

Capital Reporting Company
Hearing - Volume II - 04-20-2010

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BEFORE THE UNITED STATES COPYRIGHT ROYALTY JUDGES

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IN THE MATTER OF: :

DIGITAL PERFORMANCE RIGHT IN : Docket No. 2009-1

SOUND RECORDINGS and EPHEMERAL: CRB Webcasting III

RECORDINGS : Volume II

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Washington, D.C.

Tuesday, April 20, 2010

The following pages constitute the proceedings held in the above-captioned matter held at the Library of Congress, Madison Building, 101 Independence Avenue, Southeast, Washington, D.C., before Denise M. Brunet, RPR, of Capital Reporting Company, a Notary Public in and for the District of Columbia, 9:31 a.m., when were present on behalf of the respective parties:

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| 243 | 245 |
| <p>1 APPEARANCES</p> <p>2</p> <p>3 Copyright Royalty Tribunal:</p> <p>4 CHIEF JUDGE JAMES SLEDGE</p> <p>5 JUDGE WILLIAM ROBERTS</p> <p>6 JUDGE STANLEY C. WISNIEWSKI</p> <p>7</p> <p>8 On behalf of SoundExchange, Inc.:</p> <p>9 DAVID A. HANDZO, ESQUIRE</p> <p>10 MICHAEL B. DeSANCTIS, ESQUIRE</p> <p>11 GARRETT A. LEVIN, ESQUIRE</p> <p>12 TAJ N. WILSON, ESQUIRE</p> <p>13 JARED O. FREEDMAN, ESQUIRE</p> <p>14 Jenner & Block, LLP</p> <p>15 1099 New York Avenue, Northwest</p> <p>16 Suite 900</p> <p>17 Washington, D.C. 20001</p> <p>18 (202) 639-6000</p> <p>19</p> <p>20</p> <p>21</p> <p>22 (Appearances continued on the next page.)</p> | <p>1 APPEARANCES (continued):</p> <p>2</p> <p>3 On behalf of Live365, Inc. (continued):</p> <p>4 DAVID ROSENBERG, ESQUIRE</p> <p>5 Live365, Inc.</p> <p>6 950 Tower Lane</p> <p>7 Suite 1550</p> <p>8 Foster City, California 94404</p> <p>9 (650) 345-7400</p> <p>10</p> <p>11 On behalf of RealNetworks:</p> <p>12 CHARLES D. BRECKINRIDGE, ESQUIRE</p> <p>13 Wiltshire & Grannis, LLP</p> <p>14 1200 18th Street, Northwest</p> <p>15 Suite 1200</p> <p>16 Washington, D.C. 20036</p> <p>17 (202) 730-1349</p> <p>18</p> <p>19</p> <p>20</p> <p>21</p> <p>22 (Appearances continued on the next page.)</p> |
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| <p>1 APPEARANCES (continued):</p> <p>2</p> <p>3 On behalf of Live365, Inc.:</p> <p>4 DAVID D. OXFENFORD, ESQUIRE</p> <p>5 Davis Wright Tremaine, LLP</p> <p>6 1919 Pennsylvania Avenue, Northwest</p> <p>7 Suite 200</p> <p>8 Washington, D.C. 20006</p> <p>9 (202) 973-5256</p> <p>10</p> <p>11 ANGUS MacDONALD, ESQUIRE</p> <p>12 ABRAHAM YACOBIAN, ESQUIRE</p> <p>13 Hovanesian & Hovanesian, PC</p> <p>14 301 E. Colorado Boulevard</p> <p>15 Suite 514</p> <p>16 Pasadena, California 91101</p> <p>17 (626) 737-7288</p> <p>18</p> <p>19</p> <p>20</p> <p>21</p> <p>22 (Appearances continued on the next page.)</p> | <p>1 APPEARANCES (continued):</p> <p>2</p> <p>3 On behalf of Intercollegiate Broadcasting System:</p> <p>4 WILLIAM MALONE, ESQUIRE</p> <p>5 Miller & VanEaton, PLLC</p> <p>6 1120 Connecticut Avenue, Northwest</p> <p>7 Suite 1000</p> <p>8 Washington, D.C. 20036</p> <p>9 (202) 785-0600</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> |

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| <p style="text-align: right;">248</p> <p>1 EXHIBIT NO. RECEIVED</p> <p>2 Live365 Trial 5 250</p> <p>3 Live365 Trial 13 255</p> <p>4 Live365 Trial 14 269</p> <p>5 Live365 Trial 15 287</p> <p>6 Live365 Trial 16 290</p> <p>7 Live365 Trial 17 316</p> <p>8 Live365 Trial 18 318</p> <p>9 SoundExchange Trial 3 382</p> <p>10 SoundExchange Trial 4 410</p> <p>11 Live365 Trial 19 438</p> <p>12 SoundExchange Trial 5 442</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> | <p style="text-align: right;">250</p> <p>1 MR. OXENFORD: Your Honor, we would ask that</p> <p>2 this be accepted into evidence.</p> <p>3 CHIEF JUDGE SLEDGE: Any objection?</p> <p>4 MR. HANDZO: No objection, Your Honor.</p> <p>5 CHIEF JUDGE SLEDGE: What is the exhibit here</p> <p>6 you're referring to?</p> <p>7 MR. OXENFORD: It was his direct testimony</p> <p>8 from the Web II proceeding. We had some testimony on</p> <p>9 that yesterday.</p> <p>10 CHIEF JUDGE SLEDGE: That's Exhibit 5?</p> <p>11 MR. OXENFORD: Yes, Your Honor.</p> <p>12 CHIEF JUDGE SLEDGE: Without objection,</p> <p>13 Exhibit 5 is admitted.</p> <p>14 (Live365 Trial Exhibit Number 5 was received</p> <p>15 into evidence.)</p> <p>16 BY MR. OXENFORD:</p> <p>17 Q And yesterday, Dr. Pelcovits, we looked at a</p> <p>18 document that was labeled as Live365 Exhibit Number 7,</p> <p>19 a 20-page document listing a number of services and</p> <p>20 the amounts that were paid. Do you recognize this</p> <p>21 document, Live365 Number 7?</p> <p>22 A That's not what I have as 7. I have a</p> |

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| 399 | <p>1 those actions?</p> <p>2 A Well, I'm not sure I understand the question,</p> <p>3 but if it is part of the role and the mission of the</p> <p>4 organization that is consistent with enforcing the</p> <p>5 payments and the royalties that performers and</p> <p>6 copyright owners are entitled to, and it is a</p> <p>7 necessary cost of doing business for the organization,</p> <p>8 it is something that the organization has to do. It</p> <p>9 would seem to me that any organization always tries to</p> <p>10 improve its efficiency if you're talking about the</p> <p>11 question of efficiency.</p> <p>12 Q Let me see if I can get at it another way.</p> <p>13 Does SoundExchange prioritize its administration</p> <p>14 efforts with a view towards maximizing revenue or</p> <p>15 maximizing the disbursements to the artists and</p> <p>16 labels?</p> <p>17 A I think SoundExchange is -- certainly its</p> <p>18 mission is to try and collect and ensure that the</p> <p>19 collections and the distributions to performers are as</p> <p>20 strong as possible.</p> <p>21 Q How about -- strength, in terms of your</p> <p>22 answer, would mean a comparison of the amounts spent</p> | 401 | <p>1 A I don't know, but I don't really understand</p> <p>2 the question well enough to answer it.</p> <p>3 MR. MALONE: I have nothing further.</p> <p>4 CHIEF JUDGE SLEDGE: Any questions from the</p> <p>5 bench?</p> <p>6 Thank you, ma'am.</p> <p>7 THE WITNESS: Thank you.</p> <p>8 (Witness excused.)</p> <p>9 CHIEF JUDGE SLEDGE: Mr. Freedman?</p> <p>10 MR. FREEDMAN: Your Honor, our next witness</p> <p>11 is George Ford. I don't know if Your Honors were</p> <p>12 wanting to take a break right now or to proceed. We</p> <p>13 could do whichever you prefer, of course.</p> <p>14 CHIEF JUDGE SLEDGE: We'll recess ten</p> <p>15 minutes.</p> <p>16 (Whereupon, a short recess was taken.)</p> <p>17 CHIEF JUDGE SLEDGE: Come to order.</p> <p>18 Mr. Handzo.</p> <p>19 MR. HANDZO: Thank you, Your Honor.</p> <p>20 SoundExchange will call as its next witness Dr. George</p> <p>21 Ford.</p> <p>22 WHEREUPON,</p> |
| 400 | <p>1 in the efforts against the amounts yielded?</p> <p>2 A I'm not sure I could answer that question.</p> <p>3 Q What sort of direction does the board give to</p> <p>4 the administrators in SoundExchange as to how they</p> <p>5 should focus their efforts, how they should budget for</p> <p>6 various efforts?</p> <p>7 A As I understand, and it's not dissimilar from</p> <p>8 my experience in AFTRA which, as a nonprofit, is that</p> <p>9 the board of directors looks at the anticipated work</p> <p>10 that needs to be done, reviews that and makes</p> <p>11 appropriate approvals and judgments in consultation</p> <p>12 with the SoundExchange staff.</p> <p>13 Q And what are these judgments based on? What</p> <p>14 factors?</p> <p>15 A It will be based upon all of the information</p> <p>16 that's before a board member at the time.</p> <p>17 Q To what extent is this an efficiency test in</p> <p>18 terms of the return for the expenditure on a</p> <p>19 particular function?</p> <p>20 A I'm not -- I'm not sure I can answer that</p> <p>21 question.</p> <p>22 Q Who would be able to answer that question?</p> | 402 | <p>1 GEORGE FORD,</p> <p>2 called as a witness, and after having been first sworn</p> <p>3 by the chief judge, was examined and testified as</p> <p>4 follows:</p> <p>5 DIRECT EXAMINATION</p> <p>6 BY MR. HANDZO:</p> <p>7 Q Good afternoon, Dr. Ford. Can you please</p> <p>8 just introduce yourself for the record and spell your</p> <p>9 last name for the court reporter.</p> <p>10 A My name is George Sterling Ford, F-O-R-D.</p> <p>11 Q Dr. Ford, what's your educational background?</p> <p>12 A I have a Ph.D. in economics from Auburn</p> <p>13 University in 1994.</p> <p>14 Q Where are you currently employed?</p> <p>15 A I'm the president of Applied Economics</p> <p>16 Studies, an economic and econometric consulting firm,</p> <p>17 as well as the chief economist of the Phoenix Center</p> <p>18 for Advanced Legal and Economic Public Policy Studies,</p> <p>19 a 501(c)(3) here in Washington, D.C.</p> <p>20 Q The consulting firm that you identified</p> <p>21 first, which I'm going to call AES for short, what</p> <p>22 does that firm do?</p> |

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| <p style="text-align: right;">403</p> <p>1 A We do economic and consulting, quantitative 2 statistical analysis for various clients related to a 3 wide range of issues. 4 Q And what do you do for them? 5 A I'm the president of the organization and its 6 primary consultant. 7 Q You mentioned the Phoenix Center. What's 8 your position with the Phoenix Center? 9 A I'm the chief economist of the Phoenix 10 Center. 11 Q And what is it that the Phoenix Center does? 12 A The Phoenix Center is a non-profit research 13 organization. We do research projects primarily in 14 the communications industries, radio, television, 15 telephone, Internet, as well as some intellectual 16 property, energy issues as well. 17 Q Can you just briefly tell the court your 18 employment history before AES and the Phoenix Center. 19 A When I left Auburn University with my Ph.D., 20 I went to the Federal Communications Commission, 21 worked in its competition division, in the cable 22 services bureau, and then in the office of general</p> | <p style="text-align: right;">405</p> <p>1 Q Have you previously testified before this 2 court? 3 A I have in the '04-'05 cable royalty 4 distribution proceeding. 5 Q And were you accepted by this court as an 6 expert? 7 A I was. 8 Q In what subject? 9 A Industrial economics and maybe regulation, 10 public policy -- but I know industrial economics for 11 sure. 12 Q What do you mean by industrial economics? 13 A It's the application of microeconomics to 14 industry and firms. It's also referred to as 15 industrial organization. 16 Q And within the area of industrial economics, 17 do you have a particular area of concentration? 18 A Well, it's mainly in communications. 19 Q Have you testified in other forums besides 20 this court? 21 A Yes. I've testified before many state public 22 service commissions in matters of telecommunications</p> |
| <p style="text-align: right;">404</p> <p>1 counsel. I left the FCC and went to the federal 2 policy shop of MCI Communications here in Washington, 3 D.C., I spent five or six years there, and then went 4 to Z-Tel Communications in Tampa, Florida, which was a 5 small telecommunications start-up that -- after the 6 1996 Telecommunications Act. I worked there for four 7 years, and then took on my current positions. 8 Q Do you hold any teaching positions? 9 A I teach as an adjunct professor at Samford 10 University where I teach economics to MBA students. 11 Q Have you written any peer-reviewed or 12 published any peer-reviewed papers? 13 A I've published over 50 papers. I've 14 published over 30 papers in peer-reviewed journals. 15 Q What kinds of subjects do those papers 16 address? 17 A Most of them, again, are in the 18 communications industries, radio, Internet, telephone. 19 I've also done some energy papers. I've done some 20 papers on statistical methodology, the funeral 21 business, various other topics, but mostly 22 communications.</p> | <p style="text-align: right;">406</p> <p>1 regulation, and also before Congress on matters of 2 broadband policy, Internet policy. 3 Q And have you testified in rate-setting 4 matters before? 5 A Yes. Many of my appearances before public 6 service commissions were rate-setting proceedings 7 implementing total element long-run incremental cost 8 rates for the elements of the telecommunications 9 network that were required to be sold by the 1996 Act. 10 MR. HANDZO: Your Honor, I would offer 11 Dr. Ford as an expert in industrial economics. 12 CHIEF JUDGE SLEDGE: Any objection to the 13 proffer? 14 MR. MacDONALD: No objection, Your Honor. 15 MR. MALONE: No objection, Your Honor. 16 CHIEF JUDGE SLEDGE: Without objection, the 17 proffer is accepted. 18 MR. HANDZO: Thank you. 19 BY MR. HANDZO: 20 Q Dr. Ford, I'm going to show you what we've 21 marked as SoundExchange Exhibit Number 4. 22 MR. HANDZO: May I approach, Your Honor?</p> |

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| <p style="text-align: right;">407</p> <p>1 BY MR. HANDZO: 2 Q Can you tell us what that is, Dr. Ford? 3 A This looks like the testimony I filed in this 4 case. 5 Q And did you prepare this testimony? 6 A I did. 7 Q Is there anything in that testimony, as you 8 sit here today, that is inaccurate and that you would 9 want to correct? 10 A No. 11 MR. HANDZO: Your Honor, I would offer 12 SoundExchange Exhibit 4 into evidence. 13 CHIEF JUDGE SLEDGE: I don't believe you've 14 authenticated it. 15 BY MR. HANDZO: 16 Q Dr. Ford, is this the testimony that you 17 filed in this case? 18 A Yes, this the testimony of George S. Ford, 19 president of Applied Economics -- 20 Q And let me ask you to turn to page 16. Is 21 that your signature? 22 A It is indeed.</p> | <p style="text-align: right;">409</p> <p>1 MR. HANDZO: Your Honor, I can ask the 2 question of Dr. Ford, but I think the answer is -- 3 CHIEF JUDGE SLEDGE: No, sir, it's not a 4 question to him. It's a question to you. 5 MR. HANDZO: That's fine. I think the answer 6 is that, in his economic opinion, the legal and 7 regulatory environment in which this particular rate 8 is being set is really very much affected by the legal 9 structure and the legal rights, and he really can't 10 opine on what the rate would be in this market given 11 the particular impact of section 114 and the fact that 12 it splits the royalties between artists and the record 13 companies. 14 He can't not consider that in his analysis. 15 In fact, I suspect what he would say is his analysis 16 would be just totally wrong if he ignored that 17 regulatory environment in which he is setting the rate 18 here. And so he has to recite his understanding of 19 it. 20 CHIEF JUDGE SLEDGE: But isn't that what he's 21 put in the first page of "my conclusions" in 22 section IV?</p> |
| <p style="text-align: right;">408</p> <p>1 Q And does this report represent your own work? 2 A Yes. 3 Q And your opinions? 4 A Yes. 5 MR. HANDZO: With that foundation, Your 6 Honor, I would offer -- 7 CHIEF JUDGE SLEDGE: Any objection to 8 Exhibit 4? 9 MR. MacDONALD: No objection, Your Honor. 10 MR. MALONE: No objection. 11 CHIEF JUDGE SLEDGE: All right. We'll recess 12 just a minute or two. 13 (Whereupon, a short recess was taken.) 14 CHIEF JUDGE SLEDGE: We'll come to order. 15 Mr. Handzo, this is a good example of why 16 it's dangerous for judges to anticipate or expect what 17 parties in a proceeding will do. There's been no 18 objection to section III of the testimony. It would 19 appear from section III that all of it is testimony 20 that would only be appropriate from a legal expert. 21 How is section III appropriate for an expert in 22 industrial economics and communications?</p> | <p style="text-align: right;">410</p> <p>1 MR. HANDZO: I think that his conclusions are 2 the economic analysis, but what he is telling you in 3 this section III is how he understood the regulatory 4 environment and how that factored into his economic 5 analysis. Now, obviously, if the court believes that 6 his legal analysis is wrong, you know, that would 7 impact your consideration of his economic analysis. 8 But I think in order for him to give his 9 economic analysis, he has to tell you what he's basing 10 it on and, in part, he's basing it on his 11 understanding of what the regulatory environment is, 12 which he what he has done in other matters in the 13 communication sphere, for example. 14 CHIEF JUDGE SLEDGE: I think your last 15 comment hit the nail on the head. He's not able -- 16 he's not permitted to give an understanding of what 17 the standard -- legal standards are. The exhibit is 18 admitted, striking section III. 19 (SoundExchange Trial Exhibit Number 4, as 20 amended, was received into evidence.) 21 BY MR. HANDZO: 22 Q Dr. Ford, do you recall when you were</p> |

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| <p style="text-align: right;">411</p> <p>1 retained by SoundExchange in the case? 2 A I believe it was in August of '09. 3 Q What were you asked to do? 4 A I was asked to provide an economic analysis 5 of rate setting for the ephemeral right for digital 6 transmissions. 7 Q And did you take steps to familiarize 8 yourself with that market? 9 A I did, indeed. I read the statute, of 10 course, prior decisions, prior testimony that I could 11 find. I read -- I looked through legal research, 12 economic research on these issues and related issues. 13 I was given access to some agreements by counsel 14 related to this issue. I spoke with Dr. Pelcovits who 15 was the SoundExchange expert in this case. 16 Q And based on your research, did you come to 17 any conclusions about whether the section 112 18 ephemeral rights have value in the hypothetical market 19 that we're setting a rate for here? 20 A Certainly they would. They're an essential 21 component of the service that's being provided. 22 Without the ephemeral -- without the rights of copy,</p> | <p style="text-align: right;">413</p> <p>1 A No. 2 Q Have you seen contracts for other markets, 3 for other kinds of streaming or interactive services, 4 where the 114 and the 112 right are sold together? 5 A Yes. I've seen a number of agreements 6 covering custom radio, on-demand, interactive-type 7 services, webcasting-type services, that had rights 8 being sold together. 9 Q And in any of those agreements, was there an 10 actual allocation of how much went to the ephemeral 11 and how much went to the 114 right? 12 A Yes. In one agreement there was an actual 13 percentage allocation. 14 Q Do you recall what that was? 15 A It was the Sony broadcast properties 16 agreement. 17 Q And do you recall what kinds of services that 18 agreement covered? 19 A It carried -- it covered many services, 20 custom radio up to subscription-based, you know, 21 completely on-demand type services. 22 Q Do you recall what the actual number was, the</p> |
| <p style="text-align: right;">412</p> <p>1 the service couldn't be provided at all. So if the 2 service itself has value, the ephemeral must have 3 value. 4 Q In the what I'm going to call the target 5 marketplace, the hypothetical marketplace that we're 6 setting a rate for here, have you seen any agreements 7 in which the section 112 right and the section 114 8 right have been sold together as a bundle? 9 A Yes, I have. 10 Q And do you recall what those agreements are? 11 A In the target market, the agreements were 12 with the National Association of Broadcasters, or for 13 the broadcasters' agreement. There was a commercial 14 agreement, which I think was XM/SIRIUS. And then 15 there was an educational webcasting agreement. 16 Q And in those agreements where those rights 17 were sold together was there any allocation of the 18 amounts between the ephemeral and the 114 right? 19 A The specific amount was not specified, no. 20 Q Have you seen any agreements in this market, 21 the market we're setting a rate for, that actually 22 sold those rights separately?</p> | <p style="text-align: right;">414</p> <p>1 allocation? 2 A It was 10 percent. 3 Q To the ephemeral right? 4 A Yes. 5 Q Have you seen any agreements, again, in 6 markets -- similar markets outside of this webcasting 7 market where we're trying to set a rate -- where the 8 ephemeral was actually sold separately from the 114 9 right? 10 A I have seen -- 11 CHIEF JUDGE SLEDGE: I thought you just asked 12 that question. 13 MR. HANDZO: I'm sorry. I intended to ask 14 him whether he's seen agreements where they were sold 15 together. 16 CHIEF JUDGE SLEDGE: Before that I think you 17 asked him if he had seen any agreements where the 18 rights were sold separate. 19 MR. HANDZO: What I intended to ask in the 20 prior question was whether he had seen agreements for 21 this market; that is, within the statutory webcasting 22 market. And now I'm asking him about agreements</p> |

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| <p style="text-align: right;">415</p> <p>1 outside of this market. 2 CHIEF JUDGE SLEDGE: I see. 3 THE WITNESS: Repeat the question. 4 BY MR. HANDZO: 5 Q Sure. Sorry. Have you seen any agreements 6 outside of the statutory webcasting market where the 7 ephemeral right has actually been sold separate from 8 the 114 right? 9 A One agreement. 10 Q And do you recall what that was? 11 A The business services agreement, music played 12 in stores and things, where the performance right was 13 not part of the package. 14 Q Now, based on what you've seen from these 15 agreements, Dr. Ford, do you have an opinion as to 16 whether a willing buyer and a willing seller in our 17 market -- that is, statutory webcasting -- would sell 18 the ephemeral rights separately or bundled with the 19 114? 20 A Bundled together. 21 Q Now, you mentioned earlier that you had 22 actually seen one agreement, not in this market, that</p> | <p style="text-align: right;">417</p> <p>1 concerned with the total rate that he has to pay. How 2 it gets divided amongst the seller or sellers is not 3 material to his decisions. That leaves the seller as 4 the interested party. 5 The statutory split of the royalty -- 6 JUDGE ROBERTS: Before you go any further, 7 Dr. Ford, do you know why the buyer is not interested? 8 THE WITNESS: The buyer isn't interested 9 because the -- if you set it as a percent of the 10 total, then, if you alter the percent, it doesn't 11 affect the check the buyer has to write. 12 JUDGE ROBERTS: That's if you do it that way. 13 THE WITNESS: Yes. 14 JUDGE ROBERTS: But is the buyer ever 15 interested in the value of the 112 license? 16 THE WITNESS: Yes. If the -- if the right, 17 the ephemeral right or let's just -- if copies occur 18 in variable proportions to performances, then they 19 would care. If it doesn't, then they wouldn't. If we 20 thought that every performance required two ephemeral 21 copies -- you get one for free, so that means you have 22 one that you have to pay for. If you said it was</p> |
| <p style="text-align: right;">416</p> <p>1 actually specified what the allocation was, 2 10 percent. Would you recommend using that number as 3 the allocation here? 4 A No, I would not. 5 Q Why is that? 6 A Because the 10 percent was set in a market 7 environment that was not subject to the same set of 8 constraints that the statute provides for the 9 webcaster agreements. So it's -- they're different 10 transactions. 11 Q And what constraint are you referring to? 12 A The -- in the -- under the statute, the 13 performance royalty is split 50/50 between the record 14 companies and the artists. That's not -- that split 15 does not exist in market transactions. 16 Q So do you have an opinion about how one would 17 think about figuring out what the appropriate 18 allocation in this market would be? How would you 19 approach that? 20 A Well, the -- as a percentage of the total 21 rate, the buyer in the target or hypothetical market, 22 the webcaster, is unconcerned. The only -- he's only</p> | <p style="text-align: right;">418</p> <p>1 10 percent, then -- let's say -- to make the math 2 easy, let's say it's 10 cents a copy, 10 cents a 3 performance. Then that's one penny per ephemeral copy 4 because you get one per performance. If it's 5 variable, then it would begin to matter. 6 But I think that it may be so complicated -- 7 given this is market transactions, it may be so 8 complicated to monitor all that, or the technology may 9 be so close to fixed or may be fixed proportions, that 10 you wouldn't end up contracting for the rate. It 11 wouldn't be worth the effort to do so. 12 JUDGE ROBERTS: Are you aware of how many 13 webcasters actually need the 112 license? 14 THE WITNESS: I suspect almost all do, from 15 what I seen of the technology. 16 JUDGE ROBERTS: Why do you think that? 17 THE WITNESS: Because they're copying the 18 music. If they use multiple servers, they're going to 19 need multiple copies. There's also a debate as to 20 what constitutes an ephemeral copy, and I couldn't 21 find a good solution to that problem. 22 In the process of webcasting, the thing --</p> |

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| <p style="text-align: right;">419</p> <p>1 you know, it's broken apart and hits various parts of 2 the network and it, in essence, is being stored 3 electronically to some extent along the way. When it 4 hits the end user's computer, it's stored, it's sorted 5 and then played. Is that an ephemeral copy? 6 So there's a debate, I think, about what 7 constitutes an ephemeral copy, which, if we don't know 8 exactly what it is, then it's very difficult to meter 9 on that. I mean, it's impossible to meter on that. 10 It's somewhat like the SDARS decision where 11 we used -- where you decided to use a percentage of -- 12 of revenues instead of a performance rate, as in this 13 case, was because, well, we can't measure quantity 14 right. And if you can't measure quantity right, then 15 you have to come up with some other means to do so. 16 JUDGE ROBERTS: Well, if we can't determine 17 what it is, then how can we ever attach a value to it? 18 THE WITNESS: Well, I think that was the 19 point of the testimony. If the two occur together -- 20 like four tires on a car. Okay? I mean, if the 21 dealer said 90 percent of your car purchase is the 22 tires, you'd say, I don't care, I'm just going to</p> | <p style="text-align: right;">421</p> <p>1 don't want to bother counting them, we don't really 2 mind, so, okay, it's fine. 3 In this case, though, we've got this 4 constraint of the 50/50 split which creates the 5 motivation for the seller to try to resolve the 6 problem. 7 So while in a market agreement you might not 8 see a percentage, or you might see a percentage, I 9 don't think that -- you know, it's not really saying 10 much about this. I mean, it does say that the thing 11 is occurring in a roughly fixed proportion -- we 12 believe it to be, today, to be roughly fixed 13 proportions, and if that's true, why bother setting a 14 separate rate for it because, in the end, it's just 15 going to be a percentage anyway? 16 So I think that's the difference. But here 17 we've got this 50/50 problem that has to be resolved 18 because that doesn't exist in the market. 19 JUDGE ROBERTS: You brought up the car 20 industry, and that made me think of an analogy here. 21 When I buy a car in this area, cars don't rust, and if 22 I go to the dealer and I buy a car, and he says, you</p> |
| <p style="text-align: right;">420</p> <p>1 write a check for the car; whatever you want to do is 2 fine with me, then certainly the tire has value in the 3 same sense that the ephemeral right has value. If you 4 can't make a copy, or can't make multiple copies in 5 the webcasting context, you may not be able to provide 6 your service. 7 So it's there. It does have value because 8 it's necessary to provide the service. So it has it. 9 So the question is, how do you deal with assigning a 10 value to something when it is so tightly integrated or 11 occurring alongside the other service that you're 12 providing? 13 In economics, the buyer just wouldn't care. 14 If it comes together like that -- and it's always this 15 number for that number, fixed proportions -- if it 16 comes together, the buyer just really doesn't care. 17 Okay? And it's very difficult to separate out the 18 values for the two. 19 But in this case -- which is why I think in 20 the contracts you don't see them doing a lot of that. 21 He says, okay, you get them both, because it's not 22 worth splitting it up because they come together, you</p> | <p style="text-align: right;">422</p> <p>1 know what, I'm going to throw in rust-proofing on 2 this -- and I say, I don't care, because it doesn't do 3 me any good, the car is not going to rust in this 4 area. But he insists, no, you're going to get the 5 rust-proofing. Is there any value to that 6 rust-proofing? I don't want it. I'm not particularly 7 interested in it. But he's throwing it into the deal. 8 THE WITNESS: I think it's relevant in two 9 ways. First, you could drive off without it and the 10 car would work perfectly well, unlike webcasting where 11 that probably is not true. You know, if he says, I'm 12 going to take out the motor, you go, well, wait a 13 minute, you know, that's not -- 14 JUDGE ROBERTS: That would be different. 15 THE WITNESS: That's different because it's 16 required to provide the service. And ephemeral copies 17 are required to provide the service. 18 The second case is that there is -- the 19 seller is offering you something, okay, that is 20 important to him, and you say you don't care. So 21 there are contracts -- and you've probably seen many 22 of them, many more than I have -- where there are</p> |

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| <p style="text-align: right;">423</p> <p>1 parts of the contract that one side may care about and 2 the other side doesn't. Okay? In this case, we sort 3 of have that, where the seller does care -- 4 JUDGE ROBERTS: I'm still troubled by the 5 fact that the buyer doesn't care. Because if the 6 buyer can't run a webcasting operation without the 112 7 license, then you have every reason to care, just as, 8 in the car example, if the dealer is not going to give 9 me the engine, I have every reason to care about 10 getting that engine. But yet, your testimony says, 11 well -- and you recognize that the buyer doesn't care. 12 Why doesn't the buyer care? 13 THE WITNESS: Okay. I understand your 14 question. The buyer doesn't care because of the 15 pricing mechanism. He certainly cares about getting 16 ephemeral copies, because he can't exist without them. 17 But by assigning it as a percentage -- if it's a penny 18 a song -- to keep the math simple, if I say it's a 19 penny a song, 10 percent ephemeral. The guy says, 20 it's a penny a song, that's all I care about, here's a 21 penny. 22 JUDGE ROBERTS: Right.</p> | <p style="text-align: right;">425</p> <p>1 case that the two -- that the ephemerals and the 2 performances are consumed in fixed proportions, which, 3 I mean, you know, you get two ephemerals per play or 4 whatever it might be, then there's no reason to 5 separate your prices out. It's just an extra price 6 that has no meaning, has no purpose. 7 JUDGE WISNIEWSKI: There's no reason to have 8 two either, is there? 9 THE WITNESS: Well, the cost of contracting 10 and monitoring and all those sorts of things. You 11 could set an ephemeral rate based on performances. 12 JUDGE WISNIEWSKI: You could have 10 cents a 13 copy for performance, one cent for the ephemeral even 14 if they were in that proportion all the way 15 throughout, couldn't you? 16 THE WITNESS: If you could count ephemerals, 17 if you knew exactly how to do so, you could do that. 18 But it may -- 19 JUDGE WISNIEWSKI: Well, aren't you implying 20 you can count them when you do the allocation? 21 THE WITNESS: No. 22 JUDGE WISNIEWSKI: Well, you obviously must</p> |
| <p style="text-align: right;">424</p> <p>1 THE WITNESS: If I say it's 20 percent, it's 2 a penny a song, here's your penny. 3 JUDGE ROBERTS: Right. 4 THE WITNESS: Because of the pricing scheme 5 is why he doesn't care. It's not that he doesn't care 6 about ephemerals. Of course he cares about 7 ephemerals; they're required to provide the service. 8 It's because of the way we use the percentage which 9 makes it where he doesn't care. So it's a pricing 10 statement more than it is a technical statement, I 11 guess is what I'm trying to say. 12 JUDGE ROBERTS: So this is the -- this 13 problem that we're facing, then, is created by the 14 owners, by the fact that, in the agreements that you 15 looked at, they chose to price it out that way and 16 sell two licenses together -- two rights, I should 17 say -- since the agreements you were looking at were 18 non-statutory. 19 THE WITNESS: Right. The contracts sold -- 20 well, they sold multiple rights together, not just 21 ephemerals and performances. I'm sure there are other 22 rights involved in that as well. The -- if it's the</p> | <p style="text-align: right;">426</p> <p>1 be, because you're assuming fixed proportions. If you 2 can't count them, how do you know it's a fixed 3 proportion? 4 THE WITNESS: Well, I know that it can be -- 5 it can be a fixed proportion technology without 6 knowing what the fixed proportion is. Okay? It is -- 7 and it's -- 8 CHIEF JUDGE SLEDGE: And those proportions 9 can change depending on the technology, right? 10 THE WITNESS: Well, it may. But my view is 11 when you look at the way it's going, when you look at 12 the contracts and you say this is the way these 13 willing buyers and willing sellers are making this 14 deal in a marketplace exchange without constraint, 15 that they're thinking, for the most part, it's not 16 worth bothering with setting -- with separating these 17 two rights, okay, so we're going to put them together. 18 It eliminates a whole separate price. It eliminates a 19 whole separate monitoring scheme, accounting scheme, 20 for something that, because of the newness of the 21 technologies, we may not even be exactly sure how we 22 would go about doing it.</p> |

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| <p style="text-align: right;">427</p> <p>1 But -- so, you know, we think that as this 2 guy scales, he's going to put on servers in roughly a 3 constant rate per play, that sort of thing, so the 4 copies work out that way. 5 If you go in a different route and say, well, 6 we're going to do rate setting, like we do in telecom, 7 you might actually decide, we're going to assume, to 8 simplify the problem, that there are X number of 9 copies per play. And then, even if you used a 10 percentage allocation, you could compute from that 11 what the actual copy rate was. Okay? If we can't 12 measure the copy rate very well, or we could if we 13 knew exactly how to define it, which would require, I 14 guess, a proceeding and lots of testimony, the 15 alternative would be to say, okay, it's, you know, .1 16 cents per play, and meter it on play rather than meter 17 it on copy. That would be another pricing scheme that 18 you might observe -- and we observe all kinds of weird 19 pricing schemes in market outcomes. It depends on 20 what the buyers and sellers are interested in and how 21 they can get to a deal that's most efficient. 22 It doesn't always look like we think it would</p> | <p style="text-align: right;">429</p> <p>1 evidence -- to proceed is to assign the two rights 2 together and allocate some percentage to that rate 3 because, you know -- I mean, the register's decision 4 said, hey, I want a rate, I mean, so we want a rate. 5 We go to people who care -- under the percentage 6 pricing scheme, okay, we go to the people who care 7 what that percentage is, because the buyer doesn't 8 care what the percentage is -- he cares about 9 ephemerals, but doesn't care what the percentage is. 10 And you say, okay, seller, what would -- what 11 offer would you make -- under the constraints of the 12 statute, what offer would you make? And then that 13 becomes the market rate because the buyer is happy, 14 the seller is happy and the components of the seller 15 are happy under this artificial constraint that's been 16 levied by the statute. So everybody is happy. When 17 everybody is happy, that's the market exchange. 18 JUDGE ROBERTS: Let me ask you a question. A 19 record company that negotiates an agreement with a 20 large webcaster -- the number one webcaster right now 21 being Pandora, apparently. Pandora is going to make a 22 lot of performances. Presumably, there's going to be</p> |
| <p style="text-align: right;">428</p> <p>1 look like. I got a \$500 cell phone for free. That's 2 pretty weird. A lot of people go, ooh, that's not a 3 market outcome. Well, sure it's a market outcome. I 4 promised to send them a hundred dollar check every 5 month for two years. It's a market outcome. It just 6 doesn't look exactly like the textbook might say it 7 would look, but that's the way markets work. You 8 almost always get an answer that looks peculiar. 9 JUDGE WISNIEWSKI: As an economist, you know 10 you didn't get that phone for free. 11 THE WITNESS: Well, exactly, but I didn't -- 12 CHIEF JUDGE SLEDGE: I'm not an economist and 13 I know that. 14 THE WITNESS: Nothing is free. There's no 15 free lunch. 16 CHIEF JUDGE SLEDGE: Something you just 17 mentioned. We have had that proceeding, and the 18 technology people can't agree on how to define it. 19 They all have a different opinion. 20 THE WITNESS: And if that's the case, I think 21 the -- the cleanest way, and certainly within a zone 22 of reasonableness -- and this matches up with market</p> | <p style="text-align: right;">430</p> <p>1 a lot of ephemeral copies made because of the volume 2 of customers that Pandora serves. Yet, in the 3 agreement, the record company makes no distinction 4 between the fact that Pandora is making lots and lots 5 and lots of ephemeral copies, and yet, the agreement 6 that they negotiate with the startup webcaster, who is 7 making far less, it's -- they treat it as the same. 8 Aren't they just leaving money on the table? 9 THE WITNESS: Well, if they do, they're doing 10 it voluntarily, which is -- you know, we always -- as 11 I was always taught, always leave some money on the 12 table so everybody is happy when you leave. But I 13 think it's probably -- you could make an efficiency 14 argument that, in the end, it's whatever we might 15 could get -- the nickel we could get from it is not 16 worth the effort of trying to negotiate that specific 17 term, whatever it may be. 18 But I think the real issue is, as you scale 19 it, sure you're making more copies, but you're making 20 more copies because you're making more performances, 21 and so that the ratio of copies to performances, it 22 may vary a little, but it doesn't vary enough to</p> |

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| <p style="text-align: right;">431</p> <p>1 bother with in a market transaction. 2 CHIEF JUDGE SLEDGE: Well, that answer in 3 your earlier statement that everybody is happy, 4 doesn't that assume that the distributions of the two 5 rights is equal? As long as the distributions of 112 6 is different than the distributions of 114, how can it 7 be that it doesn't matter, because one side is getting 8 slighted, how you make that allocation? 9 THE WITNESS: Are you talking about the 10 between the musicians' and the record companies' 11 distribution? 12 CHIEF JUDGE SLEDGE: Yes. 13 THE WITNESS: In the market, that doesn't 14 occur. There is no -- the contract -- the 112 -- an 15 ephemeral rate and a performance royalty is not split 16 any differently in the market. So there is no issue 17 about how to allocate one to the other. It doesn't 18 matter. All the money comes in and goes out, however 19 the contract has been written. 20 CHIEF JUDGE SLEDGE: Isn't that because the 21 musicians aren't at the table? 22 THE WITNESS: No. It's because the musicians</p> | <p style="text-align: right;">433</p> <p>1 different, then you can't just port it, no better than 2 you could port the number from this case over to the 3 market, because the constraint was different and the 4 distribution of the royalties was different. 5 So the only people that are concerned about 6 that distribution are the musicians and the record 7 companies, as long as we're in this percentage world, 8 okay. So they're the only ones that care. 9 So if we're going to ask ourselves what a 10 willing seller is going to offer, then we go ask the 11 seller, what's your offer? And the buyer is going to 12 say, okay, whatever, you know, I don't care, 13 willing -- I'm willing. It doesn't matter to me. I 14 just want to pay you a penny a song and be done with 15 it. 16 BY MR. HANDZO: 17 Q Dr. Ford, the court has actually conducted 18 most of my examination for me, albeit they led you a 19 lot more than I could. So let me sort of cut to the 20 chase here. Do you have an opinion about what the 21 ephemeral rate should be in this case? 22 A Well, given the explanation I've provided, my</p> |
| <p style="text-align: right;">432</p> <p>1 have already signed a deal. This is just some piece 2 of their business. They've already signed some 3 agreement. The guy says, I'll give you a million 4 dollars to make a record, and then I'm going to keep 5 the first ten that comes in the door and then I'll 6 start paying you 10 percent of every record sale after 7 that, or whatever it might be, but I might not give 8 you anything. Or maybe -- you know, if it's Sting or 9 somebody like that, I'll give you \$20 million for a 10 record, and then I'll pay you 10 percent of every 11 record that gets sold. 12 So it -- all these agreements are going to be 13 different in the market, but there is no statutory 14 obligation to split the money in any particular way. 15 We come over to the statutory world and, bam, we slap 16 this obligation -- this doesn't exist over here in the 17 market. 18 So it makes it -- I know that the goal here 19 is to look to the market, grab something and put it 20 over here. I mean, that's the plan, and that's a good 21 plan. But if the transaction here is not the 22 transaction here, or has some constraint on it that's</p> | <p style="text-align: right;">434</p> <p>1 recommendation would be to ask the people that care, 2 the musicians and the record companies, what they 3 would recommend the ephemeral rate to be. They have 4 done that. They have negotiated and made a proposal 5 of 5 percent. 6 Q When you say they've negotiated and made a 7 proposal, how do we know that? 8 A They did that -- I was advised by counsel 9 that agreement through the SoundExchange, which has a 10 board that is equal part musician, equal part record 11 company, they had a meeting, they discussed the issue, 12 they voted and unanimously approved the 5 percent 13 recommendation. 14 Q And have you actually seen the board minutes 15 for that? 16 A I've seen the board minutes, yes. 17 MR. HANDZO: That's all I have for this 18 witness, Your Honor. Thank you. 19 CHIEF JUDGE SLEDGE: Any further 20 cross-examination? 21 MR. MacDONALD: Yes, Your Honor, I have 22 several questions.</p> |

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| <p style="text-align: right;">435</p> <p>1 CHIEF JUDGE SLEDGE: All right. Once again, 2 you surprise me by asking questions. 3 MR. MacDONALD: Well, we'll see how good 4 these questions are, though. I want to keep your 5 expectations up. 6 CROSS-EXAMINATION 7 BY MR. MacDONALD: 8 Q Good afternoon Dr. Ford. 9 A Good afternoon. 10 Q My name is Angus MacDonald. I represent 11 Live365. Dr. Ford, your opinion is that a 5 percent 12 rate for the ephemeral license is an appropriate one 13 for this proceeding; is that correct? 14 A Yes. 15 Q And that 5 percent rate recommendation is 16 based on your understanding that the recording artists 17 and record companies had already reached an agreement 18 for a 5 percent allocation for the ephemeral license; 19 is that correct? 20 A Yes. 21 Q Now, what's the basis for that understanding? 22 A I was advised by counsel, and I have seen</p> | <p style="text-align: right;">437</p> <p>1 A This looks like what I have seen, yes. 2 Q Just for the record, this is Bates numbered 3 SXW3_00008266 to 8268. 4 A Yes. 5 Q Who gave you these board of director meeting 6 minutes? 7 A Counsel. 8 Q Were you -- you were essentially informed 9 about the board's decision -- let me withdraw that 10 question. 11 Were you informed about the board's decision 12 on the ephemeral rate before proposing your 5 percent 13 recommendation? 14 A Would you repeat that question? 15 Q Did you already have the 5 percent 16 recommendation in mind for the ephemeral license 17 before you reviewed the board meeting minutes? 18 A I had no number until I was told the product 19 of this meeting. 20 MR. MacDONALD: Your Honor, I move for 21 admission of Live365 Exhibit 19 into evidence. 22 CHIEF JUDGE SLEDGE: Any objection to the</p> |
| <p style="text-align: right;">436</p> <p>1 subsequent to that, the minutes from the meeting. 2 Q And essentially there is an agreement within 3 SoundExchange by SoundExchange representatives of the 4 record labels on one hand and SoundExchange 5 representatives of the recording artists on the other 6 hand for this 5 percent, correct? 7 A Uh-huh. 8 CHIEF JUDGE SLEDGE: Please answer out loud. 9 THE WITNESS: Yes. 10 MR. MacDONALD: I'd like to actually mark the 11 board meeting minutes for the time being as Live365 12 Exhibit 19. And I'd ask that Mr. Yacobian please pass 13 them out. 14 CHIEF JUDGE SLEDGE: Mr. MacDonald, does 15 Live365 have a dispute with that proposal of 16 SoundExchange? 17 MR. MacDONALD: Live365's rate proposal for 18 the ephemeral rate is a little different than the 19 proposal set forth by SoundExchange. 20 BY MR. MacDONALD: 21 Q Dr. Ford, are these the board of director 22 meeting minutes that you were referring to earlier?</p> | <p style="text-align: right;">438</p> <p>1 offer? 2 MR. HANDZO: No, Your Honor. 3 CHIEF JUDGE SLEDGE: Without objection, it's 4 admitted. 5 (Live365 Trial Exhibit Number 19 was received 6 into evidence.) 7 MR. MacDONALD: I have no further questions. 8 JUDGE ROBERTS: Before you step down, 9 Counsel, I'm looking at your proposal for ephemeral 10 copies, and it seems to be the same one that was put 11 forward last time, 8.8 percent. Are you willing to 12 stipulate with counsel for the other side that 13 5 percent would be the rate? 14 MR. MacDONALD: Your Honor, we have -- we are 15 considering that, that stipulation, and I would 16 suggest that, before the end of this hearing, the 17 direct hearing, that if we were to stipulate, we would 18 do so by then. 19 JUDGE ROBERTS: Thank you. 20 CHIEF JUDGE SLEDGE: Well, it's obvious 21 you're causing curiosity on the bench by 22 cross-examining this witness.</p> |

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| 439 | <p>1 Mr. Malone, any questions? 2 MR. MALONE: No, Your Honor. 3 CHIEF JUDGE SLEDGE: Mr. Handzo? 4 MR. HANDZO: Nothing further, Your Honor. 5 CHIEF JUDGE SLEDGE: Anything from the bench 6 further? 7 Thank you, sir. 8 THE WITNESS: Thank you. 9 (Witness excused.) 10 MR. HANDZO: If we could just have a few 11 seconds, our next witness is outside. 12 (Pause.) 13 CHIEF JUDGE SLEDGE: Mr. Freedman. 14 MR. FREEDMAN: Yes. SoundExchange calls it 15 next witness, Barrie Kessler. 16 WHEREUPON, 17 BARRIE KESSLER, 18 called as a witness, and after having been first sworn 19 by the chief judge, was examined and testified as 20 follows: 21 DIRECT EXAMINATION 22 BY MR. FREEDMAN:</p> | 441 | <p>1 marked as SoundExchange Trial Exhibit 5. 2 MR. FREEDMAN: Your Honor, may I approach? 3 BY MR. FREEDMAN: 4 Q Do you have SoundExchange Exhibit 5 in front 5 of you? 6 A I do. 7 Q Do you recognize this document? 8 A I do. 9 Q What is it? 10 A It is my corrected direct testimony in this 11 case. 12 Q And if you turn to the last page, is that 13 your signature? 14 A It is. 15 Q Did you prepare this testimony? 16 A I did. 17 Q Did you review it before you signed it? 18 A Yes, I did. 19 Q Is the written testimony correct? 20 A It is. 21 MR. FREEDMAN: Your Honor, at this time, I 22 would move the admission of SoundExchange Trial</p> |
| 440 | <p>1 Q Good afternoon. Could you please state your 2 name for the record. 3 A Barrie Kessler. 4 Q Can you spell your last name, please. 5 A K-E-S-S-L-E-R. 6 Q Where are you currently employed? 7 A At SoundExchange. 8 Q What is your job title? 9 A I am the chief operating officer. 10 Q And what are your job responsibilities as 11 chief operating officer? 12 A I oversee the collection and distribution of 13 royalty payments made by services availing themselves 14 of the statutory license. I supervise staff who are 15 responsible for the collection of the royalty payments 16 as well as the distribution and the payments to the 17 artists and the copyright owners. And I oversee the 18 technology and the platform upon which we make our 19 distributions. 20 Q How long have you held that position? 21 A Since 2001. 22 Q I would like to show you now what we have</p> | 442 | <p>1 Exhibit Number 5 into evidence. 2 CHIEF JUDGE SLEDGE: Any objection to 3 Exhibit 5? 4 MR. MacDONALD: No objection, Your Honor. 5 CHIEF JUDGE SLEDGE: Without objection, it's 6 admitted. 7 (SoundExchange Trial Exhibit Number 5 was 8 received into evidence.) 9 BY MR. FREEDMAN: 10 Q In general terms, Ms. Kessler, can you 11 describe what SoundExchange does? 12 A Yes. We're charged with the fair and 13 efficient collection and distribution of royalties 14 under the statutory license. 15 Q And can you give a sense of how many 16 performances SoundExchange processes every year? 17 A We're up to billions and billions of 18 performances at this point. 19 Q Since the previous webcasting proceeding, has 20 SoundExchange developed any new collection and 21 distribution systems? 22 A Yes, we have.</p> |

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1 CERTIFICATE OF COURT REPORTER

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3 I, Denise M. Brunet, the court reporter

4 before whom the foregoing proceedings were taken, do

5 hereby certify that the proceedings were taken by me

6 stenographically and thereafter reduced to print by

7 means of computer-assisted transcription by me; that

8 said proceedings are a true record; that I am neither

9 counsel for, related to, nor employed by any of the

10 parties to this litigation and have no interest,

11 financial or otherwise, in the outcome of this matter.

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Denise M. Brunet

15 Court Reporter

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