a web service
 12 called Radio Locator. Do you recall that?
 13 A I recall some questions about, I
 14 think Mr. Kenswil's zip code, or something to
 15 that effect.
 16 Q Remember I asked you for your zip
 17 code, as well?
 18 A Yes.
 19 MR. WYSS: Your Honor, I'd like to
 20 now mark as SDARS Exhibit 20 a printout from
 21 the website of Radio Locator, which has in it,
 22 I think the witness will confirm, Mr.

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1 Eisenberg's zip code for his home.
 2 (Whereupon, SDARS
 3 Exhibit No. 20 was
 4 marked for
 5 identification.)
 6 BY MR. WYSS:
 7 Q And do you see that this is a
 8 listing of the 44 radio stations within a
 9 close listening range of Westfield, New
 10 Jersey. Is that your home?
 11 A I live in Westfield, yes.
 12 Q And do you see that the Radio
 13 Locator service provides the frequency, where
 14 to find them, and, in fact, the formats of the
 15 various stations that are available on AM and
 16 FM?
 17 MR. DeSANCTIS: Objection. Your
 18 Honor, counsel is reading from a document
 19 that's not in evidence, and has not been
 20 established whether this witness is at all
 21 familiar with this, so I would object to this
 22 line of questioning unless and until the

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1 think there's any real dispute. This was
 2 covered at his deposition.
 3 CHIEF JUDGE SLEDGE: Do you have
 4 any authority?
 5 MR. WYSS: For you taking judicial
 6 notice? I do not, Your Honor.
 7 CHIEF JUDGE SLEDGE: I thought
 8 not. Any other response?
 9 MR. WYSS: This is impeachment,
 10 Your Honor, which shows in his testimony he
 11 said you can't find it. What this exhibit
 12 shows is that you can go to the web and you
 13 can find all the different formats that are
 14 available in any zip code anywhere in the
 15 country.
 16 CHIEF JUDGE SLEDGE: If it were
 17 admitted, but how -- we're talking about
 18 whether it's admissible. Objection sustained.
 19 BY MR. WYSS:
 20 Q Now on page 8 of your written
 21 direct testimony, you state that "where a
 22 digital delivery service substitutes for

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1 document is admitted into evidence.
 2 CHIEF JUDGE SLEDGE: Mr. Wyss.
 3 MR. WYSS: Your Honor, I'll offer
 4 SDARS Exhibit 20.
 5 CHIEF JUDGE SLEDGE: Any
 6 objection?
 7 MR. DeSANCTIS: Yes, I would
 8 object on the grounds of foundation and
 9 authentication. I don't think it's been
 10 established that Mr. Eisenberg is familiar
 11 with this document, or this service.
 12 CHIEF JUDGE SLEDGE: Mr. Wyss.
 13 MR. WYSS: Your Honor, you can
 14 take judicial notice of this. It comes right
 15 off the web.
 16 CHIEF JUDGE SLEDGE: I can take
 17 judicial notice if something comes off the
 18 web?
 19 MR. WYSS: Yes.
 20 CHIEF JUDGE SLEDGE: Give me
 21 authority for that.
 22 MR. WYSS: If there is -- I don't

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1 another paid uses of recorded music" - I'm
 2 sorry.
 3 MR. WYSS: Excuse me, Your Honor.
 4 I withdraw that.
 5 BY MR. WYSS:
 6 Q On page 8 of your written direct
 7 testimony, you discuss the situation where a
 8 digital delivery service substitutes for other
 9 paid uses of recorded music. Is that correct?
 10 And I think you include examples, such as CDs,
 11 or other royalty-paying digital services.
 12 A Yes.
 13 Q Okay. What about the reverse
 14 situation, where a paid service primarily
 15 substitutes for a non-paid source of music,
 16 isn't that something that you would want to
 17 encourage, because that's more money to you?
 18 A It depends on how much the paid
 19 service is paying us. I mean, you have to
 20 look at the totality effect, the total effect
 21 of substitution. So to say that one effect is
 22 still -- one service is paying a peppercorn

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1 more than terrestrial radio, but substantially
 2 less than iTunes download service, or an on-
 3 demand subscription service, I think it's
 4 still a net loss for us, so we have to look at
 5 the totality of the circumstances in regards
 6 to all of the service offerings that we're out
 7 in the marketplace making.

8 Q Okay. But terrestrial pays
 9 nothing. Every terrestrial radio listener who
 10 comes to satellite radio is money in your
 11 pocket. Correct?

12 A That's assuming that terrestrial
 13 radio user wouldn't otherwise go to a more
 14 lucrative or higher paying service than
 15 satellite radio. It has to look at -- the
 16 overall net effect is what's important to us.

17 Q Let's finish up, and let's look at
 18 the second element, which is the promotional
 19 value. And I think you indicated you've never
 20 worked in the promotion department of a label
 21 before. Correct?

22 A Correct.

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1 documents on this topic, we objected on having
 2 to produce documents that would interfere with
 3 any confidential and ongoing investigation,
 4 and Your Honors sustained that objection. And
 5 I would make the same objection here with
 6 respect to oral testimony given its lack of
 7 relevance to the proceeding.

8 CHIEF JUDGE SLEDGE: Mr. Wyss.
 9 MR. WYSS: I think it's relevant
 10 in the sense that it shows that the
 11 promotional people who are actually trying to
 12 promote records spend millions of dollars. In
 13 fact, they push the envelope of what is
 14 appropriate in order to get songs exposed to
 15 the public on radio.

16 CHIEF JUDGE SLEDGE: Well,
 17 wouldn't that issue only be reached if this
 18 witness were testifying about promotional
 19 activities of Sony, which he said he's not
 20 familiar with?

21 MR. WYSS: Well, but he has
 22 testified here in terms of all sorts of things

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1 Q But you know that the labels have
 2 dozens of people who job it is, is to prepare
 3 marketing plans, and to spend literally tens,
 4 if not hundreds of millions of dollars getting
 5 radios to play music. Correct?

6 A I don't know if they're spending
 7 hundreds of millions of dollars in today's
 8 marketplace, and I don't know if we have
 9 dozens of people any more. We've been laying
 10 off scores of people, so honestly, I don't
 11 know how many people we have left in our radio
 12 promotions department, or how much money we're
 13 spending.

14 Q In fact, you were recently sued,
 15 were you not, by the New York Attorney General
 16 for engaging in illegal payola practices in
 17 order to try to get radios to pay - excuse me
 18 - pay radios to play your songs?

19 MR. DeSANCTIS: Objection.
 20 Objection, Your Honor, this is a topic that
 21 was the subject of motions with respect to the
 22 production of documents. They asked for

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1 about promotion, and that there's no
 2 promotional value for satellite radio. I
 3 intend to ask him questions to show him the
 4 exact marketing plans put together by the
 5 promotional people who treat satellite radio
 6 just exactly like terrestrial radio.

7 CHIEF JUDGE SLEDGE: The objection
 8 is sustained.

9 BY MR. WYSS:
 10 Q In the written direct testimony on
 11 page 12, you talk about -- you attempt to --
 12 am I correct that you attempt to distinguish
 13 satellite radio from terrestrial radio based
 14 on infrequent spins and lack of power
 15 rotations? Is that correct?

16 A I believe that starting from page
 17 10, I talk about a number of differences
 18 between terrestrial radio and satellite radio.
 19 Power rotation is one, DJ chatter, local
 20 appearances by artists and merchandise give-
 21 aways are another. There are a series of
 22 factors that I outlined in my testimony.

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1 Q You weren't trying to suggest that
 2 Sirius and XM don't provide power rotations
 3 that are very beneficial to the sale of your
 4 records, are you?
 5 A Power rotations are helpful in a
 6 way that targets a user to a particular
 7 recording. A simple play of the recording
 8 isn't promotional, in our view, in my view.
 9 And that's what I was trying to lay out in
 10 this document. There may be instances in
 11 which XM and Sirius do engage from time to
 12 time in a power rotation. There are also
 13 instances in which they just offer commercial-
 14 free music, end-to-end, and I think that's
 15 very substitutional.
 16 (Whereupon, SDARS
 17 Exhibit No. 21 was
 18 marked for
 19 identification.)
 20 BY MR. WYSS:
 21 Q Okay. I want to talk about the
 22 power rotations, and I'd like you to please

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1 Jacqueline Saturn is. I know she works in the
 2 promotions department. That's all I can say
 3 about the document.
 4 MR. WYSS: Your Honor, we would
 5 offer SDARS Exhibit 21.
 6 CHIEF JUDGE SLEDGE: Any
 7 objection?
 8 MR. DeSANCTIS: Yes, Your Honor, I
 9 object to its admission. The witness has been
 10 unable to identify this document. It is an
 11 area of the company in which he is not
 12 employed, and certainly, an email being
 13 offered for rather cryptic numbers, an email
 14 communication between two employees is
 15 certainly not a business record of the type
 16 that is admissible, as such, for the truth of
 17 the matters asserted in the document. This is
 18 not a business record, this is a
 19 communication, which this witness was not a
 20 party, and he's been wholly unable to identify
 21 it, so I would object to its admission.
 22 CHIEF JUDGE SLEDGE: Mr. Wyss.

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1 look at an exhibit that we've marked as SDARS
 2 Exhibit 21. And do you recognize SDARS
 3 Exhibit 21 as a collection of emails involving
 4 people at one or more of the Sony labels to
 5 either XM or Sirius, discussing the number of
 6 spins, and the various power rotations that
 7 had been provided?
 8 A No, I don't recognize this
 9 document. I don't believe I've seen it before.
 10 Q Okay. Well, look at the last two
 11 pages, I'm sorry, the last three pages of the
 12 exhibit. And do you recognize that the people
 13 on the to and the from are all Sony-BMG people
 14 on this exhibit that talks about the total
 15 spin leaders on Matis Yahoo?
 16 A Matis Yahoo is the name of the
 17 artist. I've never seen this email before.
 18 Q Okay. But you're not disputing
 19 that this is an internal Sony document
 20 generated in the ordinary course of business,
 21 are you?
 22 A No. I don't know. I know who

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1 MR. WYSS: Your Honor, this is the
 2 witness that was put forward to talk about
 3 promotion and how satellite radio promotes,
 4 and how it is treated. I think these exhibits
 5 show that we are treated exactly like
 6 terrestrial radio. In fact, we've got more
 7 spins than most of the terrestrial radio
 8 stations.
 9 CHIEF JUDGE SLEDGE: What are you
 10 referring to?
 11 MR. WYSS: I'm looking right at
 12 that last -- the one good example is the one
 13 in the last three pages that we talked about,
 14 where you will see that there's a list of
 15 stations, and they give total spins - I'm
 16 sorry. The last digits, Your Honor, are 767
 17 is where it starts. And as you'll see, they
 18 list the stations, they list the total spins.
 19 Those are all terrestrial radio stations,
 20 except for number 2 and number 6, which are
 21 Sirius and XM. And similarly throughout, this
 22 is the promotional people talking about the

<p style="text-align: right;">Page 317</p> <p>1 spins that they are getting, and the power 2 rotations that they are getting on the various 3 satellite radio services, as well as 4 terrestrial. It goes directly to his written 5 testimony in terms of lack of power rotations. 6 CHIEF JUDGE SLEDGE: Where in his 7 written testimony? 8 MR. WYSS: This is the top of page 9 12, where he talks about the infrequent spins, 10 "far from the proven power rotation model, 11 provide little or no promotional value to the 12 companies." 13 CHIEF JUDGE SLEDGE: Mr. Wyss, 14 I've read beginning at Bates stamp 99767- 15 99769, and one, it's incomprehensible to me; 16 and two, I can see no relationship to the top 17 sentence on page 12 to which you've referred 18 me. The objection is sustained. 19 BY MR. WYSS: 20 Q Mr. Eisenberg, just finishing up, 21 I would like you to look at some documents 22 that were actually prepared by the business</p>	<p style="text-align: right;">Page 318</p> <p>1 people whose job it is to sell records, and I 2 would like you to please look at the document 3 that we have marked as SDARS Exhibit 22. 4 (Whereupon, SDARS 5 Exhibit No. 22 was 6 marked for 7 identification.) 8 BY MR. WYSS: 9 Q Do you recognize SDARS Exhibit 22 10 as a Phase 1 Marketing Plan for the new Jamie 11 Foxx album that came out in December of 2005? 12 A No. 13 Q But you aren't disputing that this 14 is a document generated in the normal course 15 of business at Sony by the people who are 16 charged with promoting records. 17 A I have no idea. I don't know who 18 prepared this document. 19 MR. WYSS: Your Honor, we would 20 offer SDARS Exhibit 22. 21 CHIEF JUDGE SLEDGE: Any 22 objection?</p>
<p style="text-align: right;">Page 319</p> <p>1 MR. DeSANCTIS: Yes, Your Honor. 2 I object on the ground of lack of foundation 3 for this document. Again, the witness has 4 stated that he's never seen this document, or 5 is not familiar with it. And it's certainly 6 outside of his department, and potentially, 7 outside the scope of his written direct 8 testimony. Obviously, I don't know where he's 9 going with this, but his written direct 10 testimony nowhere discusses these kind of 11 marketing plans, whatever this may be. 12 CHIEF JUDGE SLEDGE: Mr. Wyss. 13 MR. WYSS: Your Honor, I'm 14 offering this to show what the actual 15 marketing people do, and how they consistently 16 treat XM and Sirius satellite radio as part of 17 radio, as part of terrestrial radio, and that 18 they separately treat the new media as a 19 totally separate activity. And that in their 20 view, at least, terrestrial radio and 21 satellite radio have the exact same 22 promotional exposure.</p>	<p style="text-align: right;">Page 320</p> <p>1 CHIEF JUDGE SLEDGE: And what 2 reference to the direct statement are you 3 making? 4 MR. WYSS: To where he's talked 5 about that there is no promotional value to 6 satellite radio. 7 JUDGE ROBERTS: What page, Mr. 8 Wyss? 9 CHIEF JUDGE SLEDGE: Page and 10 line. We don't have line numbers. 11 MR. WYSS: Page 10, Your Honor, 12 where he's got the section about SDARS are not 13 promotional. And it actually goes on all the 14 way to page 12, where he says, "We have seen 15 no evidence that these services have any 16 positive impact on sales of recorded music." 17 That's on page 12 at the end of the first 18 carry-over paragraph. 19 JUDGE WISNIEWSKI: Mr. Wyss -- 20 MR. WYSS: Yes, Your Honor. 21 JUDGE WISNIEWSKI: I'm looking at 22 SDARS 22, maybe you could help me out here.</p>

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1 Is there any place other than page 5 of this
 2 document that mentions XM and Sirius?
 3 MR. WYSS: No. That was our
 4 point, Your Honor. We are treated as part of
 5 the radio promotion; on page 9, that's where
 6 they do the new media, which is totally
 7 separate. But on page 5, we and terrestrial
 8 radio are treated as exactly the same.
 9 JUDGE WISNIEWSKI: XM and Sirius,
 10 it has a bullet point and says, "To launch
 11 this project, Jamie Foxx will conduct
 12 interviews", and cites XM and Sirius radio
 13 interviews as one of those interviews.
 14 Doesn't really say anything else about XM and
 15 Sirius in the radio context. The remainder of
 16 this talks about various market performances
 17 in terms of where it was heard, and so on and
 18 so forth, but that's all regional with respect
 19 to individual stations. It doesn't mention XM
 20 and Sirius.
 21 MR. WYSS: I have two more
 22 marketing plans, Your Honor, which, again,

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1 JUDGE WISNIEWSKI: But I take it
 2 that your point simply is that you're not new
 3 media.
 4 MR. WYSS: We are not new media,
 5 we're radio, is exactly how we get treated in
 6 terms of promotional value.
 7 JUDGE WISNIEWSKI: Well, I don't
 8 know if that goes so far, but --
 9 CHIEF JUDGE SLEDGE: The objection
 10 to 22 is sustained.
 11 MR. DeSANCTIS: Your Honor, if I
 12 may?
 13 CHIEF JUDGE SLEDGE: Yes, sir.
 14 MR. DeSANCTIS: I would like to
 15 raise an unrelated issue. Before this trial
 16 started, there was a motion pending to
 17 disqualify counsel for XM. That motion was
 18 settled, and as part of that motion, counsel
 19 for -- Weil Gotshal, counsel for XM, agreed
 20 not to cross-examine the record company
 21 witnesses, certainly not Mr. Eisenberg, who is
 22 with Sony-BMG, or to assist in any way in

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1 would drive home --
 2 JUDGE WISNIEWSKI: I just wanted
 3 to figure out where you're going with this.
 4 MR. WYSS: Where I'm going with
 5 these, and with all these plans are that the
 6 internal marketing plans consistently treat
 7 satellite radio, along with terrestrial radio,
 8 in terms of breaking new records, in terms of
 9 getting interviews, in terms of getting air
 10 play, and that's where the promotional people
 11 view us in satellite radio as the same as
 12 terrestrial radio.
 13 JUDGE WISNIEWSKI: So your point
 14 is --
 15 CHIEF JUDGE SLEDGE: Judge
 16 Wisniewski was asking you for specifics, and
 17 you gave some broad characterizations, and
 18 your broad characterizations, of course, are
 19 not evidence, and you're not a witness.
 20 MR. WYSS: They are not, Your
 21 Honor, but I think the next two documents will
 22 confirm that.

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1 Wiley's crossing of the SoundExchange
 2 witnesses. Now twice today during the
 3 examination of Mr. Eisenberg, Mr. Rich has
 4 passed a note to Mr. Joseph, who then wrote
 5 down something on a post-it and handed it to
 6 Mr. Wyss. Now, obviously, I don't know what's
 7 on those pieces of paper, but I have to say
 8 that it certainly has gotten my attention.
 9 And if it is outside the scope of the
 10 agreement that was submitted to this Court, it
 11 would allow us to reopen the motion, at a
 12 minimum. I just wanted to get that objection
 13 on the record.
 14 CHIEF JUDGE SLEDGE: Well, is it
 15 an objection, or is it simply a - something to
 16 get on the record for some use at some prior
 17 time?
 18 MR. DeSANCTIS: I suppose it's a
 19 little bit of both. It's -- and, again,
 20 obviously, I don't know what's on the notes.
 21 I'm just noting that it's happened twice today
 22 with the first record company witness in the

<p style="text-align: right;">Page 325</p> <p>1 case. It's both an objection to any questions 2 based on those notes, and a statement of the 3 record preserving our rights, all rights that 4 are preserved under the agreement. And if 5 that's not what's happening here, I apologize, 6 but it was enough to get my attention. 7 CHIEF JUDGE SLEDGE: All right. I 8 don't hear any objection raised. Mr. Rich, 9 do you want to add something -- 10 MR. RICH: I'd just like to be 11 heard. 12 CHIEF JUDGE SLEDGE: -- to the 13 record? 14 MR. RICH: I would, Your Honor, 15 and only because it's been smeared. Had Mr. 16 DeSanctis professionally found me either now 17 or at a break and asked me whether I was in 18 any compromising any understandings, I would 19 have advised him that, for example, the note 20 I just handed Mr. Joseph had to do with time 21 management, to advise him that we were about 22 to approach the 5:00 hour. If he wants to</p>	<p style="text-align: right;">Page 326</p> <p>1 construe that as coaching or providing 2 evidence to the witnesses, it's rather 3 unfortunate. I will refrain from making any 4 number of additional statements going to the 5 underlying merits, as they were, of the motion 6 directed against me, personally, or our law 7 firm. I think it's rather unfortunate that 8 Mr. DeSanctis would just shoot an arrow like 9 that, try to impugn again the integrity of our 10 firm, and me personally, without any basis, 11 and not even give me the professional courtesy 12 privately of inquiring the basis on which I 13 sent the note to Mr. Joseph. I really find it 14 personally offensive. 15 CHIEF JUDGE SLEDGE: All right. 16 It's now 5:00. We've completed the questions 17 on Exhibits 21 and 22, and you're getting 18 ready to move on to another exhibit, as I see 19 it. 20 MR. WYSS: That is correct, Your 21 Honor. 22 CHIEF JUDGE SLEDGE: We'll recess</p>
<p style="text-align: right;">Page 327</p> <p>1 until 9:30 in the morning. 2 MR. WYSS: Thank you, Your Honor. 3 (Whereupon, the proceedings went 4 off the record at 5:01 p.m.) 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22</p>	

RESTRICTED – NOT AVAILABLE

Restricted closed session oral testimony of Michael Eisenberg in Docket No. 2006 CRB DSTRA

Transcript of:

Date: June 19, 2007

Volume: X

Case: Adjustment of Rates for Pre-Existing Subscriptions

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In the matter of:)
)
Adjustment of Rates and Terms) Docket No.
for Preexisting Subscriptions) 2006-1
Services,) CRB DSTR
and)
Satellite Digital Audio Radio) Services
Services)
_____)

Room LM-408
Library of Congress
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Washington, D.C. 20540

Tuesday,
June 19, 2007

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

BEFORE:

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

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I-N-D-E-X
WITNESS DIRECT CROSS REDIRECT RECROSS
Mark Eisenberg
By Mr. Wyss 9 17
By Mr. DeSanctis 15

Barrie Kessler
By Mr. Freedman 20
By Mr. Thompson 47

Sean Butson
By Mr. Schneider 119
By Mr. Sturm 198
Voir Dire by Mr. Sturm on page 125

EXHIBIT NO. DESCRIPTION MARK RECD

SDARS
19 (Substituted for original) 8
23 Eisenberg Depo Exhibit 9
24 SDARS Payments 64 70
25 Annual Distribution Report 71 73
26 Annual Distribution Report 73 79
27 SX Financial Statement 80 81

for 2005
28 Letter to Sirius re: late fees 92 93
29 Letter to XM re: late fees 92 93
30 copy of check and envelope
from Sirius 97
31 Audit report on Muzak 101 104
32 Response letter from Muzak 101 105

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55 Kessler 2006 Testimony 22 27
56 Kessler 2005 Testimony 33 34
57 Written testimony of Sean Butson 137 138
58 Blow-up of Appendix A 150 151

1 P-R-O-C-E-E-D-I-N-G-S
2 9:33 a.m.
3 CHIEF JUDGE SLEDGE: On the
4 record. Thank you. We'll come to order. My
5 Wyss.
6 MR. DeSANCTIS: Thank you, Your
7 Honor, and if we could have Mr. Eisenberg back
8 on the stand please. One housekeeping matter
9 if I may before we go to testimony, Your
10 Honor. As we informed opposing counsel last
11 night, we have a sick witness. Mr. Kushner
12 has come down with a -- I'm not sure what it
13 is. I think it's a chest infection. We
14 ordered him to the doctor yesterday. The
15 doctor ordered him home.
16 We are trying to -- We're working
17 with him to see when he may be able to come
18 down and testify. I think the safest thing is
19 to take him out of the order. He was set to
20 be the -- We have Mr. Eisenberg on now. After
21 that is Ms. Kessler. After that is Mr.
22 Butson. Mr. Kushner was going to follow Mr.

Page 5

1 Butson. We think it's safest to take him out
 2 of the schedule and reschedule him for next
 3 week with the Court's approval.
 4 I don't know if that means we'll
 5 be able to put Mr. Bronfman on right after Mr.
 6 Butson ends, whenever he does. There may be
 7 a small gap there, but we're doing everything
 8 we can.
 9 CHIEF JUDGE SLEDGE: Thank you for
 10 the notice.
 11 MR. DeSANCTIS: Thank you and I'll
 12 get Mr. Eisenberg.
 13 CHIEF JUDGE SLEDGE: Mr. Rich.
 14 MR. RICH: Your Honor, may I get a
 15 clarification as to that please?
 16 CHIEF JUDGE SLEDGE: Yes.
 17 MR. RICH: I'm assuming that we
 18 will not occur the entire day today with the
 19 remaining witnesses. At least anticipating
 20 the length of the crosses of the remaining two
 21 witnesses, I can confidently say from the
 22 Services' perspective there isn't enough to

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1 of down time?
 2 CHIEF JUDGE SLEDGE: That is not
 3 something that I'll control. As Mr. DeSanctis
 4 was inferring, all of those hours are charged
 5 against his time and so it's something they'll
 6 have to struggle with.
 7 MR. RICH: Very well. I'm just
 8 trying to keep this as efficient as we can.
 9 MR. WYSS: With Your Honor's
 10 permission, before I -- I have just one last
 11 very short order to finish up with Mr.
 12 Eisenberg. But we did prepare a redacted copy
 13 of SDARS Exhibit 19 which we would like to
 14 just give it to the Court and substitute for
 15 the one consistent with the Court's ruling
 16 yesterday.
 17 CHIEF JUDGE SLEDGE: Do you
 18 understand that this is a substitution so
 19 there will be no renumbering?
 20 MR. WYSS: Right.
 21 CHIEF JUDGE SLEDGE: Nothing needs
 22 to appear in the transcript, right?

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1 fill the day without knowing how lengthy the
 2 directs will be.
 3 But whether or not, I understood
 4 that Mr. Bronfman was proposed to be put on
 5 by the other side tomorrow afternoon which XM
 6 did not agree to specifically. There is no
 7 precedent in this case for identifying a time
 8 slot per se for a witness immune to the flow
 9 of it.
 10 So my question is is it the
 11 proposal from my colleague across the aisle
 12 that if we end, say, at 3:00 p.m. today we
 13 will simply adjourn until tomorrow afternoon,
 14 waiting for Mr. Bronfman and my question is
 15 assuming that there are two other witnesses
 16 scheduled as well as early as tomorrow, if
 17 that's the case, could we not for the sake of
 18 continuity, efficiency and getting those of us
 19 who are not Washingtonians home at some point,
 20 can we not move up one or more of the
 21 SoundExchange other witnesses tomorrow morning
 22 at the least rather than just have a whole lot

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1 MR. WYSS: I think you're right.
 2 CHIEF JUDGE SLEDGE: Well, the
 3 substituted copy is presented.
 4 (The redacted document
 5 referred to having been
 6 previously marked for
 7 identification and
 8 received into evidence
 9 as SDARS Exhibit No. 19,
 10 was substituted for the
 11 previous document marked
 12 as SDARS Exhibit No.
 13 19.)
 14 WHEREUPON,
 15 MARK EISENBERG
 16 was called as a witness by Sirius and, having
 17 been previously duly sworn, assumed the
 18 witness stand, was reexamined and testified as
 19 follows:
 20 MR. WYSS: Mr. Eisenberg, I'd now
 21 like to ask you to look at an exhibit that's
 22 been marked SDARS Exhibit 23 please which I

Page 9

1 think you will recall was Deposition Exhibit
 2 25 at your deposition.
 3 (Whereupon, the document
 4 referred to was marked
 5 as SDARS Exhibit No. 23
 6 for identification.)
 7 (Witness proffered document.)
 8 MR. WYSS: And I will represent to
 9 the Court that this was a document that was
 10 produced to us by SoundExchange and identified
 11 in its production as a document relating to
 12 Mr. Eisenberg and, in particular, I would like
 13 to focus you on the last page of the exhibit.
 14 Do you see where it says "Radio" at the top?
 15 THE WITNESS: Yes.
 16 CROSS EXAMINATION (Cont'd.)
 17 BY MR. WYSS:
 18 Q And just below that, the first
 19 bullet says, "Not Ready To Make Nice." Do you
 20 recognize that as a song by the Dixie Chicks
 21 that was part of their most recent album?
 22 MR. DeSANCTIS: Your Honor, I

Page 11

1 includes the song, "Not Ready to Make Nice"?
 2 A No.
 3 Q At your deposition, you stated
 4 that this appeared to be that promotional plan
 5 put together by the SONY marketing people?
 6 Are you changing that testimony?
 7 A I'm saying that the first time I
 8 saw that document was at deposition. So it
 9 appears to look like a marketing plan. I've
 10 never seen it before. I've never discussed it
 11 with anyone before. I'm not -- I don't know
 12 how the promotion staff at the label promoted
 13 this particular album or single with respect
 14 to this plan.
 15 Q But it does appear to be a
 16 marketing plan of the type that you've seen
 17 before in the company. Correct?
 18 A I generally don't see marketing
 19 plans. It looks like a marketing plan. I
 20 don't know what the format of a marketing plan
 21 is necessarily. It's not part of my day-to-
 22 day job.

Page 10

1 object to questioning on reading from this
 2 document on the record when it has not been
 3 put in evidence.
 4 CHIEF JUDGE SLEDGE: For this
 5 question, that objection is overruled.
 6 THE WITNESS: I'm familiar with
 7 the song by that group, yes.
 8 BY MR. WYSS:
 9 Q And was that part of their album,
 10 Taking a Long Way or Taking the Long Way?
 11 A Yes.
 12 Q Okay, and did SONY personnel
 13 promote the Dixie Chicks' record, "Not Ready
 14 to Make Nice," to Sirius and to XM as two of
 15 the key country markets in the United States?
 16 A I don't know.
 17 Q You don't have any idea?
 18 A I wasn't involved in that process.
 19 Q Do you recognize this document,
 20 SDARS Exhibit 23, as a marketing plan that was
 21 put together by the SONY BMG personnel for the
 22 Dixie Chick album, Taking The Long Way, that

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1 MR. WYSS: Your Honor, we would
 2 offer SDARS Exhibit 23 into evidence.
 3 CHIEF JUDGE SLEDGE: Any
 4 objection?
 5 MR. DeSANCTIS: Yes, Your Honor.
 6 I would object to foundation. The only
 7 testimony from the witness has been that he
 8 does not recognize this document and does not
 9 normally see these kinds of documents in the
 10 ordinary course of his business.
 11 Mr. Wyss mentioned earlier that
 12 this was produced by SoundExchange as relevant
 13 to Mr. Eisenberg. It was not. These were
 14 requested. They came from SONY's files. On
 15 the index we provided, Mr. Eisenberg is the
 16 only SONY witness. So all SONY documents that
 17 they requested had his name on the index, but
 18 they're certainly produced as relevant to Mr.
 19 Eisenberg per se.
 20 CHIEF JUDGE SLEDGE: Mr. Wyss.
 21 MR. WYSS: Your Honor, this
 22 document was produced as a SONY document. It

<p style="text-align: right;">Page 13</p> <p>1 was identified as relating to Mr. Eisenberg. 2 He testified both in his written testimony and 3 barely here about the alleged lack of 4 promotional value. This is in the internal 5 SONY document that directly, we believe, 6 impeaches that testimony. 7 CHIEF JUDGE SLEDGE: Objection 8 sustained. 9 CROSS EXAMINATION (Cont'd.) 10 BY MR. WYSS: 11 Q Just finally, Mr. Eisenberg, when 12 you signed your written direct testimony 13 stating "At bottom we have seen no evidence of 14 these services having any constant impact on 15 the sales of recording music." Do you recall 16 having that in your written direct testimony? 17 A Can you direct me to the -- 18 Q Page 12, end of the top paragraph. 19 Am I correct that at the time you signed your 20 written direct testimony you had not reviewed 21 any of the marketing plans prepared by the 22 labels showing how they treat satellite radio</p>	<p style="text-align: right;">Page 14</p> <p>1 and terrestrial radio in launching a new 2 record? Is that correct? 3 A Yes. 4 Q And is it also correct that when 5 you signed that you had not reviewed any of 6 the emails in the promotional departments at 7 the labels to Sirius and XM requesting air 8 play to promote new records? 9 A If there were such emails, I 10 didn't review them. 11 Q Okay, and you made no effort to 12 review any of the emails from the promotional 13 departments at the labels thanking Sirius and 14 XM and sending them gold plaques for helping 15 to make records commercial successes. 16 Correct? 17 A I don't know if that was the state 18 of facts or not. I didn't -- I wasn't aware 19 of any of those and still am not. 20 Q And you didn't look for any of 21 those. Correct? 22 A I did not.</p>
<p style="text-align: right;">Page 15</p> <p>1 MR. WYSS: No further questions, 2 Your Honor. 3 CHIEF JUDGE SLEDGE: Mr. 4 DeSanctis. 5 MR. DeSANCTIS: Thank you, Your 6 Honor. 7 REDIRECT EXAMINATION 8 BY MR. DeSANCTIS: 9 Q Mr. Eisenberg, yesterday we were 10 talking about the per-play rate for non- 11 portable subscription streaming services. Do 12 you remember that? 13 A Yes. 14 Q And on cross examination, you were 15 asked whether those include on-demand 16 components that would allow you to select the 17 particular song that you wanted to hear at a 18 particular time. Do you remember that? 19 A Yes. 20 Q And do those services contain such 21 an on-demand component? 22 A Yes.</p>	<p style="text-align: right;">Page 16</p> <p>1 Q Do those services also include non 2 on-demand streams, that is, streams that are 3 preprogrammed by the service? 4 A Yes, there are playlists that are 5 selected by the editorial staff of the 6 service, by genre or sometimes tailored to a 7 profile of a particular user and they are what 8 I would call pushed to the user, meaning it's 9 preprogrammed and the user selects it in one 10 click and is able to listen to a multiple song 11 playlist at his discretion. 12 Q So that's preprogrammed the way 13 Sirius and XM preprogram their narrowly- 14 tailored genres? 15 MR. WYSS: Objection. Leading, 16 Your Honor. 17 CHIEF JUDGE SLEDGE: Mr. 18 DeSanctis. 19 MR. DeSANCTIS: I'll rephrase, 20 Your Honor. 21 CHIEF JUDGE SLEDGE: All right. 22 BY MR. DeSANCTIS:</p>

4 (Pages 13 to 16)

Page 17

1 Q Mr. Eisenberg, is what you just
 2 described preprogrammed in the same way as XM
 3 and Sirius preprogrammed their programming?
 4 A Yes. It's very similar. It's
 5 commercial-free and it's supplied as a
 6 playlist to the enduser.
 7 Q And is the pre-play rate that we
 8 were discussing yesterday the same for these
 9 pre-programmed non on-demand streams as it is
 10 for on-demand streams?
 11 A Yes, it would be one penny per
 12 play if it's a nonportable service and two
 13 pennies per play if it's a portable service.
 14 MR. DeSANCTIS: Thank you. No
 15 further questions, Your Honor.
 16 CHIEF JUDGE SLEDGE: Mr. Wyss.
 17 MR. WYSS: I just have one follow-
 18 up question, Your Honor.
 19 RE-CROSS EXAMINATION
 20 BY MR. WYSS:
 21 Q Just so the record is clear, the
 22 subscriber to one of these services who pays

Page 19

1 maintain my objection. Mr. Wyss isn't here.
 2 So I don't think it's fair to argue this issue
 3 now.
 4 (Pause.)
 5 CHIEF JUDGE SLEDGE: The objection
 6 on the two exhibits, I overrule them.
 7 (Off the record discussion.)
 8 MR. DeSANCTIS: (Off microphone.)
 9 Your Honor, this transcript we have is
 10 appearing on the received. Does the
 11 transcript -- is one that you mentioned now?
 12 CHIEF JUDGE SLEDGE: No. That was
 13 incorrect at the time. They were admitted
 14 subject to being connected. So they were
 15 admitted yesterday.
 16 MR. DeSANCTIS: Then, Your Honor,
 17 I would simply renew my motion that they both
 18 be admitted pursuant to the protective order.
 19 As we discussed, they contain rates that some
 20 of which according to the testimony are still
 21 current or still may be current. I believe
 22 that 18 was actually admitted subject to

Page 18

1 his money in which you get a percentage of has
 2 full, on-demand fully interactive ability to
 3 access the catalog, the entire catalog of
 4 those services. Correct?
 5 A Yes (Inaudible).
 6 MR. WYSS: Thank you.
 7 CHIEF JUDGE SLEDGE: Any questions
 8 from the bench?
 9 (No response.)
 10 CHIEF JUDGE SLEDGE: Thank you.
 11 Mr. DeSanctis.
 12 (Witness exits courtroom.)
 13 MR. DeSANCTIS: Your Honor, if I
 14 may just inquire. I don't know if this is the
 15 right time that Your Honors would like to
 16 address. But there are two exhibits from
 17 yesterday's testimony with Mr. Eisenberg that
 18 I think were acceptable subject to being --
 19 two memos from several years ago that were
 20 accepted subject to being sort of tied up and
 21 linked to the current circumstances and since
 22 there was never a ruling on that, I would

Page 20

1 protective order. I'm not sure the same
 2 ruling was made on 19.
 3 CHIEF JUDGE SLEDGE: I don't know.
 4 Counsel is gone. We will not take that up
 5 now.
 6 MR. DeSANCTIS: Thank you, Your
 7 Honor.
 8 CHIEF JUDGE SLEDGE: Mr. Freedman.
 9 MR. FREEDMAN: Yes, we call our
 10 next witness, Your Honor, Barrie Kessler.
 11 (Witness enters courtroom.)
 12 WHEREUPON,
 13 BARRIE KESSLER
 14 was called as a witness by SoundExchange and,
 15 having been first duly sworn, assumed the
 16 witness stand, was examined and testified as
 17 follows:
 18 MR. FREEDMAN: Good morning, Ms.
 19 Kessler.
 20 DIRECT EXAMINATION
 21 BY MR. FREEDMAN:
 22 Q Could you please state your name

Rebuttal Testimony of Mark Eisenberg

I previously filed written direct testimony discussing the factors that SONY BMG considers when licensing its sound recordings for exploitation on an array of digital platforms and the various rates SONY BMG receives when doing so. My background was provided with my written direct testimony.

I have reviewed the public versions of the written direct statements of the economists of XM Satellite Radio, Inc. (“XM”) and Sirius Satellite Radio, Inc. (“Sirius”) (collectively, “the Services”) who use as a benchmark, and argue that the royalty rate for sound recordings should be derived from, the royalty rate for musical works paid to performance rights organizations such as ASCAP, BMI and SESAC.¹ The musical works benchmark, however, has no logical application to the exploitation of sound recordings by the Services. As discussed below, the relative economic values (i.e., compensation) attaching to the musical works and master recordings distributed to end-users as music products and services are routinely asymmetrical. Indeed, as this Court itself recognized in its recent webcasting decision, in all cases in which end-users enjoy master recordings in a manner similar to the entertainment experience within a DMCA-licensed radio service, the sound recording copyright owners are compensated at significantly higher levels than musical works copyright owners.² This disproportionate allocation of the economic pie reflects a variety of considerations, including the significantly greater levels of investment and risk that sound recording copyright owners take in discovering and developing talent and in creating, marketing and promoting artists and their music to the general public.

¹ I note that in Docket No. 2005-5 CRB DTNSRA, XM, Sirius and MTV Networks similarly rely on the same type of musical works benchmark. I include those services in my definition of “Services” in this written statement.

² See *Determination of Rates and Terms of Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Docket No. 2005-1 CRB DTRA (Mar. 2, 2007) (“*Webcasting Determination*”).

I. The Distinct Markets for Sound Recordings and Musical Works

The fundamental hypothesis underlying the Services' use of a musical works benchmark is that sound recordings and musical compositions share the same economic value in the marketplace and that, for a given service, the licenses, fees, and rates for sound recordings are or should be no more than the licenses, fees, and rates for musical compositions. That tired hypothesis is directly contrary to my experience and is contradicted by historical fact. It was flatly rejected by the Judges in the Webcasting Determination, and should be similarly rejected here.

As I stated in my written direct testimony, I oversee the negotiation of all of SONY BMG's licensing of sound recordings for distribution in all forms over digital platforms, including the Internet. I oversee these negotiations whether the recordings are distributed by (i) performance or permanent reproduction such as interactive, or "on-demand," and non-interactive streaming; (ii) audiovisual works (i.e., music videos) or audio-only works (i.e., sound recordings), and/or (iii) by full-length, complete sound recordings (e.g., tracks and albums) or fractional excerpts (e.g., ringtones and mastertones). SONY BMG grants extensive catalog rights encompassing substantial portions of its commercial music archive and encompassing these myriad formats and functionalities.

In each instance – across all of the differentiated business models, product configurations and consumer experiences – music distributors must clear separate, independent rights to the master recording and the underlying musical composition, respectively. However, in *none* of these markets does musical works copyright owners receive compensation equal to that of sound recording copyright owners. Nor, to my knowledge, do musical works copyright owners themselves, in their direct negotiations, posit that a musical works rate should be equal to or on

par with the compensation received by sound recording copyright owners with respect to digitally-delivered audio products and services. Indeed, in the pending proceeding before this Court to determine mechanical royalties, Docket No. 2006-3 CRB DPRA, the music publishers themselves have proposed musical works royalties for various digital services that, while much higher than I believe appropriate, are nonetheless a fraction of the compensation received by sound recording copyright owners with respect to the very same services.

To my knowledge, the Services have never tendered an offer to music publishers which proposes paying equivalent rates to music publishers for the reproduction, distribution and/or public performance made in the course of digital audio transmissions. That is simply because the market values for sound recordings and musical works are different – and the Services themselves have economically benefited from this marketplace distinction.

Moreover, regardless of what piece of the pie music publishers might seek in their negotiations with digital distributors, SONY BMG negotiates economic terms with digital retailers and distributors based upon SONY BMG's own valuation of the use of its sound recordings in conjunction with the benefits and enjoyment accorded service providers and end-users. SONY BMG does not predicate its economic valuation upon what the music publishers might negotiate. From my perspective, as an executive charged with negotiating rates and developing sound business models for our music across newly emerging distribution platforms, such as the Internet and mobile networks, the publishers' level of compensation from digital music services is of little consequence to me. The only time such a reference might be made would be in instances when a distributor is looking to suppress our economic participation by claiming that the distributor had already committed its "pot of monies," otherwise allocable for all "licensing," to other copyright holders, such as musical works owners and/or other labels. In

my experience, however, rates requested or received by music publishers from others are irrelevant to my task of establishing a fair economic return for our company's level of investment and risk in our artists and in our recorded music business. Our objective is to obtain a fair market rate without regard to what the publishers receive from digital music services.

II. Comparing the Markets For Sound Recordings and Musical Works

As I discuss above, there is no basis whatsoever for using negotiations by ASCAP, BMI, and SESAC as a benchmark for determining the Services' rates that should be paid to copyright owners of sound recordings. The two markets are simply distinct.

My written direct testimony described the levels of compensation that sound recording copyright owners receive in many of these markets. For purposes of illustration below, I have collected information relating to the rates that music publishers receive for those very same exploitations, relying on a variety of publicly available information, as well as proprietary information from SONY BMG and my personal experiences negotiating with digital music services and music publishers. In every case, the sound recording copyright owner receives substantially more than the musical works copyright owner — hands down. Moreover, “most favored nations” clauses, which equate the amounts received by sound recording copyright owners to musical works copyright owners, do not exist in these licensing and distribution scenarios. One need only look at the actual rates that sound recording copyright owners and musical works copyright owners are paid in catalog digital distribution agreements to appreciate the marked distinctions. Indeed, they are not even close:

Service	Sound Recording Rate (in SONY BMG agreements)	Publishing Rate	Rough Multiple (Sound recording rate/publishing rate)
Wireless Full-Length Audio Downloads (Portable)	[REDACTED] ³	\$.091 per track ⁴	[REDACTED] ⁵
Digital Downloads	[REDACTED]	\$.091 per track ⁶	[REDACTED] ⁷
Mastertones and Ringtones	[REDACTED]	[REDACTED] ⁸	[REDACTED] ⁹

There are some caveats with respect to some of the markets discussed above. Record labels and distributors set the wholesale rates for sound recordings sold to end-users as digital downloads via individual, bilateral voluntary negotiations (though in essence, the theoretical “free market” rates for sound recordings are compromised to a large degree by the deleterious effects of online piracy), whereas the royalty rates for musical works in digital downloads are

³ In my written direct testimony in this proceeding, I testified that the current rate that SONY BMG receives for wireless full-length audio downloads is [REDACTED] per track. At the hearing, however, I testified that SONY BMG was in the process of renegotiating some of its contracts for wireless full-length audio downloads. Since then, SONY BMG has amended its wireless full-length audio download agreement with Verizon. In addition to other changes, we lowered the per track rate for wireless full-length audio downloads to [REDACTED]. See SX Ex. 254 RR. Similarly, we are currently operating under the terms of a draft amendment with Sprint Spectrum in which we have reduced the per track rate for wireless full-length audio downloads to [REDACTED]. See SX Ex. 253 RR. The rates in our contracts with other providers remain at [REDACTED] per track. I am submitting with this testimony a number of agreements showing the range of sound recording performance rates across the range of digital services. See SX Ex. 253 RR - SX Ex. 254 RR; SX Ex. 256 RR - SX Ex. 258 RR.

⁴ Statutory Rate set by the Copyright Office and to be set by the Judges.

⁵ This multiple reflects my having backed out \$.091 from the indicated sound recording rate, which is a gross number that includes the rate owed to the publishers.

⁶ Statutory Rate set by the Copyright Office and to be set by the Judges.

⁷ This multiple reflects my having backed out \$.091 from the indicated sound recording rate, which is a gross number that includes the rate owed to the publishers.

⁸ Based on SONY BMG's own agreements and published reports.

⁹ This multiple reflects my having backed out \$.091 from the indicated sound recording rate, which is a gross number that includes the rate owed to the publishers.

statutory rates (and new such rates will be set by the Judges). Nonetheless, the [REDACTED] difference is a reflection of the significantly greater value of sound recordings and the investment of sound recording copyright owners. Indeed, in many cases, record companies pay less than the statutory rate for mechanical licenses, showing that the current rate is actually above a free market rate.

Even in markets where the musical works rates have not yet been determined, the aspirational rates being sought by the publishers still do not reflect the 1:1 ratio assumed by the Services. Some of these are set forth in the following chart.

Service	Sound Recording Rate (in SONY BMG agreements)	Aspirational Publishing Rate	Rough Multiple (Sound recording rate/publishing rate)
Preprogrammed Music Videos	[REDACTED]	5.1% of revenue for performance ¹⁰ ; plus additional fees for synch rights under negotiation	[REDACTED]
On-Demand Music Videos	[REDACTED]	6.5% of revenue for performance ¹¹ ; plus additional fees for synch rights under negotiation	[REDACTED]

With respect to music videos, the rates incorporated in the chart above reflect aspirational fees sought by the performance rights societies and do not include the synchronization right, for which negotiations with the publishers are still pending. Once those are determined and added in, they will lower somewhat the ratios that I have provided above. [REDACTED]

¹⁰ Based on ASCAP Internet Music License Agreements, available at <http://www.ascap.com/weblicense> (last visited July 20, 2007).

¹¹ *Id.*

[REDACTED]
[REDACTED]
[REDACTED]

The royalty regimes for other closely analogous services largely defy comparison altogether. For noninteractive webcasting, for example, this Court recently set a per-play sound recording performance royalty of \$0.0011 in 2007, going up to \$0.0019 in 2010. The PROs, by contrast, publicly seek a rate of 5.1% of revenue, unconnected to the number of performances.¹² Although the per-play sound recording rate certainly would translate to a revenue share for webcasters that is multiples higher than 5.1%, the exact ratio could vary significantly among webcasters, thus making comparisons as the Services attempt to do here extremely difficult.

Similarly, for interactive streaming services, SONY BMG receives [REDACTED]
[REDACTED]
[REDACTED]. The PROs, by contrast, publicly seek a rate of 6.5% of revenue, unconnected to the number of performances.¹³ At the same time, the publishers have proposed a complex mechanical royalty rate regime of the greater of 12.5% of revenue; "\$.00275 per use or \$0.00053 per minute of playing time or fraction thereof"; or "27.5 percent of the total content costs paid for mechanical rights to musical compositions and rights to sound recordings."¹⁴ Here again, the differences in the structures of the regimes renders it difficult to make the type of comparison that the Services are attempting. In any event, even the aspirational rates sought by the publishers for interactive streaming appear to be significantly lower than the prevailing rates that SONY BMG receives for sound recording performances.

¹² *Id.*

¹³ *Id.*

¹⁴ These numbers represent what the publishers have sought in their rate proposal in the mechanicals proceeding in this Court in *In the Matter of mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding*, Docket No. 2006-3 CRB DPRA. The aspirational rates thus represent an unrealistic upper bound.

At bottom, music publishers themselves do not argue that they should receive parity in compensation with sound recording copyright owners. Music publishers – in negotiations or in other contexts, such as legislative lobbying and even in their advocacy in ratemaking proceedings before the Judges – do not advance the equivalency theory that the Services claim here. In other words, the Services here are making an argument about the value of musical works that even the music publishers themselves do not make.

The overall point is *not* that there is a particular economic “ratio” between the rates payable to sound recording copyright owners relative to musical work copyright owners. Rather, it is simply that the two markets operate completely distinct from one another. While the musical work copyright owners may ride the coattails of the sound recording copyright owners’ success (if any), they do so at a much lower level of economic participation.

Of course, none of this is new to the Judges. As the Judges conclusively held in their Webcasting Decision, “contrary to . . . expectations that the prices paid for the rights in each respective market dealing with similar rights should be the same, substantial empirical evidence shows that sound recording rights are paid multiple times the amounts paid for musical works rights in the markets for ring tones, digital downloads, music videos and clip samples.” *See Webcasting Determination* at 40. I am not aware of any changes in the relevant marketplaces which would lend credibility to the Services’ attempt to resuscitate this rejected benchmark here.

III. The Example of Ringtones

Ringtones provide a useful example of why the musical works benchmark is inapt. The ringtone market is a market that 1) music publishers tout as an example of the value of their content, and 2) record companies believe reflects a market in which publishers have extracted above-market rates for a variety of reasons. As I explained in my written direct testimony,

ringtones are excerpts of music that play exclusively on cell phones and serves as a substitute for a traditional “ringer” or “pager.” While there are several types of musical ringtones available in the marketplace, at a basic level, ringtones can be categorized into 2 general groupings: a) poly- or monophonic ringtones, which consist of electronic “synthesizer-like” versions of musical works that do not incorporate the original sound recording, and b) mastertones, which consist of an excerpt of a label’s master recording (together with the underlying musical work). A distributor of a mono- or polyphonic ringtone need only license the underlying musical work, whereas a distributor of a mastertone must obtain clearances for *both* the underlying musical work and the original sound recording.

The market for ringtones has substantially developed with the rapid deployment of cell phone handsets capable of playing different kinds of music. The earliest cell phones could not play music at all. Thereafter, “first generation” versions of music-enabled cell phones were introduced that could play mono- and then polyphonic sounds like ringtones, but not multi-track, fully-mixed recordings or even excerpted tracks like mastertones. In response to the heightened demand for high quality digital music products, cell phone manufacturers and carrier networks began moving as quickly as possible to incorporate full music functionality into their handsets and wireless data networks. At present, all mobile carriers in the U.S. now offer mastertones to their subscribers. Moreover, in the coming years, including during this license period, virtually all cell phones and carrier networks will feature sound recordings, both as mastertone or ringback excerpts and as full-length masters delivered in the form of downloads and streams.

Since mono- and polyphonic ringtones were developed years before the advent of more progressive technologies enabling the wireless delivery of master recordings, music publishers negotiated their licenses with mobile distributors with respect to musical compositions first,

before sound recording copyright holders even had a product to sell. Publishers were thus successful in extracting relatively high prices for their copyrights because the cell phone carriers had only one (rather than two) copyright owners to pay for the synthesizer-like instrumental versions of songs incorporated as mono and polyphonic ringtone products. Typically, publishers received approximately 10% of the retail selling price of a polyphonic ringtone. In the infancy of that market, polyphonic ringtones often sold for \$1.99. With the subsequent introduction of mastertones which incorporated the actual "hit" sound recording, the retail value of mono and polyphonic ringtones dropped off significantly.

In fact, once cell phones designed to play mastertones arrived on the market, consumers demonstrated their heightened interest in such a premium product by paying higher prices for mastertones – often \$2.99 or higher per excerpted master. For mastertones, publishers receive [REDACTED] [REDACTED]. However, in contrast to the publishers, SONY BMG receives [REDACTED] [REDACTED] – which is significantly more than the music publishing rate. Out of the [REDACTED] that SONY BMG receives, the publishers receive only [REDACTED].

Indeed, to accelerate the mastertone clearance process for mobile carriers and to ensure a steady flow of "hit" product releases in a timely manner, SONY BMG itself entered into direct licenses with music publishers for mastertones. Under these license agreements, the distributor pays SONY BMG [REDACTED] [REDACTED]. Thus, publishers receive just [REDACTED] of the monies allocated to the copyright holders in respect of a mastertone (which is [REDACTED] of what SONY BMG receives). While SONY BMG continues to believe that even this rate demanded by the

publishers is disproportionately high when viewed in the context of allocations of risk and investment (and the traditional splits between record companies and publishers), we acquiesced thereto on an interim, non-precedential basis, in order to avoid staying out of the marketplace altogether while pirated substitutes overtook the market, in a manner similar to what the industry had regrettably experienced in the online world.

The ringtone paradigm – while disproportionately valuing the musical composition in relation to the sound recording, due to the historical anomaly of polyphonic ringtones – nevertheless refutes the “value parity” proposition that the Services advance. The Services argue that, because one needs licenses for both copyrights, they should be valued the same. In reality, however, they are valued very differently, and the only product consumers are interested in is the sound recording.

IV. The Substitutional Impact of the Services

The Services repeatedly make the argument that their exploitation of our sound recordings increases or promotes sales of CDs and digital downloads. In turn, they argue that this proposed promotional effect warrants a decreased sound recording performance royalty. In the context of their proposed musical works benchmark, they take this argument further and contend that the supposed promotional effect justifies a sound recording royalty that is lower even than the musical works royalty. This argument is wrong for several reasons.

As an initial matter, the Services concede that if satellite radio were promotional, the promotional effect would benefit the musical works copyright holders as well as the sound recording copyright holders. They claim, however, that the economic return from each incremental sale of a sound recording due to satellite radio benefits the sound recording copyright holder more than it does the musical works copyright holder because the sound

recording copyright holder makes more money from the sale of a CD or a digital download than does the owner of the copyright in the corresponding musical work. That the sound recording copyright owner makes more money than the owner of the musical work copyright from each sale of a CD or digital download merely makes my point from above – that the sound recording copyright is worth more than the musical work copyright. As a relative matter, however, the alleged benefit touted by the Services to the owner of each right is the same – for every incremental sale, the owner of each right would earn the rate or margin to which it is entitled.

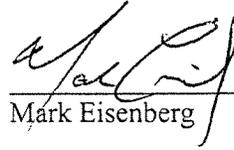
More importantly, however, my experience in the industry is consistent with other evidence that I understand that SoundExchange simultaneously is submitting which shows that subscribing to satellite radio, in fact, results in a significant and measurable net substitution effect – that is, subscribing to satellite radio actually causes subscribers to purchase *fewer* CDs. The significance of this substitutional effect cannot be overstated.

Sony BMG's gross margin on the sale of a top-line priced CD is [REDACTED], before taking into account costs such as recording costs, A&R, marketing, overhead, and unrecouped artist advances. That figure represents the net sale price of a top-line CD of [REDACTED], less average variable costs of sale of [REDACTED]. The gross margin of [REDACTED] is a number of which I remain keenly aware, as it is critical to my work in negotiating license agreements with digital service providers. As I have testified, where the service of a given digital licensee has the potential to substitute for – i.e., to decrease – CD sales, SONY BMG demands a higher rate from the service.

The reason for this should be obvious. SONY BMG depends on its margin to pay for things such as recording costs, A&R, marketing, overhead, and unrecouped artist advances. Lost CD sales that result from a particular service's substitutional effect thus are an economic loss for SONY BMG. Accordingly, if a potential licensee's service would result in a net loss of some

number of CDs per subscriber, SONY BMG knows that it needs to recover at least the value of those lost CDs through the rate *just to break even*. And because SONY BMG is not in the business of licensing its content just to break even, we would demand – *on top of that break even sum* – the normal licensee fee to which we would be entitled in the marketplace absent a substitution effect. We could never allow the loss that would result from a known substitution effect to result in SONY BMG receiving, at the end of the day (i.e., subtracting out the loss due to the substitution effect), anything less than the market rate that SONY BMG otherwise would be able to obtain.

I declare under penalty of perjury that the foregoing testimony is true and correct to the best of my knowledge and belief.



Mark Eisenberg

Date: July 24, 2007

Exhibits Sponsored by Mark Eisenberg

**Restricted exhibits, which are identified by the suffix "RR," are not included
in the Public Version of SoundExchange's Rebuttal Case**

Exhibit No.	Description
SX Exhibit 253 RR	Amendment No. 3 to Sony BMG Digital Download Sales Agreement with Sprint Spectrum L.P. (Mar. 25, 2007)
SX Exhibit 254 RR	Amendment No. 4 to the Nov. 5, 2004 letter agreement between Verizon and Sony BMG (Apr. 27, 2007)
SX Exhibit 256 RR	Ringtones agreement between Sony BMG and Alltel Communications, Inc. (SE 0000617 et seq.) (Nov. 7, 2006)
SX Exhibit 257 RR	Ringtones agreement between Sony BMG and Helio LLC (SE 0001138 et seq.) (Dec. 22, 2006)
SX Exhibit 258 RR	Video license agreement between Sony BMG and Yahoo! Inc. (SE 0005328 et seq.) (June 16, 2005)

Transcript of:

Date: August 28, 2007

Volume: 24

Case: Adjustment of Rates for Pre-Existing Subscriptions

Neal R. Gross & Co., Inc.
Phone: 202-234-4433
Fax: 202-387-7330
Email: info@nealgross.com
Internet: www.nealgross.com

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

|-----+
In the matter of:

Adjustment of Rates and
Terms for Preexisting
Subscriptions Services,

and
Satellite Digital Audio
Radio Services
|-----+

Docket No.
2006-1
CRB DSTRA

Room LM-408

Library of Congress
1st and Independence Avenue, S.E.
Washington, D.C. 20540

Tuesday,
August 28, 2007

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

BEFORE:

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

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<p style="text-align: right;">Page 3</p> <p>TABLE OF CONTENTS</p> <p>WITNESS DIRECT CROSS REDIRECT RECROSS</p> <p>Sean Butson By Mr. Sturm 4 By Mr. Cruse 14</p> <p>Michael Pelcovitis By Mr. Handzo 48 235 Voir Dire by Mr Rich on page 51 By Mr. Rich 121</p> <p>Mark Eisenberg By Mr. DeSanctis 257 By Mr. Joseph 282</p> <p>EXHIBIT MARK RECD</p> <p>SDARS 93 Wall Street Journal Article 36 39 94 Pelcovitis Deposition 214 95 Eisenberg Testimony 321</p> <p>SoundExchange</p> <p>124 Pelcovitis Written Rebuttal Testimony 50 58 125 Pelcovitis Testimony 67 72 126 Eisenberg Written Testimony 258 260</p>	<p style="text-align: right;">Page 5</p> <p>1 Q Okay. As a general matter, 2 comparing your model and Mr. Frear's In Synch 3 consensus model, you have fewer subscribers 4 and more revenue per subscriber and he had 5 more subscribers and less revenue per 6 subscriber, right? 7 A I don't know offhand. 8 Q You don't remember that from 9 looking at the models? 10 A No, I don't remember. I remember 11 generally speaking the In Synch models were 12 more optimistic than the consensus models that 13 I used, but specific metrics, I can't 14 remember. 15 Q Okay, well, do you remember 16 testifying on direct that your model included 17 a price increase and therefore, had higher 18 ARPU and his model did not have a price 19 increase and therefore, had lower ARPU? 20 A Actually, I was speaking 21 specifically to the Frear Exhibit 58. 22 Q Right.</p>

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<p>1 MR. JOSEPH: May we have a moment, 2 Your Honor? 3 CHIEF JUDGE SLEDGE: Yes, sir. 4 (Pause.) 5 MR. RICH: No recross, Your Honor. 6 MR. JOSEPH: None for me, Your 7 Honor. 8 CHIEF JUDGE SLEDGE: Any questions 9 from the Bench? 10 JUDGE WISNIEWSKI: I had one or 11 two. Dr. Pelcovits, when you were testifying 12 about the table on page 17 of your written 13 rebuttal testimony -- 14 THE WITNESS: Yes, Your Honor. 15 JUDGE WISNIEWSKI: -- you had said 16 that the results that you show in this table, 17 particularly with respect to rows 4 and 5, are 18 what you would expect because you would expect 19 the SDARS rates to be valued higher than 20 webcasting because of the portability issue? 21 THE WITNESS: Yes, Your Honor. 22 JUDGE WISNIEWSKI: Now, the rates</p>	<p>1 Some were greater, and some were not much 2 greater. But that could be true, yes. 3 JUDGE WISNIEWSKI: I guess the 4 other question I have for you had to do with 5 the third amended rate proposal submitted by 6 SoundExchange. Did I hear you to say that you 7 played a role in the construction of that rate 8 proposal? 9 THE WITNESS: Yes, sir. 10 JUDGE WISNIEWSKI: Did you have 11 any input into the CPI provision? 12 THE WITNESS: I did not. 13 JUDGE WISNIEWSKI: Thank you. 14 CHIEF JUDGE SLEDGE: Judge 15 Roberts? 16 JUDGE ROBERTS: No. 17 CHIEF JUDGE SLEDGE: Thank you, 18 sir. That ends your testimony. 19 THE WITNESS: You're welcome. 20 (Whereupon, the witness was 21 excused.) 22 CHIEF JUDGE SLEDGE: We'll recess</p>
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<p>1 are higher here because you're actually using 2 your proposed rates. Isn't that -- 3 THE WITNESS: That's correct. Your 4 Honor. 5 JUDGE WISNIEWSKI: Okay. Leaving 6 that aside for the moment, would you find that 7 there are no other characteristics that 8 distinguish webcasting and the SDARS that 9 would play out in terms of the value, relative 10 value, of the two services? 11 THE WITNESS: I can't say that 12 there are none absolutely, but there is 13 tremendous similarity just by the nature of 14 the non-interactivity and the streaming and 15 the multiple channels. 16 JUDGE WISNIEWSKI: Well, let's 17 take the multiple channels. Aren't there many 18 more multiple channels available on the 19 webcasting? 20 THE WITNESS: There are on some of 21 the services, but, as I recall in the 22 webcasting case, there were a number of them.</p>	<p>1 five minutes. 2 (Whereupon, the foregoing matter 3 went off the record at 4:00 p.m. 4 and went back on the record at 5 4:05 p.m.) 6 CHIEF JUDGE SLEDGE: We will come 7 to order. Mr. DeSanctis? 8 MR. DeSANCTIS: Thank you, Your 9 Honor. SoundExchange would like to call Mark 10 Eisenberg as our next witness. 11 CHIEF JUDGE SLEDGE: Mr. 12 Eisenberg, please raise your right hand. 13 Whereupon, 14 MARK EISENBERG 15 was called as a witness by counsel for 16 SoundExchange and, having been first duly 17 sworn, was examined and testified as follows: 18 CHIEF JUDGE SLEDGE: Thank you. 19 Please be seated. 20 MR. DeSANCTIS: Good afternoon. 21 DIRECT EXAMINATION 22 BY MR. DeSANCTIS:</p>

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<p>1 Q Would you please state your name</p> <p>2 for the record?</p> <p>3 A I am Mark Eisenberg.</p> <p>4 Q And, Mr. Eisenberg, have you</p> <p>5 testified previously in this proceeding?</p> <p>6 A Yes, I have.</p> <p>7 Q Then just very briefly could you</p> <p>8 remind us with whom you are currently employed</p> <p>9 and what your current job title is?</p> <p>10 A Sure. I'm the Executive Vice</p> <p>11 President for the Global Digital Business</p> <p>12 Group, Business and Legal Affairs for Sony BMG</p> <p>13 Music Entertainment.</p> <p>14 MR. DeSANCTIS: I want to</p> <p>15 distribute what has been marked as</p> <p>16 SoundExchange trial exhibit 126.</p> <p>17 (Whereupon, the</p> <p>18 aforementioned document</p> <p>19 was marked for</p> <p>20 identification as</p> <p>21 SoundExchange Exhibit</p> <p>22 Number SX 126.)</p>	<p>1 (Whereupon, the</p> <p>2 aforementioned document</p> <p>3 was marked for</p> <p>4 identification as</p> <p>5 SoundExchange Exhibit</p> <p>6 Number SX 126.)</p> <p>7 MR. DeSANCTIS: Your Honor, I</p> <p>8 would also like to move at this time for</p> <p>9 certain discrete portions to be treated as</p> <p>10 restricted under the Court's protective order.</p> <p>11 Those portions begin at page 5 of the</p> <p>12 testimony.</p> <p>13 These are rates and terms in</p> <p>14 current existing contracts between Sony BMG</p> <p>15 and various licensees. This is information</p> <p>16 largely that has already been previously</p> <p>17 admitted as restricted and subject to the</p> <p>18 protective order.</p> <p>19 It includes information, again,</p> <p>20 rates and terms that are in confidential and</p> <p>21 current existing contracts between Sony BMG</p> <p>22 and publishers and the ratios of those rates</p>
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<p>1 BY MR. DeSANCTIS:</p> <p>2 Q Mr. Eisenberg, do you recognize</p> <p>3 what has been marked as SoundExchange trial</p> <p>4 exhibit 126?</p> <p>5 A Yes.</p> <p>6 Q What is it?</p> <p>7 A This is my written testimony per</p> <p>8 the rebuttal part of the case, for the SDARS</p> <p>9 case.</p> <p>10 Q And if you turn to the last page</p> <p>11 of the testimony, which is page 14, is that</p> <p>12 your signature?</p> <p>13 A Yes, it is.</p> <p>14 MR. DeSANCTIS: Your Honor, at</p> <p>15 this time I would like to move for the</p> <p>16 admission of SoundExchange trial exhibit 126.</p> <p>17 CHIEF JUDGE SLEDGE: Any objection</p> <p>18 to exhibit 126?</p> <p>19 MR. JOSEPH: No objection, Your</p> <p>20 Honor.</p> <p>21 CHIEF JUDGE SLEDGE: Without</p> <p>22 objection, the exhibit is admitted.</p>	<p>1 to one another. The same is true of the</p> <p>2 testimony in the footnote on page 5, which,</p> <p>3 again, is current rates in current agreements</p> <p>4 between Sony BMG and various licensees.</p> <p>5 The same is true for the testimony</p> <p>6 marked as restricted on page 6. These are</p> <p>7 current existing rates in Sony BMG contracts</p> <p>8 with various licensees and the ratios of those</p> <p>9 rates to publicly available rates for</p> <p>10 publishers, which we had not marked as</p> <p>11 restricted.</p> <p>12 The bottom of the page and</p> <p>13 carrying over to the next page is confidential</p> <p>14 information that various music publishers have</p> <p>15 revealed to Sony BMG in the context of</p> <p>16 confidential contract negotiations. And in</p> <p>17 the spirit of the confidentiality of those</p> <p>18 contract negotiations, we ask for this</p> <p>19 information to be restricted here as well.</p> <p>20 The next line that is restricted</p> <p>21 on page 7 is again simply rates and terms in</p> <p>22 current agreements between Sony BMG and</p>

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1 various licensees. This is information that
 2 has already been admitted as restricted and
 3 protective per the Court's protective order
 4 during the direct phase of the proceeding.
 5 JUDGE ROBERTS: Mr. DeSanctis?
 6 MR. DeSANCTIS: Yes, Your Honor?
 7 JUDGE ROBERTS: Go back to page 6.
 8 MR. DeSANCTIS: Yes.
 9 JUDGE ROBERTS: That sentence
 10 carries over to page 7. Is that an
 11 acknowledgment that is expressly in one of the
 12 contracts, one or more of the contracts, or is
 13 this a conclusion of the witness?
 14 MR. DeSANCTIS: This is a
 15 representation of what happened during the
 16 negotiations for the contracts. This is
 17 testimony of the witness with respect to the
 18 discussion and negotiations that he personally
 19 was involved with.
 20 JUDGE ROBERTS: And this is his
 21 conclusion, his viewpoint?
 22 MR. DeSANCTIS: I think it is more

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1 his reporting the viewpoint of the party on
 2 the other side of the negotiation. I think
 3 this came from the music publishers. It's
 4 their acknowledgement.
 5 JUDGE ROBERTS: Maybe you need to
 6 ask him that question, this is what the music
 7 publisher said or this is his opinion as to
 8 what happened?
 9 MR. DeSANCTIS: True, Your Honor.
 10 BY MR. DeSANCTIS:
 11 Q Mr. Eisenberg, could I direct your
 12 attention to page 6 of your written direct
 13 testimony. At the bottom, the last sentence,
 14 which carries over, if you could read that to
 15 yourself for a moment?
 16 The question is whether this
 17 statement is a representation that was made to
 18 you during the course of negotiations in which
 19 you were involved or whether this is your
 20 characterization of events.
 21 A This sentence represents a
 22 conclusion that I reached based upon the

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1 request or the bid essentially that they put
 2 out on the table with respect to what the
 3 copyright was worth in their eyes, then with
 4 them knowing what the sound recording
 5 copyright holder was getting in respect of our
 6 negotiations with distributors.
 7 So there was an asymmetry between
 8 what they were asking for and what we were
 9 receiving.
 10 JUDGE ROBERTS: Now, Mr.
 11 DeSanctis, is the witness' conclusion, his
 12 viewpoint, considered confidential?
 13 MR. DeSANCTIS: Again, it is based
 14 on information that the publishers revealed,
 15 like their bid, and asked in the context of
 16 confidential negotiations. So it's really for
 17 their benefit in the spirit of the
 18 negotiations that we ask for this particular
 19 piece to be restricted.
 20 JUDGE ROBERTS: Why don't you
 21 continue?
 22 MR. DeSANCTIS: Okay. The next

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1 piece of confidential information is on page
 2 10. Again these are rates and the same kind
 3 of ratios that exist in current existing
 4 agreements between Sony BMG and various of its
 5 licensees, some of which and certainly the
 6 same type of information has already been
 7 admitted as restricted during the direct phase
 8 of this case.
 9 The final page in the testimony
 10 with restricted information is on page 12.
 11 CHIEF JUDGE SLEDGE: There is a
 12 sentence, the first sentence in that page,
 13 what the publishers receive.
 14 MR. DeSANCTIS: That's right, Your
 15 Honor. Again, my --
 16 CHIEF JUDGE SLEDGE: That's not a
 17 contract of Sony, is it?
 18 MR. DeSANCTIS: It is my
 19 understanding that that is not publicly
 20 available information that depending on the
 21 type of service that we're talking about, it
 22 may be done through private negotiation

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1 between Sony and the service. In this case,
 2 obviously this would have been executed
 3 between the publisher and the service if that
 4 --
 5 CHIEF JUDGE SLEDGE: Yes.
 6 MR. DeSANCTIS: I think that
 7 answered your question.
 8 CHIEF JUDGE SLEDGE: Yes.
 9 MR. DeSANCTIS: Okay. The final
 10 piece of information in the testimony -- and
 11 then I'll go to the exhibits -- is on page 12.
 12 And these are simply three specific numbers.
 13 One is repeated.
 14 These are numbers with respect to
 15 Sony BMG's financial operations, specifically
 16 their margins on CD sales, their variable
 17 costs on CD sales. This is information that
 18 is not shared with the public, certainly not
 19 shared with competitors, and is competitively
 20 sensitive information in the course of Sony
 21 BMG's business.
 22 The exhibits I am requesting

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1 confidential treatment for subject to the
 2 protective order all on the same grounds.
 3 Each is a current existing agreement between
 4 Sony BMG and a digital licensee.
 5 Each is in effect. Each contains
 6 rates and terms that are -- well, the
 7 agreements themselves are confidential and are
 8 not made known to the public.
 9 These are examples of agreements
 10 that are referenced in his testimony, examples
 11 of rates that are referenced in his testimony.
 12 And it is the same kind of agreement in the
 13 sense that it is current and currently in
 14 effect that has been submitted in evidence
 15 subject to the Court's protective order during
 16 the direct phase of the trial.
 17 There are five different
 18 agreements in all. Some are agreements. Some
 19 are amendments to earlier agreements, all of
 20 which contain such confidential terms.
 21 CHIEF JUDGE SLEDGE: Is that it?
 22 MR. DeSANCTIS: Yes, Your Honor.

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1 CHIEF JUDGE SLEDGE: Any objection
 2 to the motion?
 3 MR. JOSEPH: No objection, Your
 4 Honor.
 5 CHIEF JUDGE SLEDGE: The motion is
 6 granted as to page 5, the terms of the
 7 agreement; page 6, the terms. Page 7 at the
 8 top, the publisher's information, the motion
 9 is denied. The middle of page 7 on terms of
 10 contracts, the motion is granted.
 11 Page 10, the top of the page for
 12 the top information on publisher's rates, the
 13 motion is denied. And the balance of the page
 14 or contract terms, page 12, on financial data
 15 and the exhibits being current agreements, the
 16 motion is granted with the exceptions stated.
 17 MR. DeSANCTIS: Thank you, Your
 18 Honor.
 19 BY MR. DeSANCTIS:
 20 Q Mr. Eisenberg, I would like to
 21 direct your attention to pages 5, 6, and 7 of
 22 your written testimony. In this section of

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1 your testimony, you compare sound recording
 2 rates with publishing rates in various
 3 contexts. Do you recall this portion of your
 4 testimony?
 5 A Yes.
 6 Q What is the purpose of the
 7 comparisons that you have made here in your
 8 written direct testimony?
 9 A It was really just to plot out our
 10 rates vis-a-vis the publisher rates and to
 11 really demonstrate that there really is no
 12 correlation product by product between what we
 13 get for the sound recording and what the
 14 publishers get with respect to the musical
 15 composition.
 16 As you can see through each of
 17 these product categories, the delta or the
 18 multiple varies quite dramatically. And that
 19 is because we don't set ratios between the two
 20 copyright holders.
 21 We negotiate our sound recording
 22 rights independent of what the publishers may

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<p>1 ask for. Obviously we need to know how much</p> <p>2 we have to pay them so that we can get more</p> <p>3 than we're paying out. But our rates are not</p> <p>4 established as a result of or in conjunction</p> <p>5 with what we're paying to the publishers.</p> <p>6 Q And is there a general trend in</p> <p>7 the rates that you have included in your</p> <p>8 testimony as to whether sound recording rates</p> <p>9 tend to be higher or lower than publishing</p> <p>10 rates?</p> <p>11 MR. JOSEPH: Objection. Vague as</p> <p>12 to trend.</p> <p>13 CHIEF JUDGE SLEDGE: Sustained.</p> <p>14 BY MR. DeSANCTIS:</p> <p>15 Q Without speaking of any particular</p> <p>16 bids, which may be confidential, in your</p> <p>17 testimony, are the rates for sound recordings</p> <p>18 generally higher or lower than the rates for</p> <p>19 publishing?</p> <p>20 A They are higher.</p> <p>21 Q Let me direct your attention to</p> <p>22 page 12 of your written direct testimony.</p>	<p>1 product.</p> <p>2 Q And is it important in your daily</p> <p>3 basis to know Sony BMG's gross margin on CD</p> <p>4 sales?</p> <p>5 A Yes.</p> <p>6 Q Could you please explain why that</p> <p>7 is?</p> <p>8 A Well, as the executive in charge</p> <p>9 of our negotiations for digital distribution</p> <p>10 agreements, I have to know what we have to</p> <p>11 achieve in order to be profitable as a</p> <p>12 business.</p> <p>13 And to migrate from a physical</p> <p>14 configuration business to a digital business,</p> <p>15 I have to know what we have to make up for</p> <p>16 essentially in the loss of sales on the</p> <p>17 physical product to the digital side of the</p> <p>18 business so that the gross profit or the gross</p> <p>19 margin is a very relevant number in how I</p> <p>20 approach my business negotiations.</p> <p>21 Q But is that different, the gross</p> <p>22 margin, from the sort of bottom line profit at</p>
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<p>1 Here you discuss Sony BMG's gross margin on CD</p> <p>2 sales. Could you describe in general terms</p> <p>3 what a gross margin on CD sales is?</p> <p>4 A It's our profit on a unit basis</p> <p>5 after taking into account the cost of goods</p> <p>6 sold. So, for example, on a CD unit, we</p> <p>7 looked at the wholesale price, receipts that</p> <p>8 we take in from the retailer. And then we</p> <p>9 would deduct out our costs for the unit sold.</p> <p>10 And that would be the cost of</p> <p>11 manufacturing, distribution, artist royalty,</p> <p>12 obsolescence; that is, scrapping the product</p> <p>13 when we have to take it back from the</p> <p>14 retailer. And that would result in a gross</p> <p>15 margin or CD. That is before we take into</p> <p>16 account what I would call the additional</p> <p>17 expenses or costs of talent, which would be</p> <p>18 artist advances, recording costs, and</p> <p>19 marketing promotion costs.</p> <p>20 The profit margin that we are</p> <p>21 making on the CD here has to pay for those</p> <p>22 additional costs that we have in creating our</p>	<p>1 the end of the day on a CD?</p> <p>2 A Absolutely. This is a profit on a</p> <p>3 variable basis assuming we haven't covered</p> <p>4 what I would call our fixed or sunk costs in</p> <p>5 creating the content.</p> <p>6 So, in addition, as I said before,</p> <p>7 in addition to the per-unit costs that we have</p> <p>8 in manufacturing and distribution and artist</p> <p>9 royalty expense, we have overhead obviously to</p> <p>10 pay for the tremendous efforts of our staff in</p> <p>11 creating and finding the talent.</p> <p>12 We have to market and promote the</p> <p>13 artists. And we have to, you know, pay</p> <p>14 artists additional advances from time to time</p> <p>15 to get them to sign our deals.</p> <p>16 So taking the totality of those</p> <p>17 circumstances together, I look at how much is</p> <p>18 coming in versus how much is going out.</p> <p>19 Q One of the variable costs you just</p> <p>20 mentioned a couple of times is artist</p> <p>21 royalties. How, if at all, would the</p> <p>22 treatment of artist royalties differ in this</p>

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<p>1 case with respect to SoundExchange, as opposed</p> <p>2 to with respect to Sony BMG?</p> <p>3 CHIEF JUDGE SLEDGE: Mr. Joseph?</p> <p>4 MR. JOSEPH: Objection, Your</p> <p>5 Honor. There's nothing in this written</p> <p>6 rebuttal testimony that talks about artist</p> <p>7 royalties and how it relates to gross margin.</p> <p>8 CHIEF JUDGE SLEDGE: Mr.</p> <p>9 DeSanctis?</p> <p>10 MR. DeSANCTIS: If I might have</p> <p>11 just a moment, Your Honor?</p> <p>12 (Pause.)</p> <p>13 MR. DeSANCTIS: On page 12 in the</p> <p>14 second full paragraph, starting with "Sony</p> <p>15 BMG," the witness discusses what the margin is</p> <p>16 before taking into account costs such as</p> <p>17 recording costs, A&R, marketing, overhead, and</p> <p>18 unrecouped artist advances.</p> <p>19 Unrecouped artist advances is -- I</p> <p>20 should say it the other way around.</p> <p>21 Unrecouped artist advances is a form of artist</p> <p>22 royalties.</p>	<p>1 question as vague.</p> <p>2 CHIEF JUDGE SLEDGE: Overruled.</p> <p>3 THE WITNESS: In making the</p> <p>4 analysis here, I'm looking from the lens of</p> <p>5 Sony BMG, as a record company, what is our</p> <p>6 gross margin. With respect to SoundExchange,</p> <p>7 you would look through a lens of both the</p> <p>8 record company and the performer.</p> <p>9 So, in essence, you would add back</p> <p>10 in the artist royalty, which we deducted to</p> <p>11 get the record companies' gross margin. We</p> <p>12 would add that back into the equation to find</p> <p>13 out what the totality of the lost sale or the</p> <p>14 gross margin is with respect to performers and</p> <p>15 the record company.</p> <p>16 BY MR. DeSANCTIS:</p> <p>17 Q When you say "adding that back</p> <p>18 in," would that result in a higher gross</p> <p>19 margin or a lower gross margin or neither?</p> <p>20 A It would result in a higher gross</p> <p>21 margin.</p> <p>22 CHIEF JUDGE SLEDGE: Mr. Joseph?</p>
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<p>1 CHIEF JUDGE SLEDGE: Mr. Joseph?</p> <p>2 MR. JOSEPH: Unrecouped artist</p> <p>3 advances is an account of the record</p> <p>4 company's. Artist royalties is a different</p> <p>5 amount. And there's no linkage here between</p> <p>6 the two. He has just said that this is before</p> <p>7 taking into account unrecouped artist</p> <p>8 advances, a different concept and a different</p> <p>9 accounting.</p> <p>10 CHIEF JUDGE SLEDGE: Overruled.</p> <p>11 BY MR. DeSANCTIS:</p> <p>12 Q You can answer.</p> <p>13 A So can you repeat, please?</p> <p>14 Q Absolutely. You had discussed</p> <p>15 artist royalties in your testimony. And the</p> <p>16 question is, how, if at all, would the</p> <p>17 treatment of artist royalties differ in this</p> <p>18 case with respect to SoundExchange than with</p> <p>19 respect to how Sony BMG treats artist</p> <p>20 royalties in creating its gross margin?</p> <p>21 CHIEF JUDGE SLEDGE: Mr. Joseph?</p> <p>22 MR. JOSEPH: I will object to that</p>	<p>1 MR. JOSEPH: Your Honor, again, I</p> <p>2 think now we are even moving beyond any</p> <p>3 reference to unrecouped artist advances, which</p> <p>4 he didn't mention. He's now talking about the</p> <p>5 effect of gross margins on SoundExchange,</p> <p>6 which is completely beyond what we have here.</p> <p>7 CHIEF JUDGE SLEDGE: Mr.</p> <p>8 DeSanctis?</p> <p>9 MR. DeSANCTIS: I am ready to move</p> <p>10 on.</p> <p>11 CHIEF JUDGE SLEDGE: Sustained.</p> <p>12 BY MR. DeSANCTIS:</p> <p>13 Q Now, how is it in your business,</p> <p>14 Mr. Eisenberg, that you know what Sony BMG's</p> <p>15 margin is on a CD?</p> <p>16 A It is part of what I do on a daily</p> <p>17 basis in the capacity that I serve the</p> <p>18 company. I sort of sit in the intersection of</p> <p>19 two facets of the company.</p> <p>20 On the sale side of the business,</p> <p>21 I am responsible for maximizing our digital</p> <p>22 sales. So I would speak with our executives</p>

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<p>1 on the sales and marketing teams to find out 2 how digital sales and how physical sales as 3 well are taking effect in the marketplace. 4 So I talk to our sales executives. 5 And they tell me what sales we're making, are 6 sales up, are sales down, and the price points 7 of our various configurations. 8 On the other side of the business, 9 I look at what I would call the expense side 10 of the business, which is talent and 11 repertoire. As a business affairs executive, 12 I speak to our label business affairs 13 executives on a regular basis to find out what 14 their talent costs are. 15 And when you put the two sides 16 together, you find out essentially what you 17 need to run a profitable operation, both with 18 regard to the revenue side of the business and 19 on the cost side of the business. 20 Q And how did you obtain the 21 specific figure, down to the penny, that you 22 included in your testimony here?</p>	<p>1 Q Was there an attachment to the 2 e-mail? 3 A Yeah. There was a P&L that he had 4 prepared previously that had been sitting in 5 his office or on his computer. And he 6 e-mailed that to me. 7 Q And that P&L was not prepared for 8 purposes of this litigation? 9 A It must have preexisted. 10 Q Why is that? 11 CHIEF JUDGE SLEDGE: Mr. Joseph? 12 MR. JOSEPH: Objection. Lack of 13 foundation. And beyond the -- 14 CHIEF JUDGE SLEDGE: Sustained. 15 BY MR. DeSANCTIS: 16 Q How much time elapsed, Mr. 17 Eisenberg, between when you asked your Vice 18 President of Finance for the P&L and when he 19 sent it to you? 20 A Less than five minutes. 21 Q My final question is, what is 22 involved in actually calculating the gross</p>
Page 279	Page 281
<p>1 A Well, I called my Vice President 2 of Finance for the global digital business to 3 see if he had something, you know, readily 4 available at his fingertips to get the exact 5 number. 6 Q And is it frequent that you -- let 7 me withdraw that and rephrase. 8 How often do you call your Vice 9 President of Finance for specific numbers? 10 A Well, we speak to each other all 11 the time. Either I go to his office, he comes 12 to my office. We talk to each other on the 13 telephone. And we're communicating and 14 exchanging information almost every day. 15 Q And what happened when you asked 16 him for this number? 17 A He within five minutes or so, you 18 know, e-mailed me back and gave me the number 19 that is in my written testimony. 20 Q And what form did he provide it to 21 you in? 22 A It was an e-mail.</p>	<p>1 margin? 2 A You would look at your -- 3 CHIEF JUDGE SLEDGE: Mr. Joseph? 4 MR. JOSEPH: Objection. Lack of 5 foundation. 6 CHIEF JUDGE SLEDGE: Mr. 7 DeSanctis? 8 MR. DeSANCTIS: If I can ask the 9 witness a preceding question? 10 CHIEF JUDGE SLEDGE: All right. 11 The objection is sustained. 12 BY MR. DeSANCTIS: 13 Q Mr. Eisenberg, do you know how a 14 specific gross margin at Sony BMG is 15 calculated? 16 A Yes. 17 Q And how is that? 18 A You would take into account your 19 revenues and deduct your -- 20 CHIEF JUDGE SLEDGE: You are not 21 answering the question. 22 THE WITNESS: I am sorry.</p>

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<p>1 CHIEF JUDGE SLEDGE: How do you 2 know? 3 THE WITNESS: From day-to-day 4 dealings in my business capacity, I deal with 5 P&L's. And I discuss costs and revenues with 6 our executives. 7 BY MR. DeSANCTIS: 8 Q And is the gross margin one that 9 you have discussed? 10 A Yes. 11 MR. DeSANCTIS: Thank you. No 12 further questions. 13 CHIEF JUDGE SLEDGE: Any 14 cross-examination? 15 MR. JOSEPH: Yes, Your Honor. 16 Good afternoon, Mr. Eisenberg. 17 THE WITNESS: Good afternoon. 18 CROSS-EXAMINATION 19 BY MR. JOSEPH: 20 Q Let me ask you, please, to turn to 21 page 5 of your written rebuttal testimony. 22 Let's look at the table that you present at</p>	<p>1 two of those cases, the fee that you have 2 under the publishing rate is set by the 3 statutory license under section 115. Is that 4 correct? 5 A Are you talking about the wireless 6 full-length downloads and the online digital 7 downloads? 8 Q Yes, sir. 9 A Yes. 10 Q And the publishing rate for master 11 tones and ringtones, the record companies have 12 argued that the statutory rate applies, 13 correct, -- 14 A In a proceeding -- 15 Q -- publishing rate? 16 A In a proceeding, the RIAA took the 17 position on behalf of record companies that 18 the download was a DPD subject to section 115. 19 Q And the registrars of copyrights 20 have held that position, correct? 21 A I believe that he did -- she did. 22 Q And in negotiations with music</p>
Page 283	Page 285
<p>1 the top of the page. You identify three types 2 of services in that table, correct? 3 A Yes. 4 Q Wireless full-length downloads; 5 portable digital downloads, which I take it 6 are not portable. Is that correct? 7 A Which category are you looking at? 8 Q What's the middle row? 9 A The middle row are what I would 10 call online downloads. And the first row 11 consists of mobile downloads off of the 12 cellular network. 13 Q And then the bottom line is for 14 master tones and ringtones? 15 A Yes. 16 Q Is that correct? 17 A Yes. 18 Q All three of those services 19 involve reproduction and distribution rates, 20 not public performance rates, correct? 21 A Correct. 22 Q And, in all, at least in the first</p>	<p>1 publishers over the mechanical license fee for 2 ringtones, record companies have taken the 3 position prior to that ruling that, in fact, 4 the ringtone rate for publishing was subject 5 to the statutory license under section 115, 6 haven't they? 7 CHIEF JUDGE SLEDGE: Mr. 8 DeSanctis? 9 MR. DeSANCTIS: Objection, Your 10 Honor. The question is about negotiations by 11 record companies generally. If the question 12 is about Sony BMG, this witness can answer. 13 Otherwise it's beyond the scope of his 14 testimony and his knowledge. 15 CHIEF JUDGE SLEDGE: I don't know 16 that. Objection is overruled. 17 THE WITNESS: In our agreements 18 with publishers for master tones, we would pay 19 a higher rate than the statutory rate because 20 we had a disagreement over whether or not 115 21 applied. So we agreed in the context of those 22 negotiations that we would pay a higher rate.</p>

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1 MR. JOSEPH: That didn't answer my
 2 question, sir.
 3 BY MR. JOSEPH:
 4 Q My question, sir, was, did record
 5 companies -- and I will narrow it in response
 6 to Mr. DeSanctis. In those negotiations, did
 7 Sony BMG take the position that the statutory
 8 rate applied to ringtones?
 9 A We didn't take position in
 10 negotiations that we would apply that rate.
 11 There were -- to proceed under a compulsory
 12 license, you would have to do certain
 13 administrative formalities, which our record
 14 company was not in a position to do.
 15 So putting aside what the
 16 statutory rate was for a DPD for an online
 17 service, we entered into a negotiation with
 18 the publishers, irrespective of the statutory
 19 rate.
 20 Q You said there was a disagreement.
 21 I take it that the disagreement was one side
 22 saying the statutory rate applies and the

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1 other side saying the statutory rate didn't
 2 apply, correct?
 3 A It was a negotiation.
 4 Q You used the word "disagreement,"
 5 sir. I didn't. Did you not say there was a
 6 disagreement over whether the statutory rate
 7 applied?
 8 A There was a perspective as to what
 9 the value of the copyright was worth. And the
 10 starting point for us was the statutory rate.
 11 Q And it's your testimony that Sony
 12 BMG did not in its negotiations with
 13 publishers take the position that the
 14 statutory rate was applicable to ringtones?
 15 A We used that as a reference point
 16 to negotiate a deal.
 17 Q That was your starting point,
 18 right?
 19 A I believe it was.
 20 Q Now let's look at the table on
 21 page 6 that deals with music videos. These
 22 are public performance fees, correct, at least

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1 in part?
 2 A The 5.1 and the 6.5 percent.
 3 Q That's the --
 4 A The third column.
 5 Q Under the publishing rate, the
 6 third column?
 7 A Yes.
 8 Q And those are rates based on
 9 ASCAP's asking price. Is that correct?
 10 A That is their published license
 11 request.
 12 Q And ASCAP operates under an
 13 antitrust consent decree that subjects their
 14 fees to the rate court in the Southern
 15 District of New York, correct?
 16 A I don't know the particulars.
 17 Q You don't know about that?
 18 A I don't know what jurisdiction
 19 they're subjected to.
 20 Q Do you know that they operate
 21 under a rate court?
 22 A Yes.

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1 Q Now, the fees under the sound
 2 recording rate that you have listed in that
 3 column are rates that Sony BMG is able to
 4 obtain in the market, correct?
 5 A Yes.
 6 Q And they're not overseen by any
 7 sort of rate-setting body, correct?
 8 A Correct.
 9 Q Now, Sony BMG when it licenses the
 10 preprogrammed music videos and on-demand
 11 videos for the prices you have got listed
 12 there licenses all applicable rights, correct?
 13 And if that's unclear, I mean public
 14 performance reproduction distribution, any
 15 copyright right that may apply.
 16 A No, that is not correct.
 17 Q That's not correct for the sound
 18 recording? I'm sorry. Let me withdraw that.
 19 What rights does Sony BMG license
 20 for the sound recording rate you have
 21 identified in that column?
 22 A For Sony BMG-produced videos, that

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<p>1 is a music video akin to the one that you 2 would see on MTV television. We would license 3 the right to the sound recording, the mass 4 recording; in addition, the synchronization 5 and distribution -- synchronization 6 reproduction right with respect to musical 7 composition. 8 We would not license the public 9 performance right. And to the extent that we 10 are licensing user-generated music videos; 11 that is, a music video that a user has created 12 that embodies our sound recording but perhaps 13 a visual image that he or she may have created 14 on his or her own, like you would see on You 15 Tube, the musical composition is not part of 16 that grant that we license. 17 Q Let's focus on the Sony 18 BMG-produced music videos. You license the 19 public performance right in the audiovisual 20 work, correct? 21 A No. 22 Q No?</p>	<p>1 Q Yes. 2 A Yes, sir. 3 Q So you put the audio together with 4 the video portion and you get what copyright 5 lawyers refer to as an audiovisual work, don't 6 you? 7 A Yes. 8 Q And are the copyright and the 9 audiovisual work owned by Sony BMG? 10 A Yes. 11 Q Do you grant any licenses with 12 respect to the audiovisual work in the 13 agreements that you're reporting in this table 14 under the "Sound Recording Rate" column? 15 A We grant all rights that are 16 necessary with respect to the audiovisual 17 work. I thought you were talking about the 18 musical composition before. 19 Q No, sir. I was talking about the 20 rights in the audiovisual work. 21 A Okay. 22 Q You grant all rights. That</p>
Page 291	Page 293
<p>1 A No. 2 Q What right are you granting in the 3 music video as an audiovisual work? 4 A The audio or the audiovisual 5 recording, the master that we control plus the 6 synchronization musical work that's 7 synchronized to that audio bet. 8 Q I'm talking about with respect to 9 the rights that you -- the music publisher 10 owns the synchronization right, correct? 11 A Correct. 12 Q Okay. With respect to the rights 13 that Sony BMG owns in a music video, you, 14 first of all, created the sound recording, 15 correct? 16 A Yes. 17 Q That's the audio track of the 18 music video, correct? 19 A Yes. 20 Q Did you also create the video 21 portion of the music video? 22 A The visual elements?</p>	<p>1 includes reproduction rights and any 2 reproduction or distribution rights that might 3 apply if they are applicable? 4 A We license all rights necessary to 5 exploit with respect to the audiovisual work. 6 Q And, in addition, for the fee that 7 you have listed there, you also license the 8 synchronization right in the musical work, 9 correct? 10 A For Sony BMG-produced music 11 videos, not for user-generated music videos. 12 Q Right, sir. That's what we're 13 talking about. And the publishing right that 14 you have listed here is just the public 15 performance right in the musical work, 16 correct? 17 A In this third column? 18 Q Yes, sir. 19 A This represents the musical work 20 of the performance rate. 21 Q And the music publisher is not 22 involved in creating the visual elements of</p>

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<p>1 the music video, is it?</p> <p>2 A No, they are not.</p> <p>3 Q So if you were stacking up sound</p> <p>4 recording elements plus visual elements being</p> <p>5 licensed by the record company on the music</p> <p>6 publisher side, all you have is the public</p> <p>7 performance and the musical work, correct?</p> <p>8 A Which is licensed separately or --</p> <p>9 Q No. Which is what you are</p> <p>10 reporting in your two columns here.</p> <p>11 A Yes.</p> <p>12 Q Now, you did not in your sound</p> <p>13 recording rate reduce the amounts that Sony</p> <p>14 BMG pays for the synch right in the Sony</p> <p>15 BMG-produced music videos, did you?</p> <p>16 A To get to the 7 to 10x? Is that</p> <p>17 your question?</p> <p>18 Q To get to the number that you show</p> <p>19 in the sound recording rate side.</p> <p>20 A I would have to do the math that</p> <p>21 calculated that -- the formula on the prior</p> <p>22 page was to take the sound recording revenues,</p>	<p>1 A Correct.</p> <p>2 Q So, actually, your ratio to get a</p> <p>3 correct ratio would require both subtracting</p> <p>4 the synchronization right fee from the sound</p> <p>5 recording rate and adding it to the music</p> <p>6 publishing rate to get the ratio of what the</p> <p>7 publisher gets all into what Sony BMG gets all</p> <p>8 in, correct?</p> <p>9 A I believe that's correct.</p> <p>10 Q Now, on page 7, you talk about</p> <p>11 interactive streaming in the second full</p> <p>12 paragraph. Do you see that?</p> <p>13 A I'm sorry. Which page are we</p> <p>14 talking about?</p> <p>15 Q Seven.</p> <p>16 A This is the second full paragraph?</p> <p>17 Q Yes, sir.</p> <p>18 A Okay.</p> <p>19 Q And the Sony BMG license fee that</p> <p>20 you report includes all necessary rights in</p> <p>21 the sound recording, including any public</p> <p>22 performance right and any reproduction or</p>
Page 295	Page 297
<p>1 deduct the publishing revenues, divide that by</p> <p>2 the publishing revenues. And then you get a</p> <p>3 ratio.</p> <p>4 Q You didn't do that in this table,</p> <p>5 did you?</p> <p>6 A Could I take out my calculator and</p> <p>7 do the math?</p> <p>8 Q Sure.</p> <p>9 A If you were to do that, the first</p> <p>10 number would be six, instead of seven, in the</p> <p>11 preprogrammed music video column. The</p> <p>12 multiple would be six, rather than seven.</p> <p>13 Q So the answer is you did not</p> <p>14 remove from the sound recording rate that you</p> <p>15 report there the payment that must be made to</p> <p>16 the music publishers for the synchronization</p> <p>17 rate, correct?</p> <p>18 A That does not exclude that number.</p> <p>19 Q And you did not add the</p> <p>20 synchronization, right, value into the column</p> <p>21 representing the amount that the music</p> <p>22 publishers get, did you?</p>	<p>1 distribution rates that may be included,</p> <p>2 correct?</p> <p>3 A For the sound recording?</p> <p>4 Q Yes, sir.</p> <p>5 A Yes.</p> <p>6 Q Now, you then mention the PROs.</p> <p>7 They are licensing only the public performance</p> <p>8 right and musical work, correct?</p> <p>9 A Yes.</p> <p>10 Q And you mentioned the mechanical</p> <p>11 royalty being sought by the publishers in the</p> <p>12 third sentence. Do you see that?</p> <p>13 A Yes.</p> <p>14 Q And that is for the reproduction</p> <p>15 and distribution right as it applies to the</p> <p>16 musical work, correct?</p> <p>17 A Yes.</p> <p>18 Q And the fees you reported for Sony</p> <p>19 BMG in the grayed-off area in the first</p> <p>20 sentence of that paragraph are actually for a</p> <p>21 license that includes payment of the</p> <p>22 mechanical license fee to the publisher,</p>

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1 doesn't it?

2 A In some services, yes; in other

3 services, no. Some services, we include the

4 mechanical. And in other services, we don't.

5 Q As you sit here, do you know which

6 the largest services get? Is the mechanical

7 included or not included?

8 A It varies.

9 Q Well, for those that it is

10 included, are they on the low side or the high

11 side? Are the numbers you have reflected or

12 does it vary depending on the deal?

13 A I'm sorry. Could you repeat the

14 question?

15 Q Well, you give a range of

16 percentages of revenue in the grayed-out area,

17 correct?

18 A Yes.

19 Q Does the low number represent

20 those in which the mechanical is included or

21 is not included and the high number represent

22 those in which the mechanical is included or

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1 is there no relationship between the two?

2 A These are net numbers. So these

3 are net of mechanical. That range that is

4 grayed-out is net of mechanical.

5 Q That's not the amount stated in

6 the license agreements, the nominal amount

7 that the service pays you as stated in the

8 license agreement?

9 A There is sometimes an allowance

10 for a mechanical to be deducted, but this

11 number represents the net amount to us.

12 Q After you pay the mechanical?

13 A Yes.

14 Q Now, you say the publishers have

15 proposed a complex mechanical royalty regime.

16 Is that their proposal on the current section

17 115 proceeding before the judges?

18 A That's what I was referring to.

19 Q Now, if you add the mechanical

20 that the publisher is sort of seeking, the

21 performance license, you get a total of at

22 least 19 percent of revenue, don't you?

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1 A I don't know if the publishers are

2 seeking to have an additive royalty between

3 the PROs and the -- with respect to the public

4 performance and the mechanical right, I don't

5 know if they are seeking with respect to

6 publishing rights in the totality to add those

7 two categories together.

8 Q Well, we say that the 6.5 percent

9 fee is a PRO rate, correct?

10 A Correct.

11 Q That is being sought or is

12 collected by ASCAP, BMI, and SESAC. Is that

13 correct?

14 A That rate is being asked for by

15 ASCAP. That's an ASCAP request.

16 Q Right. And is it your testimony

17 that ASCAP's PRO fee and ASCAP's performance

18 rights fee is going to drop if the publishers

19 get a 12.5 percent mechanical fee?

20 A It might.

21 Q You haven't seen anything from

22 ASCAP saying that it will, have you?

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1 A Well, the publishers did lobby

2 Congress for a unilicense representing all

3 rights necessary with respect to music

4 publishing rights. And when you add those two

5 rights together, they were seeking one-third

6 of the content pool. So that is less than 27

7 plus 6.5.

8 Q One-third of the content pool

9 would have been 50 percent of what the record

10 company gets?

11 A One-third of the content pool

12 would not be 50 percent.

13 Q Of what the record company gets?

14 A No, no. I'm sorry. They were

15 seeking one-third, a one-thirds/two-thirds

16 ratio between the sound recording and the

17 music publishing right.

18 Q Right. So one-third is 50 percent

19 of two-thirds, isn't it?

20 A Yes.

21 Q That was a proposal before

22 Congress. What I'm talking about is in the

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<p>1 context of the mechanical license proceeding</p> <p>2 before these judges. Are you aware of any</p> <p>3 statements by the music publishers that they</p> <p>4 will drop their performance right fees if</p> <p>5 they're awarded the mechanical license fee</p> <p>6 that they're seeking?</p> <p>7 A I'm not familiar with what they're</p> <p>8 requesting on performance.</p> <p>9 Q Well, that's interesting because</p> <p>10 in footnote 14, you describe the publishers'</p> <p>11 proposal in the mechanical royalty proceeding</p> <p>12 as "an aspirational rate that represents an</p> <p>13 unrealistic upper bound." Do you see that?</p> <p>14 A What paragraph was that?</p> <p>15 Q Footnote 14 at the bottom of page</p> <p>16 7. Are they your words?</p> <p>17 A Yes. What was the question?</p> <p>18 A My question was, do you see that?</p> <p>19 And were they your words, "unrealistic upper</p> <p>20 bound"?</p> <p>21 A Yes, those are my words.</p> <p>22 Q How did you come to learn about</p>	<p>1 Q How were you familiar with it?</p> <p>2 A Through industry discussions.</p> <p>3 Q Did you see the submission by the</p> <p>4 referring industry?</p> <p>5 A I didn't see the actual filing,</p> <p>6 no.</p> <p>7 Q You didn't see any of the actual</p> <p>8 filing?</p> <p>9 A I may have seen excerpts.</p> <p>10 Q Are you aware of the position that</p> <p>11 the recording industry is taking in the</p> <p>12 proceeding?</p> <p>13 A I don't know what you mean by</p> <p>14 "position."</p> <p>15 Q Are you aware of the fees that the</p> <p>16 recording industry is seeking in the</p> <p>17 proceeding?</p> <p>18 A With respect to the DPD?</p> <p>19 Q With respect to the mechanical</p> <p>20 license, the statutory mechanical license,</p> <p>21 rate.</p> <p>22 A I was familiar with it at the time</p>
Page 303	Page 305
<p>1 the publisher's proposal in the mechanical</p> <p>2 section 115 proceeding?</p> <p>3 A I saw the filing.</p> <p>4 Q Did you see the filing for the</p> <p>5 purposes of this litigation or did you see it</p> <p>6 -- I think you earlier testified you sat on</p> <p>7 the RIAA mechanical license committee.</p> <p>8 A I'm privy to some information. I</p> <p>9 don't attend the calls regularly, but in the</p> <p>10 context of what I do at Sony BMG, I was aware</p> <p>11 of what their filing contained.</p> <p>12 Q And so which part of the filing</p> <p>13 did you see? Did you see any of the testimony</p> <p>14 going along with it?</p> <p>15 A I probably saw a summary that was</p> <p>16 prepared.</p> <p>17 Q And did you see the recording</p> <p>18 industry's proposal to help inform your</p> <p>19 opinion that the publisher's request was an</p> <p>20 unrealistic upper bound?</p> <p>21 A I was familiar with the rate</p> <p>22 request that was submitted.</p>	<p>1 of the filing. I have not looked at it for</p> <p>2 quite some time.</p> <p>3 Q What is the basis for your</p> <p>4 statement that the publisher's request is an</p> <p>5 unrealistic upper bound?</p> <p>6 MR. DeSANCTIS: Objection, Your</p> <p>7 Honor.</p> <p>8 BY MR. JOSEPH:</p> <p>9 Q What makes it unrealistic?</p> <p>10 A Because it doesn't bear a</p> <p>11 relationship to what they're paid currently</p> <p>12 with respect to mechanical royalties.</p> <p>13 Q And so any change is unrealistic?</p> <p>14 A Well, that magnitude of change</p> <p>15 would be very unrealistic given the state of</p> <p>16 the business.</p> <p>17 Q If what? I'm sorry?</p> <p>18 A Given the state of the business,</p> <p>19 that order of magnitude increase that they</p> <p>20 were asking for would be very unrealistic.</p> <p>21 Q What is the order of magnitude</p> <p>22 increase that they are seeking?</p>

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<p>1 A Well, if copyright expands for a 2 label runs 8 to 10 percent of billings and 3 they're seeking 27 and a half percent, seeking 4 a rate of 27 and a half percent, that is an 5 order of magnitude much higher than what we're 6 currently paying for copyright. So I would 7 say that that is an unrealistic number for us 8 as an industry, a record industry, to bear 9 given the state of the market.</p> <p>10 Q Are you aware of the basis for the 11 recording industry's position for its fee 12 proposal?</p> <p>13 MR. DeSANCTIS: Objection, Your 14 Honor. This is now deep into a line of 15 questioning about not the publisher's rate 16 proposal but the recording industry's rate 17 proposal in another proceeding that is not 18 remotely referenced in the witness' written 19 rebuttal statement. So it is beyond the scope 20 of the written rebuttal statement.</p> <p>21 CHIEF JUDGE SLEDGE: Mr. Joseph? 22 MR. JOSEPH: Well, the witness is</p>	<p>1 Copyright Royalty Tribunal adjusted for 2 changes that have occurred between 1981 and 3 today?</p> <p>4 A I don't know if it's primarily 5 based on that.</p> <p>6 Q Mr. Eisenberg, you testify on 1 7 that sound recording copyright owners face 8 significantly greater levels of investment and 9 risk than music publishers do. Do you see 10 that?</p> <p>11 A What page is that?</p> <p>12 Q It's on page 1. It's down at the 13 bottom of the page.</p> <p>14 A Yes, I see that.</p> <p>15 Q Have you ever worked in the music 16 publishing industry?</p> <p>17 A No.</p> <p>18 Q Have you ever conducted any 19 studies of the levels of investment made by 20 music publishers and their songwriters?</p> <p>21 A I talk to music publishers quite 22 frequently. And I'm aware of the levels of</p>
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<p>1 expressing his opinion on what constitutes 2 realistic and unrealistic positions. And I'm 3 trying to get a sense of what he knows and the 4 basis for his knowledge to be able to 5 formulate such a position about what the 6 publishers are seeking compared to what the 7 recording industry is seeking.</p> <p>8 CHIEF JUDGE SLEDGE: Overruled. 9 THE WITNESS: Can you repeat? 10 BY MR. JOSEPH:</p> <p>11 Q Do you know what the basis for the 12 recording industry's fee proposal is in the 13 section 115 case before these judges?</p> <p>14 A It's looking at historical costs 15 of content, historical copyright costs, 16 historical revenues for copyright holders, and 17 sales of configurations, and then trying to 18 create what we think is a reasonable proposal 19 for allocation as between the musical work and 20 the sound recording.</p> <p>21 Q Would it be fair to say that it is 22 based primarily on the 1981 decision of the</p>	<p>1 investment on a generalized basis that they 2 make in a particular sound recording and 3 promotion and marketing versus what we -- the 4 little investment that we as a record company 5 put into the process, most familiar with the 6 process of marketing and sales of recordings 7 and know what the publishers do and don't do 8 in regards to that process.</p> <p>9 Q Well, that wasn't my question, 10 sir. My question was, have you ever conducted 11 any study of the levels of investment made by 12 music publishers in their songwriters, not in 13 the creation of a sound recording?</p> <p>14 A I haven't done an independent 15 study.</p> <p>16 Q Have you ever analyzed the levels 17 of advances made by music publishers to their 18 songwriters?</p> <p>19 A They're much lower.</p> <p>20 Q Did you base that on any kind of 21 formal analysis of what they pay? 22 A They would tell you that.</p>

Page 310	Page 312
<p>1 Q They will tell you that?</p> <p>2 A Yes.</p> <p>3 Q These are publishers that you</p> <p>4 happen to speak with?</p> <p>5 A Yes.</p> <p>6 Q What is the average investment</p> <p>7 made by a music publisher to discover and</p> <p>8 develop a songwriter?</p> <p>9 A I don't know.</p> <p>10 Q And what is the average investment</p> <p>11 made by Sony BMG to develop and discover a</p> <p>12 performing artist?</p> <p>13 A It could be several million</p> <p>14 dollars.</p> <p>15 Q Do you know as you sit here what</p> <p>16 the average number is per performing artist?</p> <p>17 A It would depend on the genre and</p> <p>18 the type of artist.</p> <p>19 Q And I'm asking just if you know an</p> <p>20 average.</p> <p>21 A We don't look at the business in</p> <p>22 terms of an average per artist.</p>	<p>1 marketplace?</p> <p>2 A That music publishers have</p> <p>3 invested in first? There are many --</p> <p>4 Q Yes.</p> <p>5 A -- songs that are written before</p> <p>6 music publishers have financed a songwriter.</p> <p>7 Typically a music publisher will get involved</p> <p>8 in a songwriter's career after that songwriter</p> <p>9 has signed a record deal.</p> <p>10 So the risk is much lower for a</p> <p>11 music publisher than it is for the record</p> <p>12 company who has developed that talent first.</p> <p>13 And the music publisher comes in secondarily</p> <p>14 to sign the music -- to sign the songwriter to</p> <p>15 a publishing deal after he has already been</p> <p>16 discovered and the advances and the recording</p> <p>17 costs have already been sunk.</p> <p>18 Q What is your basis for that</p> <p>19 testimony?</p> <p>20 A When you sign an artist to a</p> <p>21 recording contract, they typically don't have</p> <p>22 a music publishing deal. So the level of</p>
Page 311	Page 313
<p>1 Q Now, what percentage of songs</p> <p>2 written by songwriters become profitable in</p> <p>3 the marketplace?</p> <p>4 MR. DeSANCTIS: Objection. This</p> <p>5 is a level of specificity that is far beyond</p> <p>6 the witness' testimony.</p> <p>7 CHIEF JUDGE SLEDGE: Mr. Joseph?</p> <p>8 MR. JOSEPH: The witness is</p> <p>9 sitting here telling the Court that there are</p> <p>10 significantly greater levels of investment and</p> <p>11 risk that sound recording copyright owners</p> <p>12 take in discovering and developing talent than</p> <p>13 music publishers.</p> <p>14 One would hope that there is some</p> <p>15 basis in knowledge for this blanket statement.</p> <p>16 And I'm exploring that, Your Honor.</p> <p>17 CHIEF JUDGE SLEDGE: Overruled.</p> <p>18 THE WITNESS: What is the</p> <p>19 question?</p> <p>20 BY MR. JOSEPH:</p> <p>21 Q What percent of songs written by</p> <p>22 songwriters become profitable in the</p>	<p>1 investment is first being made by the record</p> <p>2 company discovering and developing that talent</p> <p>3 before the music publisher comes along for the</p> <p>4 ride.</p> <p>5 Q There are music publishers who go</p> <p>6 out and discover songwriters, aren't there?</p> <p>7 A There are some.</p> <p>8 Q And they invest in those</p> <p>9 songwriters?</p> <p>10 A I don't know how much they really</p> <p>11 invest in those songwriters. Typically when</p> <p>12 the artist would -- singer/songwriter comes to</p> <p>13 us they have no money. And they're looking</p> <p>14 for advances to field their career. They</p> <p>15 first sign the record deal.</p> <p>16 And then they essentially parlay</p> <p>17 that into a music publishing deal because</p> <p>18 someone has already placed a bet on them as a</p> <p>19 commercial success.</p> <p>20 Q Well, that is one model. That</p> <p>21 certainly isn't the only model of how a music</p> <p>22 publisher operates, is it?</p>

Page 314	Page 316
<p>1 A Well, for developing talent, it's 2 quite frequent. 3 Q And it's also quite frequent that 4 music publishers go out and find songwriters, 5 isn't it? 6 A They may look for songwriters, but 7 the question is, are they making an investment 8 in them in terms of recording, in terms of 9 getting them artist advances, living advances, 10 marketing, and promoting them. Those are 11 functions of a record company, not functions 12 of a music publisher on average, generally 13 speaking. 14 Q The function of a record company 15 is for artists who also happen to be 16 songwriters, correct? 17 A There are many singer/songwriters 18 in the market who we signed. 19 Q And there are many songwriters who 20 are not singer/songwriters who have nothing to 21 do with a record company. Isn't that correct? 22 A There are some composers who are</p>	<p>1 testimony yet. Oral testimony or written 2 testimony? 3 Q Written testimony. 4 A I haven't looked at his filing. 5 Q As you sit there, do you remember 6 the names of any of the music publishers whose 7 testimony you looked at? 8 A No. 9 Q Did you look at Roger Faxon of VMI 10 Music Publishing? 11 A No. 12 Q Did you look at Ralph Peer of Peer 13 Music? 14 A Did I look at his testimony? 15 Q Testimony, yes, sir, not at him. 16 A No. 17 Q Did you look at the testimony of 18 Nick Firth of BMG Music Publishing? 19 A I don't recall. 20 Q So let me get this straight. 21 Before submitting your testimony talking about 22 the relative lists of the music publishers and</p>
Page 315	Page 317
<p>1 not also performers. 2 Q And the model you have just 3 described doesn't apply to them, does it? 4 A They would not be getting a record 5 deal because they are not a performer. 6 Q Right. Now, you testified that 7 you reviewed some of the publisher statements 8 in the section 115 proceeding. Do you 9 remember the testimony of Mr. Erwin Robinson 10 of Famous Music Company? 11 A Not specifically. 12 Q You don't remember reading that 13 one? 14 A Not specifically. 15 Q Do you remember generally reading 16 that one? 17 A No. 18 Q Name mean anything to you? 19 A I know who Erwin Robinson is. 20 Q Do you know he testified in the 21 115 proceeding? 22 A I don't know -- believe there was</p>	<p>1 the record companies, despite knowing that 2 there was a section 115 proceeding out there 3 with the music publishers or talking about the 4 publishing business, you didn't look at any of 5 the testimony? 6 A I have been in the business for 13 7 years. And based on that, I have a sense of 8 what the relative risks are between music 9 publishers and record companies. 10 I also worked as a lawyer in Sony 11 Music Entertainment, Inc., where I actually 12 drafted publishing agreements on behalf of 13 Sony BMG Publishing. 14 So I have a general sense of the 15 disparity in risks and investments in 16 publishers and record labels. 17 Q So that's a no, correct? You 18 didn't look at any of their testimony, -- 19 A I didn't -- 20 Q -- which was my only question? 21 A I didn't have to. 22 Q But you didn't. Is that correct?</p>

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<p>1 A With respect to this, filing this 2 testimony, I did not refer back to the 115 3 proceeding. 4 Q You did say that you looked at the 5 testimony in the 115 proceeding. So I'm just 6 trying to get an understanding -- 7 A I looked at -- 8 Q -- of what you looked at. 9 A I looked at the summary of the 10 requests, the rate proposals. I certainly 11 thumbed through excerpts of the filings, which 12 were quite voluminous at the time that they 13 were submitted. But I didn't sit down and 14 study them in preparation for this testimony 15 because I relied on my general knowledge. 16 Q Okay. Take a look, please, at 17 page 6 of your written rebuttal testimony. On 18 page 6, you discuss the mechanical royalty. 19 And you say -- and I quote at the end of the 20 carryover paragraph -- "Indeed, in many cases, 21 record companies pay less than the statutory 22 rate for mechanical licenses, showing that the</p>	<p>1 that. 2 Q But the overwhelming majority of 3 circumstances in which record companies pay 4 less than the statutory rate is pursuant to 5 the controlled composition clause, correct? 6 A For certain physical 7 configurations, but in the digital world, 8 where you are doing a lot of promotional and 9 one-off deals, you actually go back quite 10 frequently to publishers to ask for discounts. 11 Q Well, do you remember making a 12 similar statement in your webcasting rebuttal 13 testimony? 14 A I don't recall. 15 Q You don't recall? Do you recall 16 being asked whether it was a reference to the 17 controlled composition clause and you said 18 that it was at the time? 19 A I don't recall. 20 MR. JOSEPH: Why don't we show the 21 witness his testimony in the webcasting case? 22 (Whereupon, the</p>
Page 319	Page 321
<p>1 current rate is actually above a free market 2 rate." Do you see that? 3 A I'm sorry? Which? 4 Q At the end of the carryover 5 paragraph on the top of page 6. 6 A I see the sentence. 7 Q Okay. Now, that's a reference to 8 what is commonly called the controlled 9 composition clause, correct? 10 A Yes. 11 Q Okay. That's a yes? 12 A Yes, it is. 13 Q And specifically the circumstances 14 in which record companies pay less than the 15 statutory rate, correct, is a reference to the 16 controlled composition clause? 17 A In some cases. You may also go to 18 a publisher for a royalty break in certain 19 instances. So, in addition to the controlled 20 composition, there are times when you would 21 seek a royalty break, even if you didn't have 22 a right per the contract. You would negotiate</p>	<p>1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22</p> <p>aforementioned document was marked for identification as SDARS Exhibit Number 95.) MR. JOSEPH: Thank you. BY MR. JOSEPH: Q Let me ask you to look, sir, at the bottom of page 151, starting at line 16 and continuing to page 152, line 4. Does that refresh your recollection? A I'm sorry? One fifty-one, line 16? Q To 152, line 4. I'm sorry. Actually, let's carry it down to 152, line 14, where you actually answer the question. A What was the question? Q Does that refresh your recollection that in the webcasting case, you included essentially the same sentence and testified that it was a reference to the controlled composition clause? A It applies to the controlled</p>

<p style="text-align: right;">Page 322</p> <p>1 composition clause, but it isn't exclusive to 2 the controlled composition clause. And since 3 November 30th of last year, we have actually 4 done deals with publishers where we have 5 sought discounts beyond the controlled 6 composition. So that my testimony in this 7 proceeding is actually -- there are actually 8 more examples of negotiating discounts than 9 just for the controlled composition. 10 Q And that's in the digital world 11 you testified? 12 A I'm sorry? What is -- 13 Q I'm sorry. I'll withdraw that 14 question. With respect, though, to the 15 controlled composition clause to which you 16 referred the last time you made that statement 17 and certainly as part, I take it, of what 18 you're talking about here, that's a provision 19 in an agreement between an artist and a record 20 company, correct? 21 A The controlled composition clause 22 is a provision in our record agreement as</p>	<p style="text-align: right;">Page 324</p> <p>1 actual negotiation, whatever is going through 2 the singer/songwriter's mind? 3 A There is a negotiation for a 4 record contract. A controlled composition is 5 part of that contract. And we negotiate them 6 within the same transaction. 7 Q That's one of the terms of the 8 contract, right? 9 A Yes. 10 Q Now, with respect to ringtones you 11 talk about at some length starting on page 8, 12 it's true, is it not, that Sony BMG engages in 13 a number of activities beyond merely granting 14 a license when it makes a deal with a wireless 15 carrier to provide ringtones? 16 A I'm not sure I follow the 17 question. 18 Q Does Sony BMG take the master 19 record and create an excerpt to use for the 20 ringtone? 21 A We identify the hook of that 22 master recording and deliver it to the service</p>
<p style="text-align: right;">Page 323</p> <p>1 relates to publishing rights that the 2 singer/songwriter is granting to us. 3 Q And when you say your "record 4 agreement," that's your agreement between the 5 record company and the artist, correct? 6 A Yes. 7 Q Now, you spent some time talking 8 -- well, let me withdraw that. And back on 9 the controlled composition clause, that's part 10 of the overall negotiation of the recording 11 contract between the artist and the record 12 company, isn't it? 13 A It's negotiated at the same time. 14 And it's in the same agreement. 15 Q And it's true, is it not, that the 16 singer/songwriter sometimes trades off the 17 controlled composition clause for other 18 consideration in the agreement? 19 A I don't know what's going through 20 the singer/songwriter's mind when he makes 21 those concessions. 22 Q But that's what happens in the</p>	<p style="text-align: right;">Page 325</p> <p>1 provider. 2 Q So you do more than identify it? 3 You actually produce the ringtone? 4 A Just like we do for digital 5 downloads, we produce the digital master. And 6 we deliver the digital master to the service 7 provider. 8 Q And you actually have to 9 redigitize the recording so that it sounds 10 good on a cell phone, don't you? 11 A Just as we do with digital 12 downloads and for streams for online 13 subscription services in the digital world, 14 our responsibility is to deliver content to 15 the service provider in all formats and in all 16 different codecs and in all different bit 17 rates. It's part of what we do for all of our 18 distribution agreements. 19 Q And you prepare different versions 20 of the ringtones for different phones that the 21 carrier offers, too, don't you? 22 A Just as we do for digital</p>

<p style="text-align: right;">Page 326</p> <p>1 downloads and for streams.</p> <p>2 Q Now, does your marketing staff and</p> <p>3 sales staff work with the wireless carrier to</p> <p>4 help promote the ringtone?</p> <p>5 A In the same way that we do with</p> <p>6 our sales teams at iTunes or Napster or</p> <p>7 Rhapsody. It's a very similar process.</p> <p>8 Q So that's a yes, right, actually?</p> <p>9 A Yes.</p> <p>10 Q Does the music publisher engage in</p> <p>11 any of those activities in connection with a</p> <p>12 ringtone?</p> <p>13 A For a master recording?</p> <p>14 Q Yes, sir.</p> <p>15 A I don't believe they do.</p> <p>16 CHIEF JUDGE SLEDGE: All right,</p> <p>17 Mr. Joseph. You're taking us to the end of</p> <p>18 the day.</p> <p>19 MR. JOSEPH: Sorry about that,</p> <p>20 Your Honor. I was getting close, but I tried.</p> <p>21 CHIEF JUDGE SLEDGE: We will</p> <p>22 recess until 9:30 in the morning. And, as we</p>	
<p style="text-align: right;">Page 327</p> <p>1 conclude, I invite you to look around your</p> <p>2 space and see if this looks the way you like</p> <p>3 it to look.</p> <p>4 (Whereupon, the foregoing matter</p> <p>5 was recessed at 5:16 p.m., to be reconvened on</p> <p>6 Wednesday, August 29, 2007, at 9:30 a.m.)</p> <p>7</p> <p>8</p> <p>9</p> <p>10</p> <p>11</p> <p>12</p> <p>13</p> <p>14</p> <p>15</p> <p>16</p> <p>17</p> <p>18</p> <p>19</p> <p>20</p> <p>21</p> <p>22</p>	

Transcript of:

Date: August 29, 2007

Volume: 25

Case: Adjustment of Rates for Pre-Existing Subscriptions

Neal R. Gross & Co., Inc.
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Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

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In the matter of:

Adjustment of Rates and
Terms for Preexisting
Subscriptions Services,

and

Satellite Digital Audio
Radio Services
|-----+

Docket No. 2006-1
CRB DSTR

Room LM-408
Library of Congress
First and Independence Avenue, S.E.
Washington, D.C. 20540

Wednesday,

August 29, 2007

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

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

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

2 9:33 a.m.

3 CHIEF JUDGE SLEDGE: Mr. Joseph?

4 MR. JOSEPH: Thank you, Your

5 Honor.

6 Whereupon,

7 MARK EISENBERG

8 was recalled as a witness by Counsel for

9 SoundExchange, and having been first duly

10 sworn, assumed the witness stand, was examined

11 and testified as follows:

12 CROSS EXAMINATION

13 BY MR. JOSEPH:

14 Q Good morning, Mr. Eisenberg.

15 A Good morning.

16 Q I just want to go back for a

17 second on something we discussed yesterday,

18 the mechanical royalty which figures in a

19 couple of your entries on your table, if you

20 remember, on page 5 publishing rate. The

21 table at the top of page 5. And that's the

22 statutory mechanical rate, correct?

1 A I'm sorry. Which box?

2 Q The first two entries, wireless

3 full length and digital downloads?

4 A Yes.

5 Q And that's being revisited in a

6 new proceedings in front of these Judges,

7 correct?

8 A In the Section 115 proceeding,

9 yes.

10 Q Now that's proceeding is important

11 to you in your role as Executive Vice

12 President in the global digital business,

13 correct, since it governs your relationships

14 with the publishers for services such as

15 downloads?

16 A It's relevant.

17 Q You wouldn't call it important?

18 A I would -- the result is

19 important. The process is not something I'm

20 personally involved with. But the result is

21 important.

22 Q Okay. So I just wanted to be

<p style="text-align: right;">Page 6</p> <p>1 clear about your testimony concerning the 2 RIAA's position in that litigation. I think 3 yesterday you said you didn't recall whether 4 the basis was the 1981 CRT decision. I just 5 wanted to hand out a document to see if we 6 could refresh your recollection on what the 7 exact basis of the RIAA's position is in that 8 proceeding.</p> <p>9 CHIEF JUDGE SLEDGE: Mr. 10 DeSanctis?</p> <p>11 MR. DeSANCTIS: Your Honor, I'd 12 like to object. The witness has said that 13 he's not involved in the process. He's not an 14 RIAA employee and that he's not directly 15 involved in what positions the RIAA has taken 16 in that case, nor is his testimony about the 17 position the RIAA has taken at all. It's 18 simply the rates that the publishers are 19 paying that come out of those proceedings.</p> <p>20 CHIEF JUDGE SLEDGE: Mr. Joseph? 21 MR. JOSEPH: This proceeding is 22 governing the rates that services would pay on</p>	<p style="text-align: right;">Page 8</p> <p>1 credibility. 2 CHIEF JUDGE SLEDGE: I agree. 3 This is too afield. Sustained. 4 BY MR. JOSEPH: 5 Q Let me ask you to turn, Mr. 6 Eisenberg, to page 12 of your written rebuttal 7 testimony where you provide the gross margin 8 numbers in your testimony. 9 Now yesterday I believe you 10 testified that you called the Executive Vice 11 President of Finance in the digital business 12 to get that number? 13 A The Vice President of Finance. 14 Q The Vice President of Finance. And 15 do you remember when you made that call? Was 16 it before you submitted your testimony? 17 A Yes. 18 Q How long before? 19 A I don't know the exact date. I 20 was probably -- this was submitted in July of 21 2007, so it was before I submitted the -- the 22 written testimony.</p>
<p style="text-align: right;">Page 7</p> <p>1 a going forward basis as well as currently. 2 I'm talking about the proceeding we're in 3 front of here.</p> <p>4 Mr. Eisenberg submitted a table 5 that includes entries that include the 6 mechanical royalty that is currently the 7 subject of a proceeding before Your Honors. 8 He's testified about its significance, at 9 least the outcome significance and his role as 10 manager of the global digital business. And 11 moreover, I want to see whether he's credible 12 in terms of his statements about his knowledge 13 of such things or lack of knowledge about such 14 things. He's come in and purported to give 15 Your Honors a gross margin number that he says 16 he uses regularly. And this is an issue that's 17 at the core of some of the dealings in his 18 business.</p> <p>19 So there are a variety of reasons 20 that I believe it's relevant. And he testified 21 yesterday as to not knowing what it was. So, 22 again, I'm entitled I believe to test his</p>	<p style="text-align: right;">Page 9</p> <p>1 Q What specifically did you ask for? 2 A The specific gross margin number 3 to the penny. 4 Q I'm sorry? 5 A The specific gross margin number 6 to the penny. 7 Q And you got a document back? 8 A He sent -- he gave me the number 9 and then an attachment. 10 Q Now, when you submitted your 11 written rebuttal testimony, you didn't know 12 who prepared that number, did you? 13 A I know who -- I know where -- from 14 whom I received the number. 15 Q Right. But you don't know where 16 he got it, do you? 17 A So I don't-- he said he had it so 18 I didn't ask him whether he had prepared it or 19 someone on his staff had prepared it. 20 Q And you don't know what the source 21 of the underlying data that resulted in this 22 numbers were, do you?</p>

3 (Pages 6 to 9)

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Page 10	Page 12
<p>1 A Well, I know that he contacted</p> <p>2 finance people at the various labels and</p> <p>3 distilled information that he was given from</p> <p>4 them to come up with his analysis or his P&L.</p> <p>5 Q And he did that all in the five</p> <p>6 minutes that it took for him to forward the</p> <p>7 document to you?</p> <p>8 A No, he had the document already</p> <p>9 beforehand. I had asked "Do you have</p> <p>10 something?" And he said "Yes, I have it in my</p> <p>11 office. I'll just forward it to you." It's</p> <p>12 something that he had kept in his normal</p> <p>13 course of business.</p> <p>14 Q And is it your understanding that</p> <p>15 the numbers are the numbers for 2006?</p> <p>16 A I believe so.</p> <p>17 Q Now using the same calculations</p> <p>18 you testify about, Sony BMG's gross margins on</p> <p>19 its mid-price CDs in 2006 was \$3.25, correct?</p> <p>20 A That -- that's the number that he</p> <p>21 gave me.</p> <p>22 Q And the Sony BMG's gross margin on</p>	<p>1 provide?</p> <p>2 A Yes. Yes.</p> <p>3 MR. JOSEPH: I have no further</p> <p>4 questions.</p> <p>5 CHIEF JUDGE SLEDGE: Any questions</p> <p>6 by XM?</p> <p>7 MR. RICH: No, Your Honor.</p> <p>8 CHIEF JUDGE SLEDGE: Any redirect?</p> <p>9 MR. DeSANCTIS: Yes, Your Honor.</p> <p>10 Very briefly.</p> <p>11 REDIRECT</p> <p>12 BY MR. RICH:</p> <p>13 Q Mr. Eisenberg, what is the</p> <p>14 percentage of CD sales at Sony BMG that are</p> <p>15 frontline?</p> <p>16 A As a percentage of what I would</p> <p>17 calling billings or revenue?</p> <p>18 Q Right.</p> <p>19 A It's probably in the realm of</p> <p>20 about 85 percent in terms of units. It's</p> <p>21 perhaps less, maybe 79 or 80 percent in that</p> <p>22 range.</p>
Page 11	Page 13
<p>1 its budget priced CDs in 2006 was \$1.36?</p> <p>2 A That, again, is the number that he</p> <p>3 told me.</p> <p>4 Q Now a fairly high percentage of</p> <p>5 CDs sold in the United States are sold by</p> <p>6 major retailers like Wal-Mart and Best Buy,</p> <p>7 correct?</p> <p>8 A Yes.</p> <p>9 Q And those retailers typically</p> <p>10 negotiate discounts off the wholesale price,</p> <p>11 don't they?</p> <p>12 A They negotiate for special</p> <p>13 marketing programs. Sometimes they're in the</p> <p>14 form of discounts, sometimes they're in the</p> <p>15 form of marketing credits.</p> <p>16 Q Now, are those discounts reflected</p> <p>17 in the gross margin number that you provided</p> <p>18 in your testimony?</p> <p>19 A Yes.</p> <p>20 Q Are the marketing allowances or</p> <p>21 the allowances that you've referenced</p> <p>22 reflected in the gross margin number that you</p>	<p>1 MR. DeSANCTIS: No further</p> <p>2 questions, Your Honor.</p> <p>3 JUDGE ROBERTS: Mr. Eisenberg,</p> <p>4 what's your definition of "frontline"?</p> <p>5 THE WITNESS: It's our highest</p> <p>6 price category for wholesale products.</p> <p>7 Typically are new releases are in frontline</p> <p>8 and some of our, you know, established</p> <p>9 artists, super popular catalogue releases are</p> <p>10 in frontline.</p> <p>11 CHIEF JUDGE SLEDGE: I want to go</p> <p>12 back to something Mr. Joseph began with today</p> <p>13 on the chart on page 5. I was confused by your</p> <p>14 earlier testimony and answer to Mr. Joseph.</p> <p>15 I understood you to say that your</p> <p>16 numbers in the first two categories for</p> <p>17 wireless full length downloads and digital</p> <p>18 downloads are incorrect because the sound</p> <p>19 recording rate includes the publishing rate</p> <p>20 which was not deducted. And the publishing</p> <p>21 rate includes that same amount, which was not</p> <p>22 added. And therefore, the last column for</p>

4 (Pages 10 to 13)

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<p>1 each of those two categories is wrong. Is 2 that correct?</p> <p>3 THE WITNESS: Yes. I think what I 4 was trying to clarify is the second part where 5 the numbers should be brought down. The 6 first, page 5, is correct. So in order to get 7 the net -- the net ratio between the sound 8 recording and the publishing, you would take 9 out of the 95 and -- but we're not in closed 10 session, are we?</p> <p>11 CHIEF JUDGE SLEDGE: No.</p> <p>12 THE WITNESS: Okay. So you'd take 13 the number in the sound recording column that 14 says the X cents or dollars per track, and you 15 deduct out the third column the publishing 16 rate, which is what I had done, and you get to 17 the fourth column which is the ratio between 18 the sound recording and the publishing.</p> <p>19 CHIEF JUDGE SLEDGE: I don't know 20 where you're referring to with four columns.</p> <p>21 THE WITNESS: Right.</p> <p>22 CHIEF JUDGE SLEDGE: The fourth</p>	<p>1 THE WITNESS: Our rates on page 5 2 are inclusive of the publishing royalty. The 3 rate on page 6 is exclusive of the publishing 4 royalty.</p> <p>5 CHIEF JUDGE SLEDGE: Right. 6 Any other questions from that? 7 Thank you, sir. That ends your 8 testimony.</p> <p>9 THE WITNESS: Thank you. 10 (Whereupon, the witness was 11 excused.)</p> <p>12 CHIEF JUDGE SLEDGE: Mr. Freedman? 13 MR. FREEDMAN: Yes, Your Honor. 14 Our next witness is Barrie Kessler.</p> <p>15 CHIEF JUDGE SLEDGE: All right. 16 Mr. Rich?</p> <p>17 MR. RICH: Your Honors, I just 18 wanted to introduce the Court to my colleague, 19 Mr. Fiore who is, I think, a new face to you. 20 He will be handling any objections and cross 21 examination on behalf of XM.</p> <p>22 CHIEF JUDGE SLEDGE: Fiore?</p>
Page 15	Page 17
<p>1 column is the ratio?</p> <p>2 THE WITNESS: Yes. The ratio -- 3 these ratios are correct --</p> <p>4 CHIEF JUDGE SLEDGE: All right.</p> <p>5 THE WITNESS: -- on page 5. It's 6 on page 6 where I would make a modification 7 because I didn't deduct the publishing, or 8 didn't deduct the public performance rate. 9 And so if you would use the same methodology 10 the 7 to 10X would come down, I guess 6 to 9. 11 And the 5 to 8X would come down to 4 to 7.</p> <p>12 CHIEF JUDGE SLEDGE: Videos is 6 13 to 8 percent -- well, whatever the numbers 14 are, it's 6 to 8?</p> <p>15 THE WITNESS: 6 to 9, I believe.</p> <p>16 CHIEF JUDGE SLEDGE: All right.</p> <p>17 THE WITNESS: And 4 to 7.</p> <p>18 CHIEF JUDGE SLEDGE: All right. I 19 was confused by that because of your footnotes 20 on page 5, footnotes 5, 7 and 9 seemed to be 21 different than what I understood your 22 testimony to be.</p>	<p>1 MR. FIORE: Yes, sir.</p> <p>2 CHIEF JUDGE SLEDGE: Spell that.</p> <p>3 MR. FIORE: F-I-O-R-E.</p> <p>4 CHIEF JUDGE SLEDGE: Mr. Freedman? 5 Whereupon, 6 BARRIE KESSLER 7 was called as a witness by Counsel for 8 SoundExchange, and having been first duly 9 sworn, assumed the witness stand, was examined 10 and testified as follows:</p> <p>11 DIRECT EXAMINATION 12 BY MR. FREEDMAN:</p> <p>13 Q Good morning. Could you please 14 state your name for the record.</p> <p>15 A Barrie Kessler.</p> <p>16 Q And, Ms. Kessler, I'd like to 17 distribute to you if I could what has been 18 marked as SoundExchange Trial Exhibit 127. 19 (Whereupon, the document 20 was marked as 21 SoundExchange Trial 22 Exhibit 127 for</p>

5 (Pages 14 to 17)

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Before the
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Washington, D.C.

In the Matter of)
)
)
ADJUSTMENT OF RATES AND TERMS FOR) Docket No. 2006-1 CRB DSTR
PREEXISTING SUBSCRIPTION SERVICES)
AND SATELLITE DIGITAL AUDIO RADIO)
SERVICES)
)
)

REBUTTAL TESTIMONY OF

BRUCE R. ELBERT

President, Application Technology Strategy, Inc.

Public Version

July 2007

Rebuttal Testimony of BRUCE R. ELBERT

I. INTRODUCTION AND QUALIFICATIONS

My name is Bruce Elbert. I am the President of Application Technology Strategy, Inc., a company I own that assists users and providers of satellite technology. Prior to my current employment, I spent 25 years with Hughes Electronics, the company that invented and built the first geostationary satellite, produced and operated ground electronics and networks that control and employ such satellites, and established DirecTV as the first leading direct-to-home satellite television operator in the US. Although I had no direct role in the project, Hughes was selected during my tenure to design and construct the satellites employed by XM.

As Senior Vice President, Operations, at Hughes, I managed engineering design teams that designed communications satellites and networks for mobile and broadband applications to US and international customers. Between 1984 and 1995, I developed the design and service offering for mobile satellite programs; managed service marketing, operations and engineering of the Galaxy cable-TV satellite network; assisted with DirecTV startup by recommending space segment and control system specifications; and prepared the successful FCC filing for the Spaceway digital broadband satellites. Prior to 1984, my role was to oversee the development of the communications payload and bus for several satellites, including the first Mexican satellites. I also was responsible for the overall design and end-to-end test of two satellites and a complete ground segment for Indonesia with 40 Earth stations to support a nationwide network for television distribution and telephone communications.

In 1987, while at Hughes, I also helped establish Supermarket Radio Network, an innovative satellite-delivered service that was the first to combine multiple radio channels with individual formats with terrestrial repeaters using local FM transmitters. While at Hughes, I was

responsible for system design and end-to-end testing of the Indonesian satellite system Palapa A, overseeing a team of five suppliers and over 100 engineers and technicians. I also represented the company and the United States at two World Radiocommunication Conferences.

Prior to my employment at Hughes, I was Assistant Vice President at Western Union Corporation during the development of their second generation satellite system. My responsibility in 1979-1980 was to develop replacement satellites that would implement new digital communications services for data and video applications.

In the early days of the satellite industry, between 1969 and 1972, I worked for COMSAT, where I helped refine concepts that are the foundation of today's fixed and mobile satellite networks. I served on the engineering team that defined the mobile satellite communications architecture for the Inmarsat satellite system for serving ships and aircraft.

Prior to entering the satellite industry, I was a communications officer in the U.S. Army Signal Corps, leading field units that installed various types of wireless and wired communications for the 4th Infantry Division in Vietnam. Upon my return to the United States, I was assigned as senior radio instructor and team chief at the Army Signal School at Fort Gordon, Georgia.

I am an Adjunct Assistant Professor at the University of Wisconsin-Madison in the College of Engineering distance learning program. I have also been an instructor in the Engineering Extension program at UCLA since 1990, teaching a variety of technical courses regarding satellite communications space and ground systems, equipment and applications.

I am a member of the Institute of Electrical and Electronics Engineers (IEEE) and the American Institute of Aeronautics and Astronautics (AIAA). I am also the editor of the Artech House library concerning Space Technology and Applications. I have led and presented at

numerous technical panels and workshops over the years regarding communications satellites and the applications that they provide.

I received a Master of Science degree from the University of Maryland, College Park, with concentration in communications and computer engineering and a Bachelor of Electrical Engineering degree from the City University of New York. Both degrees include studies in radio frequency antennas and electronic systems. I also obtained a Masters of Business Administration from Pepperdine University.

I have written eight books on communications technologies, including three specifically dealing with satellites and their applications, one of which has a chapter that describes in detail the design and performance of XM and Sirius. I have written many articles and technical papers, and am a frequent contributor to SatMagazine.com, an industry trade publication available over the Internet. I have submitted testimony on satellite technology issues in other legal proceedings. My qualifications are set forth in greater detail in my current CV attached as Appendix A.

II. OVERVIEW OF TESTIMONY

I am submitting this testimony to rebut the claims by XM Satellite Radio and Sirius Satellite Radio (collectively, the “Services”) in this proceeding that satellite technology is risky, innovative or heretofore unknown, and to offer my opinions regarding technical and operational aspects of satellite digital audio radio service (“SDARS”). I believe the Services’ claims are exaggerated. Specifically, I have reviewed portions of the Services’ direct cases in this proceeding, including portions of the written and oral testimony of Anthony Masiello, Terrence Smith, Mel Karmazin, David Frear and Gary Parsons, portions of the depositions of Mr. Karmazin, Mr. Frear and Mr. Parsons, as well as documents produced in discovery to SoundExchange by the Services, and publicly available documents.

III. THE ADVANTAGES OF SATELLITE SYSTEMS

In their written and oral direct testimony, Sirius and XM's witnesses discuss the costs and risks of using satellites. Written Direct Testimony of Gary Parsons, ¶ 5 ("Parsons WDT") ("[M]assive investments would be required to build the business."), ¶ 15 (describing "inherently risky" nature of satellites"); Frear WDT, ¶ 2 (discussing Sirius's "extensive investment"), ¶ 5 ("Satellite businesses are extremely risky."), ¶ 12 ("The costs of bringing this new technology to market are enormous."); Karmazin WDT ¶ 3 (discussing "the extraordinary . . . costs and risks that Sirius has incurred . . ."); Tr., June 6, 2007 (Karmazin testimony), at 283 (claiming that "there's just lots and lots of risks associated with satellites"); Smith WDT ¶ 7 ("Designing, building and launching a satellite is an enormously lengthy, costly, and risky proposition."); Masiello WDT ¶ 12 (noting "the enormous effort and expense required").

However, this testimony ignores the many significant advantages provided by satellite systems, which outweigh the costs. Indeed, Sirius and XM's own satellite expert Roger Rusch¹ repeatedly told groups to which he lectured that satellite radio broadcasting is "Brilliant." SX Ex. 201 RP at SDARS CRB 3251 (also noting that "[s]atellite broadcasting is cost effective" and that "the business model can work").

A. Satellites Are a Cost Effective and Reliable Way to Broadcast Content Nationwide.

Satellites are the most cost effective way to broadcast content nationwide. Despite the high up-front costs for satellites, numerous companies use satellites as the most cost-effective way to implement their various business models, resulting in an extremely robust satellite communications industry that generates over \$90 billion in annual revenue. In fact, currently

¹ The Services ultimately withdrew Mr. Rusch's testimony.

[REDACTED]); SIR 33514 (noting the “[REDACTED]
[REDACTED]
[REDACTED]”).

The cost effectiveness of satellites can be further demonstrated as follows. If a satellite system space segment (consisting of two in-orbit satellites and a ground spare) with a 15-year life span costs \$800 million and serves 10 million subscribers a year, the cost amounts to 44 cents per subscriber per month.

B. XM and Sirius Benefited from Other Businesses’ Experience Using Satellites.

There is nothing new about the Services’ use of satellites. Private companies have been launching and using satellites for decades. As will be discussed in more detail below, the technology is proven and well understood, and XM and Sirius were able to leverage these existing technologies in the development of their systems. As XM noted in its own documents, [REDACTED]
[REDACTED] See SX Ex. 202 RR, at XMCRB 21582.

In fact, XM and Sirius were even able to build upon the experience of another pre-existing satellite radio service – WorldSpace. WorldSpace is capable of providing over 100 channels of music and talk radio programming to listeners with portable receivers in Africa and Asia since it launched its first satellite in October 1998.³

XM has explicitly noted its reliance on WorldSpace, stating [REDACTED]
[REDACTED]” See SX Ex. 202 RR, at XMCRB

³ There are technical differences between the WorldSpace system and the systems used by XM and Sirius (e.g., WorldSpace uses L-band frequencies rather than the S-band frequencies used by XM and Sirius), but XM and Sirius were able to build upon what WorldSpace had begun.

21583. Gary Parsons, XM's Chairman of the Board, admitted that XM [REDACTED]
[REDACTED]
[REDACTED] Parsons Depo. at 22-24, 33, 35.
[REDACTED]
[REDACTED] XMCRB 21409. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]. XMCRB 44448-44462,
at 44448.

XM and Sirius were able to capitalize on the prior experiences of other satellite services. As will be discussed in more detail below, satellites had been used for decades to transmit all sorts of user content (television signals, audio signals, telephone calls, other types of data). In particular, XM and Sirius were able to build upon the experience of the satellite television industry, including the Dish Network and DirecTV, which use satellites to provide video and audio programming directly to consumers for a monthly fee, a service similar in many ways to that of providing audio content.

In many ways, the SDARS faced an easier problem than the satellite television services, despite Mr. Masiello's claims otherwise. Masiello WDT ¶ 3. Mr. Masiello claimed that XM solved a more difficult technical problem with a smaller receiving antenna. *Id.* Mr. Smith also complained that other services used large and expensive receiving antennas. Smith WDT ¶ 4. But these witnesses ignored several key facts. The satellite television services provided audio-only music channels, just like the SDARS, but they provided video programming as well, which requires the transmission of much more data than just audio. Furthermore, satellite television

uses a different part of the spectrum, the Ku-band rather than the S-band, that has reception problems when there is cloud cover or rain, thereby requiring larger receiving antennas. Finally, as is discussed below, other organizations, including NASA, had previously successfully used satellites to transmit to moving vehicles (cars, planes, and ships), and many services used small, omni-directional antennas to receive information from satellites without having to point a receiving antenna at the satellite

In addition, the satellite television industry had developed business systems to support the management of satellite systems (*e.g.*, systems to initiate service, collect revenue, etc.). Mr. Parsons admitted that XM gained experience in billing, programming, and customer service (along with monetary investments) directly from DirecTV. Parsons WDT ¶ 9.

Because of the leverage from pre-existing satellite services, XM and Sirius could start their services relatively rapidly and garner millions of paying subscribers in one of the shortest periods in history. Although XM's and Sirius's witnesses complained of the amount of time they spent developing their services, Smith WDT ¶ 4 (noting "decade-long gestation period"); Parsons WDT ¶ 5 (discussing the "years of effort" put in by XM); Karmazin WDT ¶¶ 13-22; Tr., June 6, 2007, at 268-70 (Karmazin testimony), DirecTV required even more time to develop its service because it developed its service first.

Moreover, given the number of different satellite manufacturers, satellite businesses can pit companies against one another to compete for the rights to build the satellites. With their recent satellite purchases, both XM and Sirius [REDACTED]

[REDACTED]
[REDACTED] XMCRB 98577-79. [REDACTED]

65.

C. For Decades Satellite Businesses Have Been Able to Raise Significant Funds from the Capital Market for the Operation of Their Satellites.

XM's and Sirius's witnesses emphasized the high upfront costs of satellite businesses.

See, e.g., Parsons WDT ¶ 13; Frear WDT ¶¶ 8, 14; Masiello WDT ¶ 8; Tr., June 6, 2007

(Karmazin testimony), at 269. Such statements ignore two facts: as discussed above, satellites have long operational lives requiring minimal attention; and satellite businesses have experience raising significant amounts of capital through the markets. As early as the mid-1960s, a satellite company used an IPO to raise hundreds of millions of dollars. By the early 1980s, the major Wall Street investment firms had specialists who maintained contacts with the principal satellite operators and manufacturers. Echostar, Iridium, GlobalStar, and WorldSpace all used the capital markets to raise huge sums of money to finance their initial operations. As large as XM's and Sirius's initial investments were, they are the norm in the satellite industry.

Furthermore, satellite businesses take steps to control and predict these costs. For example, satellites are purchased with so-called "fixed-price" contracts. Under these contracts, the manufacturers bear the risks of any cost increases during the manufacture of the satellites. The contracts also frequently contain liquidated damages clauses whereby the manufacturer must pay the satellite business if the satellite is not delivered on time. Typically, businesses make progress payments under the contract as the satellite is being built, but many withhold a portion of the price until the satellite has been successfully tested and as an incentive for the continued satisfactory performance of the satellite. If the satellite business feels that the manufacturer did not build the satellite to proper specifications, the business can terminate the contract for cause and receive back all monies paid. [REDACTED]

[REDACTED]

[REDACTED] XMCRB 102580-102727 at 102634, 103636, 102697-98.

D. XM and Sirius Have Another Unique Benefit: a Government Created Duopoly.

XM and Sirius have an advantage unique to their satellite systems: a government-created duopoly. The Federal Communications Commission (FCC) auctioned the frequencies used to broadcast satellite radio signals. The predecessors of XM and Sirius successfully bid on these frequencies, and they received *exclusive* licenses to the frequencies in question, thereby forestalling any possible competition by a third satellite radio service. Further, the FCC, along with providing domestic licenses, arranged for international acceptance of the licenses as well.

IV. PRIVATE BUSINESSES HAVE DESIGNED, LAUNCHED, AND OPERATED SATELLITES FOR FORTY YEARS.

Contrary to the testimony of XM's and Sirius's witnesses, XM and Sirius did *not* need "to create an entirely new means of providing audio programming." Karmazin WDT ¶ 3; *see also* Parsons WDT ¶ 2 ("We built the new satellite radio industry . . . from scratch . . ."); Frear WDT ¶ 2 (asserting that Sirius has "create[d] from scratch a new transmission system"); Masiello WDT ¶ 2 (noting that XM "had to design, build and launch virtually from scratch, all aspects of its service infrastructure"); Smith WDT ¶ 4 ("Sirius took on the enormous task of designing and building from scratch a . . . satellite digital audio radio service.").

In fact, XM and Sirius created their systems by building upon existing technologies and designs from the many satellite ventures that existed before. As Mr. Rusch admitted, "many of the practical technical issues were resolved in 1963." Rusch WDT ¶ 11.

While there are no off-the-shelf satellite systems, and each system must be independently tailored to fit specific system requirements, each system builds on previously designed systems.

The satellite industry has time-tested and proven methodologies for designing, verifying, and testing satellite systems, including adaptations made to previously proven designs. Nearly every satellite system – including the geostationary satellites used by XM and the elliptical-orbit satellites used by Sirius – starts with a proven satellite design and is tailored by the manufacturer to meet the specific needs of the operator. The industry standards and methodologies provide assurance that the satellites will operate as planned for many years once in orbit.

Private companies have been designing, launching, and operating satellites for over 40 years, since two private companies, COMSAT and Hughes, launched a satellite in 1965. COMSAT, Intelsat, Western Union, RCA, AT&T, Hughes, NTT, France Telecom, Inmarsat, and News Corp have all employed satellites for decades to provide reliable communications services. More recently, DirecTV and DISH Network demonstrated that they could develop multi-billion dollar businesses based on the direct provision of content (in their case television programming) to consumers via reliable satellite systems.

V. THE SATELLITE INDUSTRY UNDERSTANDS AND MANAGES RISK.

XM's and Sirius's witnesses suggest that the satellite industry is extremely risky. Frear WDT ¶ 5; Smith WDT ¶¶ 16-17; Masiello WDT ¶ 23; Karmazin WDT ¶ 3. Tr., June 6, 2007, at 283 (Karmazin testimony). But the last 40 years of commercial satellite launch and operation history demonstrate that the business of putting up and operating satellites is straight-forward and reliable. While there are risks, they are well known, and the industry has developed methods for mitigating them.

Contrary to Mr. Masiello's testimony that "[l]aunching satellites is inherently a risky endeavor, even for the most experienced launch companies," the commercial satellite launching industry has an extremely good track record going back decades. Masiello WDT ¶ 23; *see also* Tr., June 5, 2007, at 12-13 (Parsons testimony) (stating that "[l]aunching satellites are a

historically fairly risky venture”). Since 1965, approximately 700 commercial satellites have been launched with a failure rate of only approximately five percent. Satellite launches are said to “fail” when an otherwise working satellite is not delivered within a set radius of its target destination. Thus, after some launch failures, the satellites are still operable and can be moved into the proper orbit, although the expenditure of extra fuel to move the satellite can lower the satellite’s life expectancy. Since 1997, 185 geostationary communications satellites, most of which are used for commercial purposes, have been launched with only *eight* failures. Neither XM nor Sirius has had a single launch failure to date.

Mr. Karmazin misstates the case when he claims that “any mistake in trajectory can render a satellite worthless.” Karmazin WDT ¶ 28. Launch vehicles routinely deliver satellites to the general vicinity of the desired orbit, and the satellites’ on-board propulsion systems are then used to maneuver the satellite into its proper orbit. It is extremely rare for the satellite’s initial position to be so far off that the satellite is abandoned. Furthermore, satellite engineers have understood the physics of orbital trajectories for decades, and they have used them to launch rockets successfully onto their desired trajectories countless numbers of times.

As with all types of business ventures, some satellite businesses have failed (*e.g.*, due to poor business models); but many more have succeeded. The satellite television companies are perhaps the closest examples to the SDARS. Both DirecTV and the Dish Network successfully raised large amounts of initial capital and parlayed that capital into thriving subscriber bases. Many other telecommunications business models have succeeded as well. For instance, SES-Global has very successfully operated a satellite system called Astra in Europe. Astra has been in existence for at least 15 years and provides television broadcasting to many European countries, including SkyTV to the United Kingdom. Thuraya, a company based in the United

Arab Emirates, provides mobile satellite communications via handheld phones. The cable television network HBO began by using satellites to deliver pay per view events (and later movies) to individual cable operators, who would then transmit the broadcasts to their own customers via cable.

It is important to understand the difference between the risks associated with new businesses and the risks unique to satellite businesses. Of course, satellite businesses face the same business risks that all start-up businesses face (*e.g.*, poor business models, lack of consumer demand, etc.). XM's and Sirius's witnesses testified about a number of satellite business failures, but these businesses failed because of failures in the business models rather than due to any failure of the satellites. Parsons Depo. at 28-29; Parsons WDT ¶ 5; Smith WDT ¶ 4. Mr. Rusch admitted during his deposition that he could not think of a single satellite operator whose business failed because of a satellite failure, either during launch or in-orbit. Rusch Depo. at 73. Where the businesses failed, the satellites functioned as designed, but the consumers were not sufficiently interested in the product. That is the type of risk faced by any new business, not something unique to the satellite industry.

There are two primary forms of risk unique to satellite businesses: the risk of a launch failure and the risk of an in-orbit failure. As discussed above, the risk of launch failure is approximately five percent. The risk of total satellite loss once the satellite is in orbit is even lower, approximately one percent. The satellite industry has developed a number of different methods for mitigating each type of risk, and two of those methods – insurance and spares – can mitigate both types of risk. Furthermore, I am not aware of a single commercial satellite business that has failed because of a satellite failure, either during launch or in-orbit, precisely because these risks are well understood and businesses can take steps to mitigate them.

A. Satellite Businesses Insure Their Satellites.

First, there is a well-developed insurance industry to cover both types of risk. Satellite businesses have used insurance to mitigate the risks of launching and operating their satellites for at least thirty years, and most major satellite operators purchase such insurance, including, for example, DirecTV, Dish Network, and Intelsat. Indeed, both XM and Sirius have at times purchased launch insurance and in-orbit insurance (also called “life” insurance). *See, e.g.*, SIR 15838; SIR 39547; XMCRB 18681-713; XMCRB 18723-18742.

Launch insurance covers two types of risk related to launching satellites. First, the purchaser receives payments/benefits when the satellite suffers damage or is destroyed during the actual launch (*e.g.*, the launch vehicle or satellite malfunctions). Second, the purchaser also receives benefits when the satellite is delivered into orbit safely, but the satellite does not arrive within a specified distance of its target orbit. In many of these situations, the satellite can be moved into the proper orbit, where it can then function as planned; however, doing so may shorten the satellite’s expected life (due to the extra fuel that must be used to move the satellite), and the launch insurance covers this lost life expectancy.

Satellite life insurance is generally significantly cheaper, and the price typically decreases as the satellite ages because the price is percentage of the insured value, which drops as the satellite depreciates each year. Satellites are designed and fueled to function without loss of performance or capacity for many years. While the precise life expectancy of any given satellite varies depending on a variety of factors, satellites generally last between 12 and 15 years, although they can last as long as 20 years. When in-orbit problems arise that disable all or part of the satellite or reduce the life expectancy of a satellite, life insurance covers the value of that lost “life.” Life insurance is considered standard practice in the satellite industry, in part because

it provides assurances to investors, and both XM and Sirius have purchased such insurance. SIR 39547; XMCRB 18723-18742.⁴

Mr. Smith, senior vice president for engineering at Sirius, testified that Sirius currently does not carry life insurance for its satellites. Tr., June 7, 2007, at 118 (Smith testimony). Thus, Sirius must have concluded that as a business matter the risk of loss from an in-orbit failure was so low that it did not justify the cost of the insurance.⁵ Such a decision can be a reasonable business decision based on the satellite business's specific situation.

B. Satellite Businesses Maintain Spare Satellites.

Satellite businesses acquire spare satellites so that they can maintain their services in the event of a failure of a satellite. Both XM and Sirius included ground spares in their original satellite purchase contracts. Satellite businesses frequently negotiate provisions in their launch contracts that give them priority so that they can launch a spare satellite within a set period if there is a failure in the original launch. For example, XM's contract with Boeing for its first two satellites, Rock and Roll, contained a provision that [REDACTED]
[REDACTED]
[REDACTED]. XMCRB 102580-102727, at 102688. In addition, because satellite businesses launch satellites periodically, many have pre-existing contracts for future launches, and if they need to launch a replacement satellite quickly, they can substitute the replacement satellite into a pre-existing

⁴ In fact, XM filed a claim on the life insurance for its first two satellites ("Rock" and "Roll"). Both satellites launched successfully, but they suffered a premature loss of power due to a problem with the solar panels. This problem reduced the expected life of the satellites. Both satellites continued to "[REDACTED]" despite the problems, XMCRB 130615, and both satellites functioned until XM placed replacement satellites in orbit, at which point Rock and Roll were turned off. Moreover, both satellites remain in orbit and can be used as spares if necessary. See http://www.tbs-satellite.com/tse/online/sat_xm_1; http://www.tbs-satellite.com/tse/online/sat_xm_2.

⁵ See, e.g., <http://investor.sirius.com/ReleaseDetail.cfm?ReleaseID=187963> (noting that Sirius's satellite expenses decreased when Sirius decided not to renew its satellite insurance policy in August 2004).

contract to do so. Furthermore, a spare can be launched ahead of the actual need, and the original satellites can be turned off and held as in-orbit spares. If there is ever a catastrophic failure, the business can simply re-activate the spare satellites to maintain the service until a new replacement satellite is launched. In fact, XM currently has its first two satellites, Rock and Roll, in-orbit but turned off, even though they both could provide service for many years. Parsons Depo. 77-78.

C. Satellite Businesses Also Mitigate the Risk of Launch Failure Through Their Choice of Launch Company and Their On Board Systems.

A satellite business also can minimize launch risk through its choice of launch company. Mr. Smith testified that Sirius faced an “enormous hurdle in launching [its] satellites successfully.” Smith WDT ¶ 16. However, this statement is an exaggeration. At the time XM and Sirius required launch services, there were at least two different companies capable of meeting their general requirements on a reliable and cost-effective basis, offering at least four different launch vehicles.⁶ In selecting a launch vehicle, businesses weigh a number of different factors: the weight and size of the satellite, the orbit required, the availability of launches in the companies’ schedules, the companies’ recent launch experiences, and the terms of the launch agreement, including in particular the price of the launch.

Mr. Parsons testified that XM performed exactly this type of weighing. He testified that XM chose Sea Launch from among several competing companies based on the combination of attributes offered by Sea Launch, including its low price. Tr., June 5, 2007, at 54-55 (Parsons testimony); Parsons Depo. at 66-69; XMCRB 130649 (comparing [REDACTED]), 130714 (noting

⁶ Lockheed Martin, Boeing, which operates Sea Launch and which was used by XM, and International Launching Services (“ILS”), currently launches satellites. ILS, which launches the Proton vehicle used by Sirius, used to be part of Lockheed Martin but is now an independent private company.

that XM received [REDACTED] [REDACTED]). Both Mr. Masiello and Mr. Parsons stated in their written direct testimonies that XM chose Sea Launch despite its having launched only “a handful of satellites” prior to launching XM’s satellites. Parsons WDT ¶ 15; Masiello WDT ¶ 23. These statements overstate the risks associated with choosing Sea Launch. First, XM clearly felt that any increased risk was more than offset by the cost savings offered by Sea Launch, especially given that the launch itself was insured and XM had a ground spare that could have been launched within six months of any launch failure. Second, XM used the Zenit launch vehicle. Although Sea Launch did have a failure in one of its first launches while using the Zenit vehicle prior to XM’s launches, the Zenit vehicle itself had a good launch record during its use by the Soviet Union. DirecTV has also used Sea Launch and the Zenit vehicle.

As Mr. Smith testified, Sirius considered two possible launch vehicles and eventually decided to use the Proton launch vehicle. Smith WDT ¶ 16. The Proton vehicle has been in use for over 40 years and is the most experienced Russian large launch vehicle. In addition, Sirius launched the Proton vehicles carrying its satellites from a site in Kazakhstan where the former Soviet Union launched the Molniya satellites into their highly elliptical orbits, the orbits on which Sirius’s orbits were based. By choosing the Proton vehicle and launching from the Kazakh facility, Sirius had access to that accumulated experience.

D. Satellite Businesses Mitigate the Risk of In-Orbit Failure Through Design Methodologies and In-Flight Work-Arounds.

Finally, satellite businesses use a number of proven strategies for minimizing the risk once the satellites are in-orbit. Several of the Services’ witnesses testified that satellites are difficult to repair physically once they are in orbit. Smith WDT ¶ 14; Karmazin WDT ¶ 28. As the repair of the Hubble space telescope demonstrated, such repairs are possible, but as a

practical matter, for a private business, such repairs are generally not feasible. Satellite engineers and operators have understood this problem since the first satellites were launched, and consequently, they developed design and testing methodologies that insured that problems were caught, and fixed, prior to launch. For example, a typical satellite undergoes six months of thorough testing, including environmental testing, after assembly and prior to shipment to the launch site. Satellite engineers build on pre-existing satellite designs that have been proven to work in space, and they use as many pre-existing components as they can. Thus, satellite businesses are able to leverage the experience that their satellite manufacturers gained in developing satellites for other customers, and by using known designs and components, the businesses minimize the risk of failure.

Satellite engineers also typically build redundant components directly into the design of the satellite so that if a critical component fails in-orbit, the satellite operators can simply engage the redundant system to continue operating at full efficiency. For example, satellite designers routinely back up receivers, amplifiers, thrusters, solar cells, batteries, and computers with redundant parts. In addition, designers create alternative modes of operation so that if there is a problem with the primary mode, the operators can switch to another mode and keep the satellite functioning. This design methodology is a common-sense adaptation to the difficulties of repairing satellites in-orbit and has been used by satellite engineers since the very first satellites were launched.

In addition, satellite engineers extensively and thoroughly test satellites, and their individual components, on the ground prior to launch. They put the satellites through a rigorous series of tests designed to mimic the harsh realities of operation in space. They even test the satellites and their components in near vacuum to approximate the actual in-orbit conditions.

such work-around from the 1960s during his deposition in this matter. Rusch Depo. at 48-49.

Similarly, Sirius developed two work-around solutions [REDACTED]
[REDACTED]. SIR 7573-75.

VI. XM AND SIRIUS DRAW ON A RICH HISTORY OF SATELLITE TECHNOLOGY.

A. History of Communications Satellites

Although the mere mention of satellites may summon up futuristic images, in fact, satellites are nothing new. They have been around for fifty years, and the technology that underlies them is well-understood and well-executed. In general, there has been a trend where satellites become progressively more powerful, more robust, with more communications capacity, with larger antennas, and with longer lives as each new satellite is designed.⁷ Nonetheless, modern satellites also still rely on innovations that were introduced in the very earliest satellites.

In addition, from the very beginning, satellites have been used to provide broadcast content to viewers and listeners. Syncom II, one of the earlier commercial satellites, broadcast live coverage of the 1964 Tokyo Olympics to the United States. Similarly, the first pay-per-view boxing event, the “Thrilla in Manilla” match between Muhammad Ali and Joe Frazier, was broadcast by satellite in 1975, and national cable television stations, including ESPN, HBO, Nickelodeon, and CNN, used satellites as early as 1983 to transmit their content. As the satellite industry developed, services began using satellites to provide content directly to users as well. In addition to the various satellite phone and data services and GPS services that developed, WorldSpace used satellite to provide “radio” channels to listeners, and satellite television services did the same for video channels (along with some music channels as well). Thus, XM’s

⁷ Similarly, there has been a trend where the receiving antennas become smaller.

and Sirius's use of satellites is not out of the blue; it is merely part of a general trend in using satellites to provide content to consumers.

1. First Satellites

The first satellite, the Russian Sputnik, was launched on October 7, 1957. The United States Army launched the first American satellite, Explorer, on January 31, 1958, and in December 1958, the Army Signal Corps put SCORE, the first radio broadcasting satellite, into orbit to transmit a Christmas message by President Eisenhower.

AT&T designed and built the Telstar satellite, which was the first commercial satellite, launching it with the help of NASA in 1962. Telstar transmitted television signals and relayed telephone calls between the United States and the United Kingdom. Many of the key components of modern communications satellites were included on Telstar, including the traveling-wave tube power amplifier, the use of solar cells to convert solar energy into electricity, and the use of transmit and receive antennas attached to the body of the satellite. XM's and Sirius's satellites make use of each of these innovations, although naturally with some modifications. In 1963, Hughes Aircraft Company pioneered the 24-hour Earth orbit with the small spinning communications satellite, Syncom I.

2. Comsat and Intelsat

The Communications Satellite Act of 1962 created the Communications Satellite Corporation (COMSAT). A successful IPO in 1964 gave COMSAT almost \$200 million with which to develop a global satellite network, which became a successful business in only a few years. Rather than using the low Earth orbit (LEO) approach of the AT&T Telstar, COMSAT instead chose the geostationary Earth orbit (GEO) design based on the Hughes Syncom satellite.

COMSAT also fulfilled the mandate of the Act by creating a global alliance called INTELSAT. The INTELSAT system was a quasi-governmental cooperative which had nearly a hundred countries of the world as its members. The first INTELSAT satellite was launched successfully on April 6, 1965 and took up an orbit position over the Atlantic Ocean. COMSAT expanded INTELSAT from this single satellite to a system that covered the globe from orbit locations over the Atlantic, Pacific and Indian Oceans. By providing spare equipment and alternative operating modes, COMSAT could maintain a satellite in working order for a lifetime that extended to seven years or more.

Each successive INTELSAT satellite had more power, more communications capacity, and a longer lifetime than the predecessor. Intelsat IV, first launched on January 25, 1971, had innovations that are key both to direct broadcast satellite (“DBS”) television companies and to the Services, including a large solar array capable of more than one kilowatt of DC power output, efficient traveling wave tube amplifiers, dish antennas on board with the ability to direct beams on the Earth, full backup through batteries and redundant power electronics, attitude control to keep beams properly directed, and thermal environment and orbit control to last an extended period in orbit.

The growth of demand for services coupled with increasing use of smaller diameter dishes led INTELSAT contract manufacturers to build larger and more powerful satellites. Intelsat 7, launched in 1992, produces nearly 4,000 watts of solar power and carries equipment to relay 90,000 telephone calls. Space Systems/Loral, the company that developed and manufactured Intelsat 7, went on to [REDACTED]. [REDACTED]. SIR 221-318, at 232; XMCRB 28768-28842, at 28840.

3. Domestic Satellites

By 1970, the INTELSAT system established itself so well from a performance and reliability standpoint that communications companies recognized that GEO satellites offered the opportunity to extend the coverage of their domestic networks. Also in 1970, the Nixon administration introduced the “Open Skies” policy, which allowed any financially qualified organization to apply for authority to operate a domestic satellite system.

One of the first to file and the first to actually construct a U.S. domestic satellite system was Western Union Telegraph Company. Western Union contracted with Hughes for the design and construction of satellites with the same coverage as those later launched by XM and Sirius. Western Union’s first three satellites, dubbed Westar 1, 2 and 3, all had successful launches and lived out their live expectancies of 7 years. Western Union established the practice of launching multiple identical satellites and purchasing additional hardware for use as a ground spare in the event of a launch failure, the same process followed by XM and Sirius to ensure their satellite systems would be technically successful. *See, e.g.,* Karmazin WDT at ¶ 9. Other U.S. companies such as AT&T, RCA, GTE and Southern Pacific Railways, also purchased their own satellites.

One application of the Westar satellites was to relay audio programs for AM and FM radio stations. National Public Radio (NPR) established a nationwide presence using Westar to relay programming from its studio in Washington, D.C. to hundreds of public radio stations throughout the United States. As discussed by Mr. Masiello, ABC Radio Network began with an analog terrestrial network, and transitioned to digital broadcast satellites. *See* Masiello WDT at ¶

4. This is fundamentally the same approach taken at both XM and Sirius. Prior to 1990, many other radio networks also relied on satellites to provide continuous delivery of their services.⁸

B. Comparable Precursor Systems

XM and Sirius were not built on “a new untested technology,” nor did they “require[] the development of” a new means of transmitting satellite signals. Karmazin WDT at ¶ 27. Nor did they “open[] new technological avenues in the broadcasting field.” Masiello WDT ¶ 3. In fact, there are several examples of precursor satellite systems that included the important technological elements of the SDARS systems and which established relevant business models. Numerous organizations, both private business and governmental entities, were able to use satellites to carry out missions very similar to XM’s and Sirius’s later goals.

1. Iridium and GlobalStar

Iridium and GlobalStar were important precursors to XM and Sirius. Both these systems provided two-way mobile communications using non-geostationary constellations of moving satellites – akin to Sirius. Iridium and GlobalStar delivered a working mobile telephone service directly to an individual handheld unit slightly larger and heavier than a cellular phone. Motorola proposed the Iridium system concept in 1987, and filed with the FCC in 1990. Loral and Qualcomm followed with GlobalStar. These systems include many important technological innovations subsequently used by XM and Sirius.

⁸ Hughes Aircraft Company moved from being a manufacturer of satellites to being an operator as well. During 1983-84, Hughes successfully launched the Galaxy 1, 2 and 3 satellites, which made Hughes a leader in distributing TV and audio programming to cable TV systems and TV networks. In 1986, Hughes provided satellite delivery for a new service for grocery store chains called Supermarket Radio Network: Supermarket Radio Network originated several radio channels in their Atlanta, Georgia studio and transmitted those channels by satellite to grocery chains. Like XM and Sirius, Supermarket Radio Network used terrestrial repeaters to retransmit the satellite signal to individual grocery stores.

For Iridium and GlobalStar to operate properly, Motorola and Loral/Qualcomm each had to provide all of the elements and integrate them. These efforts took several years and hundreds of engineers. The corresponding effort for either XM or Sirius would be, in my opinion, considerably less.

While the Iridium system employed a different orbital configuration than Sirius, there are nevertheless several similarities between Sirius and Iridium. The Iridium satellites operate in polar orbits, which are inclined by almost 90 degrees. This is greater than the Sirius inclination of 63 degrees, but likewise required corrective motion for adequate solar panel orientation toward the sun, a tool later utilized by Sirius. The Iridium satellites also used their on-board batteries to supplement the solar panels at times of low solar illumination – just as Sirius’s satellites would later do.

The orbit of the GlobalStar satellites is inclined by 52 degrees, very similar to the 63 degrees used by Sirius. Space Systems/Loral, which designed both the GlobalStar satellites and the Sirius satellites, in both cases started with a spacecraft bus intended for geostationary orbit and modified it for use in low Earth orbit. Like the Sirius satellites, *see* Smith WDT at ¶ 12, the GlobalStar satellites employ yaw steering.

The satellite control and communications gateway Earth stations of Iridium and GlobalStar both use large dishes that track the satellites continuously as they pass from horizon to horizon. Sirius later adopted the same technique. Tracking moving satellites in orbit is nothing new – this was required for every launch starting with the first satellites in the late 1950s and the need for tracking continues to this day.

The Iridium voice service used a digital audio compression “algorithm” that greatly reduced the quantity of bits needed to provide conduct a conversation. XM and Sirius use a

similar algorithm in order to provide their information services channels, such as channels announcing local weather and traffic for a number of large metropolitan areas, with minimal impact on the greater amount of bandwidth available for music.

The satellite component of Sirius and XM vehicular antennas can be found in the handset and vehicular antennas used with Iridium and GlobalStar devices. The antenna component for terrestrial repeater reception is based on designs for cellular telephones.⁹

2. Satellite Mobile Broadcasting Experiments

The concept of using satellites to broadcast radio signals to moving receivers did not originate with XM or Sirius, but was conceived much earlier as a beneficial use of broadcast satellites. Voice of America, a multimedia broadcasting service in 44 languages from the United States, and a company called TRW investigated satellite radio broadcasting in the 1980s. In 1992, NASA embarked on intensive research, using the S-band, to determine whether radio programming could be transmitted to moving vehicles and portable receivers via satellites.¹⁰ The results of this extensive testing were reported openly to engineers in the general community.

NASA's test program found that expected signal blockages from tree trunks, hills and buildings would cause interruption of reception; based on the NASA tests, it was logical to introduce the same signal over a different, non-blocked path. Radio engineers of normal skill know that there are two ways to provide a different path that would not be blocked by the same obstruction: use a second satellite whose signal is coming from a different direction or use a

⁹ Iridium and GlobalStar both suffered bankruptcies, principally because they failed to acquire enough customers in the first year of operations. See SDARS CRB 2340-2348, at 2341-42 (article by Roger Rusch, stating that "[t]he fundamental reason that Iridium failed was that it was too expensive," that "[t]he Iridium defects are not intrinsic to all satellite communication systems . . ."). Both GlobalStar and Iridium were subsequently taken over by new investors who are continuing to provide voice and data services to several hundred thousand users worldwide. More importantly, the fact that both of these business entered bankruptcy does not diminish from the technological firsts each achieved.

¹⁰ James E. Hollansworth, Utilizing a TDRS Satellite for Direct Broadcast Satellite-Radio Propagation Experiments and Demonstrations, presented to the Third International Mobile Satellite Conference (IMSC 1993).

land-based (terrestrial) signal source that can “fill in” the gaps produced by this kind of blockage (*i.e.*, terrestrial repeaters). Neither of these solutions was new to the satellite industry. AT&T used signals from multiple satellites as early as the 1970s to counter the high noise intensity produced by direct illumination from the sun. Likewise, the GPS system uses multiple satellite signals to deliver reliable data on users’ position location. The GlobalStar system also utilizes two satellites for most of its region of coverage. The same principles involved in the use of terrestrial repeaters have long been applied by cellular telephone networks which use hundreds of base stations in major cities. Smith also identifies time and frequency diversity as two additional techniques employed by the Services. *See* Tr., June 7, 2007, at 47-48 (Smith testimony). As I discuss later, both techniques have long been used in digital communications.

3. Satellite DBS TV

XM and Sirius also owe a debt of gratitude to companies that broadcast television programs to homes via satellites, such as DirecTV and DISH Network (so-called direct broadcast satellite, or “DBS,” companies). Not only did XM and Sirius build on the satellite technology advances of the DBS systems, but they were able to build on the DBS companies’ business models.

While DirecTV is primarily a TV service, it also provided more than 100 audio channels, including stereo sound, via its satellites, ahead of XM and Sirius. While the majority of these were for the sound associated with the picture, there was a package of music channels much like that provided on XM and Sirius. To provide all of these services, DirecTV employs digital compression technology much like that later used by XM and Sirius. DirecTV also pioneered

the use of forward error correction (“FEC”)¹¹ to provide excellent signal quality into a small dish antenna; this was essential to XM and Sirius for much the same reason.

In addition, according to Mr. Parsons, DirecTV invested in XM and contributed its expertise in important areas such as billing, programming, and customer service. Parsons WDT at ¶ 9. Thus, XM took advantage of lessons learned in developing the DBS business model.

The Services claim that they made a significant contribution by integrating all of the elements properly into a working system that served mobile users. But in fact, integrating a number of existing elements is not a unique contribution by the Services, but is a normal aspect any new satellite communications system. DirecTV had to go through the same process and required more time to build its system than did either XM or Sirius.¹² In my opinion, XM and Sirius had a much easier job since DirecTV and WorldSpace had preceded them.

4. WorldSpace SDARS Service

WorldSpace, Inc., implemented the first true satellite digital audio radio broadcasting system, before XM and Sirius. WorldSpace was designed to provide digital satellite audio, data and multimedia services primarily to Africa and Asia. WorldSpace uses two satellites to cover a very large broadcast footprint: over 130 countries including India and China, all of Africa and the Middle East and most of Western Europe. Like XM, WorldSpace utilizes a geostationary orbit. WorldSpace broadcasts 62 channels, of which 30 are WorldSpace-branded stations produced by or for WorldSpace and 32 are provided by third parties.¹³

¹¹ FEC is a data encoding and data processing technique that corrects errors caused by noise and other interference that is picked up with the signal.

¹² XM’s witness Mr. Masiello acknowledges the innovations of the DBS systems but downplays the challenges DBS operators faced. Masiello WDT at ¶ 3. For instance, he fails to acknowledge that DBS employs the higher Ku-band portion of the spectrum that is subject to heavy fades due to rain attenuation. The S-band spectrum used by XM and Sirius is not affected by rain at all.

¹³ About WorldSpace International Satellite Radio Service, <http://www.worldspace.com/about/index.html> (last visited July 22, 2007).

WorldSpace successfully launched its first satellite, AfriStar, in October 1998, and successfully launched its second satellite, AsiaStar, in March 2000. Each WorldSpace satellite has the capability to transmit more than 100 channels of programming for reception by portable receivers similar in design to those of XM and Sirius. WorldSpace began with a “free-to-air” service but moved toward a paid-subscription business model as practiced by XM and Sirius. The service is available to mobile digital radio receivers as well. Thus, WorldSpace provided a system with all of the essential elements found in XM and Sirius.

The chipset inside the WorldSpace receiver had most of the functions of XM and Sirius. The main difference between the WorldSpace chipset and the XM and Sirius chipsets is the absence of circuitry to coordinate signals from two satellites and a repeater. This is because WorldSpace only operates a single satellite in a given region without terrestrial repeaters. A mobile service from WorldSpace is possible as long as sufficient antenna size is provided and blockage is minimal; for instance on an aircraft, train or vehicle traveling in open country.

The WorldSpace compression algorithm for chipsets was provided by the Fraunhofer Institute, which also provided to XM some of its underlying work done for WorldSpace. Parsons Depo., 33-35. WorldSpace also employed TDM to deliver the many channels to receivers, and included concatenated FEC very similar to what had previously be employed in DirecTV and Dish Networks.¹⁴

Both XM and Sirius benefited from the advances in satellite broadcasting that WorldSpace pioneered. XM in particular was able to take advantage of lessons learned by WorldSpace, because WorldSpace was an original investor in XM and shared much of its

¹⁴ Dr. S. Joseph Campanella, Seminar on the WorldSpace Satellite Direct Digital Audio Broadcast System, Address at the IEE Colloquium on Communication Opportunities Offered by Advanced Satellite Systems (July 19, 1998) (Ref. No. 1998/484).

knowledge with XM. Parsons WDT at ¶ 8; Parsons Depo 22:9-24:8. I am also aware that several of the WorldSpace engineering staff were seconded to XM as a means to transfer this know-how.

WorldSpace and AMRC, the predecessor to XM, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]. XMCRB 00044448. Alcatel, [REDACTED]

[REDACTED]. XMCRB

00021409. AMRC also was assisted [REDACTED]

[REDACTED].

XMCRB 123333-123346, at 123342; Parsons Depo. at 33.

C. Earlier Uses of Elements of Satellites

1. Multiple Signals

XM's and Sirius's witnesses make much of the fact that their companies had to combine the signals from two different satellites and the terrestrial repeaters. Masiello WDT ¶ 25; Smith WDT ¶¶ 8, 24-25. But using multiple signals to overcome barriers (*e.g.*, trees, buildings, or tunnels) that might block a single satellite's signal (so-called signal "diversity") is a well-known technique within the satellite industry. In the late 1970s, as part of an experiment with NASA, the DEA, and the INS, General Electric demonstrated that two satellites could be used to broadcast a signal to an omni-directional antenna mounted on an automobile, thereby countering disruptions to the signal.¹⁵ AT&T also used diversity in the 1970s, receiving signals from multiple satellites in order to counter the high amount of noise created by direct illumination

¹⁵ Axel F. Brisken et al., *Land Mobile Communications and Position Fixing Using Satellites*, Vol. VT-8, IEEE TRANSACTIONS ON VEHICULAR TECHNOLOGY, No. 3, 153 (1979).

from the sun. Similarly, the GPS system uses multiple satellites to increase the reliability of its location determinations, and GlobalStar usually has two satellites transmitting information to provide diversity to its system. NASA conducted additional experiments in the 1990s demonstrating that diversity was required to receive a reliable satellite signal in a moving vehicle.

Indeed, engineers understood the importance of diversity long before those systems. Satellite textbooks first mentioned diversity in 1964, and ocean-going vessels have long used multiple receivers on different frequencies to receive information reliably. Both Services employ time diversity to deal with signal interruption inside a tunnel or overpass. However, the principle of time diversity had been applied in high-frequency radio communications many years before. In addition, portable and vehicular audio CD players employ a form of time diversity very similar to that used by the Services (referred to as anti-skip) so that playout would not be interrupted when the vehicle hits a bump. In the 1960s and 1970s, radio engineers used diversity to overcome signal fading that resulted from various propagation effects, building receivers that combined signals from different incoming paths. In the 1970s and 1980s, military and civilian services commonly used diversity in over-the-horizon tropospheric links, which used the same spectrum frequencies as the SDARS.

Terrestrial repeaters are just another path to increase diversity in locations where satellite signals are likely to be blocked (like urban environments). They function similarly to cellphone towers, broadcasting a stronger signal to a smaller area.

2. Antennas

Witnesses for the Services have claimed that XM's and Sirius's antennas are unique and designed for a unique purpose. Tr., June 4, 2007, at 311 (Parsons testimony); Tr., June 7, 2007,

at 67, 121-124 (Smith testimony). However, XM and Sirius drew significantly on antennas used by other satellite systems.

The small antennas used on vehicles were based on designs similar to that used for the Global Positioning Satellite (GPS) system, which broadcasts positional location data in the L-band spectrum (just below S-band). This was not acknowledged by Sirius's Terrence Smith who asserts that antennas available at the time were "generally large and expensive dishes, which are not practical for use with vehicles." Smith WDT ¶ 4. GPS, which initiated operation in 1985, uses an inclined orbit like Sirius but like Molniya the orbit period is half a day. Since satellites and ground receivers are in motion relative to each other, and multiple satellites are in view at one time, it is necessary to use an omni-directional receiving antenna. Such antennas are compact and simple to construct, and were described in the published engineering literature in the 1960s and 1970s. They were available in marine and handheld receivers on the market in the early 1990s. Both XM and Sirius have benefited from development work and use similar types of antennas for their mobile receivers.

Mr. Karmazin claims that Sirius "developed the world's smallest non-directional satellite antenna to make sure our service could be received in vehicles." Karmazin WDT ¶ 10. But the general class of small receiving antennas existed for mobile satellite communications for many years before either Sirius or XM needed to develop theirs. Like a terrestrial cellular antenna on a cellphone or car, the mobile satellite antenna needs to receive from a radio transmitter that could be located in any direction.

The typical satellite omni-directional antenna was employed for the Inmarsat C service used to transmit and receive low speed data communications. A common design for this is the

quadri-filler helix, which was first published in the open engineering literature in 1974. Inmarsat C and its terminals were in active use as early as 1990.

The satellite portion of SDARS requires the antenna to possess a hemispherical pattern toward the entire sky at one time. This can be done with a variety of simple antenna designs, all of which existed in the engineering literature prior to 1990. In fact, such an antenna could be found in commercial GPS receivers which could “see” the entire sky and are as small as those employed for SDARS reception.

One feature of the SDARS system that required some additional antenna design work was combining the hemispherical coverage technique for satellite reception with a terrestrial type of mobile antenna (like that used on a cellphone) to receive from a terrestrial repeater. In my opinion and based on the designs I have examined, this is not a very difficult design requirement and involves picking appropriate legacy designs for each that can be accommodated in the same physical package. According to the engineering literature, there are a number of alternatives for how this can be accomplished. For example, instead of the quadri-filler helix, the satellite receive antenna could be formed from a compact flat spiral that receives the satellite broadcast and a single vertical monopole inserted in the center to receive the terrestrial repeater broadcasts. The designer only needs to consider the technical requirements for the antenna, and then review the literature to see what existing type of antenna can be applied or adapted to the requirement.

Mr. Smith asserts that one of the main issues that impeded the SDARS was that existing “commercial satellite antennae capable of capturing the relatively weak signal from a satellite were generally large and expensive dishes, which are not practical for use with vehicles.” Smith WDT ¶ 4. This is untrue – several satellite systems employed small antennas like those of XM

and Sirius to receive weak satellite signals. Among these are Inmarsat C, GPS, Iridium and GlobalStar.

3. Repeaters

The service reliability of SDARS systems in the US is enhanced through the use of terrestrial repeaters. Contrary to the testimony of the Services' witnesses, Tr., June 4, 2007, at 315-316 (Parsons testimony) ("So the next innovation was, in fact, building a terrestrial-based urban repeater network . . ."); Tr., June 6, 2007, at 208-210 (Masiello testimony), the use of terrestrial repeaters was not innovative. Terrestrial repeaters are a natural answer to the requirement that satellite broadcasts reach urban areas. Satellite diversity is sufficient in rural or suburban areas, particularly along Interstate highways, where blockage is relatively infrequent. As I discussed above, Supermarket Radio Network and NPR were both using terrestrial repeaters in the 1980s as part of their satellite radio delivery to different locations. Even before that, the US Army employed terrestrial repeaters, called automatic retransmission systems, to extend the range and coverage of tactical VHF radios. This was very effective in South Vietnam in the 1960s, where there was a high degree of signal blockage due to jungles and mountain ranges. Since the 1970s, amateur radio operators have placed such repeaters on hill tops for use in emergency communications when local telephone and cellular services are destroyed by storms, fires or earthquakes.

The terrestrial repeaters used by XM employed existing modulation techniques for broadcasting digital radio signals. Indeed, XM has acknowledged that [REDACTED]

[REDACTED]

[REDACTED] See SX Ex. 202 RR, at XMCRB 00021582.

4. Business Operations

The business operations of XM and Sirius also imitated those of DirecTV and DISH Network. In addition to the satellites employed by XM and Sirius, both companies acquired ground systems to compress and assemble content in various forms, including music and talk, and transmit it to the respective satellites. The components either are off-the-shelf or modified existing designs and the software that runs the system is similar to that developed for DBS television systems, like DirecTV, that preceded the Services. Indeed, according to Mr. Parsons, DirecTV and others “provided expertise in various elements of the business, such as billing, programming and customer service.” Parsons WDT ¶ 9.

5. Chipsets

The SDARS receivers installed or attached to vehicles employ chip sets that were developed according to common practice in the consumer electronics industry. They are not significantly different from their counterparts in DBS systems and cellular telephone networks. A similar design was produced for WorldSpace, which produced a working high power satellite, using L-band rather than S-band (a minor change as far as technology is concerned), low cost receivers and a broadcast of many audio channels on a single radio channel. [REDACTED]

[REDACTED]. See SX Ex. 202 RR, at XMCRB 00021582

([REDACTED]). Some of [REDACTED]

[REDACTED]

[REDACTED]. See XMCRB 00044448-44462.

6. Orbits

Despite their claims otherwise, Smith WDT ¶ 7; Masiello WDT ¶ 25, both XM and Sirius used orbits that had been developed first by others. As mentioned above, XM uses a

geostationary orbit. Satellites, and in particular communications satellites similar to XM's and Sirius's, have used geostationary orbits since the mid-1960s. The mechanics and benefits of these orbits are well understood, as XM itself has recognized. *See* SX Ex. 202 RR, at XMCRB 21582 (“[REDACTED].”).

Similarly, Sirius's highly elliptical orbit has also been used before – as Mr. Smith admitted on cross-examination. *See* Tr., June 7, 2007, at 91-92 (Smith testimony). Within the satellite industry, such an orbit is referred to as a “Tundra” orbit. The Soviet Union developed the highly elliptical Molniya orbit in the 1960s. The United States military also developed a highly elliptical satellite system in the 1970s to communicate at high latitudes (the Satellite Data System, or SDS), and in the 1980s, a European group developed a project called Archimedes that would have used a highly elliptical orbit combined with several satellites to provide continuous coverage across Europe. Although Archimedes was not implemented, it was reported and its proposed use of the Tundra orbit was well known in the late 1980s. Indeed, Sirius has explicitly acknowledged these predecessors to its own system. *See* SIR 16721 [REDACTED].

Mr. Smith's statements about the “dozens of orbit-specific requirements as well as operational requirements” of which Sirius had to take account ignores the fact that these predecessor systems had to solve the same or similar problems. Smith WDT at 5, ¶ 9. For example, GlobalStar used an inclined low Earth orbit prior to Sirius's launch, and Space Systems/Loral (the company that later built Sirius's satellites) had to design the satellites so that they kept their solar panels aligned with the sun as they moved.

Similarly, Sirius must rotate its satellite antenna reflector as the satellite moves so that it continues to point at the proper locations. However earlier geostationary satellites, like the

Intelsat IV launched in 1971 and Westar 4 in 1982, also had to move their reflectors to compensate for the movement of those satellites. While those satellites moved less than the Sirius satellites, the same mechanisms and control software had to be modified.

7. Mobile Receivers

Satellite communications engineers like those who designed the XM and Sirius systems understand the basic principles of line-of-sight propagation to stationary as well as moving receivers. The satellite link is nearly ideal because it is stable, being only subject to atmospheric effects and to obstacles that may block the path. These principles are covered in text books written more than 15 years ago, including my own.

Research into the effects of obstacles that can block the path, which will occur in the case of SDARS with moving vehicles, was undertaken over the past 20 years by NASA, JPL and others, and reported in the literature. In providing service to moving vehicles, XM and Sirius draw heavily on the experiences of satellite businesses that provided mobile satellite service (MSS), from which it takes the means of serving individual users who are in motion in cars and other forms of transportation. The first MSS satellite operator and service provider was a consortium called Inmarsat, which went into early operation in the late 1970s.

Iridium and GlobalStar were the two low LEO MSS systems that offered two-way voice and data communications services to handheld and vehicular phones. The antennas used in these systems were small so as to have omni-directional directivity. In addition, Motorola, the developer of the Iridium system, produced a variety of small, omni-directional antennas for their mobile devices, which were small and compact like antennas used for Sirius and XM. The first satellite handset, the Motorola 9500, had a quadrifiller helix antenna about the size of a cigar or small tube of toothpaste that was extended above the head of the user. This allowed the phone to

receive the weak satellite signals from any direction in the sky. For vehicular use, Motorola supplied a much smaller “patch” type of antenna that was extremely flat and small, about the size of a silver dollar and one half inch in thickness. Both of these antennas were in commercial production by 1998.

8. Audio Compression

The broadcasting of 100 or more audio channels by a satellite is based on engineering principles understood well before of the development of Sirius and XM. Audio compression has been applied since the 1970s to compress telephone channels, including by the military, which requires that the speech be encrypted as well. Even Mr. Masiello testified that, as early as 1988 at CBS, he “developed . . . expertise in the processing of digital audio signals, and in ‘audio compression’ technology that could reduce the amount of digital information in a broadcast transmission signal yet still produce clear digital sound quality.” Masiello WDT ¶ 7.

In the early 1990s, DirecTV and others employed the new compression standards from the Motion Picture Experts Group (MPEG) to reduce the required number of bits to transfer both sound and picture. The audio portion of MPEG is known as MPEG Audio Layer 3, which has been abbreviated to the popular consumer form, MP-3.

The other aspect of delivering 100 or more audio programming channels is based on the established principle of time division multiplexing (“TDM”). AT&T and the US Army adopted TDM in the 1960s so that several telephone conversations can be carried by a point-to-point link, which was more efficient than having separate cables or radio transmitters for each conversation. Another well-developed application of TDM prior to 1980 was for multiple channels of telemetry data from satellites. TDM in and of itself does not reduce bandwidth requirements but actually increases the total amount of data transferred.

Mr. Smith states that Sirius “pioneered statistical multiplexing for audio applications.” Smith WDT ¶ 20. The technique of statistical multiplexing (“STATMUX”) was not new for Sirius but was introduced in the 1980s to compress a TDM data stream by only sending information from active channels. Thus, time is not wasted on periods when no information is coming from one or more of the channel sources, and the ones needing more bits are given faster access to the TDM stream. This technique was also applied in 1970 with audio information for long distance telephone calls, particularly over the oceans, to double the quantity of voice links. DirecTV and DISH networks adopted STATMUX around 1997 for their multi-channel television and audio services to effectively double the capacity of a given satellite. While Mr. Smith acknowledges that STATMUX was common in video, Smith WDT ¶ 20, in fact DirecTV and DISH networks used STATMUX to reduce bandwidth requirements for the audio associated with the video and for the music channels delivered by these systems.

9. High Power Satellites

Satellites in geostationary and geosynchronous orbit, like XM’s and Sirius’s satellites, need significant power to transmit to small omni-directional antennas located throughout the continental United States. To accomplish this task, XM and Sirius each contracted with leading satellite manufacturers who already had in production spacecraft busses that could meet the Services’ power requirements. The XM satellites employed the Boeing 702 vehicle, which was previously purchased by PanAmSat for a high capacity satellite to be used for television and other services.

Sirius chose Space Systems/Loral, which offered the high-powered L-1300 vehicle. One year into its relationship with SS/L, Sirius directed SS/L make a change from a two-satellite GEO system to a three satellite HEO system. SS/L followed normal space systems engineering

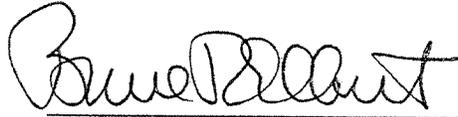
practice to modify the satellite for a somewhat different orbit environment. *See* SIR 00007551 at 7562. SS/L had previously accomplished a similar modification of a GEO satellite design for GlobalStar satellites launched prior to the year 2000.

The power systems onboard the XM and Sirius satellites employ standard designs based on nearly four decades of experience by the respective manufacturers. In the case of XM, the B-702 satellite included solar collectors to re-radiate the sun's light onto the main solar panels. At the time XM launched its satellites, solar collectors were already working on Galaxy 11, demonstrating that power could be augmented by increasing the solar intensity using collectors.

VII. CONCLUSION

As described above, the Services' use of satellite technology is neither as risky nor as innovative as some of their witnesses' testimony suggests. To the contrary, satellites are reliable and have been in use for decades.

I declare under penalty of perjury that the foregoing testimony is true and correct to the best of my knowledge and belief.

A handwritten signature in cursive script, appearing to read "Bruce R. Elbert", written above a horizontal line.

Bruce R. Elbert

Date: July 24, 2007

Exhibits Sponsored by Bruce R. Elbert

**Restricted exhibits, which are identified by the suffix "RR," are not included
in the Public Version of SoundExchange's Rebuttal Case**

Exhibit No.	Description
SX Exhibit 201 RP	Rusch slideshow presentation (SDARS CRB 00003250 et seq.)
SX Exhibit 202 RR	"XM Satellite Radio Technical Overview" slideshow presentation (XMCRB 0021578 et seq.)

BRUCE R. ELBERT

Experience:

2000 to date **President, Application Technology Strategy, Inc.**

Founded consulting firm specializing in technical and business aspects of satellite fixed and mobile broadband communications.

Clients include United States Air Force, United States Army, United States Navy, News Corp, DirecTV, Hughes Network Systems, Boeing, EchoStar, ntl (UK), Rockwell Collins, Stratos Global, GlobeCast, AsiaSat, JSAT, and KVH Industries.

Client work involves system design/engineering for space and ground segments, frequency planning and satellite bandwidth assessment, network design for voice/video/data applications, operations and organization management, specification and evaluation of satellite coverage and performance, earth stations and user/subscriber terminals, market assessment and development, contract review and negotiation, frequency coordination and international regulatory support, and technical training; including review and assessment of candidate satellites in terms of technical performance and cost; design of digital content delivery systems for commercial aircraft and retail networks; performance of due-diligence for acquisition of communications microwave component supplier; review and recommendation of payload requirements for replacement Ku-band satellites; and technical expert work in various litigation cases.

1980 to 1999 **Hughes Electronics, Inc., El Segundo, California,
Senior Vice President, Operations, HSCII**

Managed technical and business teams that designed and proposed satellite systems to US and international customers. Led successful campaign for sale of DBS satellites to News Corporation to provide local channels. Developed the architecture for Hughes' geostationary mobile satellites, gateways and handheld devices, which subsequently were purchased by Thuraya. Revenue oversight: approximately \$800 million per year; 20 direct reports and indirect responsibility for product design and development by 8,000 person organization.

At Hughes Communications, Inc. (1984-1995): Managed engineering and marketing of the Galaxy cable TV and data communications satellites. Led effort to acquire operating satellites from Western Union and supported the sale/leaseback of Galaxy 2 transponders with First Boston Corp. Contributed to DIRECTV startup; and prepared the successful FCC filing for Spaceway.

Operations director of Hughes ground stations and customer VSAT networks. P&L oversight: approximately \$200 million per year; led an organization of over 100 technical and administrative staff.

At Hughes Aircraft Company (1980-1984): Managed the successful campaign for the sale of two satellites and ground facilities to Mexico; led technical management for several satellite programs, including Galaxy, Westar and SBS.

1978 to 1980 **Western Union Corporation, Upper Saddle River, New Jersey, Assistant Vice President, Advanced Westar**

Directed program management and engineering activity for Western Union's second-generation broadband Ku-band digital satellite network (TDRS), contracted at a value of approximately \$500 million. Led the evaluation of proposals for the Westar IV and V C-band satellites submitted by three potential suppliers.

1972 to 1978 **Hughes Aircraft Company, El Segundo, California, Senior Project Engineer, Systems Engineering Laboratory**

Directed the communications system design and on-site testing of Indonesia's first nationwide satellite telephone and TV network (Palapa A), contributing to program success in terms of on-time service activation, customer satisfaction and profit. Established Hughes' ITU regulatory support activity, representing the company and the US at two World Radiocommunication Conferences in Geneva. Led test efforts for quality evaluation of FM-TV over satellite links. Designed and tested the first working Ka-band microwave repeater and multi-beam spacecraft antenna under contract from AT&T Bell Laboratories.

1969 to 1972 **Communications Satellite Corporation, Washington, D.C., Member of the Technical Staff, Systems Laboratory**

Participated in new technology development for INTELSAT and system architecture for the first aeronautical mobile satellite application; other project activities included: millimeter wave transmission technology and systems; integration of ground based networks with satellites using TDMA and DAMA access schemes; digital speech and video processing and compression; and terminal design for mobile satellite service.

Military Service:

1965 to 1969 **Captain, U.S. Army Signal Corps**

Radio communications instructor in the officer training program at the Signal School. Prior to this assignment, served two years duty as signal detachment commander, and radio engineering officer with the 4th Infantry Division in the US and Vietnam.

Education: Pepperdine Univ.: MBA (Presidential/Key Executive), 1985
Univ. of Maryland: MSEE, Communications and Computer Engineering, 1972
City College of New York: BEE, 1965

Languages: Fluent Spanish, Conversational French.

Academic History:

2000 to date: **Adjunct Professor, University of Wisconsin – Madison**
Department of Engineering Professional Development, College of Engineering

Faculty in the Master of Engineering in Professional Practice.

1990 to date: **Instructor, University of California at Los Angeles**
Department of Engineering, Information Systems and Technical Management,
UCLA Extension

Instructor in Satellite Communications, Information Systems, and
Communications Engineering; developed sequence of five short courses in
satellite television and radio, mobile and broadband communications
engineering and advanced applications; member of the advisory committee for
communications engineering; 2006 recipient of the Dean’s Distinguished
Instructor Award.

Affiliations: IEEE; AFCEA; AIAA; Series Technical Editor of the Artech House Space
Technology and Applications Library.

Selected Publications:

Engineering and Professional Books

- *The Satellite Communication Applications Handbook*, 2nd edition, Artech House, 2004
- *The Satellite Communication Ground Segment and Earth Station Handbook*, Artech House, 2001
- *Introduction to Satellite Communication*, 2nd edition, Artech House, 1999
- *Client/Server Computing – Architecture, Applications and Distributed Systems Management*, Artech House, 1994 (co-authored with Bobby Martyna)
- *Networking Strategies for Information Technology*, Artech House, 1992
- *International Telecommunication Management*, Artech House, 1990
- *Private Telecommunication Networks*, Artech House, 1989

Selected Technical Journal and Conference Papers

- Elbert, “Achieving complementarity when integrating satellite, terrestrial and wireless communications,” *19th AIAA International Communication Satellite Systems Conference*, Montreal, Canada, 12-15 May, 2002.

- Elbert, "Broadband data communications via satellite – networks and methodology," *24th Pacific Telecommunications Council Conference*, 13-17 January 2002, Honolulu, Hawaii
- Elbert, "Commercial satellite applications: short term and long term trends," *17th AIAA International Communications Satellite Systems Conference*, 23-27 February 1998, Yokohama, Japan
- Elbert, "Geostationary communications satellites and applications," *The Communications Handbook*, Dr. Jerry D. Gibson, Editor in Chief, IEEE Press, 1996
- Elbert and P.A. Louie, "The economics of mobile service by satellite," *14th AIAA International Communications Satellite Systems Conference*, Washington, D.C., June, 1992
- Elbert, "Next generation C-band satellite systems for cable program distribution," *Cable '88 National Cable Television Association*, May 1, 1988, Los Angeles
- Sanchez-Ruiz, M.E., and Elbert, B.R., "Mexico's First Domestic Satellite," *AIAA International Communications Satellite Systems Conference*, 1984, Orlando
- Sanderson, C.C., and Elbert, B.R., "Communication system design of the Indonesian satellite system," *1976 IEEE Wescon*, September 14-17, Los Angeles
- Kiesling, J.D., Elbert, B.R., Garner, W.B., and Morgan, W.L., "A technique for modeling communications satellites," *COMSAT Technical Review*, Vol. 2, No., 1, Spring 1972

Frequent contributor to SatMagazine (all articles available at <http://www.satmagazine.com>)

Transcript of:

Date: August 27, 2007

Volume: 23

Case: Adjustment of Rates for Pre-Existing Subscriptions

Neal R. Gross & Co., Inc.
Phone: 202-234-4433
Fax: 202-387-7330
Email: info@nealrgross.com
Internet: www.nealrgross.com

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

|-----+
In the matter of:
Adjustment of Rates and
Terms for Preexisting
Subscriptions Services,
and
Satellite Digital Audio
Radio Services
|-----+

Docket No.
2006-1
CRB DSTRA

Room LM-408
Library of Congress
First and Independence Avenue, S.E.
Washington, D.C. 20540

Monday,

August 27, 2007

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

BEFORE:

THE HONORABLE JAMES SLEDGE, Chief Judge

THE HONORABLE WILLIAM J. ROBERTS, JR., Judge

THE HONORABLE STAN WISNIEWSKI, Judge

Page 148	<p>1 Q And when did you found it?</p> <p>2 A In 1999. Excuse me, correction,</p> <p>3 2001.</p> <p>4 Q And can you tell the Court what</p> <p>5 the company does?</p> <p>6 A Yes. ATSI is a satellite</p> <p>7 communications consulting firm. It's</p> <p>8 basically my firm that I operate out of. And</p> <p>9 I provide satellite communications and systems</p> <p>10 consulting services to a variety of clients in</p> <p>11 the private sector and the public sector.</p> <p>12 Q Who are some of the private sector</p> <p>13 clients for whom you consult?</p> <p>14 A Well, that would include companies</p> <p>15 like Northrup Grumman, Japan Satellite</p> <p>16 Communications, a Japanese satellite operator,</p> <p>17 Boeing, and a German company by the name of ND</p> <p>18 SatCom that makes ground communication</p> <p>19 equipment for satellites.</p> <p>20 Q I think you also mentioned you</p> <p>21 consult for government agencies. What are</p> <p>22 some of the government agencies for whom you</p>
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Page 149	<p>1 MR. FREEDMAN: Yes, Your Honor.</p> <p>2 SoundExchange calls Bruce Elbert.</p> <p>3 CHIEF JUDGE SLEDGE: Please raise</p> <p>4 your right hand.</p> <p>5 WHEREUPON,</p> <p>6 BRUCE ELBERT</p> <p>7 was called as a witness by Counsel for</p> <p>8 SoundExchange and, having been first duly</p> <p>9 sworn, assumed the witness stand, was examined</p> <p>10 and testified as follows:</p> <p>11 DIRECT EXAMINATION</p> <p>12 BY MR. FREEDMAN:</p> <p>13 Q Good afternoon. Could you please</p> <p>14 state your name for the record?</p> <p>15 A Yes. My name is Bruce R. Elbert.</p> <p>16 Q And where are you employed, Mr.</p> <p>17 Elbert?</p> <p>18 A I'm President of Application</p> <p>19 Technology Strategy, Inc.</p> <p>20 Q And were you the founder of that</p> <p>21 company?</p> <p>22 A Yes, I'm the founder.</p>	Page 151	<p>1 consult?</p> <p>2 A Yes, primarily Department of</p> <p>3 Defense, so that would be the U.S. Army, U.S.</p> <p>4 Navy, and the Air Force.</p> <p>5 Q And what are the kinds of projects</p> <p>6 for which you provide consulting?</p> <p>7 A I assist clients who are</p> <p>8 developing satellite communications systems to</p> <p>9 put their -- put down their requirements, to</p> <p>10 convert those requirements into technical</p> <p>11 designs. I can assist with various aspects of</p> <p>12 that, and with optimizing or operating a</p> <p>13 system to provide the kinds of services it's</p> <p>14 supposed to provide. And that includes the</p> <p>15 satellites that are put in orbit and also the</p> <p>16 ground systems on the ground that provide the</p> <p>17 actual services and control everything.</p> <p>18 Q How long have you worked in the</p> <p>19 satellite industry?</p> <p>20 A I have worked in the satellite</p> <p>21 industry a total of 38 years.</p> <p>22 Q And can you take us through,</p>
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Page 152	Page 154
<p>1 starting at the beginning of that 38 years, 2 the positions you've held and the jobs you've 3 done? 4 A Sure. Specifically, satellite 5 communications. When I left the U.S. Army in 6 1970 -- I'm sorry, '69 -- I joined the 7 Communications Satellite Corporation. And in 8 that company, we were developing the global 9 satellite communications system now known as 10 IntelSat, and I was a satellite communications 11 system design engineer there working on 12 projects to expand that system to provide 13 telephone, television, and also mobile 14 services. 15 And then, in 1972, I joined Hughes 16 Aircraft Company on the west coast, and that's 17 a company I stayed with until I retired in 18 1999. And at Hughes I was a systems engineer 19 working on a number of satellite projects and 20 total system projects to put in satellite 21 systems for customers overseas and in the U.S. 22 Also, during that period I took a</p>	<p>1 Indonesia called Palapa A, and my team 2 designed that system and then we subsequently 3 oversaw the testing and initial operation in 4 Indonesia. I spent six months there during 5 the testing and verification, and that system 6 used two satellites and 40 stations around the 7 country to provide the first nationwide 8 telephone network and also television 9 distribution in that country. 10 Then, I mentioned that I was with 11 Western Union for about two years on this TDRS 12 program. That would have been the next 13 generation satellite system for Western Union. 14 And Western Union was the first U.S. domestic 15 satellite operator, incidentally, and I came 16 in as they developed their second generation 17 system. 18 Then, following that, I was back 19 at Hughes again and managed a system from 20 Mexico called Morelos that was -- two 21 satellites in that system provided a variety 22 of services ranging from telephone and also</p>
Page 153	Page 155
<p>1 position briefly with Western Union 2 Corporation in New Jersey where I was 3 responsible for the commercial aspects of the 4 tracking and data relay satellite system. 5 That's a satellite that transmits on a variety 6 of frequencies, including S band, which is 7 used in -- happens to be used in the SDARS 8 field. 9 And so that takes me through 1999 10 when I retired from Hughes so I could start my 11 career as a consultant and also as a teacher 12 and professor. 13 Q And at Hughes, what were your job 14 responsibilities at Hughes? 15 A I was lead systems engineer on a 16 number of programs, and then moving up through 17 management, becoming engineering manager and 18 then subsequently senior vice president of 19 operations at Hughes when I retired. So I 20 worked on a number of satellite communications 21 systems. 22 The first big one was the one for</p>	<p>1 distance education in that country to 2 elementary schools. Subsequently, I took on 3 the position as Director of the Galaxy 4 satellites for Hughes, which was a Hughes- 5 owned satellite system. 6 Up to that point, Hughes had built 7 satellites and built systems for customers, 8 but then had the strategy to go out and use 9 their own satellites and provide services, and 10 that was primarily to cable television 11 operators, like Home Box Office and Turner, 12 and then also to TV networks, CBS, NBC, 13 etcetera, and also National Public Radio. 14 National Public Radio used 15 satellites back in the '80s, and still does, 16 to distribute their radio programs to PBS -- 17 I'm sorry, NPR affiliates, public radio 18 affiliates, around the country. 19 The next system worth mentioning 20 is a system using geostationary satellites 21 similar to the ones that XM uses for 22 broadcasting sound. In this case, this</p>

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1 satellite was to be used for handheld
 2 satellite phones -- a system which eventually
 3 was put in for the Middle East out of UAE.
 4 And what's special about this
 5 particular system is it had a very large
 6 satellite, has a very large satellite in
 7 orbit, and it communicates with a small
 8 handheld device with a very small antenna on
 9 it, very similar to the nature of the
 10 transmission from an SDARS satellite to a
 11 vehicular antenna.
 12 And then, at the time I retired,
 13 just prior, coincidentally, since I was in
 14 charge of a lot of these new programs that
 15 were coming to Hughes, the XM satellite radio
 16 spacecraft were purchased from Hughes while I
 17 was there, although I had no direct
 18 involvement, but I did know it was going on,
 19 was quite aware of it.
 20 Q During the course of your career,
 21 have you worked on the design of satellite
 22 systems?

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1 A Yes, absolutely. I've worked on
 2 the design of the satellites themselves,
 3 starting at Comsat and then when I was with
 4 Hughes. In fact, I ran the design and
 5 development of a number of satellites,
 6 including those for Mexico.
 7 I've also worked on the total
 8 system. I kind of pride myself in looking at
 9 the whole end-to-end project, every aspect of
 10 a system, and so I got to do that at Hughes.
 11 And, of course, in my consulting I continue to
 12 do that.
 13 So the end-to-end aspect is
 14 something that is particularly important in
 15 understanding how everything fits together,
 16 and that it's going to provide the service to
 17 the end user or to whoever is the customer,
 18 whether it's commercial or government.
 19 Q Have you worked on the engineering
 20 of satellite systems?
 21 A Yes. In taking the requirements
 22 and converting them into specifications, and

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1 then picking out the equipment, whether it's
 2 going on a satellite or whether it's on the
 3 ground, the equipment and the testing of that,
 4 the verification, prior to launch and after
 5 launch. So, yes, I've been heavily involved
 6 with engineering of satellite systems.
 7 Q Have you worked on the
 8 construction of satellite systems?
 9 A Yes. As part of the engineering,
 10 the construction that's going on, and myself
 11 and my team are observing that construction at
 12 each stage, tracking its progress and the
 13 technical performance. And then, of course,
 14 the construction of the ground facilities,
 15 such as in Indonesia. And while I was at
 16 Hughes, I oversaw the operation and in some
 17 cases upgrade of ground facilities that were
 18 put in.
 19 Q And have you worked on the
 20 operation and management of satellite systems?
 21 A Yes, I have. Very heavily at
 22 Hughes when I was Director of Operations for

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1 the Hughes Galaxy system and a system of 12
 2 satellites and four ground stations.
 3 Q I want to briefly ask you about
 4 your educational background. I neglected one
 5 fact. You mentioned your military service.
 6 Just briefly, what was your military service,
 7 and what was your rank?
 8 A Okay. In connecting it to my
 9 educational background, I have a Bachelor of
 10 Electrical Engineering from City College of
 11 New York, and I was in the ROTC program there.
 12 So I was considering a career as an officer,
 13 and I accepted a regular Army commission,
 14 being a distinguished military graduate, and
 15 served four years, starting out as a
 16 lieutenant and -- with the 4th Infantry
 17 Division, including a tour in Vietnam, as a
 18 radio officer and detachment commander, and
 19 then when I came back I taught radio
 20 communications in the Signal School at Fort
 21 Gordon until, you know, such time as I left
 22 the service to go into the commercial or the

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1 -- you know, the civilian engineering field.
 2 Q And in addition to your BA, do you
 3 have any other advanced degrees?
 4 A Yes, I have a Master of Science in
 5 Engineering from University of Maryland here
 6 in College Park, which I got while I was still
 7 working for Comsat, and I specialized in
 8 communications engineering and computers. I
 9 also have an MBA from Pepperdine University
 10 from the mid '80s.
 11 Q Have you authored any books on
 12 satellite technology?
 13 A Yes. I've written three books
 14 specifically on satellite communications and
 15 satellite technology, and two of those are in
 16 second editions.
 17 Q Can you briefly describe the
 18 subject matter of those books?
 19 A Sure. The subject matter is the
 20 overall design of a satellite communications
 21 system, the satellites, the ground systems,
 22 and how they all work together, including

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1 launch and operations in orbit, and a variety
 2 of technical aspects of that -- risk
 3 management for example, the use of different
 4 frequency bands.
 5 I also covered specific
 6 applications in books. I described, for
 7 example, the SDARS application in a chapter
 8 and the companies that are involved in this
 9 particular matter, as well as other companies.
 10 And DirecTV, for example, was described. I
 11 did work a little bit on DirecTV while at
 12 Hughes, so that's covered. You know, I tried
 13 to cover every aspect of the satellite
 14 communication industry.
 15 Q Have you also written articles on
 16 satellite technology?
 17 A Yes. During and throughout my
 18 career, I have written engineering papers that
 19 have been delivered at conferences,
 20 engineering conferences such as the Institute
 21 of Electrical and Electronic Engineers and the
 22 American Institute of Aeronautics and

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1 Astronautics.
 2 I have also written articles in
 3 trade publications that view different aspects
 4 of the industry and where it's going, what my
 5 observations are on that. And I also
 6 frequently speak at conferences.
 7 Q Have you taught in the area of
 8 satellite systems?
 9 A Yes. Beginning in 1990, I started
 10 teaching, through UCLA extension in their
 11 engineering program, the principles of
 12 satellite communications to engineers in the
 13 L.A. area who wanted to learn about the
 14 communications aspects of aerospace systems.
 15 And from that, after I retired, I
 16 obtained appointment as an adjunct assistant
 17 professor at University of Wisconsin, who was
 18 looking for an instructor to teach information
 19 technology and wireless communications to
 20 engineers. So I've been doing that since
 21 2001.
 22 Q Do you also teach in government

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1 forums or the private sector?
 2 A Yes. Through UCLA extension, I
 3 have taught at a number of government
 4 facilities around the country for Air Force,
 5 Navy, and NASA. And then, through another
 6 organization called Technology Training
 7 Corporation, I have taught -- will be teaching
 8 actually -- courses in the military uses of
 9 satellites.
 10 And I can also add that through a
 11 contract I have to support the Air Force, I'll
 12 actually be teaching a course after I leave
 13 here down at Wright Pattern Air Force Base.
 14 Q Just briefly, what is that course
 15 on?
 16 A That course is on the ground
 17 segments for satellite communications.
 18 Q Have you ever been qualified as an
 19 expert witness in satellite systems in the
 20 Federal Court?
 21 A Yes, I have, in the Bankruptcy
 22 Court of the Southern District of New York

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1 last December.

2 Q In preparing your written

3 testimony in this case, what kinds of

4 information did you review?

5 A I reviewed documents that were

6 provided to me that are primarily technical

7 documents from XM and Sirius describing their

8 systems, the programs, their evaluations of

9 different technologies in different launch

10 vehicles, a whole collection of the kind of

11 information that would help me understand how

12 they got to where they got to and how they got

13 there, basically, you know,

14 corroborating/confirming my general impression

15 from just looking at it as an industry person.

16 I also reviewed the written

17 testimonies of certain key XM and Sirius

18 employees, such as Mr. Massiello and Mr.

19 Parsons of XM, and Mr. Karmazin and Mr. Smith

20 of Sirius. I read as well depositions and

21 some trial testimony.

22 Q Other than documents that were

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1 produced or created in this case, did you look

2 at any academic or other literature?

3 A Yes, I did a literature search

4 through the libraries and the institutes I'm

5 involved with and came up with a number of

6 papers that indicate the prior art and the

7 satellite broadcasting and the use of these

8 frequencies and the types of ground antennas

9 and things like that involved. So I did quite

10 an extensive literature search on that what I

11 might call "prior art."

12 And I also looked at a variety of

13 textbooks that contain relevant information.

14 Plus, I have also relied on my own experience.

15 Q And are all of these kinds of

16 information that you have just described the

17 kind of information you typically rely upon in

18 your consulting work and in your academic or

19 in writing your books?

20 A Yes. Yes, they are.

21 MR. FREEDMAN: Your Honor, at this

22 point, I would move to qualify Mr. Elbert as

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1 an expert in the design, engineering,

2 construction, operation, and management of

3 satellite communications systems.

4 MR. MILLER: We have no objection

5 with regard to --

6 CHIEF JUDGE SLEDGE: Hold on.

7 MR. MILLER: I'm sorry. Excuse

8 me, Your Honor.

9 JUDGE ROBERTS: Design,

10 engineering, construction, and management, did

11 you say?

12 MR. FREEDMAN: Operation and

13 management.

14 JUDGE ROBERTS: Operation and

15 management.

16 CHIEF JUDGE SLEDGE: Any objection

17 to the offer?

18 MR. MILLER: Excuse me, Your

19 Honor. Ralph Miller on behalf of XM. We have

20 no objection with regard to design,

21 engineering, construction, and operation of

22 satellite systems from a technical standpoint.

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1 We're not certain what is included in

2 management. We don't believe that he has had

3 business experience managing satellite

4 operations, and so if that's limited to

5 technical management, how to make the

6 equipment work together, we have no objection

7 on that limited scope of expertise.

8 CHIEF JUDGE SLEDGE: Mr. Freedman?

9 MR. FREEDMAN: Your Honor, may I

10 voir dire the witness about the use of the

11 word "management" in this context and how he

12 understands it?

13 CHIEF JUDGE SLEDGE: All right.

14 VOIR DIRE EXAMINATION

15 BY MR. FREEDMAN:

16 Q When we talk about the word -- the

17 management of satellite communications

18 systems, what is your understanding of how

19 that word is used in the industry?

20 A Well, the word "management," as I

21 would use it, would describe the management of

22 the resources and the assets of the company

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<p>1 that's providing satellite communications</p> <p>2 services, because I did that for Hughes with</p> <p>3 regard to the Galaxy system. I also reviewed</p> <p>4 plans for that sort of thing from other</p> <p>5 companies as we considered selling or</p> <p>6 financing of sales to companies that were</p> <p>7 intending to go into the business.</p> <p>8 I also have knowledge of the --</p> <p>9 and have managed applications delivered over</p> <p>10 the system dealing with customers. I have</p> <p>11 some selling or commercial experience,</p> <p>12 although that has not been my primary role,</p> <p>13 but certainly I can manage, and have managed,</p> <p>14 people involved with sales and marketing and</p> <p>15 have reviewed business plans, marketing plans.</p> <p>16 Although, again, that's not my primary role,</p> <p>17 I have familiarity with that. Of course, I</p> <p>18 have an MBA, so I have the training for it.</p> <p>19 And the last area might be with</p> <p>20 regard to finance, that I've had involvement</p> <p>21 with financing and, because in some cases you</p> <p>22 don't sell something unless it gets financed</p>	<p>1 Q Mr. Elbert, at this time, I'd like</p> <p>2 to show you what we've marked as SoundExchange</p> <p>3 Trial Exhibit 122. Mr. Elbert, if I could</p> <p>4 have you open SoundExchange Trial Exhibit 122</p> <p>5 and look at the first document in there. Do</p> <p>6 you recognize this document?</p> <p>7 (Whereupon, the above-</p> <p>8 referred to document was</p> <p>9 marked as SX Exhibit</p> <p>10 No. 122 for</p> <p>11 identification.)</p> <p>12 A Yes, I do.</p> <p>13 Q And what is it?</p> <p>14 A This is my written testimony that</p> <p>15 I prepared and submitted.</p> <p>16 Q And if you look at page 41, is</p> <p>17 that your signature?</p> <p>18 A Yes, it is.</p> <p>19 Q And you see that there are two</p> <p>20 documents at the back of -- following your</p> <p>21 written testimony that are marked as exhibits?</p> <p>22 A Yes.</p>
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<p>1 dealing with the Ex-Im Bank, and some -- some</p> <p>2 other, you know, lenders or shall I say</p> <p>3 investment bankers who -- who provide</p> <p>4 financing and capital in the industry.</p> <p>5 CHIEF JUDGE SLEDGE: Anything</p> <p>6 further?</p> <p>7 MR. FREEDMAN: No, Your Honor.</p> <p>8 CHIEF JUDGE SLEDGE: Any further</p> <p>9 objection?</p> <p>10 MR. MILLER: Your Honor, I think</p> <p>11 we believe that management of the operations,</p> <p>12 resources, and assets, he is qualified for.</p> <p>13 We think that he indicated that he had very</p> <p>14 limited experience with selling or formation</p> <p>15 of business plans, and so I think if it's --</p> <p>16 if the management is limited to resources and</p> <p>17 assets, we have no objection on that</p> <p>18 management aspect.</p> <p>19 CHIEF JUDGE SLEDGE: All right.</p> <p>20 The offer is accepted.</p> <p>21 DIRECT EXAMINATION (cont'd)</p> <p>22 BY MR. FREEDMAN:</p>	<p>1 Q Are those documents you relied on</p> <p>2 in preparing your testimony?</p> <p>3 A Yes, among many others.</p> <p>4 MR. FREEDMAN: Your Honor, at this</p> <p>5 time, I would move the admission into evidence</p> <p>6 of SoundExchange Trial Exhibit 122.</p> <p>7 CHIEF JUDGE SLEDGE: Any</p> <p>8 objection?</p> <p>9 MR. MILLER: Yes, Your Honor, we</p> <p>10 have a narrow objection on two areas. With</p> <p>11 regard to the written direct testimony first,</p> <p>12 we think that Mr. Elbert has no training or</p> <p>13 experience that would qualify him under</p> <p>14 Federal Rule of Evidence 702 with regard to</p> <p>15 insurance for either satellite launches or</p> <p>16 satellite operations, and I'll explain that</p> <p>17 further.</p> <p>18 The second objection is that we</p> <p>19 think he has performed a calculation of a per</p> <p>20 subscriber cost for two hypothetical</p> <p>21 satellites and hypothetical ground spare, but</p> <p>22 he has not demonstrated that that particular</p>

<p style="text-align: right;">Page 172</p> <p>1 testimony is the product of reliable 2 principles and methods, nor that he has 3 applied the principle and methods reliably to 4 the facts of this case. 5 If I might talk first about 6 satellite insurance, the discussion of that 7 begins on page 14 and goes through the top of 8 page 15. And based upon his qualifications, 9 as he testified to and as we understand them, 10 his only basis for talking about satellite 11 insurance would have to be experience. 12 The comment to the 2000 amendments 13 to Rule 702 has this notation. It says, "If 14 the witness is relying solely or primarily on 15 experience, then the witness must explain how 16 that experience leads to the conclusion 17 reached why that experience is a sufficient 18 basis for the opinion, and how that experience 19 is reliably applied to the facts." 20 The Trial Court's gatekeeping 21 function requires more than simply taking the 22 expert's word for it. As we understand it,</p>	<p style="text-align: right;">Page 174</p> <p>1 hypothetical ground spare with a hypothetical 2 15-year life span and cost and 10 million 3 subscribers per year. 4 We can't tell what is included in 5 the costs or the estimate at all, and we 6 believe that he does not explain the reliable 7 principles and methods he uses, and he has not 8 applied the principles and methods reliably to 9 the facts of this case and this calculation. 10 For example, he doesn't tie in any 11 way the subscriber number. In fact, the 12 undisputed evidence is that neither of these 13 services has ever achieved these subscribers, 14 and he doesn't explain how this could have any 15 particular relationship to this case. 16 So we believe that that fails the 17 prongs of Rule 702 and that that paragraph 18 should be stricken. 19 Should I go ahead and talk about 20 the separate attached exhibits at this time, 21 Your Honor. 22 CHIEF JUDGE SLEDGE: Yes.</p>
<p style="text-align: right;">Page 173</p> <p>1 and Mr. Elbert states, by the way, in the 2 first page of -- first line of page 14, "There 3 is a well-developed insurance industry for 4 satellites." 5 The problem is he has never worked 6 in that industry at all. From what we can 7 tell, he has never sold insurance, he hasn't 8 underwritten insurance. He is an engineer. 9 We don't believe he knows anything about the 10 insurance business. He is not a lawyer, and 11 we don't think he should be giving any 12 opinions about the well developed insurance 13 industry, and we don't think he has shown how 14 his experience could add anything to what the 15 Court already might know about that from its 16 own experience. 17 The second objection is -- with 18 regard to this particular document is directed 19 at a statement on page 6 of his testimony, the 20 first full paragraph, where he purports to 21 perform a calculation. There he purports to 22 take two hypothetical satellites and a</p>	<p style="text-align: right;">Page 175</p> <p>1 MR. MILLER: All right. With 2 regard to Exhibit -- well, with regard to both 3 of these exhibits, 201 and 202, although he 4 says he relied upon them, there has been no 5 predicate laid showing that these are final 6 documents, what they were prepared for, who 7 prepared them, or that they are documents that 8 can be introduced into evidence. 9 The mere fact that he relied upon 10 them does not make them appropriate for 11 introduction into evidence, so we would object 12 on the basis of a lack of predicate for the 13 two exhibits that are attached to his written 14 direct testimony. 15 CHIEF JUDGE SLEDGE: Any response? 16 MR. FREEDMAN: Yes, Your Honor. 17 First, on the issue of insurance, Mr. Elbert 18 has testified that he has 38 years of 19 experience working with satellite systems. 20 His testimony discusses the availability of 21 insurance as a means of mitigating risks, 22 which is a topic he is fully qualified to talk</p>

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<p>1 about.</p> <p>2 He is not offering testimony as an</p> <p>3 expert on the insurance industry. He is not</p> <p>4 talking about the workings of the insurance</p> <p>5 industry. He is talking about the</p> <p>6 availability of insurance. That certainly</p> <p>7 falls, I think, within the rubric of the</p> <p>8 management and operation of satellite systems,</p> <p>9 in which he has been qualified as an expert.</p> <p>10 As to the testimony on page 6, Mr.</p> <p>11 Elbert performed some I think fairly</p> <p>12 straightforward arithmetic here. If I</p> <p>13 understood Mr. Miller's objections, they</p> <p>14 sounded to me like cross examination, if he so</p> <p>15 chooses, about why Mr. Elbert chose particular</p> <p>16 numbers in a hypothetical or how he did his</p> <p>17 math. This is hardly a complicated arithmetic</p> <p>18 that he has done here, I believe.</p> <p>19 As to the two exhibits, these are</p> <p>20 documents that the SDARS themselves produced</p> <p>21 to us in this case. These are documents that</p> <p>22 are directly relevant to rebutting claims</p>	<p>1 rest of his testimony either, and beyond the</p> <p>2 experience of the witness.</p> <p>3 On the objection to Exhibits 201</p> <p>4 and 202, there was no ground given as to why</p> <p>5 they're admissible, other than the fact that</p> <p>6 these are things that experts in this field</p> <p>7 typically rely upon, and that is no basis for</p> <p>8 admissibility, and that objection is</p> <p>9 sustained.</p> <p>10 With those rulings, the exhibit is</p> <p>11 admitted with those restrictions.</p> <p>12 (Whereupon, the above-</p> <p>13 referred to document,</p> <p>14 previously marked as</p> <p>15 SX Exhibit No. 122 for</p> <p>16 identification, was</p> <p>17 admitted into evidence.)</p> <p>18 All right. Mr. Miller?</p> <p>19 MR. MILLER: Your Honor, XM would</p> <p>20 like to move to apply the protective order to</p> <p>21 two very narrow portions of Exhibit 122, both</p> <p>22 having to do with the terms of XM's contract</p>
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<p>1 presented by the SDARS in this case about the</p> <p>2 risky nature and innovative nature of their</p> <p>3 satellite systems.</p> <p>4 I think Mr. Elbert has testified</p> <p>5 that these and other documents he looked at</p> <p>6 are of the kind that an expert in the field</p> <p>7 typically relies upon.</p> <p>8 CHIEF JUDGE SLEDGE: All right.</p> <p>9 We will recess.</p> <p>10 (Whereupon, the proceedings in the</p> <p>11 foregoing matter went off the</p> <p>12 record at 1:57 p.m. and went back</p> <p>13 on the record at 2:06 p.m.)</p> <p>14 CHIEF JUDGE SLEDGE: On review of</p> <p>15 the objections, the objection to the section</p> <p>16 on pages 14 and 15 on insurance is overruled.</p> <p>17 The experience stated is sufficient to</p> <p>18 authorize that testimony. The testimony on</p> <p>19 page 6, the last paragraph, and paragraph A,</p> <p>20 objected to on the lack of any systems and</p> <p>21 methods, the objection is sustained on that</p> <p>22 ground and having no real relevance to the</p>	<p>1 with Boeing.</p> <p>2 The bottom of page 9 highlighted,</p> <p>3 it says, "XM's Boeing contract, for example,</p> <p>4 contains provisions," and then it describes</p> <p>5 the provisions on the top of page 10. We</p> <p>6 would like to apply the protective order to</p> <p>7 the provisions at the top of page 10.</p> <p>8 And on page 15, in the middle of</p> <p>9 the page there is a grade portion talking,</p> <p>10 again, about the contract with Boeing, and it</p> <p>11 has some specific contractual provisions.</p> <p>12 These are confidential, because XM will be</p> <p>13 negotiating contracts probably with other</p> <p>14 launch providers if all goes well, and the</p> <p>15 terms of this contract are confidential and</p> <p>16 proprietary.</p> <p>17 CHIEF JUDGE SLEDGE: Any objection</p> <p>18 to the motion?</p> <p>19 MR. FREEDMAN: No, Your Honor.</p> <p>20 CHIEF JUDGE SLEDGE: Without</p> <p>21 objection, the motion is granted.</p> <p>22 All right.</p>

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1 MR. REID: Your Honor, Ben Reid
 2 for Sirius. We would also like to move at
 3 this time for one passage of Mr. Elbert's
 4 testimony to be treated as restricted under
 5 the protective order. On page 36, there is a
 6 citation to a document that references Sirius
 7 orbits and the orbital designation. That
 8 information is not publicly available.
 9 It's confidential related to the
 10 orbit in which Sirius satellites operate, and
 11 we would move that information not be provided
 12 or disclosed as it would be information that
 13 Sirius would not disclose to its competitors.
 14 CHIEF JUDGE SLEDGE: What is the
 15 significance of the word -- hyphenated word
 16 preceding "elliptical"?
 17 MR. REID: My understanding is
 18 that that is the type of orbit -- that
 19 references another satellite that is a -- that
 20 has been used in that type of orbit.
 21 CHIEF JUDGE SLEDGE: And what is
 22 the significance of the name of the

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1 designation?
 2 MR. REID: Your Honor, I'm not
 3 fully aware of the technical application, what
 4 that actually means, but I know that that is
 5 a designation of that orbit. That is not
 6 something that Sirius discloses to the public.
 7 That's my understanding.
 8 CHIEF JUDGE SLEDGE: I'm not
 9 persuaded by that, Mr. Reid. I don't believe
 10 that information is private. I think that's
 11 common knowledge, that the satellite is in an
 12 elliptical orbit.
 13 MR. REID: I was more referring to
 14 the designation, Your Honor. That was my
 15 concern.
 16 CHIEF JUDGE SLEDGE: I don't know
 17 why that would be private based -- because you
 18 don't know.
 19 All right.
 20 MR. FREEDMAN: Thank you, Your
 21 Honor.
 22 BY MR. FREEDMAN:

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1 Q Mr. Elbert, in your written
 2 testimony you stated that XM and Sirius
 3 benefitted from other companies' experience
 4 using satellites. Can you explain what you
 5 mean by that?
 6 A Fundamentally, the use of
 7 satellites to provide a communications service
 8 like audio broadcasting on a reliable basis
 9 has its origins with the first communications
 10 satellite company, which was Comsat, the one
 11 I worked for back in the '60s, and that
 12 company established the procedures/policies
 13 for procuring extra satellites, put them up,
 14 purchasing launch insurance, and a variety of
 15 operational procedures that are the core of
 16 how satellite services are a reliable means of
 17 providing communications. So there is that
 18 kind of beginning.
 19 Q And are those developments with
 20 that company helpful to XM and Sirius?
 21 A Well, absolutely, because it
 22 happens that key technical people out of both

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1 companies come from that background
 2 themselves, as do many of the staff, plus just
 3 the fact that the manufacturers who produce
 4 the satellites for those companies also
 5 produce them for XM and Sirius.
 6 So all of that legacy is present,
 7 all of that knowledge is present, all of the
 8 resources are there. And so that's the first
 9 core.
 10 Now, then, there are a number of
 11 other kinds of satellite communication
 12 businesses over the years that are built on
 13 the foundation of a reliable means of
 14 delivering the service. You know, launching
 15 a satellite is one part of it, but then having
 16 sufficient satellites, using insurance, and
 17 operating things in a very methodical manner,
 18 those are core methodologies in the industry,
 19 and Comsat was the first.
 20 I mentioned previously that I
 21 worked for Western Union for a while, and that
 22 company, prior to me working for them, was the

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1 first U.S. domestic company to put up
 2 satellites and operate them to provide a
 3 service across the United States. And those
 4 satellites we used for a variety of
 5 communications, including television
 6 distribution for the TV networks and for cable
 7 TV, and for their own telephone network, and
 8 also for radio, and then NPR was one of the
 9 users of the Westar satellites to deliver
 10 audio.

11 And then, we moved quickly into
 12 the '90s with DirecTV, which began in the
 13 early 1990s and went into service in 1994,
 14 established a system that could deliver a lot
 15 of programming to individuals. I don't have
 16 to go into the details of what it looks like,
 17 people know what that looks like, 100 or more
 18 channels of high-quality video and audio and
 19 sound and music.

20 And the business model for doing
 21 that, the structure of the business, the
 22 methodologies for putting up satellites and

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1 operating them in a reliable way, having
 2 redundancy, using ground facilities,
 3 distributing low-cost receiving equipment,
 4 managing all of that, and building up a large
 5 customer base, supporting a customer base of
 6 millions of people. All of that was
 7 demonstrated by, first, DirecTV and then
 8 shortly after by the Dish Network, by
 9 EchoStar.

10 So those are three examples.

11 Q Were XM and Sirius the first to
 12 use satellite technology to deliver radio
 13 service?

14 A No. I mentioned NPR, and also the
 15 radio networks, like CBS, ABC, NBC, used
 16 satellites in the '80s. There was a company
 17 called Super Market Radio Network that I
 18 provided satellite capacity to in the '80s.

19 That was innovative idea of
 20 setting up a studio similar in concept to what
 21 XM and Sirius have, which is the studio that
 22 serves many virtual radio networks, if you

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1 will, several radio networks out of the same
 2 facility, and delivering all those different
 3 radio programs by satellite to separate
 4 organizations. In that case, it was different
 5 supermarket chains.

6 They also were innovative in
 7 another regard, is they didn't deliver
 8 directly by satellite to all stores. In many
 9 cases, they brought the signal to a local FM
 10 transmitter and rebroadcast it as a repeater
 11 that could be received at, you know, dozens or
 12 hundreds of stores located in a certain
 13 community. And that way they didn't have to
 14 deliver it directly everywhere. So that's an
 15 example.

16 Now, during the '80s, the late
 17 '80s, early '90s, there were a variety of
 18 experimental programs in using satellites or
 19 examining the use of satellites to deliver
 20 programming directly, audio programming
 21 directly to the public. This is something
 22 that Voice of America looked at in the 1980s.

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1 And then, early 1990s, NASA did
 2 experiments transmitting at S band, the same
 3 frequencies used by SDARS -- and the S is
 4 coincidental, by the way, in the S band. The
 5 S doesn't stand for anything in particular.
 6 It just refers to the frequencies around 2.4
 7 gigahertz.

8 And that satellite -- TRDS,
 9 incidentally, the satellite I was the system
 10 program manager of or Westar program manager
 11 of when I was with Western Union, that that
 12 satellite transmits -- would transmit an audio
 13 signal, and then it would be picked up in a
 14 vehicle as it drove around and collected data
 15 on that transmission to understand what the
 16 characteristics would be of such a service,
 17 and from that one could determine, using
 18 normal engineering practice, what would be
 19 need to build out a commercial service. So
 20 that existed.

21 Now, there's another -- there's a
 22 very important precursor to SDARS, which is a

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1 system which basically is the same idea and
 2 the same implementation, and that's World
 3 Space, that came in the later part of the
 4 1990s. And World Space is a company that put
 5 up two satellites, one covering Africa
 6 primarily and parts of Europe, and the other
 7 one covering Asia.

8 And with those satellites, World
 9 Space broadcast radio programs, some 60 or so
 10 channels of radio programming that could be
 11 received with a portable receiver, something
 12 like the old portable receivers we used to
 13 carry around when we were teenagers, only this
 14 would have a relatively small satellite
 15 receiving antenna on it, about the size of --
 16 something smaller than a saucer, and with that
 17 get these radio programs, and it would be
 18 music primarily, and be able to overcome the
 19 obstacles of terrain or the lack of
 20 infrastructure in different countries.

21 So that company predates XM and
 22 Sirius, of them starting their projects and

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1 going into service. And, in fact, World Space
 2 was an investor and a contributor to the
 3 startup of XM.

4 Q Let me ask you about one specific
 5 feature of the SDARS, and that is their
 6 antennas. Were their antennas innovative, in
 7 your opinion?

8 A No, they are not innovative.
 9 Those antennas are based on antenna
 10 engineering principles that are well known to
 11 engineers in the field, going back in some
 12 cases 40 years, but similar in concept and in
 13 design to antennas used with the GPS
 14 receivers, for example.

15 And also, another type of system
 16 we didn't talk about, which are the mobile
 17 satellite systems like Iridium and
 18 GlobalStar, I mentioned that I worked on a
 19 project using a geostationary satellite and a
 20 small handheld phone, small -- relatively
 21 small, and it had a small antenna similar in
 22 design to the antennas used by XM and Sirius.

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1 So that idea of a small antenna is
 2 -- was not new. The technology of the antenna
 3 was not new. And, incidentally, it's made
 4 possible by having a high-power satellite that
 5 can broadcast all of the data, all of those
 6 audio channels with sufficient power to get
 7 adequate signal into the small antenna. So
 8 it's not the small antenna that makes it
 9 possible. It's the powerful satellite.

10 Q Let me ask you a different subject
 11 area.

12 A Sure.

13 Q Are there risks -- are there some
 14 risks involved in the launch and operation of
 15 satellite systems?

16 A Yes, there are some well
 17 understood risks. The risk that one always
 18 recognizes is that when you launch a satellite
 19 on an expendable rocket, which is the way all
 20 rockets are today, that there is a possibility
 21 that that launch will fail, and that something
 22 will fail in the process of boosting it off

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1 the ground and delivering it ultimately to its
 2 final orbit as a working satellite.

3 And that risk is quantifiable, is
 4 known, and on average, over the last 40 years,
 5 it's about five percent. So, in other words,
 6 one in 20 launches, on average, can be -- you
 7 know, will fail. Of course, you don't know
 8 which one it is, so you have to prepare that
 9 a given launch could fail. And so there are
 10 several well proven methods, as I say, going
 11 back 40 years, that involve having spare
 12 satellites.

13 If you have satellites in orbit
 14 already, that you would expect to have
 15 satellite capacity you could rely on. If that
 16 launch failed and/or you have a ground spare,
 17 which is an extra satellite you've built which
 18 can be prepared and launched in a matter of
 19 months, perhaps six months, maybe a little
 20 longer, it all depends on the particulars of
 21 the situation and how urgent it is to get it
 22 up there. So that's number one is spare

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1 satellites.

2 Q Let me stop you there and ask --

3 A Yes, okay.

4 Q -- you a couple of other questions

5 on that.

6 A Sure.

7 Q When you say a launch fails, does

8 that necessarily mean that the satellite is

9 inoperable?

10 A No, it doesn't mean that. That

11 there are situations with the -- most of the

12 launch vehicle works -- that is, the first

13 stage, the second stage, and there might be a

14 malfunction with the third stage, where it

15 doesn't give all of the boost that it's

16 supposed to, and it leaves a satellite in a

17 somewhat incorrect orbit or not on the target

18 if you will. And they do measure it in terms

19 of a target, where it's supposed to be in

20 terms of velocity and orbit parameters.

21 And it can still be maneuvered

22 into the correct orbit using onboard

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1 propulsion -- that is, onboard the satellite

2 -- by ground command. This is done all the

3 time. In fact, for every mission there is

4 always some error. But if you have a lot of

5 error, you can still potentially correct for

6 that. It may result in a satellite with

7 somewhat reduced lifetime, because you consume

8 some of the life maintenance of fuel to do

9 this orbit correction.

10 Q Has XM or Sirius ever experienced

11 a launch failure?

12 A No. The records in -- both from

13 XM and Sirius, and also public domain

14 information, and my knowledge say, no, they

15 have not experienced any launch issues. Their

16 satellites were delivered in working

17 condition, and with the projected lifetimes at

18 the time they were turned over to their -- to

19 the buyers, to the operators.

20 Q Once a satellite has been launched

21 into orbit, is there a risk of failure after

22 that point?

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1 A Yes, there is. Because it's not

2 economically feasible to repair a satellite,

3 either by human beings or by some type of

4 robot machine, it's just not going -- not

5 going to be effective. Instead, what we -- we

6 have to expect that something will fail at

7 some point on one -- on some satellite, some

8 component, some subsystem on the satellite.

9 So the way to deal with that is we

10 carry a lot of redundancy, a lot of extra

11 parts, spare parts, backup systems, and

12 alternate modes of operation to work around

13 something that might fail. So, you know,

14 these are expected, what could fail. If it's

15 something that's unexpected, we can come up

16 with a workaround, and thereby many, many

17 failures that might have even been life-

18 threatening or serious can be overcome. And

19 the routine failures, of course, can be taken

20 care of with no effect at all on service.

21 Q And what is the failure rate of

22 satellites once they're in orbit?

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1 A Once they're in orbit, my recent

2 review of the data -- approximately 700

3 satellites launched in the last 40 years --

4 it's about one percent, give or take a few, so

5 it might be one percent, one and a half

6 percent, something like that, is the total.

7 And so in any given year, you might expect one

8 -- you know, one percent probability that a

9 satellite might fail or something might fail

10 on the satellite.

11 And that would be a catastrophic

12 failure that I'm talking about that would

13 render the entire satellite useless.

14 Q You've mentioned in the course of

15 your testimony today several ways that

16 companies can mitigate risk. You mentioned I

17 think having spare ground satellites and

18 having redundant components built in and in-

19 flight workarounds in satellites. Are those

20 all features that are routinely used in the

21 industry to -- in the satellite?

22 A Yes, and over the last 40 years.

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1 Q And are those all features that
 2 are available to XM and Sirius?
 3 A Yes, they are.
 4 Q In closing, Mr. Elbert, are there
 5 advantages to XM and Sirius of using satellite
 6 systems to deliver their radio programming?
 7 A Yes, there are.
 8 Q And, briefly, what are those?
 9 A Well, using a satellite some -- a
 10 satellite that is high enough above the earth
 11 and relatively fixed with respect to the earth
 12 is it can put a beam down or coverage down
 13 that covers the entire area of interest, the
 14 entire market.
 15 In the case of XM and Sirius, it's
 16 the United States, which is arguably the best
 17 economy in the world and one that has a hunger
 18 for new technologies and new media and also
 19 new ways of getting them media.
 20 So the market is attractive, the
 21 satellite can cover that market effectively,
 22 and so that's number one. You have this

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1 ability to address and to serve this market,
 2 this valuable market. And then, with
 3 satellites that we have available, or have
 4 been available over the last 10 years, you can
 5 put down a sufficient power to be able to use
 6 small low-cost equipment to recover the
 7 signal. So that's -- that's a thing.
 8 And you can build a very large
 9 business. You can build a business of tens of
 10 millions, even hundreds of millions on the
 11 outside. It's theoretically possible. And
 12 using satellites -- once you invest in that
 13 infrastructure, putting those satellites up
 14 there and getting everything in position, the
 15 incremental cost of adding customers amounts
 16 to just the marketing cost and maybe a few
 17 other little startup costs for a given
 18 customer, but serving them from what is
 19 already being distributed everywhere is at no
 20 additional cost.
 21 So the -- as the subscribers
 22 climb, effectively the cost per subscriber

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1 goes down and you end up at some point where
 2 you cross the break even. And this happened
 3 with DirecTV and Dish Networks. It becomes
 4 very profitable.
 5 MR. FREEDMAN: Your Honor, I have
 6 no further questions for this witness.
 7 JUDGE ROBERTS: Mr. Elbert, you
 8 said what is not innovative with respect to XM
 9 and Sirius. Can you tell us what, if
 10 anything, is innovative?
 11 THE WITNESS: Do you mean about XM
 12 and Sirius?
 13 JUDGE ROBERTS: Yes.
 14 THE WITNESS: The term
 15 "innovative," as I'm using it, means that it's
 16 a technology that has not existed, that it has
 17 been invented. And what I'm pointing out is
 18 that this is a system that integrates together
 19 a number of existing proven technologies, both
 20 of these systems.
 21 And so everything about them that
 22 matters, from a technological standpoint, pre-

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1 existed. And what they have done is a very
 2 good engineering job. That is, they started
 3 off with a requirement to provide service
 4 throughout the U.S. to users who would be in
 5 vehicles, or maybe in their homes, or out in
 6 the open.
 7 And so they, in an engineering
 8 fashion, examined, what are the alternatives
 9 for doing this? And they pick from the
 10 technologies that are on the pallet that are
 11 available -- high-power satellites, low-cost
 12 consumer equipment, digital processing to
 13 compress all of these channels together. Each
 14 one of these elements were available, and,
 15 incidentally, that's why they could put their
 16 systems together so quickly is that they had
 17 that available to them.
 18 JUDGE ROBERTS: So they -- in
 19 essence, you're saying that they took things
 20 off the shelf and the -- created a new service
 21 with them, but using existing technology.
 22 THE WITNESS: That's a correct

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1 statement, yes.
 2 JUDGE ROBERTS: Okay.
 3 CHIEF JUDGE SLEDGE: Cross
 4 examination?
 5 CROSS EXAMINATION
 6 BY MR. MILLER:
 7 Q Mr. Elbert, my name is Ralph
 8 Miller, a lawyer here for XM Satellite Radio.
 9 We've never met before today, is that correct?
 10 A That's correct.
 11 Q And you were not deposed in this
 12 case, is that true?
 13 A That's correct.
 14 Q First, I want to ask you a little
 15 bit about development and deployment of the
 16 Sirius and XM systems, building on the
 17 question Judge Roberts asked you. Do you
 18 agree that satellites are the most cost
 19 effective way to broadcast content nationwide?
 20 A Yes.
 21 Q And I think you have said that for
 22 the SDARS the trick was to be sure that the

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1 programming flows in the same manner as
 2 listeners are accustomed to hearing, is that
 3 right?
 4 A I believe I've said that, yes.
 5 Sounds about right.
 6 Q And this means that the
 7 programming has to be delivered on a
 8 continuous basis regardless of the location of
 9 the user, is that right?
 10 A Yes.
 11 Q And you aware that the
 12 availability track record of both XM and
 13 Sirius is in excess of 99 percent?
 14 A Well, I'm not surprised -- how is
 15 that -- first, back up and define the
 16 availability there for that number, if you
 17 would. There are many definitions, and I want
 18 to answer you precisely.
 19 Q I think we're saying that out of
 20 100 seconds of time in a region outside of a
 21 tunnel where it should be available that 99 of
 22 those seconds on average will be -- will have

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1 music coming in, and only one out of the 100
 2 seconds wouldn't.
 3 A If we could further say you're not
 4 in an urban or concrete canyon, and there are
 5 places where you could be where the various
 6 diverse pads won't reach you, that it's
 7 possible that in a highly built-up area, or a
 8 highly mountainous area, you wouldn't make the
 9 99 percent.
 10 But if you're in the open,
 11 suburban area, without very high mountains
 12 around you, not going under underpass, not a
 13 lot of blockage around you, certainly, yes.
 14 Q Well, my question is: do you know
 15 whether the availability record of both XM and
 16 Sirius is in excess of 99 percent, or not know
 17 that?
 18 A I don't know that.
 19 Q Okay. Do you understand that the
 20 reception of XM and Sirius is equal to or
 21 better than FM, on average, nationwide?
 22 A Again, where are we talking about

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1 the reception being equal to or better?
 2 Q We're talking about any place
 3 outside of a tunnel, basically, including the
 4 urban areas.
 5 A That is such a broad statement, I
 6 wouldn't be able to say categorically under
 7 all circumstances it's the case. Generally
 8 speaking, and by my experience, because I'm a
 9 subscriber, I believe that it is as good as
 10 FM, certainly.
 11 Q And that was important, as you
 12 understand it, for consumers in a large market
 13 to get something that was the quality they
 14 were used to hearing. Is that true?
 15 A Yes.
 16 Q Now, XM and Sirius both combine
 17 the features of multiple satellites that are
 18 using simultaneous broadcasts with terrestrial
 19 repeaters and inexpensive mobile receivers, is
 20 that right?
 21 A Yes.
 22 Q And they did that to produce

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1 continuous coverage for automobiles, right?
 2 A Yes.
 3 Q And they used the repeaters in
 4 part to improve the quality in urban areas.
 5 A Yes.
 6 Q Let's talk about for Sirius --
 7 Sirius receivers for a moment. A Sirius
 8 receiver is capable of getting three signals
 9 at the same time, isn't it? Two signals from
 10 different satellites and one from a
 11 terrestrial repeater?
 12 A Yes.
 13 Q And it has a circuit called a
 14 comparator that selects the best signal and
 15 saves it, and then plays it at the appropriate
 16 time. Is that true?
 17 A Yes, it's -- it's an example of
 18 the type of comparator, or also called a rate
 19 receiver. But that technology has existed for
 20 quite some time.
 21 Q The World Space Receiver that you
 22 were talking about didn't receive three

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1 simultaneous signals and use a comparator, did
 2 it?
 3 A No, it didn't -- doesn't.
 4 Q XM receivers actually use --
 5 A Nor does it need to, because
 6 there's only one satellite.
 7 Q Well, and for that reason, by the
 8 way, the World Space Receiver was portable,
 9 you said, is that true?
 10 A Yes.
 11 Q You could move it, for example,
 12 from in front of your hut to behind your house
 13 in Africa and still point it at the satellite,
 14 true?
 15 A Yes.
 16 Q But you couldn't very well move
 17 around with it in, say, the back of a pickup
 18 truck, other than very open areas, and expect
 19 it to work if you went into a city, for
 20 example, isn't that true?
 21 A That's true.
 22 Q Now, XM actually uses something

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1 called maximum gain rather than comparators.
 2 Do you know the difference between the maximum
 3 gain system and the comparator system?
 4 A Well, you know, people use buzz
 5 words, commercial names, for things. The name
 6 doesn't communicate exactly what's going on.
 7 So I have not heard the term "maximum gain,"
 8 but I know how it works. So if we can parse
 9 that, or find out what is under that name,
 10 then I can answer your question.
 11 Q Is it true that XM receivers look
 12 at data packets and they select the most
 13 error-free data packet from the three signals
 14 coming in, and then weave those data packets
 15 together to form a continuous signal?
 16 A That makes sense to me, yes.
 17 Q And that's not something that was
 18 done by the Super Market Radio Network, was
 19 it?
 20 A It wasn't done by them, nor did
 21 they need to, but it has been done in other
 22 systems -- that technique of picking the best

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1 packet. In fact, the internet works on that
 2 basis.
 3 Q You said that NASA did research to
 4 determine whether radio programming could be
 5 transmitted to moving vehicles and portable
 6 receivers via satellites, right?
 7 A That's -- no, I said mobile
 8 receivers.
 9 Q Well, I believe if you look to
 10 your written direct testimony on page 26,
 11 please, sir, you said at the bottom of the
 12 first paragraph under heading 2, "NASA
 13 embarked on intensive research using the S
 14 band to determine whether radio programming
 15 could be transmitted to moving vehicles and
 16 portable receivers via satellites." True?
 17 A Yes. But I -- I'm sorry. When I
 18 heard you ask, all I heard you say was
 19 "portable receivers." You may have said
 20 "moving vehicles" and I didn't hear it.
 21 Q Well --
 22 A I apologize.

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1 Q -- I meant to say "moving
 2 vehicles." If I didn't, I apologize.
 3 A Okay. All right. We're straight.
 4 Q But what NASA found was that
 5 expected signal blockages from tree trunks,
 6 hills, and buildings would cause interruption
 7 of the reception, right?
 8 A That's correct, and I acknowledge
 9 that in my report.
 10 Q And NASA did not develop
 11 commercial-level receivers that could overcome
 12 this interruption of service by receiving
 13 three signals and weaving them together as a
 14 part of this experiment, did it?
 15 A No, it didn't.
 16 Q The overall XM system integrates
 17 many elements to provide a commercial
 18 subscription service, isn't that true?
 19 A Yes.
 20 Q And Sirius satellite radio uses an
 21 integrated architecture of space segments and
 22 ground segment components. Isn't that also

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1 true?
 2 A Well, they're both the same in
 3 that regard. You could say it one way or the
 4 other for the other. You could just switch
 5 those around; they would apply, yes.
 6 Q Well, the point is that the
 7 systems take a series of components to get a
 8 broadcast operation that uses moderately
 9 priced receivers to get what is essentially a
 10 continuous flow of music to moving vehicles,
 11 isn't that right?
 12 A Did you mean to say what -- I
 13 heard "moderately high-priced receivers."
 14 Q I said "moderately priced," is
 15 what I meant. If I said "high priced" -- let
 16 me start over.
 17 A Okay.
 18 Q Both of these systems use a series
 19 of satellites and repeaters and moderately
 20 priced radio receivers to deliver continuous
 21 music to moving vehicles, isn't that true?
 22 A Yes.

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1 Q And no one before XM or Sirius had
 2 ever developed a commercial nationwide system
 3 that combined the elements of multiple
 4 satellites with simultaneous broadcasting and
 5 terrestrial repeaters and moderately priced
 6 mobile receivers with the ability to combine
 7 those signals and produce real-time listening
 8 quality in automobiles, isn't that true?
 9 A Yes.
 10 Q And making these systems work on a
 11 commercial basis did require detailed systems
 12 development to produce a reliable interaction
 13 among the segments, isn't that true?
 14 A I'm glad you said it that way,
 15 because that was system development or systems
 16 engineering is the process by which those
 17 elements were brought together.
 18 So, and this is what I was talking
 19 before when, Your Honor, you were asking me
 20 that question and I was clarifying where the
 21 innovation was and where it wasn't, and that
 22 in my opinion, and as a systems engineer

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1 myself, I don't feel that the bringing
 2 together of those elements represents
 3 innovation.
 4 Q Well, whether it's innovation or
 5 not, it did require detailed systems
 6 development that had not occurred in that form
 7 for a commercial nationwide system before,
 8 true?
 9 A That's true.
 10 Q It's also true that the receivers
 11 that were produced took more time than the
 12 original business plans of either business
 13 expected, isn't that true?
 14 A Well, when I made the statement in
 15 my testimony here to that effect -- and it was
 16 a broad statement -- I was really referring to
 17 Sirius, because Sirius was delayed in getting
 18 the chips and getting their receivers out, and
 19 that was because their chip supplier or their
 20 developer of the chips -- Lucent -- was late,
 21 substantially late.
 22 And from the record, I understand

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1 -- that is to say, from the documents I have
 2 seen, I understand that Sirius changed their
 3 strategy and went over to the strategy that XM
 4 used, which was to bring internal, bring
 5 inside, the engineering of that chip set, so
 6 that they had more control and could get the
 7 job done more efficiently, and then the chips
 8 were produced.

9 The radios came later than XM,
 10 and, as most people are aware, XM was late to
 11 market, but they have recovered very well. So
 12 I don't --

13 Q XM was late to market, or Sirius
 14 was late to --

15 A I meant Sirius, thank you. Sirius
 16 was late to market, and -- but XM was not
 17 late. XM, to my knowledge, got to market when
 18 they expected to. That is to say, within a
 19 reasonable time after the satellites were
 20 launched and in service.

21 Q Now, with regard to those chip
 22 sets you're talking about from Lucent, those

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1 were not off-the-shelf items that Lucent had
 2 been selling to other people, isn't that true?

3 A Well, they are no more not off the
 4 shelf than the chips that went in -- go into
 5 some new Motorola handset. I mean, every --
 6 every handset product that comes out has a
 7 chip set that's a new version of a previous
 8 chip set, or it has got some new features on
 9 it, or a Palm Pilot or a -- if you will, a
 10 Blackberry.

11 And so it's the same methodology
 12 to develop a chip set as it is to -- for a
 13 cell phone or for a satellite TV receiver as
 14 it is for developing it for XM or Sirius. And
 15 so I don't see that as a technological
 16 innovation. Again, it's taking your design,
 17 bringing it to the people who develop chips,
 18 and have them produce the chips that you need.

19 Q Do you consider it off the shelf
 20 if you go to Lucent, give them design
 21 specifications, they try to build it, and it
 22 takes them longer than planned, is that off

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1 the shelf?

2 A Well, I might have gone some place
 3 else than Lucent, yes. You know, it's not off
 4 the shelf, because I'm trying -- what I'm
 5 trying to communicate is development of a chip
 6 set is a methodology that produces a chip to
 7 meet requirements. What's off the shelf is
 8 the methodology, is the tools, is the
 9 manufacturing, and all of that that's
 10 basically a world-class capability that exists
 11 and existed at the time that they need it.

12 Q Both XM and Sirius had to develop
 13 customized signaling protocols, waveforms, and
 14 transmission techniques, didn't they?

15 A No, they didn't. No, what they
 16 did is they used existing waveforms and
 17 compression and other signaling techniques.
 18 There was some fine-tuning to the particulars
 19 of the satellite broadcast and the manner in
 20 which it's being received on a moving vehicle.

21 But the fundamental methodology
 22 and the particular waveforms, they are pre-

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1 existing features of other systems that are
 2 adapted to this one.

3 Q They are pre-existing systems, but
 4 the particular mix of signaling protocols,
 5 waveforms, and transmission techniques that
 6 each one used, was something that was
 7 customized for their own system, isn't that
 8 true?

9 A Yes.

10 Q Would you agree that Sirius and XM
 11 commercial systems for nationwide delivery of
 12 high-quality audio directly to automobiles did
 13 constitute an advancement over prior
 14 commercially available systems?

15 A Would you read that again for me?

16 Q Yes. Would you agree that Sirius
 17 and XM commercial systems for nationwide
 18 delivery of high-quality audio directly to
 19 automobiles did constitute an advancement over
 20 prior commercially available systems?

21 A Yes.

22 Q XM and Sirius used, as you have

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<p>1 said, the S band, isn't that correct?</p> <p>2 A Yes.</p> <p>3 Q And much prior communication</p> <p>4 satellite technology involved the C or the KU</p> <p>5 or the L bands, isn't that true?</p> <p>6 A Also S band.</p> <p>7 Q But making --</p> <p>8 A In other words, S band is a band</p> <p>9 that was used for satellites for years prior.</p> <p>10 In fact, the first geostationary</p> <p>11 communications satellite called SynchCom used</p> <p>12 S band. That was back in 1963. So S band --</p> <p>13 and NASA has used S band extensively. TDRS I</p> <p>14 mentioned uses S band.</p> <p>15 Also, there was a broadcasting</p> <p>16 satellite in -- used in Indonesia in the early</p> <p>17 1990s, and also the late 1980s I think in --</p> <p>18 in the Middle East they used an S band TV</p> <p>19 broadcasting satellite. So, no, I would not</p> <p>20 -- I do not recognize S band as a new piece of</p> <p>21 spectrum. No, it has been used almost as --</p> <p>22 or as long as all of the other bands, the ones</p>	<p>1 the working payload, as we call it, the</p> <p>2 satellite equipment.</p> <p>3 They tested it on the ground to</p> <p>4 verify that it would work according to the</p> <p>5 design. So prior to them even launching it,</p> <p>6 they knew they had a satellite that would meet</p> <p>7 the requirements. So that work that you're</p> <p>8 referring to is work that's done on</p> <p>9 essentially every satellite that's built.</p> <p>10 Q But the work was well done and</p> <p>11 produced a successful system ultimately,</p> <p>12 correct?</p> <p>13 A Correct.</p> <p>14 Q Now, let's talk about the patents</p> <p>15 for a moment. You included a number of</p> <p>16 patents in your supporting documents, isn't</p> <p>17 that right?</p> <p>18 A Yes.</p> <p>19 Q I could find 44 patents in your</p> <p>20 materials for XM, does that sound about right</p> <p>21 to you?</p> <p>22 A Yes.</p>
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<p>1 you mentioned.</p> <p>2 Q Making the Sirius and XM systems</p> <p>3 work as a commercial system nationwide on the</p> <p>4 S band required incremental development from</p> <p>5 prior work done at the C, KU, and L bands,</p> <p>6 isn't that correct?</p> <p>7 A Well, what's important to</p> <p>8 understand is what is the nature of that</p> <p>9 incremental work. The answer is, yes, it</p> <p>10 requires incremental work, but that</p> <p>11 incremental work is the normal standard</p> <p>12 engineering process used by, for example,</p> <p>13 satellite manufacturers like Boeing and Space</p> <p>14 Systems Loral who developed XM and Sirius.</p> <p>15 And they took all of the</p> <p>16 technology that's available to them. They</p> <p>17 came up with the specifics -- actually,</p> <p>18 Alcatel supplied the communication part that</p> <p>19 went on the Boeing satellite. But either way,</p> <p>20 they took their know-how that existed at the</p> <p>21 time and they used their methods of making the</p> <p>22 engineering changes or adaptations to produce</p>	<p>1 Q And I found 14 patents for Sirius</p> <p>2 in your materials, does that sound about</p> <p>3 right?</p> <p>4 A Yes.</p> <p>5 Q And I noticed that there are some</p> <p>6 patents in there on system architecture, is</p> <p>7 that right?</p> <p>8 A Yes, there are.</p> <p>9 Q And there are some patents on</p> <p>10 orbital configuration, is that right?</p> <p>11 A Well, we have to be careful on</p> <p>12 that orbital configuration. Those patents,</p> <p>13 those are from Sirius. They had one patent on</p> <p>14 a geostationary system like XM.</p> <p>15 Now, it's not on the orbit; it's</p> <p>16 on a system or -- what they're patenting is a</p> <p>17 -- as you said, an architecture to provide the</p> <p>18 service. And so they define the architecture</p> <p>19 in one way when they had the geostationary</p> <p>20 satellites, and then when they moved to the</p> <p>21 highly elliptical earth orbit satellites that</p> <p>22 they eventually went with, the three</p>

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1 satellites, and the variously known as Tundra
 2 orbit or modified Moinya orbit, that that --
 3 that that configuration, there is a patent
 4 that includes that orbital configuration, but
 5 also the features you described of the
 6 terrestrial repeaters and the way the receiver
 7 would operate with those satellites.
 8 So it's my opinion -- and I've
 9 done quite a bit of patent work as an expert
 10 as well -- that the orbit per se is not what
 11 the patent is being granted -- the grantee is
 12 being granted is some kind of global patent on
 13 the orbit.
 14 No, it's on the architecture that
 15 happens to use that orbit, and I think that's
 16 an important distinction, and one I didn't
 17 make in something I wrote in one of my books
 18 where I mentioned that the orbit was patented.
 19 Actually, it's not the orbit, but it's the
 20 architecture.
 21 Q There are patents on chip set and
 22 receiver design?

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1 A Yes.
 2 Q There are patents on antenna
 3 characteristics?
 4 A Yes. Those -- it's interesting
 5 that those antennas were not the ones that
 6 they actually use.
 7 Q The patents do demonstrate that
 8 there was an ability to overcome technical
 9 challenges in working toward the objective of
 10 seamlessly connecting cars through satellites
 11 and repeaters as they travel around the
 12 country, isn't that true?
 13 A Would you say that again?
 14 Q Yes. The patents demonstrated
 15 that there was ability of both XM and Sirius
 16 to overcome technical challenges in reaching
 17 the objective of seamlessly connecting cars
 18 through satellites and repeaters in real time
 19 as they move around the country.
 20 A Well, unfortunately, with patents
 21 they don't necessarily do that, because --
 22 because one doesn't have to demonstrate they

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1 can actually build it in a patent.
 2 Now, as a systems engineer, I can
 3 look at that and I can assess whether it can
 4 be built, but that's really not what the
 5 patent describes. The patent describes
 6 something, and they describe how they would do
 7 it, but they don't necessarily have to do it.
 8 So I'm afraid that, really, with just a
 9 patent, you can't be sure that it will work.
 10 Q Do you know when the license was
 11 granted by the FCC on these satellite systems?
 12 A I'm generally aware in the late
 13 1990s.
 14 Q April 1997, how does that sound?
 15 A Sounds good.
 16 Q And then, full operation for XM
 17 was November 2001, does that sound right?
 18 A Yes.
 19 Q So that's about four years and
 20 seven months?
 21 A Sounds good.
 22 Q Wasn't that a relatively short

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1 period of time for achievement of nationwide
 2 deployment of a new commercial system?
 3 A Yes.
 4 Q And I'd like to talk now about
 5 risks a little and change the subject. Do you
 6 agree that placement of communication
 7 satellites into service is inherently a risky
 8 business
 9 A I believe, yes, that a given a
 10 launch -- you know, depending on that
 11 particular launch being a success, if you were
 12 to bet everything on that, that would be
 13 risky.
 14 Q One of your books makes the
 15 statement that it's inherently a risky
 16 business, doesn't it?
 17 A Yes, it does, and that's with
 18 respect to the launch, which I just described.
 19 But the overall business of the satellite
 20 operator with multiple satellites is not a
 21 risky business, if done right.
 22 Q Well, let's explore that a little.

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<p>1 You are familiar with the satellite known as</p> <p>2 XM-4, which was the last XM satellite</p> <p>3 launched?</p> <p>4 A Well, what I'm trying to remember</p> <p>5 is -- is that satellite was probably built by</p> <p>6 Loral, is that correct? And as -- or was it</p> <p>7 Boeing? Now I have to remember which -- which</p> <p>8 in the sequence.</p> <p>9 XM-1 and 2 are rock and roll, and</p> <p>10 3 and 4 are rhythm and blues. So I know that</p> <p>11 there are those four satellites that have been</p> <p>12 launched and put into service.</p> <p>13 Q Well --</p> <p>14 A Is that what the point is?</p> <p>15 Q No. Let me go ahead and --</p> <p>16 A Okay.</p> <p>17 Q -- ask the questions.</p> <p>18 A All right.</p> <p>19 Q You do know they launched four</p> <p>20 satellites.</p> <p>21 A Yes.</p> <p>22 Q And they used a service called Sea</p>	<p>1 say rock and roll --</p> <p>2 Q I am.</p> <p>3 A -- in those?</p> <p>4 Q I am.</p> <p>5 A Okay. Now, rock and roll's issue</p> <p>6 has to do with a premature degradation of the</p> <p>7 solar rays. It has nothing to do with the</p> <p>8 launch. So we have to be careful what we</p> <p>9 associate with launch, because that premature</p> <p>10 degradation is an on-orbit issue which I</p> <p>11 described as a separate aspect.</p> <p>12 Those satellites, those two --</p> <p>13 rock and roll -- were delivered properly to</p> <p>14 orbit. In fact, they were very accurate. As</p> <p>15 I recall, the launches were extremely</p> <p>16 accurate. And then, those satellites</p> <p>17 projected to have their full lifetimes.</p> <p>18 Q Well, they were projected to have</p> <p>19 their full lifetimes until the solar</p> <p>20 degradation started showing up, right?</p> <p>21 A That's correct. The degradation</p> <p>22 showed up because those satellites were using</p>
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<p>1 Launch.</p> <p>2 A Yes.</p> <p>3 Q Are you aware that the Sea Launch</p> <p>4 rocket, immediately after the one that</p> <p>5 launched XM-4, was launching a satellite</p> <p>6 called New Skies owned by SCS Global that</p> <p>7 exploded and destroyed the satellite and the</p> <p>8 launch vehicle?</p> <p>9 A Yes, I am aware of that.</p> <p>10 Q Do you know how many Sea Launch</p> <p>11 satellites have failed during launch?</p> <p>12 A Probably, if I recall, two.</p> <p>13 Q How about three out of 23, does</p> <p>14 that sound right?</p> <p>15 A Well, it's either two or three. I</p> <p>16 don't recall, you know, precisely which is</p> <p>17 which.</p> <p>18 Q Do you know how many satellites</p> <p>19 launched by Sea Launch have had their useful</p> <p>20 lives shortened because of malfunctions on the</p> <p>21 satellites after they were placed in orbit?</p> <p>22 A Are you including XM, or should I</p>	<p>1 a somewhat new scheme of solar collector, in</p> <p>2 addition to the solar panels, and exhibited</p> <p>3 degradation that would result in a lifetime</p> <p>4 that was shortened -- significantly shortened.</p> <p>5 But what's important about that to</p> <p>6 note, Mr. Miller, is that that's a gradual</p> <p>7 process, and XM was able to go into the mode</p> <p>8 of procuring and launching satellites to</p> <p>9 assure themselves that they would have no --</p> <p>10 absolutely no interruption in service. And</p> <p>11 they have collected on their -- they have made</p> <p>12 claims and they have collected monies for that</p> <p>13 shortened lifetime.</p> <p>14 So they've been compensated for</p> <p>15 that, and that, in fact, is the normal method</p> <p>16 in the industry, and a typical method for how</p> <p>17 that's addressed.</p> <p>18 Q All right. I'd like to mark as</p> <p>19 SDARS Exhibit 91 a page from one of your</p> <p>20 books, and ask you about it.</p> <p>21 (Whereupon, the above-</p> <p>22 referred to document was</p>

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<p>1 marked as SDARS Exhibit</p> <p>2 No. 91 for</p> <p>3 identification.)</p> <p>4 A Okay.</p> <p>5 Q I have here the full copy of your</p> <p>6 Satellite Communication Applications Handbook,</p> <p>7 Second Edition. That was published in 2004,</p> <p>8 right?</p> <p>9 A Yes.</p> <p>10 Q And the bottom of page 275 has a</p> <p>11 picture there of what you show as -- called</p> <p>12 rock and roll, and then the satellite as it</p> <p>13 would look in space, is that true?</p> <p>14 A Yes.</p> <p>15 Q Now, one of the things that</p> <p>16 happens is that those solar panels are folded</p> <p>17 up. That's one of the things the picture</p> <p>18 shows, right?</p> <p>19 A On the left, yes.</p> <p>20 Q So they have to unfold correctly</p> <p>21 to work right, isn't that --</p> <p>22 A Correct.</p>	<p>1 Q And their function was to put</p> <p>2 sunlight -- more sunlight on the solar array.</p> <p>3 A Correct.</p> <p>4 Q And that was to put more power out</p> <p>5 of the satellite, right?</p> <p>6 A Yes.</p> <p>7 Q And what is outgassing?</p> <p>8 A Yes. Outgassing is what we're</p> <p>9 accustomed to with a new car, where you can</p> <p>10 smell the upholstery. What you're smelling is</p> <p>11 gases or emissions from the leather or from</p> <p>12 the plastic or what have you. So much of the</p> <p>13 satellite is built with different forms of</p> <p>14 plastic and epoxies and that sort of thing,</p> <p>15 and those -- those emit gases.</p> <p>16 Those gases are in close proximity</p> <p>17 to the satellite, and they basically cover or</p> <p>18 they film out over other surfaces, and in some</p> <p>19 cases those are surfaces where we'd rather not</p> <p>20 have that happen, such as the solar --</p> <p>21 Q And these satellites -- XM-1 and 2</p> <p>22 -- were called -- or Boeing 702 satellites,</p>
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<p>1 Q -- one of the things?</p> <p>2 A Yes.</p> <p>3 Q And are you -- and once they're</p> <p>4 unfolded, they had what were called solar</p> <p>5 concentrators, which are hard to see in this</p> <p>6 picture, but they're these little shaded</p> <p>7 things on either side of the solar panel,</p> <p>8 right?</p> <p>9 A Yes.</p> <p>10 Q And how big would that solar panel</p> <p>11 be if we had it in the courtroom here?</p> <p>12 A Well, darned near the length of</p> <p>13 the courtroom.</p> <p>14 Q All right. And how big -- so</p> <p>15 let's say we had it laid out that way. How</p> <p>16 big would the solar concentrator be?</p> <p>17 A Well, they would be almost as wide</p> <p>18 as the flat portion that you see there. So</p> <p>19 they would be two or three feet I suppose,</p> <p>20 roughly.</p> <p>21 Q And do they look like a mirror?</p> <p>22 A Yes.</p>	<p>1 right?</p> <p>2 A Yes.</p> <p>3 Q And they didn't have experience in</p> <p>4 orbit when they put up the Boeing 702s, did</p> <p>5 they?</p> <p>6 A Well, they -- there was one that</p> <p>7 was launched ahead of the first XM and --</p> <p>8 first XM launches. So there was already data</p> <p>9 on the operation of that satellite, but it was</p> <p>10 a relatively short period of time.</p> <p>11 Q It turned out that there was more</p> <p>12 outgassing than expected on Boeing 702s, and</p> <p>13 they fogged those mirror-like solar</p> <p>14 concentrators, right?</p> <p>15 A I think that's -- that's a good</p> <p>16 description, yes.</p> <p>17 Q And also, some of those particles</p> <p>18 bounced off the solar concentrators and came</p> <p>19 back and fogged the actual solar ray itself,</p> <p>20 isn't that true?</p> <p>21 A I don't know about that detail.</p> <p>22 Q But you do understand that the</p>

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1 outgassing has caused those solar panels to
 2 get to where they work less and less over
 3 time, isn't that true?
 4 A Yes. And one very interesting
 5 thing about that, I attended a conference
 6 earlier this year where the operator of that
 7 satellite that was launched ahead of XM and
 8 Sirius, and the operator said that the chief
 9 -- you know, chief operations officer said
 10 that that degradation has ceased, that for the
 11 last year it has not continued to degrade.
 12 So that's some good news that says
 13 -- that would indicate that the satellites
 14 aren't going to degrade as much as originally
 15 thought, and that, you know, there is probably
 16 more life there than people --
 17 Q Well, both XM --
 18 A -- believed.
 19 Q Excuse me. Both XM-1 and XM-2 are
 20 turned off now, isn't that true?
 21 A I understand that after they had
 22 been operated together as a pair they were

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1 turned off, and they represent a backup that
 2 can be activated if they need. And as I said,
 3 having backup satellites is a very important
 4 strategy for an operator to maintain, you
 5 know, continuity of service from space.
 6 Q XM had to launch two satellites
 7 earlier than anticipated because of the solar
 8 concentrator problems, isn't that right?
 9 A Yes.
 10 Q Do you know how much power XM-1 or
 11 XM-2 can put out now, whether they're at 50
 12 percent or 40 percent or 60 percent?
 13 A I don't know the number, no.
 14 Q Okay. It turned out that all six
 15 of the first Boeing 702 satellites had this
 16 solar concentrator problem, isn't that true?
 17 A Well, they have the solar
 18 concentrators, and, therefore, they have the
 19 outgassing problem, yes.
 20 Q And those have been designed by
 21 Hughes.
 22 A Yes, and Boeing took over the

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1 company.
 2 Q And Hughes was about as
 3 sophisticated as anybody was in designing
 4 satellites at that point.
 5 A Yes.
 6 Q But they still didn't anticipate
 7 this problem once it got up into orbit.
 8 A Well, we could go back in history
 9 and find lots of examples where something
 10 didn't quite work as expected, and the reason
 11 -- you know, this is the reason why we make as
 12 few changes as we can. We don't want to
 13 change something that we're going to launch,
 14 because we could run up against this kind of
 15 an issue.
 16 So you're quite correct that this
 17 -- this happened to a very experienced
 18 company, and it is a bit of a setback for that
 19 particular design. It's probably not as bad
 20 as it could have been. And by the way, it
 21 didn't cause a massive failure of the
 22 satellite, but a little bit faster, not a

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1 little bit but significantly faster
 2 degradation.
 3 And the operator was able to get
 4 satellites up to replace them, still using
 5 those as backups. So I really don't see this
 6 as being an indication of any risk or
 7 something that is not manageable.
 8 Q Well, if we look at both the
 9 launch probability and the probability of some
 10 type of service life reduction, you have said
 11 that that probability is approximately 10
 12 percent, isn't that correct, if you combine
 13 those two risks?
 14 A I didn't quite do the math that
 15 way. Could you just say that again?
 16 Q I think you've said the
 17 probability is approximately 10 percent that
 18 the satellite will not reach its orbit and
 19 provide service.
 20 A Okay. That needs a little
 21 explanation. The five percent that I have
 22 stated in my report, and that I stated here,

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<p>1 is based on the previous record of 700 2 satellite launches. I'm looking for launch 3 failures, and in that case the failure is 4 defined as getting a satellite to orbit, to 5 its final position, and working. 6 So that includes any problems 7 getting to that point, including launch 8 vehicle failure or a satellite which comes out 9 not working. And sometimes that happens, that 10 even though the satellite makes it all the way 11 it doesn't work. That's rare, but it has 12 happened. So it includes that whole process 13 of getting it to orbit and checking it out and 14 having it work. 15 Now, that's the history. The 16 number 10 percent that I use there was based 17 on kind of a subtle point that if -- let's 18 take, for example -- let's take, for example, 19 the one you gave me, which was the Sea Launch, 20 which has had, you said, three failures out of 21 23 launches. Now, that's a little worse than 22 10 percent, and it's certainly significantly</p>	<p>1 industry average record. 2 Q Let's talk about insurance for a 3 minute. Do you know what the approximate cost 4 was at the peak for both launch and in-orbit 5 insurance that XM has had to pay? 6 A I don't know the precise number. 7 I know the range of numbers. 8 Q Do you know that -- what is the 9 range that you think it has had to pay? 10 A The range would be in the range of 11 10 percent to 10 to 20 percent. 12 Q Do you know that they paid 24.6 13 percent for one launch? 14 A Well, that's very high. 15 Q Do you know of other businesses 16 where insurance costs are regularly greater 17 than 20 percent of the cost of the equipment 18 needed for that business? 19 A You know, I'm not an insurance 20 expert. I am very knowledgeable about the 21 satellite insurance situation, plus my own 22 homeowner's policy. But it's, again,</p>
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<p>1 worse than five percent. 2 So here we have a system which has 3 not demonstrated the five percent industry 4 average. So now if you want to sign on with 5 Sea Launch, you have to think about what their 6 probability is, as contrasted to the overall 7 industry probability. That's what I'm 8 referring to there. 9 That is, in some cases, you could 10 be choosing or looking at a launch vehicle 11 which has more like a 10 percent, which is -- 12 which there cases like Sea Launch, and there 13 have been other cases in the past, which have 14 fit the 10 percent case. 15 There were some that fit the two 16 percent -- for example, the McDonnell-Douglas, 17 now Boeing, Delta -- had a 98 percent success 18 record, or two percent failure rate. So the 19 -- you know, the five percent is an industry 20 average. The 10 percent comes up if you 21 happen to be working with a launch vehicle 22 that doesn't quite have the industry record --</p>	<p>1 indicative of the risk on a single launch, 2 because what we have here is an insurance 3 company, or actually their syndicates, that 4 are going to take -- are going to bet on a 5 particular launch. 6 And they're going to bet it's 7 going to be successful, and they're going to 8 -- what they're going to get is they're going 9 to get a bunch of money, which is some 10 percentage of the value that they're insuring, 11 and they've got this money up front. And 12 they're betting that they're going to get to 13 keep that money. 14 So that is more risky than 15 insuring, let's say, millions of homes in the 16 United States. It's a different kind of 17 spread of risk. 18 Q You don't know of any other 19 business that has that kind of insurance 20 rates, commercial business, do you? 21 A I don't, no. 22 Q Do you know how much was the</p>

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1 insured amount on the first two XM satellites
 2 that had the solar concentrator problem?
 3 A I don't recall seeing it.
 4 Q Does \$400 million sound right?
 5 That's what --
 6 A Yes.
 7 Q And do you know --
 8 A That would be about right.
 9 Q Do you know that they only
 10 recovered about \$140 million of that \$400
 11 million from insurance?
 12 A Yes.
 13 Q Do you know why that is?
 14 A Well, my understanding is that
 15 they don't represent -- they certainly don't
 16 represent a total loss, and that they have
 17 gotten life out of them and they will continue
 18 to get some life out of them. So this is --
 19 often happens that there is a settlement for
 20 less than the -- than the original cost,
 21 because they're still working.
 22 Q Do you know how much the two

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1 replacement satellites cost?
 2 A Well, they're going to be of the
 3 order of that \$400 million.
 4 Q Did you know that they were
 5 \$500 million, because the price --
 6 A Well --
 7 Q -- had gone up?
 8 A -- with inflation, yes. Plus the
 9 cost of insurance. We might have paid for
 10 that in addition.
 11 Q So we've been talking now about
 12 risks associated with launching the satellite
 13 and getting it to operate for its full life,
 14 right?
 15 A Yes.
 16 Q Are there also some risks
 17 associated with overall system design when
 18 satellites are put up to work in an integrated
 19 system that has never been used before like
 20 the XM and Sirius systems?
 21 A That kind of risk is a different
 22 kind of risk, as you say, just like, you know,

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1 that's a completion risk. Are we going to be
 2 able to complete this product -- this project
 3 on schedule and within budget? And that's why
 4 they -- each of them had teams.
 5 They had subcontractors, they had
 6 detailed specifications, they had test plans
 7 and test procedures. They had all this
 8 methodology, which I saw in the record, and
 9 which I'm aware of. So this is how one deals
 10 with the project kind of risk, which is there
 11 for any kind of telecommunication project,
 12 satellite or otherwise.
 13 Q Excuse me?
 14 A Which meant they did a good job of
 15 managing that component of the risk.
 16 Q Now, there is also risk with
 17 regard to developing these receivers that
 18 could be sold to consumers and used by
 19 consumers, isn't that true?
 20 A Well, using the term "risk," I
 21 don't necessarily see that as a risk. It's a
 22 job, it's a function of the company that's

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1 going to come out with this service. So the
 2 risk is if you don't have the right staff, and
 3 you don't have the right subcontractors, yes,
 4 there is a risk. If you do the job right,
 5 then I don't see there is a risk.
 6 Q Well, XM set up its own technical
 7 development center to work on receiver and
 8 intended design, is that true?
 9 A Yes.
 10 Q And that was focused on designing
 11 and qualifying low-cost, high-performance
 12 radios and miniaturized antennas. That was
 13 its purpose, is that true?
 14 A Yes.
 15 Q You're familiar with the Iridium
 16 system, right?
 17 A Yes.
 18 Q And who designed the receivers for
 19 the Iridium system?
 20 A Do you mean the handsets?
 21 Q Yes, sir.
 22 A Motorola.

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1 Q And Motorola had substantial
 2 technical breadth and depth in mobile
 3 communications design, isn't that true?
 4 A Yes.
 5 Q Iridium did go bankrupt, didn't
 6 it?
 7 A Yes.
 8 Q And one of the factors that has
 9 been cited for Iridium, was it the fact that
 10 the receiver was very expensive and
 11 unattractive, isn't that true?
 12 A Cited where?
 13 Q Well, by -- it's one of the
 14 factors that the literature has reported and
 15 that the public has -- the business observers
 16 believed in putting litigation have alleged is
 17 the reason that there weren't enough
 18 subscribers to the Iridium system, which are
 19 things like a brick, and it costs 2,000 bucks.
 20 A Yes, I agree. I didn't know what
 21 you meant by "unattractive." So I'm trying to
 22 --

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1 Q All right.
 2 A -- get that. It's in the eyes of
 3 the beholder. Something that's too big and
 4 bulky, yes.
 5 Q The Global Star --
 6 A That was a factor, yes.
 7 Q Excuse me. The Global Star
 8 system, who designed the receivers for it?
 9 A Qualcom.
 10 Q And Qualcom is a company with
 11 technical breadth and depth, right?
 12 A Yes.
 13 Q And Global Star also went
 14 bankrupt, right?
 15 A Yes.
 16 Q And there were problems getting
 17 public acceptance of the Global Star receiver,
 18 isn't that true?
 19 A I believe so.
 20 Q So one of the successes of both XM
 21 and Sirius is that they managed to get
 22 receivers that were inexpensive enough that

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1 they were able to get them out there with a
 2 substantial subscriber base, isn't that true?
 3 A Yes.
 4 Q So, to sum up, there were risks
 5 that these satellites would blow up or fail to
 6 work when they were not in orbit of some
 7 dimension. That risk existed, true?
 8 A When you say "satellites," I
 9 believe that when you consider all of the
 10 satellites, yes, that's very low risk.
 11 Q But there was also some technical
 12 risk that once the satellites were up, and the
 13 repeaters were hooked up, they would not work
 14 as well as expected to produce continuous
 15 listening for consumers. There was some risk.
 16 A No, I don't -- I don't -- no, I
 17 don't agree to that.
 18 Q You don't think there was any
 19 risk?
 20 A We didn't discuss that, and I
 21 don't agree to that, because what that --
 22 Q Okay.

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1 A -- takes account is the mobile
 2 environment in which the user is at any given
 3 time, and the manner in which the satellites
 4 and the repeaters operate. And I will make
 5 the point now that all of that can be verified
 6 prior to launch through test and simulation on
 7 the ground prior to the satellites being in
 8 orbit.
 9 So it's very straightforward to
 10 verify that that will all work. So when the
 11 satellites get up and in orbit, and they turn
 12 on the system it will function, you know, as
 13 it was intended if it has been verified the
 14 way I describe ahead of time. That's why you
 15 go through that process of engineering, and I
 16 forget how you characterized it, but the
 17 system development process. That's part of
 18 the process.
 19 Q Well, Hughes and Boeing tried to
 20 verify how those solar concentrators and
 21 panels were going to work before they launched
 22 those 702s, didn't they?

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<p>1 A Well, that's a different kind of 2 verification. That's due to the space 3 environment. Out there in space, you're 4 subject to a variety of forces. The 5 outgassing is one, the vacuum is another, the 6 temperature is another, and so we can simulate 7 those things to a certain extent on the 8 ground, but in space it's going to take -- 9 it's going to take its course.</p> <p>10 And, of course, those effects have 11 taken awhile to exhibit themselves, whereas 12 getting the system to work when you turn it on 13 is a whole different matter, and I still stick 14 by what I said that that can be verified 15 before the satellites are in orbit and 16 functioning.</p> <p>17 Q In 2004, it was your view, with 18 regard to Sirius and XM, that becoming a 19 mainstream service taken by millions of paying 20 subscribers was still only an expectation at 21 best or a dream at worst, isn't that true? 22 A I did say that, yes, and that was</p>	<p>1 Q Chapter 3 is issues in space 2 segment and satellite implementation, correct? 3 A Yes. 4 Q And Chapter 7 is titled Satellite 5 Digital Audio Radio Service, isn't that 6 correct? 7 A Yes. 8 MR. MILLER: We would offer 9 Exhibit 92. 10 CHIEF JUDGE SLEDGE: Any objection 11 to Exhibit 92? 12 MR. FREEDMAN: No, Your Honor. 13 CHIEF JUDGE SLEDGE: Without 14 objection, it is admitted. 15 (Whereupon, the above- 16 referred to document, 17 previously marked as 18 SDARS Exhibit No. 92 for 19 identification, was 20 admitted into evidence.) 21 MR. MILLER: We have no further 22 questions, Your Honor.</p>
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<p>1 written in 2003 when they each had a total -- 2 when there was a total of one million 3 subscribers.</p> <p>4 Q Would you look at SDARS Exhibit 5 92, and see if you can identify that as the 6 cover page and Chapters 1, 3, and 7, from your 7 2004 book? 8 (Whereupon, the above- 9 referred to document was 10 marked as SDARS Exhibit 11 No. 92 for 12 identification.) 13 A Okay, yes. 14 Q And do you consider that that is 15 an authoritative work on communication 16 satellites? 17 A On communication satellite 18 applications, yes. 19 Q And Chapter 1 is dealing with the 20 evolution of satellite technology and 21 applications, is that correct? 22 A Yes.</p>	<p>1 CHIEF JUDGE SLEDGE: We'll take a 2 10-minute recess. 3 (Whereupon, the proceedings in the 4 foregoing matter went off the 5 record at 3:13 p.m. and went back 6 on the record at 3:29 p.m.) 7 CHIEF JUDGE SLEDGE: Any questions 8 by Sirius? 9 MR. REID: No, Your Honor. 10 CHIEF JUDGE SLEDGE: Any redirect? 11 MR. FREEDMAN: No, Your Honor. 12 CHIEF JUDGE SLEDGE: Questions 13 from the Bench? 14 JUDGE ROBERTS: Yes. Mr. Elbert, 15 I have just a few questions about orbits for 16 my own understanding. Geostationary orbit, 17 are all geostationary orbits over the Equator? 18 THE WITNESS: Yes. 19 JUDGE ROBERTS: They are? 20 THE WITNESS: Yes. 21 JUDGE ROBERTS: And they have to 22 be that way?</p>

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1 THE WITNESS: Yes.
 2 JUDGE ROBERTS: And why is that?
 3 THE WITNESS: Otherwise what we're
 4 talking about is a 24-hour orbit so it's
 5 synchronized for the Earth's rotation. And
 6 it's in the same direction as the Earth's
 7 rotation. And there's only one orbit that
 8 will work that way. And that's one that's at
 9 a certain altitude, about 23,000 miles. So
 10 that that's the configuration now.
 11 If it's in the plan of the Equator
 12 as the satellite goes around, it follows the
 13 Earth around perfectly. The alternative is if
 14 the orbit is inclined, like that, like with
 15 sometimes you see Saturn has the rings
 16 inclined. If you can imagine the orbit
 17 inclined, then for 12 hours, it goes above the
 18 Equator and 12 hours it goes below the
 19 Equator. So that would make the satellite
 20 move and follow a figure 8 in the sky.
 21 And so that would not be a
 22 geostationary orbit. We would call that a

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1 geosynchronous orbit, meaning it's still 24
 2 hours. It's synchronized for the Earth's
 3 rotation, but it's not stationary with respect
 4 to a point on the ground.
 5 JUDGE ROBERTS: Satellites in
 6 geostationary orbit, do they require less
 7 fuel? I assume that there is probably little
 8 to no movement of satellites in orbit like
 9 that?
 10 THE WITNESS: Well, actually they
 11 do require fuel to correct increase in
 12 inclination. There's about a one degree per
 13 year motion of the orbital plane. It wants to
 14 move this way. And so by one degree per year,
 15 it will increase.
 16 So to keep an in plane, keep it in
 17 the plane of the Equator, there are maneuvers
 18 performed using the on-board propulsion
 19 system. And that's what most of the fuel is
 20 consumed doing, is those corrections.
 21 We don't let it get anything like
 22 a degree out. We keep it within a tenth of a

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1 degree or less or half of that, close to the
 2 -- you know, being in the Equatorial plane.
 3 JUDGE ROBERTS: I think I heard
 4 you say in your testimony that there's been
 5 about 700 and some odd satellite launches?
 6 THE WITNESS: Yes.
 7 JUDGE ROBERTS: Of those, how many
 8 are in geostationary orbit relative to other
 9 orbits?
 10 THE WITNESS: Most of them are
 11 geostationary. There might be a few
 12 geosynchronous in there but no low Earth orbit
 13 satellites are in there. They're all
 14 communication satellites that are of primarily
 15 geostationary variety.
 16 JUDGE ROBERTS: Okay. Excuse me.
 17 I do have one more question. Who is the
 18 decision-making body that decides when a new
 19 satellite is sent into orbit, where since
 20 there are so many of them in that same pattern
 21 where they are going to be located?
 22 THE WITNESS: Okay. It starts off

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1 within the country of -- associated with that
 2 operator. So in the United States, for
 3 commercial satellite operators, like XM and
 4 Sirius, it would be the FCC.
 5 So the FCC can assign frequencies
 6 in orbit positions -- does do that to
 7 operators. In this case, there was an auction
 8 that was held. And the winners each got
 9 respective orbit positions and frequencies.
 10 Then the FCC goes to the next
 11 level or the higher level, which is a U.N.
 12 agency called the International
 13 Telecommunications Union, the ITU. And that
 14 agency is headquartered in Geneva,
 15 Switzerland.
 16 So they send a package of
 17 information to Geneva. The ITU publishes it.
 18 And that initiates a process called
 19 coordination. And other nations have a chance
 20 to examine it, shoot holes in it. And then
 21 there is some negotiation possibly if those
 22 same frequencies are being used in another

<p style="text-align: right;">Page 256</p> <p>1 country. And the FCC handles that.</p> <p>2 JUDGE ROBERTS: How long does that</p> <p>3 entire process typically take?</p> <p>4 THE WITNESS: It could take three</p> <p>5 years.</p> <p>6 JUDGE ROBERTS: Three years.</p> <p>7 THE WITNESS: One thing that made</p> <p>8 it easier in this instance, as I understand</p> <p>9 it, is there is a footnote in the -- what's</p> <p>10 called the radio regulations, which allow the</p> <p>11 U.S. to put these satellites up at those</p> <p>12 frequencies. So there was already kind of a</p> <p>13 toehold, if you will, to do this, but they</p> <p>14 would still have to go through the formal</p> <p>15 process.</p> <p>16 JUDGE WISNIEWSKI: Would someone</p> <p>17 -- I'm sorry.</p> <p>18 CHIEF JUDGE SLEDGE: And a treaty</p> <p>19 would determine that the U.S. will not put up</p> <p>20 a satellite that the SEC has approved that has</p> <p>21 not gotten the U.N. panel approval?</p> <p>22 THE WITNESS: Correct, yes.</p>	<p style="text-align: right;">Page 258</p> <p>1 sir.</p> <p>2 THE WITNESS: Thank you.</p> <p>3 (Whereupon, the witness was</p> <p>4 excused.)</p>
<p style="text-align: right;">Page 257</p> <p>1 CHIEF JUDGE SLEDGE: Okay.</p> <p>2 JUDGE WISNIEWSKI: And if you have</p> <p>3 gotten these approvals, once the approvals are</p> <p>4 obtained for the satellites, do they stay in</p> <p>5 place for those satellites, even though the</p> <p>6 ownership of the satellite will change?</p> <p>7 THE WITNESS: Well, as far as the</p> <p>8 ITU is concerned, it doesn't matter. Those</p> <p>9 are U.S. satellites, as long as they stay</p> <p>10 under control of the FCC. To the FCC, there</p> <p>11 is a process by which the licenses can get</p> <p>12 transferred.</p> <p>13 There has to be a formal</p> <p>14 application and all of that. And there may be</p> <p>15 comments from -- you know, public notice and</p> <p>16 others can comment on that.</p> <p>17 Generally speaking, you have been</p> <p>18 able -- you can sell your business and your</p> <p>19 licenses in the process, but you have to go</p> <p>20 through the rigmarole of it, which is going on</p> <p>21 right now.</p> <p>22 CHIEF JUDGE SLEDGE: Thank you,</p>	

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

In the Matter of

**ADJUSTMENT OF RATES AND TERMS FOR
PREEXISTING SUBSCRIPTION SERVICES
AND SATELLITE DIGITAL AUDIO RADIO
SERVICES**

)
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) **Docket No. 2006-1 CRB DSTR**
)
)
)
)

TESTIMONY OF

LAWRENCE KENSWIL

**President of Universal eLabs,
a division of Vivendi Universal's Universal Music Group**

PUBLIC VERSION

October 2006

DIRECT TESTIMONY OF LAWRENCE KENSWIL

Background and Qualifications

I am the President of Universal eLabs, a division of Vivendi Universal's Universal Music Group ("UMG"). I have headed eLabs from its founding in January 1999. Previously, I was UMG's Executive Vice President, Business and Legal Affairs. I sit on the Board of Directors of the Recording Industry Association of America and, previously, the Board of the International Federation of the Phonographic Industry.

Universal eLabs is dedicated to exploring, developing, and evolving global business and new technology strategies to deliver music to consumers in innovative ways. eLabs is comprised of a team of business, legal, and technical professionals devoted to developing, implementing, and operating new music products, programming and digital distribution initiatives across all emerging technology and convergence platforms, including Internet, mobile, physical, kiosk, home networking and set-top box systems. As President of eLabs, I oversee all of UMG's efforts to license sound recordings for electronic distribution.

About Universal Music Group

UMG is the world's largest music company with a history dating back to the 19th century. In 2005, UMG held a 31.7% share of the domestic recorded music market.

UMG includes an extensive and diverse collection of music labels — including Decca Record Company, Deutsche Grammophon, Interscope Records, Geffen Records, A&M Records, Island Records, Def Jam Records, Lost Highway Records, MCA Nashville, Mercury Nashville Records, Motown Records and Universal Records — and artists — including Beck, Black Eyed Peas, Bon Jovi, Sheryl Crow, Dr. Dre, Eminem,

Jay-Z, Diana Krall, Nelly, No Doubt, Gwen Stefani, Shania Twain, Stevie Wonder, and Sting.

UMG International operates directly or through joint ventures and licensees in 77 countries. Universal Classics Group is responsible for more than 40% of world sales in the classical music genre, and Verve Music Group is the world's largest jazz recording company. Universal Music Publishing Group owns or administers more than one million copyrights.

The Electronic Distribution Market

The Rapid Development of New Ways to Consume Music

Recognizing the considerable growth in the electronic distribution market and the potential for more in the coming months and years, UMG is transforming from a “record company” to a “music entertainment company.” UMG’s annualized revenues from electronic distribution of recorded music in the United States have grown from near zero a few years ago to approximately [REDACTED]¹ as of the first half of 2006. Universal Music Mobile, a division of UMG, was a pioneer in fusing recorded music and the burgeoning mobile phone market.

Whereas in the past UMG focused almost exclusively on selling CDs and other physical product, the future for UMG is about receiving a fair return from multiple revenue streams. Consumers now enjoy music in more ways than ever before — satellite radio, satellite and cable T.V. services, permanent digital audio downloaded tracks and albums, streaming and conditional downloads, and webcasting, mobile and wireless services, video services, and sales of other digital products (e.g., ringtones). We at UMG

¹ The information in this testimony that has been marked as restricted is proprietary and commercially sensitive information that is not generally known to the public.

are hopeful that the revenues from all of these uses of music will, in the long run, more than compensate for any lost physical sales. Because consumers value the ability to purchase music in many forms and access music from almost everywhere, UMG believes that the evolution to electronic distribution — while challenging at first for many reasons, not the least of which is digital piracy — will ultimately expand the market for music and augment UMG's revenue from sound recordings.

Digital piracy over the last few years has posed a serious threat to the industry, with physical sales declining in five of the last six years, at the same time that the economy has been growing. According to RIAA data, sales of CDs in the United States have declined 25.2% from 2000 to 2005. SX Ex. 004 DP. At the same time, the costs of identifying, developing and promoting the artists that consumers want to hear (the core of UMG's business) have not changed. Consequently, the importance of a fair return from all of these different markets cannot be overstated.

In addition, although these new revenue streams sometimes provide additional compensation for UMG, they also can substitute for sales of other UMG products, including CDs. This includes satellite radio and the pre-existing "over T.V." services. There is only so much time in the day for people to spend listening to music. With 70 or more music channels offering niche programming, satellite radio is "narrowcasting," not broadcasting. Because of the number of channels and its enormous variety, satellite radio and the other services can provide consumers with exactly the mood or genre of music that they want at a particular time, reducing the need of consumers to purchase CDs, downloads and subscription services. With such tremendous breadth and high digital audio quality, these services substitute for the other ways that people experience music —

not only for CDs, from which the record companies currently make most of their sales, but also for other digital services from which UMG derives increasingly important and substantial revenue.

UMG's Approach to Licensing

UMG's approach to licensing digital rights has evolved over time. For a period, UMG sought to license legitimate new services in the marketplace in order to create competition with peer-to-peer networks on which people could illegally download UMG sound recordings. But times have changed, and there are now many legitimate services distributing music in different forms.

In selling and licensing its products, UMG seeks to protect its sound recordings from piracy and to receive a fair return according to the value that consumers place on them. UMG does not enter into agreements for broad or blanket licenses of its catalog in the hope that it will "promote" sales of CDs or another revenue stream. Rather, UMG tries to maximize each and every revenue stream. UMG does not view as promotional the commercial exploitation by others of the very product that it seeks to sell. In attempting to price UMG's products consistent with the value to the consumer, UMG considers both the means by which its sound recordings will be distributed and how those recordings will be enjoyed by the consumer.

The Development of Portability and Wireless Services

One of the most significant developments in the digital marketplace is the availability of music via portable devices and wireless networks. In addition to consumers' traditional choice of which artists to listen to, consumers are beginning to choose when and where they want their music content delivered. Since the introduction

of the first mp3 player, consumers have been able to download music to their computers, transfer it to a portable device and take the music with them. Now consumers also can access and acquire music from anywhere, through the ever-improving wireless networks that are offering audio and video content.

Exploitation (often by others) of UMG's content is directly related to the expansion of these wireless networks. Wireless carriers need audio and video content to attract wireless customers to more expensive data packages (often an additional \$15-25 per month) and new cell phones. For them, music is a key component to selling subscriptions and equipment. Thus, they are racing to offer as much content as possible.

The market has already shown that consumers will pay a substantial sum (in addition to paying for a wireless service and a cell phone) to be able to access music and other content anywhere at any time. Consumers already pay a monthly premium of about \$5 for portable subscription services (over the monthly price for non-portable subscription services). And in the nascent market for audio and video downloads to mobile phones, sales figures from around the world and the initial trials in the United States indicate that the mobile consumer is willing to pay significantly more than the PC-based consumer of digital content.

In sum, UMG views the wireless transmission of music to be of enormous value to consumers. Indeed, UMG licenses distribution of its content over wireless networks separately from licensing for services that allow access only over fixed lines. This ensures that UMG receives fair value for the music that it provides and that consumers enjoy. The value that consumers place on portable and mobile functionality is reflected

in UMG's marketplace agreements because UMG's pricing — the rates UMG charges its licensees — is based on the value of the service to consumers.

And the same is true of satellite radio. Whether in the car or with the many available wireless hand-held devices, satellite radio subscribers can enjoy their music anytime and anywhere. Accordingly, just as our marketplace dealings show a very significant premium for wireless delivery — both in terms of what consumers are willing to pay the services and what the services pay UMG for the use of our music — the same should be true of the satellite radio services. That consumers are willing to pay \$12.95 per month for a base subscription to satellite radio shows the high value of these types of services to subscribers. It follows that the record companies are entitled to their fair share of that added consumer value as well.

Value of Marketplace Agreements

When UMG licenses its sound recordings in the marketplace for digital distribution, UMG requires licensees to pay not only reasonable royalty fees, but also to meet extensive security requirements, provide audit rights, and offer guaranteed promotional consideration. While many of these forms of consideration are difficult to quantify, there is no question that, in their absence, UMG would require additional compensation.

There are a number of ways in which these considerations are manifested in UMG's licensing practices:

First, [REDACTED]

Second, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].

Third, [REDACTED]

[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED].

Fourth, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

Fifth, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

Sixth, [REDACTED]
[REDACTED].

Finally, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

New Media Agreements

Over the past few years, UMG has entered into agreements for a wide variety of digital rights, including Interactive Streaming and Conditional Downloads (tethered and portable), Video Streaming, Permanent Audio Downloads, and Mobile/Wireless Services. Below, I provide some representative examples of the agreements for these services.

Subscription Services (On Demand Streaming and Conditional Downloads)

UMG licenses a number of services that provide consumers with streams or conditional downloads of sound recordings. These services are interactive or “on-demand” (*i.e.*, the user can choose the specific song or album to download or stream) and are conditional (*i.e.*, the user may download the song to a PC and then play the song at will only so long as the subscription is in effect).

The conditional downloads are either non-portable or portable. With a non-portable service, a user can only listen to the music (whether as a conditional download or a stream) on a personal computer or other approved home device. Often, the same companies both offer interactive and non-interactive versions of these services. Rhapsody, for example, offers a non-portable interactive subscription service for \$9.99 per month and a non-portable, non-interactive service pursuant to the DMCA for \$4.99 per month (with discounts for annual subscribers).

A portable subscription service, by contrast, is quite a bit different. With a portable service, a user may transfer the conditional download onto a portable device that includes software to prevent further copying. Thus, users get the significantly more valuable portability function. Rhapsody offers its portable subscription service, Rhapsody To Go, for \$14.99 per month.

Video Streaming

UMG has pioneered the monetization of music videos on demand. The switch from seeing videos as promotional to recognizing that they are an important revenue stream mirrors similar developments throughout the electronic distribution market.

UMG's licenses for video agreements are a useful comparison for determining the market value of the content because all video agreements — whether non-interactive or interactive — are entirely market-driven. There is no compulsory license negatively affecting UMG's free market decisions. Among other things, UMG has complete control over the videos that it will release as part of these agreements. [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED].

For 2006, UMG has generally licensed music video streaming for royalties equal to [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

Permanent Audio Download

UMG has entered into numerous permanent audio download agreements that allow services to sell individual sound recordings to users on the Internet. The common retail price for these downloads is \$0.99, although some services offer a discounted price for permanent downloads to subscribers. [REDACTED]

[REDACTED]

[REDACTED]

Mobile/Wireless Services

The market for wireless music services is developing rapidly. As discussed above, all signs are that consumers value the ability to receive music over wireless devices very highly, and that, in the marketplace, record companies have negotiated higher license rates for delivery of sound recordings to wireless devices. In negotiated agreements, UMG receives higher rates for downloads to wireless devices and video streaming over wireless networks than it does for downloads and video streaming to personal computers.

Cell Phone Tones (Ringtones and Mastertones)

Users download ringtones — digital versions of sound recordings — and use them as the ringer on their cell phones. Mastertones are ringtones that sound identical to the master sound recording (typically a portion of a sound recording under 30 seconds).

[REDACTED]

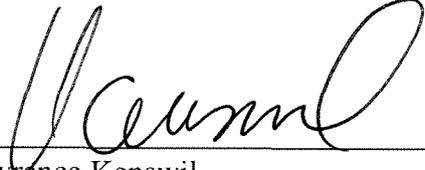
Wireless Audio Downloads

UMG is negotiating with a number of companies to offer wireless audio downloads. [REDACTED]

[REDACTED]

[REDACTED].

I declare under penalty of perjury that the foregoing testimony is true and correct to the best of my knowledge and belief.



Lawrence Kenswil

Date: 10/26/06

Exhibits Sponsored by Lawrence Kenswil

Exhibit No.	Description
SX Ex. 004 DP	[Redacted]
SX Ex. 105 DR	[Redacted]

Transcript of:

Date: June 27, 2007

Volume: XV

Case: 0627crb

Neal R. Gross & Co., Inc.
Phone: 202-234-4433
Fax: 202-387-7330
Email: info@nealgross.com
Internet: www.nealgross.com

XV-1

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

-----+ In the matter of: Adjustment of Rates and Terms for Preexisting Subscriptions 2006-1 Services, and Satellite Digital Audio Radio Services -----+	 Docket No. CRB DSTRA
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Room LM-408
Library of Congress
First and Independence Avenue,
S.E.
Washington, D.C. 20540

Wednesday,
June 27, 2007

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

BEFORE:

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

Page 6

1 Q It involves general oversight of
2 business policies, development of new business
3 models and continuing the transition of the
4 music industry from a physical to a digital
5 industry.
6 Q And how long have you had that
7 position?
8 A About three months.
9 Q Before that?
10 A Before that I was president of
11 eLabs.
12 Q Can you explain a little what
13 eLabs is?
14 A eLabs is the division we started
15 about ten years ago to actually make the
16 business arrangements that would change the
17 business, again, the music business to a
18 digital era; both developed the business
19 models and make the -- do the actual deal
20 making.
21 Q And just to be clear, is eLabs
22 part of Universal Music Group?

Page 7

1 A Yes, it is.
2 Q When you said -- when you
3 described the digital deal making just now,
4 were you personally involved with negotiating
5 digital licenses when you were with eLabs?
6 A Yes, I was.
7 Q Were you the head of that unit?
8 A Yes, I was.
9 Q How long have you been in the
10 music industry all together?
11 A About 24 years.
12 Q And do you hold any positions with
13 the Recording Industry Association of America?
14 A Yes, I do.
15 Q What is that?
16 A I'm on the Board of Directors.
17 Q Let me show you, Mr. Kenswil, what
18 has been pre-marked as SoundExchange Trial
19 Exhibit 66.
20 (Whereupon, the above-referred to
21 document was marked as
22 SoundExchange Exhibit No. 66 for

Page 8

1 identification.)
2 (Pause.)
3 If I could ask you to look at the
4 first document in the binder. Have you seen
5 this document before?
6 A Yes, I have.
7 Q What is it?
8 A It is my written testimony for
9 this proceeding.
10 Q And if you turn to page 14, is
11 that your signature?
12 A Yes, it is.
13 Q Can you look at the document
14 behind the first tab in the binder?
15 Was this a document appended to
16 your written direct testimony in this case?
17 A Exhibit 004DP?
18 Q Right.
19 A I'm not sure.
20 Q Have you seen this document
21 before?
22 A Yes, I have.

Page 9

1 Q What is it?
2 A It is a summary of sales figures
3 and unit shipments and retail dollars for the
4 entire RIAA, RIAA companies.
5 Q Let me turn your attention to page
6 3 of the written testimony. Do you see where
7 that exhibit is cited in the middle of the
8 page?
9 A Yes, I do.
10 Q And turning to the last tab in the
11 binder, are you familiar with this document?
12 A Yes, I am.
13 Q What is it?
14 A This is the -- an amendment to an
15 on-going agreement between Universal Music and
16 Real Networks for Real's music service.
17 Q And does this represent the
18 agreement, the terms that are currently in
19 effect between UMB and Real Networks?
20 A Yes, they do.
21 MR. DeSANCTIS: Your Honor, at
22 this time I'd like to move for the admission

3 (Pages 6 to 9)

Page 10	Page 12
<p>1 of SoundExchange Trial Exhibit 66.</p> <p>2 CHIEF JUDGE SLEDGE: Any objection</p> <p>3 to the exhibit?</p> <p>4 MR. WYSS: No objection, Your</p> <p>5 Honor.</p> <p>6 CHIEF JUDGE SLEDGE: Without</p> <p>7 objection, it's admitted.</p> <p>8 (The document, having been marked</p> <p>9 previously for identification as</p> <p>10 SoundExchange Exhibit No. 66, was</p> <p>11 received in evidence.)</p> <p>12 MR. DeSANCTIS: Your Honor, I</p> <p>13 would also like to move for certain portions</p> <p>14 to be restricted under the Court's protective</p> <p>15 order.</p> <p>16 There is much in the written</p> <p>17 testimony that was marked as restricted that</p> <p>18 we will not be moving forward today to be</p> <p>19 treated as restricted. What we are moving</p> <p>20 forward today to be treated as restricted is</p> <p>21 only the testimony marked on pages 10 through</p> <p>22 13 which discuss the rates currently in effect</p>	<p>1 Universal and Real Networks also be treated</p> <p>2 restrictive under the Court's protective</p> <p>3 order. As the witness testified, this is the</p> <p>4 current agreement currently in effect between</p> <p>5 the parties containing the confidential rates</p> <p>6 and terms which again are subject to</p> <p>7 confidentiality provisions in the agreement</p> <p>8 and may not be shared with competitors in the</p> <p>9 industry.</p> <p>10 (Pause.)</p> <p>11 CHIEF JUDGE SLEDGE: Any objection</p> <p>12 to the Exhibit 105?</p> <p>13 MR. WYSS: No objection, Your</p> <p>14 Honor.</p> <p>15 CHIEF JUDGE SLEDGE: Without</p> <p>16 objection, the motion is granted.</p> <p>17 MR. DeSANCTIS: Thank you very</p> <p>18 much, Your Honor.</p> <p>19 BY MR. DeSANCTIS:</p> <p>20 Q Mr. Kenswil, can you tell us how</p> <p>21 long you have been with UMG or a UMG entity?</p> <p>22 A Since 1983.</p>
Page 11	Page 13
<p>1 for various types of services contained in</p> <p>2 contracts currently in effect that UMG has</p> <p>3 with various digital licensees. This is</p> <p>4 information that's not in the public domain,</p> <p>5 cannot be shared with competitors and is</p> <p>6 subject to confidentiality provisions in the</p> <p>7 agreements.</p> <p>8 CHIEF JUDGE SLEDGE: Cannot be</p> <p>9 shared with competitors sounds like some</p> <p>10 physical barrier.</p> <p>11 MR. DeSANCTIS: Legal rather than</p> <p>12 physical, Your Honor.</p> <p>13 (Pause.)</p> <p>14 CHIEF JUDGE SLEDGE: Any objection</p> <p>15 to the motion?</p> <p>16 MR. WYSS: No objection, Your</p> <p>17 Honor.</p> <p>18 CHIEF JUDGE SLEDGE: Without</p> <p>19 objection, the motion is granted.</p> <p>20 MR. DeSANCTIS: Thank you, Your</p> <p>21 Honor. And finally, we would ask for the</p> <p>22 second exhibit which is the agreement between</p>	<p>1 Q And can you tell us a little bit</p> <p>2 about what UMG is and its role in the music</p> <p>3 industry?</p> <p>4 A UMG is the name generally given to</p> <p>5 the group of companies that comprise the music</p> <p>6 businesses owned by Vivendi. As a whole, it</p> <p>7 is the largest recording music company in the</p> <p>8 world, and now it is also the largest music</p> <p>9 publishing company in the world.</p> <p>10 Its main business is to obtain and</p> <p>11 exploit copyrights, both sound recording</p> <p>12 copyrights and musical work copyrights.</p> <p>13 Q Now during the 20 some odd years</p> <p>14 that you've been with UMG, have you seen a</p> <p>15 shift in the way people consume music and the</p> <p>16 products that UMG sells?</p> <p>17 A Yes, I have.</p> <p>18 Q Can you explain that, please?</p> <p>19 MR. WYSS: Objection, Your Honor.</p> <p>20 This may be outside the scope of the written</p> <p>21 direct.</p> <p>22 CHIEF JUDGE SLEDGE: Mr.</p>

4 (Pages 10 to 13)

1 DeSanctis?

2 MR. DeSANCTIS: Actually, Your
3 Honor, I think we'll find his answer is very
4 much within the scope of the written direct,
5 starting essentially at the last full
6 paragraph on page two and continuing through
7 the next several pages.

8 MR. WYSS: I withdraw the
9 objection, Your Honor.

10 CHIEF JUDGE SLEDGE: All right.

11 BY MR. DeSANCTIS:

12 Q Mr. Kenswil, the question was in
13 your time at Universal Music Group, have you
14 seen a shift in the way people consume music
15 and the products that UMG sells?

16 A Yes.

17 Q Can you please explain that?

18 A Well, from the invention of the
19 photograph onward, the main way to make money
20 in a commercial world from sound recordings
21 was to sell physical copies of those sound
22 recordings. There have been various methods

1 of doing that over the years, the latest one
2 being a compact disk. Before that, there was
3 the music cassette and before that for many
4 years the vinyl record in various forms.

5 The public is shifting away from
6 obtaining music in that form to obtaining
7 music in various ways, not always entailing
8 full ownership of the copy of the sound
9 recording. More and more copies of the sound
10 recordings are obtained electronically,
11 essentially by downloading them, either from
12 the internet from a mobile, but they also
13 obtain their music in other ways that don't
14 entail, as I said, ownership. It could be
15 paying for access to music on demand or paying
16 for services that deliver music to them. But
17 generally, those are all done now
18 electronically rather than by physical copy.

19 Q And during that time have CD
20 shipments and sales declined?

21 A Yes, they have.

22 Q Could you tell us a little about

1 the extent to which they've declined say since
2 2000?

3 A Well, CD sales, as a result,
4 physical sales, the CDs are well over 90
5 percent of telephysical sales and have been
6 for a while. They have been declining
7 regularly since 2000 and that decline has
8 essentially been accelerating as a percentage
9 and at this point it's declining at about 20
10 percent a year.

11 Q And has the same been true so far
12 in 2007?

13 A Yes. In 2007, this year, over
14 year to day last year it is down just under 20
15 percent.

16 Q And do you anticipate that
17 downward trend to continue or to reverse
18 itself?

19 A No, I anticipate and the general
20 thought in the industry is it will continue
21 until it reaches at some level which will
22 indicate that the demand, the public demand

1 for physical goods for music going forward.
2 What that steady state is no one knows yet,
3 but most people expect it to be relatively
4 low.

5 Q So how, if at all, has the decline
6 in CD in physical sales affected the way in
7 which UMG attempts to maximize its revenues?

8 A Well, early on we recognized that
9 we could not mirror the same business model on
10 line as we had off line in the physical
11 market. Certainly the music business as a
12 whole has realized that now and is, if
13 anything, been criticized for realizing that
14 too late. So the
15 -- our job was early on to develop business
16 models that would create revenue streams for
17 the company in addition to selling physical
18 copies and in addition to selling electronic
19 copies. And hopefully, in order to create a
20 total amount of revenue that would more than
21 replace the lost CD sales.

22 Q And to date, has the revenues from

1 digital sales been enough to compensate for
2 the decline in CD and physical sales?

3 A No, they have not.

4 Q Do you expect that to happen in
5 the near future?

6 A Well, we hope one year that the
7 increase in digital sales will offset the
8 decrease in physical sales. That is bound to
9 happen. At what point it makes up for the
10 history of losses is speculative at this
11 point.

12 Q I want to talk a little bit about
13 UMG's approach to digital licensing which you
14 discuss in your testimony.

15 In your written testimony you
16 state that "UMG does not enter into blanket
17 licenses of its catalog in the hope that it
18 will promote sales of CDs." That's on page
19 four of your testimony.

20 Can you first describe what you
21 mean by a blanket license of UMG's catalog?

22 A A blanket license means that we

1 license the rights for the specific purpose
2 under the license to all sound recordings to
3 which we have the rights being granted.

4 Q So is that like the statutory
5 license that satellite radio services have?

6 A It would be the voluntary
7 equivalent, yes.

8 Q So what does it mean then that UMG
9 does not enter into blanket licenses of its
10 catalog in the hope that it will promote sales
11 of CDs?

12 A Well, we recognize that CD is
13 reducing in importance and that these new
14 revenue streams are increasing in importance
15 and therefore we see any grant of our entire
16 catalog for commercial exploitation by a third
17 party to be something that has to give a
18 return directly to us from that exploitation,
19 otherwise we are trading off the new business
20 for the old which is very unwise.

21 Q Similarly, you state in your
22 testimony that "UMG does not view as

1 promotional the commercial exploitation by
2 others of the very product that it seeks to
3 sell."

4 How would that principle apply to
5 the satellite radio services?

6 A Well, the satellite radio services
7 are delivering to people a listening
8 experience, so many minutes or hours a day of
9 our sound recordings and those sound
10 recordings are delivered in their entirety.
11 They essentially fill up a desire for that
12 listening experience. They're the entirety of
13 the recordings and therefore, there is a value
14 there to both satellite company and the
15 consumer and there is a very real -- those are
16 very real evidences of hot set of time spent
17 listening to music in other forums once they
18 listen to it on satellite.

19 Q Let's drill down for a minute on
20 how UMG prices its sound recordings in its
21 digital licenses. Your testimony explains
22 that the price UMG charges turns on the value

1 to the consumer. Can you explain how the
2 concept of the value to the consumer of
3 different digital services affects first the
4 retail price of the service and then what UMG
5 is able to obtain?

6 A Well, in general, as in anything
7 else, the value to consumer affects the demand
8 for the product. Of course, the higher the
9 demand, generally, the higher the price that
10 the product will be able to command. More
11 usefully, the service is or the product is to
12 the consumer the more they're willing to pay
13 for it. Now that payment may be in money, it
14 may be in time spent or it may be in exposure
15 to advertising. Those are very different
16 business models, but in any event all of them
17 need to compensate the creators of the sound
18 recordings.

19 Q So that's the retail side of
20 things. How does the idea of value to
21 consumer and its effect in the retail markets
22 affect how, what UMG is able to negotiate for

1 with licensees?
 2 A Well, generally, the more value
 3 that goes to the end consumer, we're more able
 4 to obtain in compensation for our rights,
 5 either directly from the consumer or through
 6 a third party that aggregates content between
 7 us and the consumer.
 8 Q You use portability and wireless
 9 as an example, an example that you use in your
 10 testimony. Can you just very briefly, so we
 11 know what we're all talking about explain the
 12 difference between a nonportable and a
 13 portable service in the context of
 14 subscription streaming services?
 15 A Well, the subscription services
 16 essentially sell access to music. They sell
 17 the ability to listen to music on demand. But
 18 only so long as you're paying for that access.
 19 When first launched, the technology was such
 20 that you could only do that while sitting at
 21 a computer. And so the music was tied to that
 22 computer and you could not bring it with you

1 because the computer was stationary and the
 2 computer had to be tied into the internet
 3 through a wire. Technology has changed
 4 such that you can now transfer the music from
 5 the computer on to a portable device, an
 6 equivalent to an iPod, that you can carry
 7 around with you wherever you go and listen to
 8 all the music whenever you like, and therefore
 9 those services have become much more valuable
 10 to the consumer because they can take it with
 11 them.
 12 Q Are there now services that also
 13 allow you not only to transfer from a PC to a
 14 portable device but to receive streams
 15 directly on to a portable device?
 16 A That's correct, the devices can
 17 not only be hooked up physically to the
 18 computer, but they have receivers in them that
 19 can connect to the internet by any number of
 20 means in order to download music.
 21 Q So if customers, consumers value
 22 portable services more than nonportable

1 services, how, if at all, is that reflected in
 2 the retail price that customers are willing to
 3 pay?
 4 A Customers are willing to pay more
 5 money for that right.
 6 Q And roughly how much more?
 7 A In general, the services charge
 8 about 50 percent more.
 9 Q Fifty percent more for the
 10 portable services?
 11 A That's correct.
 12 Q Now on page nine of your testimony
 13 you stated that Rhapsody which is one of the
 14 services, has a non-portable streaming
 15 service that sells for \$9.99 and a portable
 16 service that sells for \$14.99. Do you know
 17 whether that's still the case that the non-
 18 portable is \$9.99 and the portable is \$14.99?
 19 A No, Rhapsody recently changed its
 20 non-portable price.
 21 Q Do you know what they changed it
 22 to?

1 A They now charge \$12.99.
 2 Q Do you know if they raised the
 3 price to \$12.99 because consumers are willing
 4 to pay \$12.99 for a non-portable service?
 5 MR. WYSS: Objection, lack of
 6 foundation. Calls for speculation.
 7 MR. DeSANCTIS: The question was
 8 does he know. I think the witness can answer
 9 whether he knows or not. If Your Honor would
 10 like me to lay a separate foundation for that,
 11 I'd be happy to.
 12 CHIEF JUDGE SLEDGE: That question
 13 with the emphasis on the limit on what your
 14 answer can be is overruled.
 15 THE WITNESS: Yes, I know.
 16 BY MR. DeSANCTIS:
 17 Q And what is the reason?
 18 CHIEF JUDGE SLEDGE: Objection
 19 sustained.
 20 (Laughter.)
 21 BY MR. DeSANCTIS:
 22 Q Can you explain to us how you

1 know?
 2 A We have asked employees of
 3 Rhapsody and former employees of Rhapsody
 4 their reasoning behind the increase in price
 5 and they have told us at Universal.
 6 Q And what is that reason?
 7 MR. WYSS: Objection, Your Honor,
 8 hearsay.
 9 MR. DeSANCTIS: Hearsay is
 10 admissible under the Court's rulings.
 11 CHIEF JUDGE SLEDGE: Hearsay may
 12 be admissible.
 13 MR. DeSANCTIS: May be admissible
 14 at the discretion of the Court.
 15 And we would ask that this be
 16 admissible. This is the type of information
 17 that Mr. Kenswil deals with on a daily basis.
 18 It's the core of his business. Rhapsody is a
 19 very significant customer of Universal and his
 20 conversations with them are part of his core
 21 business.
 22 CHIEF JUDGE SLEDGE: Any response?

1 MR. WYSS: Yes, Your Honor. I
 2 mean this is the worst kind of hearsay.
 3 There's no way that I can go behind it. This
 4 was not raised at his deposition. There was
 5 no hint that he had talked to people and knew
 6 all the reasons. We have no way to talk to
 7 the Rhapsody people to find out what, in fact,
 8 the real reasons are.
 9 CHIEF JUDGE SLEDGE: Is this in
 10 the statement?
 11 MR. DeSANCTIS: No, this happened
 12 since, I'm actually correcting something
 13 that's in the statement. The statement gives
 14 a price of \$9.99 for the non-portable service.
 15 Since then it has changed and I just wanted to
 16 clarify that for the record.
 17 CHIEF JUDGE SLEDGE: Objection
 18 sustained.
 19 BY MR. DeSANCTIS:
 20 Q Mr. Kenswil, have other services
 21 that provide non-portable streaming services
 22 maintained the roughly 50 percent premium for

1 portable services that you described earlier?
 2 A Yes, they have.
 3 Q And what would those services be?
 4 A They include Napster, Yahoo and
 5 MTV.
 6 Q Now without getting into specific
 7 numbers because we're not in restricted
 8 session, what impact does portability have on
 9 the rates that UMG is able to charge the
 10 services on say a per play or a per subscriber
 11 basis?
 12 A They allow us to increase the
 13 rate.
 14 Q By approximately how much?
 15 A By approximately twice as much.
 16 Q And exactly why is that? What are
 17 the reasons that allow you to charge more for
 18 the portability?
 19 A First, because it allows the
 20 services to charge more for the consumer and
 21 secondly, because it increases the value to
 22 the consumer and finally because it has much

1 more of a replacement effect on other
 2 services.
 3 Q Can you describe what you mean by
 4 that last part, a replacement effect on other
 5 services?
 6 A Essentially, a portable
 7 subscription service allows someone to listen
 8 to any recording any time they want is a
 9 perfect replacement if implemented perfectly
 10 of ownership of the music, so there would be
 11 no need to buy a CD or a download if one has
 12 that service.
 13 Q Are the satellite radio services
 14 an example of a portable service or non-
 15 portable service?
 16 A They are portable.
 17 Q Can you describe the ways in which
 18 they're portable?
 19 A They have portable receivers you
 20 can walk around with and they have portable
 21 receivers that are in automobiles.
 22 Q You don't have to be tied to a PC

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1 to receive their service?
2 A That's correct.
3 Q You mentioned automobiles. Is
4 listening in the car a significant portable
5 market?
6 A Yes, it is.
7 Q What happened to cassette tape
8 sales when cassette tape players became widely
9 available in cars?
10 MR. WYSS: Objection, Your Honor.
11 This is outside the scope of the witness'
12 testimony.
13 MR. DeSANCTIS: Certainly the idea
14 of the replacement value of the substitution
15 value is in the written testimony. The
16 specific example I'm asking about is just an
17 example to flesh out --
18 CHIEF JUDGE SLEDGE: That's a very
19 general response.
20 MR. DeSANCTIS: I can direct the
21 Court to the page of the testimony where
22 substitution and replacement is discussed.

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1 It would be the last full
2 paragraph on page three continuing over to
3 page four. It's been discussed in the first
4 full paragraph at page six.
5 (Pause.)
6 CHIEF JUDGE SLEDGE: Objection is
7 overruled.
8 THE WITNESS: Could you repeat the
9 question?
10 BY MR. DeSANCTIS:
11 Q Sure. The question was what
12 happened to, for example, cassette tape sales
13 when cassette tape players first became widely
14 available in cars?
15 A Cassette sales increased
16 dramatically.
17 Q And what happened to CD sales when
18 CD players first became widely available in
19 cars?
20 A CD sales increased dramatically.
21 Q So do satellite radio companies --
22 I'll withdraw that.

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1 (Pause.)
2 Given the type of portability
3 that's available from the satellite radio
4 services, how would that affect the rates that
5 UMG would receive from satellite radio
6 services if there were an open market
7 transaction between UMG and the satellite
8 radio services?
9 A Certainly a portable satellite
10 radio service which I guess is by definition
11 any satellite service is portable would always
12 mean that we would be able to get more money
13 for our licenses than a similar service that
14 was not portable.
15 Q In your testimony you also discuss
16 various nonmonetary terms that are in your
17 arm's length licenses and I'd like to just ask
18 you a few questions about some of those. The
19 first one that you discuss at the bottom of
20 page six is the fact that many of your
21 licenses have a greater out rate structure.
22 Can you describe briefly what that is and why

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1 it's important to UMG?
2 A Well, there are generally three
3 ways, three measurements that have to be taken
4 in order to pay us and then we get paid
5 whichever measurement gives us the most money
6 and those measurements are based on either a
7 percentage of revenue to the service, the
8 number of times our songs are played, and all
9 that subject to a minimum per subscriber
10 amount.
11 Q If you couldn't include a greater
12 rate structure in a particular digital license
13 would that affect the rate that you would
14 charge the licensee under whatever metric you
15 did charge them?
16 A Well, in order to protect
17 ourselves in that respect I suppose we would
18 have to raise the other rates to make up for
19 it.
20 Q You also explain in your testimony
21 that --
22 JUDGE WISNIEWSKI: I didn't get

9 (Pages 30 to 33)

1 much out of that answer. Can you tell me why?
 2 THE WITNESS: Sure. The different
 3 rates are meant to cover different ways the
 4 services may use the music. And they don't
 5 always use the music just to directly charge
 6 the consumer or they may use the music and not
 7 encourage the consumer to actually use the
 8 service, some refer to it as the health club
 9 model. Nonetheless, there's a certain value
 10 of the music to the service and these
 11 different methodologies are meant to capture
 12 those values.

13 If we were to be denied one of the
 14 methodologies, we would have to consider
 15 possibly raise another rate in order to make
 16 up for that loss, although it would be an
 17 imperfect substitution.

18 JUDGE WISNIEWSKI: Well, can you
 19 give me examples in each case?

20 THE WITNESS: Sure. If we were to
 21 not receive let's say a minimum per
 22 subscriber, which is to protect us from a

1 service under charging the subscriber and
 2 using it for example to funnel those
 3 subscribers to other services that the company
 4 might be selling, the third party company
 5 might be selling. We would increase our per
 6 play rate to make up for that so that we would
 7 get paid more times -- more each time someone
 8 plays the song because the value to the
 9 service can't just be measured by pure plays
 10 at the normal rate.

11 JUDGE WISNIEWSKI: That's one
 12 example?

13 THE WITNESS: That's one example.

14 JUDGE WISNIEWSKI: That's the
 15 example of the minimum subscriber. What about
 16 the other cases?

17 THE WITNESS: Well, if --

18 JUDGE WISNIEWSKI: I'm trying to
 19 understand how these things -- you say they
 20 interact. I'm trying to understand what you
 21 mean by that.

22 THE WITNESS: If we can't get a

1 percentage of the total, then we would not be
 2 sharing equitably I believe in the total
 3 amount of money coming in and again, we would
 4 have to -- if we were simply paid based on the
 5 minimum or the per play rate and the company
 6 can charge whatever they wanted for the
 7 subscription service and it wouldn't affect
 8 how much we made, then we'd probably raise the
 9 minimum in order to make sure that we got a
 10 reasonable amount of money no matter what they
 11 charge.

12 JUDGE WISNIEWSKI: I hear what
 13 you're saying in both of your examples, but
 14 what I'm not understanding is where the
 15 leakage comes about and therefore why you
 16 structure it as a greater over rate structure.

17 THE WITNESS: Well, each
 18 measurement itself would allow a third party
 19 company to essentially play with their
 20 business model to under pay us in our opinion.
 21 Each covers a different scenario in the way
 22 they structure their business.

1 We don't restrict how they
 2 structure their business. They can give away
 3 the service if they want to or they can charge
 4 \$100 for the service if they want to. What we
 5 want is a fair return no matter what the
 6 business structure is and we think each of
 7 these different measurements has a -- is
 8 limited in how it can capture that. And so we
 9 need all three to kick in in order to capture
 10 whichever one is in effect.

11 JUDGE WISNIEWSKI: I hear that,
 12 but I'm still not quite understanding your
 13 explanation here because what you've described
 14 is a greater over rate structure and you say
 15 that given this greater over rate structure,
 16 if you're not getting an adequate amount say
 17 on the percentage of revenue, measure for X,
 18 Y, or Z reason, that may in fact be picked up
 19 for you by the alternatives under the greater
 20 over rate formula. But in fact, under your
 21 testimony you said that if you couldn't have
 22 the -- one of these three measures within that

1 context, you'd have to charge more, but if
2 it's being picked up as an alternative, why
3 would you have to charge more?

4 THE WITNESS: What I meant was if
5 we couldn't have one of the measurements and
6 therefore the business models that would pass
7 under that measurement was no longer paying us
8 under that measurement essentially because
9 it's not there, in order to make up for that,
10 the only way that I can think of making up for
11 that would be to charge more under another
12 measurement which would, in essence, limit the
13 company's ability to create business models
14 and force them into a business model that made
15 sense under that measurement.

16 In my mind, these different models
17 allow more flexibility for the company in
18 presenting the service.

19 JUDGE WISNIEWSKI: Thank you.

20 BY MR. DeSANCTIS:

21 Q Another of these characteristics
22 of the UMG licenses that you describe in your

1 testimony is the inclusion of guaranteed
2 marketing considerations. Can you explain
3 what those are and how they work?

4 A Well, in the music business, we
5 tend to market release by release and artist
6 by artist. And much of our marketing is
7 around exposing the artist's brand essentially
8 to the consumer in many different ways. And
9 these services can help do that and when they
10 do that we essentially can sell or create more
11 revenue for that artist from all the different
12 revenue streams, not just the service
13 involved. So examples of that is using the
14 artist in advertising the service, the
15 artist's name and picture; could be featuring
16 the artist when someone comes on to the
17 service in the first place. They see this
18 artist and the name and they're told about the
19 release. It could be interviews with the
20 artist or live performances by the artist, all
21 sorts of things that create greater exposure
22 for that artist to the public.

1 Q And is that made easier by the
2 power of the internet?

3 A Well, the internet certainly has
4 made it much easier to find methods of
5 exposing artists to the public. On the other
6 hand, it is a challenge because it has also
7 decreased the way of finding mass exposure for
8 any one artist. So it works both ways.

9 Q And is that different from a
10 service simply playing your sound recordings
11 and saying that would be the marketing
12 component of a license?

13 A Yes, it is. That's not what we
14 ask for in the marketing component. None of
15 these licenses have any sort of mandatory
16 plays in them at all. It is other things than
17 just simply playing the songs.

18 Q Another aspect of the licenses
19 that you discuss in your testimony is service
20 reports regarding consumer usage. Can you
21 explain what those are and why those are
22 important to UMG?

1 A We get detailed reports of how
2 consumers use the products in the various
3 forms. We're not talking about the name of
4 the consumer and what they're doing. We're
5 talking about aggregate data of what consumers
6 are listening to, how often they play music,
7 how often they -- what other artists they
8 listen to, how the artists correlate with each
9 other. So it gives us more information on how
10 to market our music.

11 Q And why is that value to UMG?

12 A Well, it's a new source of data
13 that we never had data like that before. And
14 it's very valuable in putting together
15 marketing plans.

16 Q Finally, you state in your
17 testimony with respect to these various
18 aspects of the licenses that UMG tends not to
19 enter into licenses for more than two years.
20 Can you explain why that is?

21 A Well, it's a very evolving
22 business. These are new businesses. It is

1 unclear the direction any of them are going
2 in, how much money is going to be generated by
3 these businesses and how much they're going to
4 be able to afford to pay us and therefore both
5 sides involved generally prefer shorter term
6 deals so they can be reevaluated every few
7 years rather than anyone being stuck with a
8 bad deal.

9 Q And if a licensee came to you and
10 said we are only interested in a longer term,
11 say a five-year term, if UMG was amenable to
12 entering into that would it have any effect on
13 the rate you charged?

14 A Well, we would probably charge a
15 higher rate, but even more likely we would
16 charge a very large guarantee in order to make
17 sure that this company paid us a certain
18 amount for that five-year period, no matter
19 what the rates were.

20 Q I'd like to talk next about the
21 rates that -- the actual rates that UMG
22 obtains in its licenses for various kinds of

1 digital services. I'd like to avoid going
2 into restricted session and therefore I'd like
3 to turn your attention to page 10 of your
4 written statement.

5 The first couple of paragraphs
6 there discuss the rates that UMG currently
7 receives for nonportable subscription
8 streaming services. Do you see that?

9 A Yes, I do.

10 Q Is that still the current rates
11 that UMG is receiving for non-portable
12 subscription services in the marketplace?

13 A Yes, they are.

14 Q And the contract that is discussed
15 in the next paragraph, is that contract still
16 in effect?

17 A Yes, it is.

18 Q In fact, is that the contract that
19 we looked at earlier that's attached to your
20 testimony?

21 A That's correct.

22 Q The next service is portable

1 streaming subscription services, and the rates
2 for these services are set out at the bottom
3 of page ten. Do you see that?

4 A Yes, I do.

5 Q Are the rates listed there still
6 in effect?

7 A Yes, they are.

8 Q And is that representative of what
9 UMG is receiving in the marketplace for this
10 kind of portable subscription streaming
11 service?

12 A Yes.

13 Q And the next page you discuss
14 video streaming deals. And in the third
15 paragraph you discuss the actual terms of
16 existing video streaming deals, do you see
17 that?

18 A Yes, I do.

19 Q Are those rates and terms that are
20 discussed in the third paragraph of page 11
21 still in effect and representative of what UMG
22 is obtaining in the marketplace today?

1 A Yes, they are.

2 Q I'm going to ask you the same
3 questions with respect to permanent audio
4 downloads which begins at the bottom of page
5 11 and continues at the top of page 12 where
6 the numbers are.

7 Are these rates for permanent
8 audio downloads rates that are currently in
9 effect and representative of what UMG is
10 receiving from licensees for permanent audio
11 download licenses?

12 A Yes, they are.

13 Q Same question for the next type of
14 service you discuss which is ring tones and
15 master tones. These rates are given in the
16 second full paragraph on page 12. Do you see
17 those?

18 A Yes.

19 Q And are those rates currently in
20 effect and representative of what UMG obtains
21 in the marketplace for ring tone and master
22 tone licenses?

1 A Yes, they are.
 2 Q Finally, your testimony discusses
 3 the current rates and terms for wireless audio
 4 downloads. Do you see those rates and terms?
 5 A Yes, I do.
 6 Q Are those rates and terms
 7 currently in effect in any contracts that UMG
 8 has with licensees?
 9 AA They are.
 10 Q Have any licenses that UMG has
 11 with licenses changed since the writing of
 12 this testimony?
 13 A Well, licenses that UMG has is not
 14 how it feeds us but putting that side --
 15 Q You would attribute it --
 16 A We view it as the sale of goods.
 17 We have developed a different pricing model
 18 which we have offered to the carriers and they
 19 have another option of which model they want,
 20 the old one or the new one.
 21 Q And without getting into specific
 22 numbers, given that we're not in restricted

1 testimony, could you just sort of describe
 2 what that new structure is?
 3 A It essentially increased the
 4 percentage but decreased the minimum.
 5 Q And do any carriers currently in
 6 the marketplace today have that new deal?
 7 A Yes, one does.
 8 Q And do any still have the old deal
 9 that's described in your testimony?
 10 A Yes, more than one does.
 11 Q Now looking at the services that
 12 are discussed in your testimony, they are
 13 nonportable subscriptions streaming, portable
 14 subscriptions streaming, video streaming,
 15 permanent audio downloads, mobile and wireless
 16 services such as ring tones and master tones
 17 and wireless audio downloads.
 18 If we look at those services as a
 19 group, what percentage of the digital
 20 marketplace, of the entire digital marketplace
 21 do those services represent roughly?
 22 A Over 95 percent.

1 MR. DeSANCTIS: I have no further
 2 questions, Your Honor.
 3 (Pause.)
 4 JUDGE WISNIEWSKI: Any cross
 5 examination, Mr. Wyss?
 6 MR. WYSS: Yes, Your Honor, if I
 7 may.
 8 CROSS EXAMINATION
 9 BY MR. WYSS:
 10 Q Good morning, Mr. Kenswil.
 11 A Good morning.
 12 Q You and I had a chance to meet
 13 before your deposition, correct?
 14 A That's correct.
 15 Q I'm going to be asking you many of
 16 the same questions we asked you there,
 17 hopefully it will be easy today.
 18 It is correct that you are a
 19 lawyer, is that not correct?
 20 A That is correct.
 21 Q And you graduated from Georgetown
 22 Law School here in D.C.?

1 A That's correct.
 2 Q What year did you graduate?
 3 A 1980.
 4 Q And you are currently a member of
 5 the California bar?
 6 A Yes, I am.
 7 Q And you are on active status
 8 authorized to practice law, correct?
 9 A That's correct.
 10 Q And you've been with UMG I think
 11 you said quite a number of years, but focusing
 12 on the period from 1991 to 1998, you were
 13 basically head of the business and legal
 14 affairs group?
 15 A That's correct.
 16 Q And in doing that you were
 17 essentially doing general counsel work for
 18 UMG?
 19 A Among other things, yes.
 20 Q And then you came to eLabs, I
 21 believe you said in 1990, correct?
 22 A That's correct.

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1 Q And at eLabs you have continued to
2 do legal work, correct?
3 A Well, I supervise lawyers who are
4 negotiating agreements and that's a
5 combination of business and legal work, yes.
6 Q And eLabs is not an operating
7 division is it?
8 A No, it is not.
9 Q And eLabs doesn't create any sound
10 recordings, correct?
11 A Nothing that can be commercially
12 exploited.
13 (Laughter.)
14 Q All right, and certainly is it
15 correct that the creative work and the
16 monetary investment from the creation of the
17 actual music works that's done down at the
18 label level, correct?
19 A We refer to it as up at the label
20 level, yes.
21 (Laughter.)
22 Q All right. Now I think you said

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1 you're on the board of the RIAA, correct?
2 A That's correct.
3 Q That's the Recording Industry --
4 A Association of America.
5 Q Association of America. That's
6 the trade association for the record industry,
7 correct?
8 A That's right.
9 Q And you regularly attend meetings
10 of the RIAA regarding different issues
11 affecting the industry, correct?
12 A That's correct.
13 Q And that includes the RIAA
14 strategy with respect to satellite radio,
15 correct?
16 A Well, with respect to the
17 compulsory licensing of satellite radio, yes.
18 Q And does it also include RIAA's
19 support for SoundExchange in these
20 proceedings?
21 A I'm sorry, does it include?
22 Q The RIAA's support for

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1 SoundExchange in the proceeding we are here
2 today?
3 A Yes.
4 Q And you yourself have testified a
5 number of times before in similar proceedings
6 like this, correct?
7 A That's correct.
8 Q Now you gave us a little bit of a
9 background concerning UMG and in your
10 testimony today you talked a little bit or in
11 your written direct testimony, you talk about
12 the label structure, some market share
13 information and digital revenue information.
14 I'd like to give the Court a little more
15 context for that, please. And I would like to
16 mark as SDARS Exhibit 51, a document bearing
17 production number SE0123316 through 535.
18 (Whereupon, the above-referred to
19 document was marked as SDARS
20 Exhibit No. 51 for
21 identification.)
22 (Pause.)

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1 Mr. Kenswil, do you recognize
2 SDARS Exhibit No. 51 as the slides that you
3 used for a presentation that you gave back in
4 mid-2006?
5 A Yes, I do.
6 Q And if you'd look at the first
7 slide with page number one at the bottom, do
8 you see on the left hand side that there is a
9 --
10 MR. WYSS: First of all, Your
11 Honor, we would offer into evidence SDARS
12 Exhibit No. 51.
13 CHIEF JUDGE SLEDGE: Any objection
14 to Exhibit 51?
15 MR. DeSANCTIS: Not to its
16 admission, Your Honor.
17 CHIEF JUDGE SLEDGE: Without
18 objection, it's admitted.
19 (The document, having been marked
20 previously for identification as
21 SDARS Exhibit No. 51, was received
22 in evidence.)

14 (Pages 50 to 53)

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1 MR. DeSANCTIS: I would, however,
2 like to move that it be treated as restricted
3 under the Court's protective order. This was
4 an internal presentation, internal to
5 Universal. As I flip through it, I see a
6 significant amount of nonpublic information
7 both regarding revenues and sales data that is
8 not shared with the public and it's
9 competitively sensitive, in addition to
10 strategic planning that would, because of its
11 relatively current date, may quite still be
12 strategies on the table. I don't know. But
13 this is obviously highly competitively
14 sensitive vis-a-vis to other record companies.
15 CHIEF JUDGE SLEDGE: Any
16 objection?
17 MR. WYSS: No objection, Your
18 Honor.
19 Based on the representation that was conveyed,
20 I do not know the circumstances under which to
21 who it was presented and how it may have been
22 disseminated other than counsel has stated.

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1 CHIEF JUDGE SLEDGE: Please
2 establish those points.
3 MR. DeSANCTIS: I'm sorry?
4 CHIEF JUDGE SLEDGE: Establish
5 those points.
6 MR. DeSANCTIS: I was actually
7 just going to say, Your Honor, that I can't
8 speak for the witness, this was my
9 understanding of this document and I was
10 actually just going to ask whether counsel or
11 I should elicit points from the witness.
12 CHIEF JUDGE SLEDGE: It's your
13 motion.
14 MR. DeSANCTIS: Okay.
15 CHIEF JUDGE SLEDGE: You have a
16 microphone there.
17 MR. DeSANCTIS: Oh, I do.
18 BY MR. DeSANCTIS:
19 Q Mr. Kenswil, you're familiar with
20 this document?
21 A Yes, I am.
22 Q Was this delivered -- the

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1 information contained in this document
2 disseminated publicly outside of Universal or
3 Universal entities?
4 A It was projected on a screen for a
5 group visiting, a group of students visiting
6 from Russia who were not employees.
7 Q Was each slide in the presentation
8 projected on the screen to those students?
9 A Yes, it was.
10 MR. WYSS: On that basis, Your
11 Honor --
12 CHIEF JUDGE SLEDGE: Just a
13 moment.
14 MR. WYSS: I'm sorry.
15 MR. DeSANCTIS: Your Honor, I
16 apologize. I withdraw my motion. I was
17 unaware of that.
18 (Pause.)
19 CHIEF JUDGE SLEDGE: Continue.
20 MR. WYSS: Thank you, Your Honor.
21 BY MR. WYSS:
22 Q Looking at the first, the page of

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1 the slides that has page number one and on the
2 left side of it, you see a figure there has is
3 entitled 2005 U.S. market share?
4 A Yes.
5 Q And does that figure accurately
6 reflect the 2005 U.S. market shares for the
7 various labels indicated there?
8 A Well, it doesn't say - it doesn't
9 define market and you can't tell from this
10 slide exactly what market was being divided up
11 from what they were referencing.
12 Q You don't see U.S. market?
13 A Marketing being within the U.S.
14 what was being sold in that market, what
15 product.
16 Q Would you know the general market
17 shares among the labels in the U.S.?
18 A I know the general distribution
19 company market shares of recorded music, yes.
20 Q And how do they correspond to
21 what's shown, the slide that you projected on
22 the screen to the Russian students?

15 (Pages 54 to 57)

1 A It's my recollection that
2 Universal's market share was higher than this
3 number that year. That's why I questioned
4 what market.

5 Q How about the other shares, do
6 they seem about right?

7 A Approximately, yes.

8 Q All right, if you go to page three
9 or the slide, slide number three where it
10 talks about the structure or UMG, do you see
11 that?

12 A Yes.

13 Q And the first thing you talk about
14 is the record labels, correct?

15 A Correct.

16 Q And you say that they are the ones
17 that produce and promote the releases,
18 correct?

19 A That's correct.

20 Q So the actual activity in
21 promoting in what you do to market and promote
22 is done at the label level, correct?

1 A Primarily, yes.

2 Q And on the next slide, does that
3 slide accurately reflect the different labels
4 that are part of UMG?

5 A In general, yes.

6 Q And if you go to page five, does
7 that indicate, you gave your presentation, did
8 you describe the role of the record labels in
9 the creation and bringing to the public new
10 creative works?

11 A Yes.

12 Q And in terms of the marketing, one
13 of the things that labels do is they are
14 responsible for radio promotion, correct?

15 A That's correct.

16 Q And that is one of the important
17 marketing tools used by your record labels,
18 correct?

19 A That's correct.

20 Q And finally, just on page six, the
21 next slide, eLabs, that's your group which is
22 different from the record labels, correct?

1 A Well, it's not different from what
2 we meant by record label on page five, but in
3 structure it is different, yes.

4 Q Okay, and now looking at the
5 second bullet, eLabs is the group with the UMG
6 that's responsible for working with RIAA on
7 cross-industry technical issues, webcasting
8 rate negotiations, and similar types of
9 activities, correct?

10 A Correct.

11 Q Now, you gave us a little bit of
12 information about UMG and its market shares.
13 I would like to update the Court with the most
14 recent information that we could find. I
15 would ask you to please look at the document
16 that has been marked at SDARS Exhibit 52.

17 (Pause.)

18 (Whereupon, the above-referred to
19 document was marked as SDARS
20 Exhibit 52 for identification.)

21 Did you recognize SDARS Exhibit
22 No. 52 as the Universal Music Group investor

1 leading presentation, dated November 30, 2006,
2 which is posted on the Universal website and
3 available under its investor relations
4 section?

5 A I'm not aware of that.

6 Q I'm sorry?

7 A I have no personal knowledge of
8 that fact.

9 Q But you do recognize this as the
10 2006 -- excuse me, November 30, 2006 investor
11 meeting presentation that Universal Music made
12 available to the public?

13 A Well, I can't testify that that is
14 what it actually is. It is what it purports
15 to be.

16 MR. WYSS: And, Your Honor, we
17 would offer into evidence SDARS Exhibit No.
18 52.

19 CHIEF JUDGE SLEDGE: Any objection
20 to the Exhibit No. 52?

21 MR. DeSANCTIS: Yes, Your Honor.
22 I would object both to the foundation that has

1 been laid. I think the witness has not laid
2 an adequate foundation for this document.
3 More importantly, it is a document from
4 November 30, 2006. Written testimony in this
5 case was submitted on October 30, 2006.
6 Obviously, any numbers in here go beyond the
7 scope of his written direct testimony, and I
8 would object on that ground as well.

9 CHIEF JUDGE SLEDGE: Mr. Wyss?

10 MR. WYSS: The purpose is to
11 update the numbers that appear in his
12 testimony, Your Honor, consistent with our
13 understanding of the Court's desire for the
14 most pertinent information that is available.

15 CHIEF JUDGE SLEDGE: As you have
16 only responded to one of the objections, the
17 objection is sustained.

18 BY MR. WYSS:

19 Q Would you please look at page four
20 of this slide? And does page four correctly
21 identify that Universal's market share in 2006
22 was 31.4 percent?

1 MR. DeSANCTIS: Objection, Your
2 Honor. I would object to the lines of
3 questioning that are reading from documents
4 not in evidence.

5 CHIEF JUDGE SLEDGE: Sustained.

6 BY MR. WYSS:

7 Q Mr. Kenswil, is it correct that in
8 2006, Universal's market share was 31.4
9 percent?

10 A I know I have looked at the year
11 end numbers and I know that plus or minus a
12 point or a point and a half, that is correct.

13 Q Okay. Is it also correct that the
14 year end numbers for Sony BMG were
15 approximately 26.9 percent?

16 A I just don't recall what Sony
17 BMG's numbers were.

18 Q Do you recall that the EMI numbers
19 year end for 2006 were approximately 10.1
20 percent?

21 A Well, actually my recollection is
22 that they were lower, but I may be mistaken.

1 Q And is it your recollection that
2 the numbers, year end market share numbers for
3 Warner were approximately 18.5 percent?

4 A I would say that is correct, but
5 within two percent either way.

6 Q All right, the shares for the
7 digital market are different, however. Are
8 they not?

9 A Slightly, yes.

10 Q And is it correct that the BMG is
11 the leader in digital and had a market share
12 of about 32.7 percent?

13 A Again, plus or minus a small
14 amount, that is correct.

15 Q And the number two company in
16 digital would be Sony BMG with about 25.6
17 percent?

18 A That is correct, although again I
19 don't know the precise number.

20 Q And the third company would be
21 Warner with approximately 20 percent?

22 JUDGE WISNIEWSKI: At what point

1 in time? Several questions have not specified
2 a time.

3 MR. WYSS: I'm sorry, at the year
4 end of 2006, all of these questions have been
5 focusing on that time period, Your Honor.

6 THE WITNESS: I know Warner is
7 number three, my recollection is. I would be
8 surprised if it was that high, but it may be.

9 BY MR. WYSS:

10 Q I'm going to ask you to turn to
11 page 17 of this exhibit and see if that
12 refreshes your recollection as to the
13 approximate digital share of Warner.

14 MR. DeSANCTIS: Your Honor, again
15 I'm going to object to any use of this
16 document that's not been put in evidence.

17 CHIEF JUDGE SLEDGE: Overruled.
18 You can ask him if it refreshes his memory.

19 THE WITNESS: It doesn't change
20 any recollection I have of what those numbers
21 are.

22 BY MR. WYSS:

1 Q And is your recollection of EMI's
 2 digital shares, the end of 2006, to be
 3 approximately eight percent?
 4 A My recollection is that it was
 5 below ten percent, but I can't tell you how
 6 much below.
 7 Q Now in your written direct
 8 testimony, you talked about several different
 9 categories of various deals. Some of the on
 10 demand subscription services, the video
 11 services, the cell phone services. Do you
 12 recall that?
 13 A Yes.
 14 Q I would like to put into context
 15 for the Court the economic significance of the
 16 different deals, and I would like you to
 17 please look at a document that we are marking
 18 as SDARS Exhibit no. 53?
 19 (Whereupon, the above-referred to
 20 document was marked as SDARS
 21 Exhibit 53 for identification.)
 22 I would ask you if you recognize

1 SDARS Exhibit No. 53 as the document that
 2 reflects UMG's U.S.-only digital financial
 3 information of 2006?
 4 A Well, the document is in a format
 5 I recognize. I don't have the numbers
 6 memorized, so I do recognize the format of the
 7 document.
 8 MR. WYSS: Your Honor, we would
 9 offer SDARS Exhibit No. 53.
 10 CHIEF JUDGE SLEDGE: Any objection
 11 to the Exhibit No. 53?
 12 MR. DeSANCTIS: Yes, Your Honor, I
 13 would object only to the -- really only to the
 14 extent that the foundation that has been laid
 15 so far is only that the witness recognizes the
 16 format of the document, not that he's familiar
 17 with this document or any of the numbers in
 18 the document.
 19 I should also add that the next
 20 witness that is going to be before the Court
 21 this morning is the chief financial officer of
 22 Universal Music Group and I assume that he

1 would be able to answer questions related to
 2 the details of the financial documents.
 3 CHIEF JUDGE SLEDGE: Any response?
 4 MR. WYSS: I am not going to ask
 5 him about details, but I will certainly ask
 6 Mr. Kenswil, if I may ask the witness, Your
 7 Honor, whether or not these numbers are
 8 consistent with his recollection of the
 9 performance of UMG Digital, which is his area.
 10 CHIEF JUDGE SLEDGE: You have
 11 already asked that and it's already been
 12 answered, but I will permit you to do it again
 13 if you like.
 14 BY MR. WYSS:
 15 Q Mr. Kenswil, isn't it correct that
 16 these numbers accurately correspond to your
 17 recollection of the digital detail financial
 18 performance of UMG U.S. only?
 19 A The bottom line total revenue
 20 approximates my recollection of what our
 21 bottom line total revenue was in 2006 for the
 22 United States. Yes. But I am not aware of

1 the expense breakdown.
 2 Q Remember we talked about this
 3 exhibit in your deposition, and that point you
 4 recognized it as the digital detail that you
 5 were familiar with?
 6 A No, I don't recall talking about
 7 it in my deposition.
 8 MR. WYSS: Could we please mark as
 9 deposition Exhibit No. 54, a copy of the
 10 witnesses deposition testimony?
 11 (Whereupon, the above-referred to
 12 document was marked as SDARS
 13 Exhibit 54 for identification.)
 14 CHIEF JUDGE SLEDGE: Concluding
 15 your voir dire, the objection is sustained.
 16 (Pause.)
 17 MR. WYSS: Your Honor, I am going
 18 to come back to this one if I may a little bit
 19 later. I'll wait until after the break so I
 20 can find the correct citation.
 21 BY MR. WYSS:
 22 Q Mr. Kenswil, in your written

1 direct testimony and in your oral testimony
 2 today, you have discussed the sales decline in
 3 physical CDs over the last several years,
 4 correct?
 5 A Correct.
 6 Q And it is not something that you
 7 talked about in your Moscow speech, right,
 8 which has been marked as SDARS Exhibit No. 51?
 9 A Yes.
 10 Q Okay, and if you would turn to
 11 page eight of that. There's no question in
 12 your mind, is there, that the number one
 13 reason for the decline in physical sales of
 14 CDs was because of piracy?
 15 A That's correct. Over the last
 16 seven years of decline, the number one factor
 17 has been piracy.
 18 Q And there are also other factors
 19 as well, are there not?
 20 A Yes.
 21 Q And one of the factors is the
 22 changing tastes of consumers on how they want

1 to purchase music, correct?
 2 A Correct.
 3 Q For example, they don't want to
 4 buy albums that have 10 and 12 tracks as was
 5 available before on CDs, correct?
 6 A That's true of many consumers,
 7 yes.
 8 Q And clearly now consumers prefer
 9 to buy music in littler chunks, in singles and
 10 small bundles, correct?
 11 A Well, they may have always
 12 preferred that. Those are now available to
 13 them, so they are exercising that preference.
 14 Q Okay, and back in the old days
 15 they could only buy albums because that's all
 16 you offered, right?
 17 A Well, in the older days they could
 18 buy singles and they bought singles. So the
 19 record industry took singles off the market
 20 for a long time.
 21 Q Right, and what I'm talking about
 22 is in the 1990s and in the early 2000s. All

1 you could buy is albums because you didn't
 2 offer singles, correct?
 3 A That's correct.
 4 Q And now that singles have become
 5 available, consumers have voted with their
 6 pocket book and they buying singles rather
 7 than albums, correct?
 8 A More consumers are buying singles
 9 than albums, correct.
 10 Q Now on the slide, you also
 11 mentioned some other factors including higher
 12 CD prices and the end of the CD replacement
 13 cycle, is that correct?
 14 A That is correct.
 15 Q Okay, and then on the next slide,
 16 this is --
 17 JUDGE WISNIEWSKI: Before you go
 18 further, Mr. Wyss, can I ask that Mr. Kenswil
 19 can explain the end of the CD replacement
 20 cycle, please?
 21 THE WITNESS: When the CD was
 22 first introduced, it was looked at as by

1 consumers as being a better format than the
 2 cassette, especially, and certainly much more
 3 convenient than vinyl records. So we found
 4 that many people who bought CDs already owned
 5 the exact same album in older formats and were
 6 replacing them with the newer format. That
 7 sometime in the last ten years ended, because
 8 that entire cycle ended.
 9 JUDGE WISNIEWSKI: Thank you.
 10 BY MR. WYSS:
 11 Q Looking at the next page, slide
 12 number nine. Is this information that you
 13 also presented as part of your speech to the
 14 visiting students?
 15 A It is.
 16 Q And was the purpose of this slide
 17 to discuss existing problems that were
 18 contributing to the financial problems of the
 19 record industry?
 20 A Yes.
 21 Q And one of those problems was that
 22 the talent and recording costs were spiraling

1 out of control?
 2 A I'd say that is a bit of an
 3 exaggeration, but yes.
 4 Q And marketing costs were following
 5 suit, and that included the radio promotion
 6 marketing costs?
 7 A Yes.
 8 Q And you also cited bloated
 9 overhead cost structure as a problem for the
 10 industry, correct?
 11 A That's probably an opinion, but
 12 yes.
 13 Q And those are what appears on the
 14 SG&A line in the financial statement?
 15 A Well, that third bullet is yes.
 16 Q And then also you mentioned radio
 17 consolidation. Is that because with the
 18 various mergers of radio companies that it
 19 becomes harder to get your recordings played
 20 on the radio with restricted play lists?
 21 A It becomes harder to get new
 22 artists to get recordings played on the radio.

1 Q I want to look a little more
 2 closely at the sales decline. I would ask you
 3 to look at an Exhibit which we have marked as
 4 SDARS Exhibit No. 55.
 5 (Whereupon, the above-referred to
 6 document was marked as SDARS
 7 Exhibit 55 for identification.)
 8 Do you recognize Exhibit No. 55
 9 as not only Deposition Exhibit No. 21 from
 10 your deposition, but an eLab's document that
 11 was prepared back in January of 2006 by your
 12 group?
 13 A Yes, I do.
 14 Q Okay. If you would please turn to
 15 page five of the exhibit. Does that slide
 16 accurately reflect the 2005 digital market
 17 shares as compiled by the people in your
 18 group?
 19 A Well, it's my recollection of the
 20 market shares. I did not prepare the slide,
 21 so I don't know exactly where the numbers came
 22 from. But my recollection coincides with

1 those numbers, yes.
 2 Q And this was prepared by the group
 3 that you are the head of, correct?
 4 A Correct.
 5 Q And it was presented at an
 6 eCouncil meeting in January of 2006, correct?
 7 A That's correct.
 8 Q And looking at the right-hand
 9 side, you see that the 2005 versus 2004 market
 10 share charts?
 11 A Correct.
 12 Q And am I correct that both you and
 13 Warner agree in both physical and in digital
 14 market share?
 15 A That's correct.
 16 Q Okay, and EMI and the others were
 17 sort of split. They were up in digital but
 18 they were down in physical, correct?
 19 A Except for Sony BMG that was down
 20 in both.
 21 Q Sony BMG had a really bad year
 22 that year, correct?

1 A I'll let them speak to that. It
 2 appears so.
 3 MR. WYSS: Your Honor, we would
 4 offer SDARS Exhibit No. 55.
 5 CHIEF JUDGE SLEDGE: Any objection
 6 to the Exhibit No. 55?
 7 MR. DeSANCTIS: I would object to
 8 the foundation being established. I think
 9 that only this was prepared by someone in his
 10 group, not that he necessarily was -- not that
 11 this witness necessarily was involved with the
 12 preparation or that he can -- or that he
 13 directly oversaw the preparation of someone
 14 under his supervision.
 15 CHIEF JUDGE SLEDGE: Objection is
 16 overruled. The exhibit is admitted.
 17 (The document, having been marked
 18 previously for identification as
 19 SDARS Exhibit 55, was received in
 20 evidence.)
 21 BY MR. WYSS:
 22 Q And now I would like you to look

1 at one more exhibit that we have marked as
2 SDARS Exhibit No. 56 which also has a
3 deposition exhibit sticker Kenswil Exhibit No.
4 28.

5 (Whereupon, the above-referred to
6 document was marked as SDARS
7 Exhibit 56 for identification.)

8 Do you recognize Exhibit No. 56 as
9 a copy of another document prepared by your
10 group for presentation at an October 2000
11 eCouncil meeting?

12 A Yes, I do.

13 Q Okay, and if you would look at
14 slide 11, and does this slide reflect an
15 analysis prepared by people in your group
16 about digital cannibalization analysis of
17 Metallica and Linkin Park?

18 A Yes.

19 Q And in both cases was the
20 conclusion of the analysis performed by the
21 people in your group "digital sales appear to
22 be mostly incremental and make up for decline

1 in physical." A Yes.

2 Q And if you would turn to the last
3 slide, page 14, does this slide set forth
4 industry projections for 2006 and 2007 for
5 both physical albums and digital downloads?

6 A Yes.

7 Q And this was again prepared by the
8 people in your eLabs group which you're the
9 head of, correct?

10 A Yes.

11 Q And they are clearly projecting
12 that from 2006 to 2007 the physical albums are
13 going to go down, correct?

14 A Correct.

15 Q But at the same time there's going
16 to be a big increase in the -- excuse me,
17 there will be an increase, they're projecting
18 an increase in the digital downloads of
19 albums, correct?

20 A Correct.

21 Q And at the same time, they're also
22 projecting a substantial increase in the

1 single tracks, correct?

2 A Correct, although I'm not sure who
3 they is.

4 Q Now in your deals you on your
5 download deals, you have a minimum that you
6 get as part of your license agreement for
7 permitting downloads, correct?

8 A Correct.

9 Q And it's in your record, I don't
10 want to go into restricted session, but there
11 also is a minimum that you get for album
12 downloads, correct?

13 A That's correct.

14 Q And the ratio between the minimums
15 for single track downloads as compared to
16 album downloads is 10 to 1, correct?

17 A Yes, that's correct.

18 Q So in those licenses you treat for
19 your licensing purposes the downloads of 10
20 tracks to be the equivalent of the download of
21 the single album, correct?

22 A For financial purposes, yes.

1 Q Now it would be possible then to
2 simply take these projections, do the math and
3 find out whether digital -- whether or not
4 your people were projecting that the digital
5 downloads would more than make up for the
6 physical, correct?

7 A Right. I'm just not sure that
8 these are my people's projections or if they
9 were quoting a third party. It doesn't say on
10 the slide.

11 MR. WYSS: Your Honor, we would
12 offer into evidence, Exhibit 56.

13 CHIEF JUDGE SLEDGE: Any objection
14 to Exhibit 56?

15 MR. DeSANCTIS: Yes, to
16 foundation. It not being established that
17 this witness was involved in the preparation
18 of this document and his testimony that he
19 does not know where these numbers came from
20 and could have come from third party sources.

21 CHIEF JUDGE SLEDGE: The objection
22 is overruled, the exhibit is admitted.

1 (The document, having been marked
2 previously for identification as
3 SDARS Exhibit 56, was received in
4 evidence.)
5 BY MR. WYSS:
6 Q On page three of your written
7 direct testimony in connection with the
8 decline in physical sales, you state and I'm
9 quoting, "at the same time, the class of
10 identifying and developing" -- excuse me,
11 "identifying, developing and promoting artists
12 that consumers want to hear (the core of UMG's
13 business) have not changed."
14 Do you recall that?
15 A Yes.
16 Q Now those are the costs that your
17 company has been incurring ever since it was
18 in business, correct?
19 A Yes.
20 Q And those costs, you were
21 incurring those costs before satellite radio
22 ever came into fruition, correct?

1 A Correct.
2 Q And ever since satellite radio has
3 come into fruition, you continue to invest in
4 those costs, correct?
5 A Correct.
6 Q And isn't it correct that the
7 money that you have received from your
8 statutory royalties which includes webcasting
9 and satellite radio and others, that those
10 have not been material to any considerations
11 of what the UMG labels are doing
12 strategically?
13 A I'm sorry, could you repeat the
14 sources of the money you're referring to?
15 Q The statutory royalties that are
16 paid by webcasting and satellite radio.
17 A That's correct. The receipt of
18 that money by Universal has not affected the
19 strategy of the labels.
20 Q And is it also correct that the
21 receipt of those monies do not affect your
22 resource planning for any given year?

1 A That's correct.
2 Q And is it also correct that the
3 receipt of those resources do not have any
4 effect on the signing of artists' contracts or
5 anything like that?
6 A They may have an effect on making
7 sure we obtain those rights, but other than
8 that, no.
9 Q Okay, and it has no material
10 effect on the current operation of your
11 business, correct?
12 A No material affect, that's
13 correct.
14 Q And the actual decision to either
15 sign an artist or exercise an option for an
16 additional recording on one of your artists,
17 that's a decision that's made at the label
18 level, correct?
19 A Within certain parameters, yes.
20 Although they need authority to go beyond what
21 those parameters, but generally, yes.
22 Q And when the labels are making

1 this economic assessment, they're going to
2 look at the overall revenue that they expect
3 the artists to generate from the sale of
4 record sales, correct, CD sales?
5 A Among other things, yes.
6 Q And they'll also look at trying to
7 analyze potential permanent downloads from
8 iTunes and sources like that, correct?
9 A Yes, they will.
10 Q But is it not correct that they do
11 not give any consideration to the royalties
12 from the on-demand subscription services or
13 from satellite radio?
14 A Those royalties are so small that
15 they give it no consideration.
16 MR. WYSS: Your Honor, it's 11
17 o'clock and I'm about to wander into a
18 different area. I am not sure if this is the
19 time you take for a morning break or not.
20 CHIEF JUDGE SLEDGE: What other
21 area are you going into?
22 MR. WYSS: I am going to talk

1 about substitution which was addressed.
2 CHIEF JUDGE SLEDGE: We'll recess
3 ten minutes.

4 (Whereupon, the foregoing matter
5 went off the record at 10:59 a.m. and went
6 back on the record at 11:13 a.m.)

7 CHIEF JUDGE SLEDGE: On the
8 record. We will come to order.

9 CROSS EXAMINATION (Cont'd.)
10 BY MR. WYSS:

11 Q Before I go to substitution, there
12 is one other area I need to cover quickly and
13 in your direct testimony, you talked today a
14 lot about the value of music to consumers.
15 Correct?

16 A Yes.

17 Q And do you recall in your written
18 direct testimony at page six, you state "That
19 consumers are willing to pay \$12.95 per month
20 for a basis subscription to satellite radio
21 show the high value of these types of services
22 to subscribers." Do you recall that?

1 A Yes.

2 Q Okay. Now the \$12.95, that covers
3 a whole lot more than just the playing of the
4 sound recordings. Correct?

5 A It covers all the channels.

6 Q Okay, and it includes a bundle of
7 channels that are exclusive to satellite radio
8 including Howard Stern, Oprah, NFL, NASCAR,
9 Major League Baseball and a variety of other
10 exclusive content. Correct?

11 A Well, some of those are exclusive
12 to satellite. Some of them are exclusive on
13 one service or the other, but there are other
14 ways of getting them as well. So they vary,
15 but, yes.

16 Q But you remember at your
17 deposition, I asked you what you would want if
18 Napster came to you and said, "Gee, I'd like
19 to get an exclusive against all other on-
20 demand subscription services for universal
21 music." Do you remember me asking you that?

22 A Vaguely, yes.

1 Q And you remember that your own
2 personal view that there was no price high
3 enough that would justify offering that sort
4 of exclusive. Correct?

5 A That's correct.

6 Q Now for in addition to the
7 exclusive channels, isn't it correct that for
8 \$12.95 you also get sports channels, news
9 channels, talk, comedy and a variety of other
10 channels as well?

11 A Yes.

12 Q And in addition to the exclusive
13 and in addition to all other channels, you
14 also get channels that are offering music
15 programming. Correct?

16 A Yes.

17 Q And if you don't want to pay
18 \$12.95 for that entire bundle of services from
19 satellite radio, but you still want to get
20 music in your car, you can just flip over to
21 AM/FM radio and hear it there. Correct?

22 A I think the satellite service and

1 the record companies would agree that AM/FM
2 radio is a poor substitute for the music
3 available on satellite radio.

4 Q Isn't it correct that if you don't
5 want to pay \$12.95 for all the bundle of
6 services that satellite radio provides you can
7 still get music in your car by flipping over
8 to AM/FM terrestrial radio?

9 A You can get some music on those
10 bands, yes.

11 Q Now with respect to substitution,
12 you state that satellite radio in your written
13 direct testimony on page three, you suggest
14 that satellite radio can substitute for the
15 sales of other UMG products. Correct?

16 A Correct.

17 Q Okay. You have not seen any
18 survey that attempts to assess the degree to
19 which satellite users might buy more or less
20 CDs, have you?

21 A I've seen at least one.

22 Q I'm sorry.

1 A I have seen at least one.
 2 Q Okay. At the time of your --
 3 That's something you've seen since your
 4 deposition?
 5 A I believe so, yes.
 6 Q All right. And you have not seen
 7 any economic or statistical studies that have
 8 attempted to establish a causal effect between
 9 the listening to satellite radio and a
 10 decrease in subsequent purchases of CDs.
 11 Correct?
 12 A I don't know if the study I saw
 13 would satisfy your criterion in that question.
 14 I only saw the one study.
 15 Q And you're not aware of any
 16 studies that show a before and after effect on
 17 CD sales caused by satellite radio
 18 subscriptions. Correct?
 19 A I believe that study covered that
 20 area.
 21 MR. WYSS: Your Honor, this is
 22 something that came after his deposition and

1 I don't believe it's been produced to us at
 2 all and I don't intend to go into it without
 3 first having had a chance to look at it and if
 4 there are studies that are being done and that
 5 have not been produced that are relevant to
 6 this proceeding we would move they be
 7 produced.
 8 CHIEF JUDGE SLEDGE: I have
 9 nothing to rule on.
 10 MR. WYSS: We will put it in an
 11 appropriate form, Your Honor.
 12 CROSS EXAMINATION (Cont'd.)
 13 BY MR. WYSS:
 14 Q Would you agree that in terms of
 15 potential cannibalization of CD sales that the
 16 on-demand subscription services like Rhapsody
 17 and Napster that you discussed earlier today,
 18 that those pose a greater threat than
 19 satellite radio?
 20 A I believe that in the aggregate
 21 those services can be more cannibalizing than
 22 satellite radio, correct.

1 Q And would you also agree that if
 2 they're well implemented and on-demand music
 3 service gives the consumer the exact same
 4 experience they would get from buying either
 5 a CD or a digital download? Those are the on-
 6 demand subscription services.
 7 A The exact same listening
 8 experience, yes.
 9 Q And isn't it correct that you have
 10 seen documents and studies that indicate that
 11 on-demand subscriptions service subscribers
 12 do, in fact, continue to purchase CDs after
 13 they subscribe to an on-demand subscription
 14 service?
 15 A Yes, they do continue to buy CDs.
 16 Q Now the on-demand subscription
 17 services that you were talking about, the
 18 Napsters, the Rhapsodies, the Yahoos, you can
 19 get any song from any artist anytime you want.
 20 Right?
 21 A Assuming it's in the catalog of
 22 licensed material, correct.

1 Q Now satellite radio by contrast,
 2 you can't order up a particular song for a
 3 particular artist at a particular time, can
 4 you?
 5 A No.
 6 Q And in your view, satellite radio
 7 is definitely a different user experience from
 8 these on-demand subscription services.
 9 Correct?
 10 A Yes.
 11 Q And, in fact, satellite radio is
 12 legally prohibited from announcing its
 13 playlist in advance that would allow a
 14 listener to know when to tune in to hear a
 15 particular artist. Correct?
 16 A I believe so.
 17 Q I'm sorry.
 18 A I believe so.
 19 Q And isn't it also correct that
 20 satellite radio is restricted on a number of
 21 times they can play a particular artist or a
 22 particular song in given time periods?

1 A That's correct.
 2 Q Now in your discussion of
 3 substitution, you talk about satellite radio
 4 as being "narrow casting not broadcasting."
 5 Do you remember that?
 6 A Yes.
 7 Q And when you wrote that, you were
 8 not referring or thinking about the Sirius Top
 9 40 channels, were you?
 10 A I was thinking about the services
 11 as a whole. I wasn't thinking specifically
 12 about that channel, no.
 13 Q Okay, but you were not contending
 14 the Top 40 channels on Sirius are any
 15 different than the 40 channels offered on
 16 terrestrial radio on thousands of stations
 17 around the country, are you?
 18 A Oh, they are very different.
 19 Q And isn't it correct that you
 20 universal spends a lot of money trying to
 21 convince Top 40 channels to play your new
 22 releases?

1 A I don't think that's currently
 2 correct.
 3 Q You don't think that's correct?
 4 A Not currently, no.
 5 Q Now in your written direct
 6 statement, you state that satellite radio can
 7 substitute for other ways that people
 8 experience music." Correct?
 9 A Yes.
 10 Q And isn't it correct that by far
 11 and away the number one way people experience
 12 music in their cars today is by listening to
 13 terrestrial AM/FM radio?
 14 A I don't recall ever -- I don't
 15 recall a survey one way or the other on that.
 16 So I have no opinion.
 17 Q You don't have any information on
 18 that or any belief?
 19 A If I do, I don't recall seeing it.
 20 Q Now free terrestrial radio, they
 21 can play any sound recording they want. You
 22 don't have any control over that. Correct?

1 A That's correct.
 2 Q And free terrestrial radio doesn't
 3 pay royalties for any of the sound recordings
 4 to your company. Correct?
 5 A Sadly, no.
 6 Q And every piece of music that you
 7 license to satellite radio is available to
 8 terrestrial radio for free. Correct?
 9 A Yes.
 10 Q That's simply an existing economic
 11 fact of life in the industry. Correct?
 12 A It's a legal fact.
 13 Q Okay, and satellite radio,
 14 however, does pay a royalty to you for sound
 15 recordings. Correct?
 16 A Well, they pay it to
 17 SoundExchange, correct.
 18 Q Okay, and so every time a listener
 19 switches from listening to AM/FM and
 20 subscribes to satellite radio that's money in
 21 your pocket. Correct?
 22 A Assuming they -- Yes, assuming

1 they -- A new subscriber to satellite radio
 2 should produce more money to us. I don't
 3 think currently it does, but it should.
 4 Q Well, because when they're
 5 listening to AM/FM they're not -- You don't
 6 get anything from that, do you?
 7 A That's correct.
 8 Q Let's now move on to talk a little
 9 bit about the promotion that you discuss on
 10 page four of your written direct testimony and
 11 I think, am I correct, that's basically
 12 handled at the label level?
 13 A Promotion, yes.
 14 Q And at the labels, there are whole
 15 groups of people whose job it is to come up
 16 with marketing plans and figure out how to
 17 promote and sell new records. Correct?
 18 A That's right.
 19 Q And those are the people who make
 20 the decision as to how much money to spend on
 21 radio promotion for sound recordings.
 22 Correct?

1 A A subset of that group, yes.
 2 Q Okay. But you yourself are not
 3 personally responsible for any of that
 4 activity. Correct?
 5 A That's correct.
 6 Q And in addition to the people at
 7 the promotional department, isn't it true that
 8 you also use independent promoters to help
 9 promote records?
 10 A The industry certainly has. I'm
 11 not aware of the current practice.
 12 Q Okay. But the money that is paid
 13 to the independent promoters, that's money to
 14 individual who work outside the company who
 15 they have relationships mostly with radio
 16 stations and they help you get air play and
 17 other promotional endeavors on radio stations.
 18 Correct?
 19 MR. DeSANCTIS: Your Honor, I want
 20 to object to this line of questioning as being
 21 beyond.
 22 CHIEF JUDGE SLEDGE: Sustained.

1 BY MR. WYSS:
 2 Q Would you agree that satellite
 3 radio can play a role in promoting universal
 4 label artists?
 5 A I agree.
 6 Q And would you agree that XM and
 7 Sirius play music that listeners don't
 8 normally hear on terrestrial radio?
 9 A That's correct.
 10 Q And is it correct that there are
 11 ongoing activities between the people at the
 12 various universal label groups and XM and
 13 Sirius trying to promote and get new
 14 recordings played on satellite radio?
 15 MR. DeSANCTIS: Objection again.
 16 Beyond the scope of the written direct
 17 testimony.
 18 CHIEF JUDGE SLEDGE: Your
 19 response?
 20 MR. WYSS: I think, Your Honor, he
 21 talked about in his written direct testimony
 22 that he specifically talked that promotion

1 doesn't -- the role that promotion plays or
 2 doesn't play. I think I'm entitled to talk
 3 about who the people are who do know about the
 4 promotion to confirm that it is something that
 5 is done regularly all the time for UMG.
 6 CHIEF JUDGE SLEDGE: He said he
 7 doesn't know what they do.
 8 MR. WYSS: He does know that
 9 they're there, however, Your Honor. I think
 10 he has a general knowledge. He certainly did
 11 at his deposition. He professed to have a
 12 general knowledge of the activities of the
 13 people at the label.
 14 CHIEF JUDGE SLEDGE: Where is
 15 this?
 16 MR. WYSS: In his deposition, Your
 17 Honor?
 18 CHIEF JUDGE SLEDGE: No sir. In
 19 his statement.
 20 MR. WYSS: In his statement, it is
 21 on page four is where he discusses promotion
 22 and he states "We don't enter agreements on

1 the mere hope." And then it says, "UMG does
 2 not view as promotional the commercial
 3 exploitation of others by the very product
 4 that it seeks to sell."
 5 CHIEF JUDGE SLEDGE: Objection
 6 sustained.
 7 CROSS EXAMINATION (Cont'd.)
 8 BY MR. WYSS:
 9 Q Mr. Kenswil, in your statement,
 10 you see where you said "UMG does view as
 11 promotional the commercial exploitation by
 12 others of the very product that it seeks to
 13 sell."
 14 A Correct.
 15 Q Is it not correct that terrestrial
 16 radio commercially exploits your sound
 17 recordings?
 18 A Yes, it does.
 19 Q And isn't it correct that you
 20 spend, you being universal in general,
 21 millions of dollars to encourage radio in all
 22 forms to play new sound recordings?

1 MR. DeSANCTIS: Objection. Again,
2 beyond the scope of the testimony what UMB
3 expenditures are on any marketing effort.
4 It's just not in the testimony.
5 CHIEF JUDGE SLEDGE: Any response?
6 MR. WYSS: I think, Your Honor,
7 impeachment is where he says that they don't
8 view it as promotional. I think the fact that
9 they, in fact, and I believe that he does know
10 that they spend millions of dollars to promote
11 to radio that that is an important fact,
12 impeaching his written direct testimony.
13 CHIEF JUDGE SLEDGE: Objection
14 sustained.
15 BY MR. WYSS:
16 Q Would you agree that when XM and
17 Sirius play music the listener doesn't
18 normally hear -- I'm sorry. Let me strike
19 that and withdraw. Would you agree that XM
20 and Sirius play music that listeners don't
21 normally hear on terrestrial radio?
22 CHIEF JUDGE SLEDGE: That's

1 already been asked.
2 MR. WYSS: Okay.
3 BY MR. WYSS:
4 Q Is it correct that listeners can
5 sample and discover artists on satellite radio
6 whom they may never hear on terrestrial radio?
7 A It follows directly from the other
8 question, I think, yes.
9 Q All right. And because of the
10 deep playlist on satellite radio, the listener
11 doesn't know when a particular song is going
12 to come up. Correct?
13 A I would say that's because -- I
14 don't know whether that's a factor of the deep
15 playlist or it's just a factor that it's not
16 pre-announced. They can't know exactly when
17 a song is coming up.
18 Q However, Sirius and XM are legally
19 required to display the name of the artist and
20 the name of the song each time they broadcast
21 them. Correct?
22 A I'm not aware of the law. I know

1 that they do.
2 Q All right. And wouldn't you agree
3 that people who hearing the song recording on
4 satellite radio strikes their fancy that they
5 then have the option if they really like it to
6 go to iTunes or another download service and
7 purchase a permanent copy? Correct?
8 A They certainly may if they want
9 to.
10 Q Let's talk a little bit finally
11 about the marketplace deals that you talked
12 about in your statement. In setting your
13 prices for license agreements with the
14 wireless carriers, the on-demand subscription
15 services, the permanent download services,
16 isn't it correct that you neither know nor
17 consider the prices being charged by other
18 record companies for their licenses?
19 A Generally, that's correct.
20 Q Okay. And the licensee is not
21 choosing between Universal and Sony based on
22 who is quoting the lowest price. Correct?

1 A That's correct.
2 Q And that's because a lower price
3 charged by someone else has no effect on what
4 you're going to charge. Correct?
5 A I don't know that that's the case.
6 Q All right. If a company like
7 Apple wants to run a download store and offer
8 universal music, it has to come to you to get
9 your music. Correct?
10 A Correct.
11 Q You can't get that from anybody
12 else. Right?
13 A Right.
14 Q Now on your download deals, isn't
15 it correct that the substantial majority of
16 UMG's digital revenue comes from a combination
17 of permanent downloads and track.
18 A Correct.
19 Q And wouldn't that figure be about
20 85 percent or so?
21 A It may be lower now, but it's
22 certainly been around that in the past.

1 Q Now permanent download, that
2 constitutes the sale of a permanent copy of an
3 individual track or album. Correct?
4 A Correct.
5 Q And the purchaser can load it onto
6 an iPod or an MP3 player. Correct?
7 A They can load it on a player that
8 plays the format they downloaded. They can't
9 load it onto any player.
10 Q But they can listen that track any
11 time they want anywhere they want once they've
12 purchased it.
13 A That's within their power, yes.
14 Q And in your written direct
15 testimony, you said that the consumer price
16 for permanent downloads is now 99 cents.
17 Correct?
18 A The consumer price generally is 99
19 cents. Correct.
20 Q And in your written direct
21 testimony, I don't want to go into closed
22 session, you identified the minimum price that

1 you get for a download track. Correct?
2 A Right.
3 Q Is that number still secret?
4 A Well, it's nothing that we've -- I
5 don't recall ever stating it publicly.
6 Q Okay.
7 A I don't know if anyone else has,
8 but I never. Certainly, we consider it
9 proprietary, but whether it's leaked out or
10 not, I don't know.
11 Q At pages 12 to 13 of your written
12 direct testimony, you talk about some of the
13 mobile wireless deals. And the first portion
14 you talk about there are the cell phone tones.
15 Correct?
16 A Correct.
17 Q Now from your perspective, isn't
18 it correct that you do not consider ring tones
19 to be in the same category as permanent
20 downloads or on-demand subscription services?
21 A That's correct.
22 Q In fact, you don't consider them

1 to be the consumption of music, do you?
2 A Generally, we don't look on it
3 that way.
4 Q You look at them as a
5 personalization product. Correct?
6 A That's correct.
7 Q And in addition to the ring tones,
8 you also offer wireless audio downloads
9 through the cell phones. Correct?
10 A Correct.
11 Q And that's discussed at pages 12
12 to 13 of your written direct testimony?
13 A Correct.
14 Q And at page five of your written
15 direct testimony, you state that the mobile
16 consumer is willing to pay significantly more
17 than the PC-based consumer for digital
18 content. Correct?
19 A Correct.
20 Q Now since you signed your
21 statement, isn't it correct that things have
22 changed regarding mobile downloads?

1 A We have a subsequent offer on
2 mobile downloads. Correct?
3 Q And isn't it a fact that Sprint
4 right now is selling single track downloads
5 for 99 cents just like Apple is over the
6 computer?
7 A They are selling at the same price
8 as Apple. Correct.
9 Q And so there is currently no
10 significant difference between the Sprint
11 price and the price you can get from Apple
12 over the web. Correct?
13 A The price is identical.
14 Q And has Verizon indicated to you
15 that they would like to offer the same 99
16 cents deal?
17 A Not that I'm aware of.
18 Q Now with respect to the amount
19 that UMG gets from these wireless download
20 deals, that has also changed since the time
21 you wrote your statement in connection with
22 Sprint. Correct?

1 A We have given the carriers the
2 ability to change it. Not all have.

3 Q Okay, but in the case of Sprint,
4 they no longer pay you the amount stated in
5 your -- minimum amount stated in your written
6 testimony. Correct?

7 A Sprint has opted for the new
8 pricing offer.

9 Q Okay, and under the new pricing
10 option, is it correct that the per track
11 minimum price that you get from Sprint is
12 exactly the same as the per track minimum
13 price that you get from computer-based
14 download stores like iTunes and others?

15 A That's correct.

16 Q Now you mentioned some of the on-
17 demand subscription deals that you negotiated.
18 Correct?

19 A Yes.

20 Q Now your counsel in his questions,
21 he -- Excuse me. SoundExchange's counsel kept
22 referring to streaming downloads. Isn't it

1 correct that each and every one of those
2 subscription services that you deal with has
3 an on-demand component in it?

4 A Well, there are subscription
5 services that do not have on-demand
6 components. There is a category that does.

7 Q Okay, but the ones that you -- the
8 examples of deals that you discuss in your
9 statement, those all have an on-demand
10 component. Correct?

11 A I'm not positive, but I think I
12 talked about both.

13 CHIEF JUDGE SLEDGE: How is that
14 distinguished? From streaming?

15 MR. WYSS: I don't know, Your
16 Honor. The witness himself, I believe, talked
17 mostly about on-demand can call up and call a
18 song anytime you wants.

19 CHIEF JUDGE SLEDGE: Your question
20 inferred that there was a distinction between
21 the two.

22 MR. WYSS: I don't know whether

1 there is or not. I just wanted to make the
2 record clear that this is a concept that
3 includes the ability to call up a song anytime
4 anywhere you want.

5 CROSS EXAMINATION (Cont'd.)
6 BY MR. WYSS:

7 Q Now you used Rhapsody for the
8 example in your written direct testimony for
9 the pricing of the nonportable versus portable
10 services. Correct?

11 A Correct.

12 Q And you said that Rhapsody, in
13 your written direct testimony, you talked
14 about a \$4.99 per month for nonportable,
15 noninteractive service. Correct?

16 A Could you tell me what page that's
17 on?

18 Q This is in on pages nine to ten.
19 Actually, page nine.

20 A Yes, \$4.99 for noninteractive
21 service.

22 Q And then you talked about \$9.99

1 for portable on-demand service. Correct?

2 A No, \$9.99 is for the nonportable
3 service.

4 Q I'm sorry. The nonportable on-
5 demand. Correct?

6 A Correct.

7 Q And then \$14.99 for the portable
8 on-demand service. Correct?

9 A Correct.

10 Q And then I think you indicated
11 there had been changes since then on your
12 direct testimony this morning. Correct?

13 A Correct.

14 Q Isn't it true that the \$4.99 price
15 that's no longer offered at all? Correct?

16 A I don't know.

17 Q You made no effort what the
18 current offering is of the Rhapsody service
19 before you came to testify today?

20 A I have not looked to see what that
21 current offering is lately, no.

22 Q Did you remember we asked you

1 about it in your deposition and that they had
2 done away with the other one and now offer a
3 limited free service of 25 tracks per month?

4 A I'm aware of the 25 track per
5 month free service, yes.

6 Q Okay, and are you aware that the
7 nonportable service has gone from \$9.99 all
8 the way up to \$12.99? Correct?

9 A Yes.

10 MR. WYSS: And let me ask you to
11 look at the exhibit which we're marking as
12 SDARS Exhibit 57.

13 (Whereupon, the above-referred to
14 document was marked as SDARS
15 Exhibit No. 57 for
16 identification.)

17 MR. WYSS: Your Honor, I've
18 received a note from my co-counsel. I'm not
19 going to examine about this exhibit and I will
20 withdraw it.

21 (The document referred to having
22 been previously marked for

1 seen it.

2 Q Okay, and that information, that
3 would allow us to put into perspective how
4 important the various portable versus
5 nonportable services are to the actual
6 subscribers. Correct?

7 A Well, I assume anyone who uses it,
8 it's very important to them. It would tell
9 you how many people it's important to.

10 Q The on-demand subscription
11 services have not been very successful, have
12 they?

13 A They have not reached the success
14 we would have hoped. That's correct.

15 Q And isn't it true that even though
16 the on-demand subscription services allow
17 customers to listen to a particular song
18 anytime anywhere, isn't it true the consumer
19 still prefer to own their own songs on a
20 permanent basis?

21 A More people opt for the option of
22 permanent ownership than they do for

1 identification as SDARS Exhibit
2 No. 57, was withdrawn from
3 evidence.)

4 CROSS EXAMINATION (Cont'd.)

5 BY MR. WYSS:

6 Q How many subscription services --
7 Excuse me. How many subscribers does Rhapsody
8 have at the \$14.95 level?

9 A I don't know off the top of my
10 head.

11 Q That's something that gets
12 reported to you. Correct?

13 A That's correct.

14 Q And how many subscribers do they
15 have at the \$12.99, the nonportable level?

16 A Again, I don't know off the top of
17 my head.

18 Q Do you know how many free
19 listeners they have who for nothing get the 25
20 tracks per month downloads?

21 A I don't think they report that
22 number to us, but they may. But I've never

1 subscription services in this country.

2 Q One type of deal that is not
3 mentioned in your written direct testimony is
4 deals that you negotiate with a custom radio.
5 Correct?

6 A Correct.

7 Q And those are market deals
8 negotiated between UMG and other businesses.
9 Correct?

10 A Correct.

11 Q And isn't it correct that you have
12 negotiated such deals where the per sub per
13 month fee was an absolute 15 cents paid to
14 Universal?

15 A It's possible, but I don't recall
16 it.

17 Q You don't recall that?

18 A No.

19 Q Let me ask you then just finally
20 about one other type of deal. Isn't it correct
21 that there are -- that you do, you being
22 Universal, negotiate deals for the specific

1 use of sound recordings and television
 2 programs and in motion pictures?
 3 A Correct.
 4 Q And you negotiate what? Hundreds
 5 of those deals every year?
 6 A Well, the company does, yes.
 7 Q Okay, and isn't it correct that in
 8 those deals the studio generally pays the same
 9 amount for sound recordings as it pays for the
 10 musical composition right?
 11 MR. DeSANCTIS: I want to object
 12 to that being well beyond anything in the
 13 testimony addressing movies and motion
 14 pictures or musical works rates. There's just
 15 nothing in the testimony about any of that.
 16 CHIEF JUDGE SLEDGE: Any response?
 17 MR. WYSS: Yes, Your Honor. The
 18 witness has said, "Here are examples of the
 19 rates we negotiate." He has not included an
 20 additional category which they negotiate under
 21 -- and I believe he knows the answer to my
 22 question which shows another situation in the

1 market how people value the sound recording
 2 rights as compared to the musical composition
 3 rights.
 4 CHIEF JUDGE SLEDGE: Overruled.
 5 BY MR. WYSS:
 6 Q Isn't it correct that in the deals
 7 that are negotiated with the studios, they pay
 8 generally the same amount for the sound
 9 recording rights as for the musical
 10 composition rights?
 11 A Traditionally, that is what the
 12 CEOs offer the record companies and the
 13 musical composition owners. It's -- What
 14 proportion of deals end up that way or not is
 15 beyond my expertise.
 16 MR. WYSS: No further questions,
 17 Your Honor.
 18 CHIEF JUDGE SLEDGE: Any cross by
 19 XM?
 20 MR. RICH: No, Your Honor.
 21 CHIEF JUDGE SLEDGE: Any redirect?
 22 MR. DeSANCTIS: Yes, Your Honor.

1 REDIRECT EXAMINATION
 2 BY MR. DeSANCTIS:
 3 Q Mr. Kenswil, can I direct your
 4 attention first to the document that should
 5 still before you marked SDARS Exhibit 51.
 6 This was your Moscow presentation.
 7 A Correct.
 8 Q And can you turn to slide five of
 9 that presentation please. On cross
 10 examination, counsel directed your attention
 11 under the label "Marketing" to radio
 12 promotion.
 13 A Yes.
 14 Q Were you including satellite radio
 15 when you wrote and delivered this or were you
 16 -- Well, I'll just leave the question there.
 17 A I did not consider satellite radio
 18 as being under this category, no.
 19 Q Can I next direct your attention
 20 to the document that should still be in front
 21 of you marked SDARS Exhibit 56. What's the
 22 date of this document?

1 A It is October 2006.
 2 Q Can I direct your attention to
 3 slide 11. What does this tell us about the
 4 date on which the Metallic catalog became
 5 available digitally?
 6 A It became available on July 30,
 7 2006.
 8 Q Does that mean that before that
 9 date the catalog was not available digitally
 10 so that if one wanted Metallica one had to buy
 11 CDs?
 12 A That's correct.
 13 Q So are the numbers listed here
 14 reflecting the short-term results of the
 15 months immediately following the catalog
 16 becoming digital for the first time?
 17 A Yes.
 18 Q And is that also true with respect
 19 to the Lincoln Park data which is below that?
 20 A Yes.
 21 Q And when did -- Where it says in
 22 the presentation that "digital sales appear

1 mostly to be incremental and make up for the
 2 decline in physical sales," in your experience
 3 in the industry, is that true industry wide?
 4 A No, it is not.
 5 Q Can you explain that?
 6 A All the numbers are very easy to
 7 compare. If you look at total revenue for
 8 units from digital sales and compare them to
 9 decrease in physical and then in no year as an
 10 industry wide has the digital increase been
 11 more than the physical decrease.
 12 Q And then can you explain why the
 13 results and data might be different in this
 14 situation that is discussed here on slide 11
 15 of Exhibit 56?
 16 A Well, these are two very popular
 17 acts that happen to appeal to the demographic
 18 that is very digital and in my opinion
 19 reflects the pent-up demand for digital
 20 downloads and anytime you have something first
 21 released you're going to see a larger number
 22 of sales than when it goes through a steady

1 state.
 2 Q And do you have any idea -- Well,
 3 I should ask you. Do you know if either of
 4 these have reached a steady state now?
 5 A I don't know.
 6 MR. DeSANCTIS: I have no further
 7 questions, Your Honor.
 8 CHIEF JUDGE SLEDGE: Any further
 9 cross?
 10 MR. WYSS: No, Your Honor.
 11 CHIEF JUDGE SLEDGE: Any questions
 12 from the bench?
 13 JUDGE WISNIEWSKI: I have one.
 14 CHIEF JUDGE SLEDGE: Judge
 15 Wisniewski.
 16 JUDGE WISNIEWSKI: In response to
 17 a question on cross examination, you had
 18 indicated that you were not sure that a new
 19 satellite subscriber necessarily provides
 20 additional revenue to the record company. I
 21 was curious as to why you made that statement
 22 unless I misheard you.

1 THE WITNESS: Right. My
 2 recollection of the money being paid up to now
 3 was not dependent on the amount, the number,
 4 of subscribers that the satellite service had
 5 and I don't believe prior to the periods this
 6 proceeding is covering that each individual
 7 subscribing to satellite increased the amount
 8 of royalties being paid by the service.
 9 JUDGE WISNIEWSKI: Thank you.
 10 CHIEF JUDGE SLEDGE: Anything
 11 further, Judge Wisniewski?
 12 JUDGE WISNIEWSKI: No.
 13 CHIEF JUDGE SLEDGE: Thank you,
 14 sir.
 15 (Witness excused.)
 16 CHIEF JUDGE SLEDGE: With the
 17 timing of this break in witnesses, we'll go
 18 ahead and recess and return at 12:50 p.m. Off
 19 the record.
 20 (Whereupon, at 11:50 a.m., the
 21 above-entitled matter recessed to reconvene at
 22 12:50 p.m. the same day.)

1 CHIEF JUDGE SLEDGE: Mr. Handzo.
 2 MR. HANDZO: Your Honor, we're
 3 ready to proceed with our next witness.
 4 SoundExchange calls Mr. Ciongoli.
 5 CHIEF JUDGE SLEDGE: Go ahead and
 6 sit down. Thank you, sir, now if you'll
 7 stand. Will you raise your right hand?
 8 Whereupon,
 9 CHARLES CIONGOLI
 10 was called as a witness and, having been first
 11 duly sworn, was examined and testified as
 12 follows:
 13 CHIEF JUDGE SLEDGE: Thank you,
 14 please be seated.
 15 MR. HANDZO: Good afternoon, MR.
 16 Ciongoli.
 17 THE WITNESS: Good afternoon.
 18 DIRECT EXAMINATION
 19 BY MR. HANDZO:
 20 Q State your name for the record,
 21 please.
 22 A Charles Ciongoli.