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COPYRIGHT ARBITRATION ROYALTY PANEL

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In the matter of: Digital Performance Right in Sound Recording and Ephemeral Recording	Docket No. 2000-9 CARP DTRA 1 & 2
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CARP Hearing Room
 LM-414
 Library of Congress
 Madison Building
 101 Independence Ave, SE

Washington, D.C.

Monday,
 August 27, 2001

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

BEFORE

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

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C-O-N-T-E-N-T-S

WITNESS DIRECT CROSS REDIRECT RECROSS

Paul Kempton
By Mr. Schaeffer 6181 6397
By Mr. Garrett 6270
Voir Dire by Mr. Garrett on page 6202
Adam Jaffe
By Mr. Rich 6409
Voir Dire by Mr. Katz on page 6420

EXHIBIT NO. DESCRIPTION MARK RECD

034 DRX	Kempton email	6280 6291
035 DRX	Bates 00134-00142	6317 6320
036 DRX	Switzerland emails	6336 6343
037 DRX	Email with Austria	6375 6390
038 DRX	Kempton email	6390 6396
166 DPX	Australia Copyright	6320 6326
167 DPX	"Review of Intellectual	6328

Property Legislation"

168 DPX	Swiss Copyright	6338
169 DPX	U.K. copyright tribunal	6344 6345
170 DPX	Canadian decision	6354 6364

paragraph 34 of your testimony, it's actually a 22 to 33.3 percent figure, were you testifying about an ephemeral license or a mechanical license?

A I was testifying about a mechanical license and I must then go back to my board because it seems to have caused some confusion on this particular point. The point about ephemeral in the context of this particular part is a side of two sides, so the left hand side of musical world and the left hand side of sound recording is that it's effectively a royalty-free activity under U.K. law and I believe that's the principle of ephemeral exemption in most jurisdictions in this context.

Q And finally -- sorry.

A I was just trying to make a distinction between there's a right and the requirements to have a license for it. The right is the mechanical right, but it is expunged, if you like, by the ephemeral exemption.

Q Mr. Kempton, the rates in your study, were they the currently prevailing rates for the sound recording and music composition performance rights or

copies that can be made?

A It's one copy for the broadcast, but that's not to say that you may not make more than one copy for broadcasting purposes.

Q And if you make more than one copy for broadcasting purposes, are you still within the exemption?

A You could be, according to your interpretation of that exemption.

Q So it's not clear, is that what you're saying?

A It's possibly not clear as to whether or not you can create a broadcast tape and use it for 27 days and create another broadcast tape and use that for 27 days and so on and so forth.

Q And if the law were that you could not come within the ephemeral exemption, then you would need a mechanical license, is that right?

A That's correct.

Q I have no further questions.

CHAIRMAN VAN LOON: Thank you very much, then, for your testimony. Thank you so much for being

were they some other rights?

A They were, to the best of my knowledge, the rates prevailing at the time I assembled the data.

Q I have no further questions, Your Honors.

CHAIRMAN VAN LOON: Anything further, Mr. Garrett or Recross?

MR. GARRETT: Just one brief set of questions.

RECRASS EXAMINATION

BY MR. GARRETT:

Q Going back to ephemerals and mechanicals here, the answer that you gave a moment ago was confined to the United Kingdom, is that correct?

A Yes.

Q You're not talking about what the situation might be anywhere else other than the United Kingdom, correct?

A Well, my understanding is the concept of ephemeral is similar in most jurisdictions where it applies.

Q Let's focus on the United Kingdom. Is there a limit on the number of copies, ephemeral

witness and you'll look forward doubtless to vacating the stand and turning it over to Professor Jaffe.

(The witness was excused.)

CHAIRMAN VAN LOON: Thank you for your patience in waiting what's -- already a long day and welcome to the witness stand.

THE WITNESS: Thank you.

CHAIRMAN VAN LOON: Let me ask you to raise your hand, please, so that the Court Reporter

WHEREUPON,

ADAM JAFFE

WAS CALLED FOR EXAMINATION BY COUNSEL FOR THE BET.COM, ET AL. AND, HAVING FIRST BEEN DULY SWORN, WAS EXAMINED AND TESTIFIED AS FOLLOWS:

DIRECT EXAMINATION

BY MR. RICH:

Q I've scratched out good morning, so I'll say good afternoon, Professor Jaffe.

A Good afternoon.

Q Would you state your name for the record, please?

1 A Yes, Adam, B as in Benjamin, Jaffe,
 2 J-A-F-F-E.
 3 Q What is your occupation?
 4 A I'm a Professor of Economics.
 5 Q Where?
 6 A At Brandeis University in Waltham,
 7 Massachusetts.
 8 Q And how long have you been at Brandeis?
 9 A I've been at Brandeis since 1994.
 10 Q And are you simply a member of the faculty
 11 or do you hold any administrative positions with
 12 respect to your economics role?
 13 A Well, in addition to my faculty position,
 14 I'm the chair of the Department of Economics and I'm
 15 also the chair of the University Intellectual Property
 16 Policy Committee.
 17 Q Let's come back to that in a couple of
 18 minutes and well, why don't I just ask you what does
 19 that entail?
 20 A It's a committee of faculty and
 21 administrators that was established last year by the
 22 Provost in order to recommend to the Provost and I

1 guess ultimately to the President a revised
 2 intellectual property policy for the university.
 3 Q I take it that's university-wide, as
 4 opposed to Economics Department limited position, is
 5 that right?
 6 A That's correct.
 7 Q And what is your educational background,
 8 sir?
 9 A I have a Bachelor's degree in chemistry
 10 from MIT; a Master's degree in technology and policy
 11 from MIT; and a Ph.D. in economics from Harvard.
 12 Q And prior to joining the Brandeis faculty,
 13 did you teach elsewhere?
 14 A Yes.
 15 Q Where was that?
 16 A From the time I completed my Ph.D. in
 17 1985, until I moved to Brandeis in 1994, I was on the
 18 faculty at Harvard in the Economics Department.
 19 Q And in your career have you done any
 20 stints in the government?
 21 A Yes.
 22 Q What have those entailed?

1 A I took leave from Harvard for the academic
 2 year 1990-1991 to serve as Senior Staff Economist at
 3 the President's Council of Economic Advisors here in
 4 Washington.
 5 Q What were your staff responsibilities in
 6 that position?
 7 A I had primary responsibility in the areas
 8 of regulation, economic regulation, anti-trust policy
 9 and science and technology policy.
 10 Q You testified you did that for about a
 11 year?
 12 A That's correct.
 13 Q And have you served on one or more
 14 editorial boards of peer-reviewed journals?
 15 A Yes.
 16 Q Can you describe those positions, please?
 17 A Well, I was on the editorial board of the
 18 American Economic Review which is probably the lead
 19 American academic journal in economics for a number of
 20 years. I'm currently associate editor of the RAND
 21 Journal of Economics and the Journal of Industrial
 22 Economics, both of which are journals that focus

1 specifically on the area of what economists call
 2 industrial organization.
 3 Q And I take it, well, why don't I ask you,
 4 what are your areas of principal teaching, what are
 5 your principal teaching disciplines?
 6 A I teach industrial organization. I teach
 7 macroeconomics. I have taught statistics and
 8 econometrics, but I particularly focus in on economics
 9 and regulation, anti-trust economics and the economics
 10 of innovation and technological change.
 11 Q Does your teaching encompass both the
 12 undergraduate and graduate levels?
 13 A It has over the last years, yes.
 14 Q What is your expertise with respect to
 15 intellectual property issues as they intersect with
 16 economics?
 17 A Well, in terms of my academic research
 18 really motivated by my interest in the economics of
 19 innovation and technological change, I've done a lot
 20 of academic research on patents and the patent system
 21 which I suspect is why the Provost decided that maybe
 22 I should be the guy to take on this nettle of policy

1 for the university.

2 In terms of my consulting, I've worked on
3 a number of issues related to patents, related to
4 copyrights and also related to the valuation of data,
5 testing data in a context where it's neither
6 copyrighted nor patented, but nonetheless has value.

7 ARBITRATOR VON KANN: Could you keep your
8 voice up?

9 THE WITNESS: Yes, I'm sorry, yes. We're
10 all tired.

11 BY MR. RICH:

12 Q Professor Jaffe, what expertise have you
13 developed specifically with respect to music
14 copyrights?

15 A I've worked on, in a consulting capacity,
16 I've worked on anti-trust issues relating to music
17 copyright, particularly vis-a-vis ASCAP and BMI in the
18 musical work setting and I've also consulted on and
19 testified on valuation of musical work, royalties in
20 a number of different settings.

21 Q What specific testimony have you rendered
22 with respect to the valuation of music copyrights?

1 described, is that correct?

2 A Yes, I think that's correct.

3 Q And were you the sole economic expert
4 testifying on behalf, respectfully, of PBS and NPR and
5 on behalf of Music Choice in each of those trial
6 settings?

7 A Certainly on behalf of Music Choice, since
8 that was just a few months ago. My recollection PBS
9 was that I was the sole expert.

10 Q I'll represent to you that my recollection
11 is you were as well.

12 A Okay.

13 Q I had some involvement with that case,
14 too. In the PBS for the Panel's benefit, in the
15 PBS/NPR CARP, what's your recollection as to the
16 respective economic positions brought to the CARP by
17 the parties?

18 A What was at issue in that case was a
19 license for a 5-year period for the public radio and
20 public television. I think my recollection is that my
21 model which was based on essentially an updating of
22 prior fees, that those parties had paid was an

1 A Well, I testified in one previous CARP
2 Panel which Judge Gulin might recall.

3 Q Can you identify that?

4 A On behalf of PBS and NPR in determining
5 the royalties that they should pay to ASCAP and BMI
6 for the public performance of musical works on public
7 radio and public television.

8 I have prepared to testify and done
9 written testimony, although the case hasn't gone to
10 trial on behalf of a group of cable television
11 networks in ASCAP rate court where again the issue is
12 the appropriate public performance royalty for ASCAP's
13 musical work repertoire.

14 And I testified on behalf of Music Choice
15 which is a subscription music service delivered by
16 cable and satellite in BMI rate court where the issue
17 was if the reasonable fee for the public performance
18 of the BMI musical works.

19 Q So if I understand you in actual trial
20 type settings respecting music copyright issues,
21 you've testified in one CARP proceeding as you
22 described and in one BMI rate court proceeding as you

1 estimate of about \$20 million for the 5-year period.

2 My recollection is that the combination of ASCAP and
3 BMI who presented their own separate cases regarding
4 how much they thought they were entitled to get, with
5 the combined total was on the order of \$75 million.

6 Q What was the ultimate outcome, what level
7 of dollars over a 5-year period combined to your
8 recollection

9 A It as 27 point something.

10 Q And in the Music Choice/BMI rate
11 proceeding, what were the respective economic
12 positions of the parties to your recollection? That's
13 very recent, I assume you do recall?

14 A That was recent. My testimony in the
15 BMI/Music Choice proceeding was that the reasonable
16 royalty for Music Choice to pay BMI would fall in a
17 range from 1.38 percent of revenue to 1.75 percent of
18 revenue. BMI's position, which was supported by their
19 expert was that essentially they should be paid 4
20 percent of revenue.

21 Q And what was the outcome of that
22 proceeding?

1 A The Judge determined that the reasonable
2 royalty was 1.75 percent.

Q Now am I correct that next to your written
4 direct testimony as Appendix A is a true and accurate
5 copy of your curriculum vitae?

6 A Hopefully it's accurate. To the best of
7 my knowledge it was true as of April when it was
8 filed.

9 Q Okay, and would you describe at a general
10 level the nature of the assignment you were given
11 here, please?

12 A Yes. Basically, I was asked to examine
13 the economic issues surrounding the determination of
14 the royalty, the task the Panel was assigned under the
15 statute and to ultimately develop an economic basis
16 for a fee proposal.

17 Q And am I correct that the opinion, the
18 expert opinion you provided pertains both to the
19 Section 112 and Section 114 rates to be set here?

20 A Yes, that is correct.

21 Q And am I also correct, I don't think
22 there's any dispute that you've done this analysis

1 A Yes.
2 MR. RICH: I'll make this witness
3 available on voir dire.

4 VOIR DIRE

5 BY MR. KATZ:

6 Q Professor Jaffe, you've testified as an
7 expert in various cases before?

8 A Yes.

9 Q Others in addition to the two that you
10 testified about?

11 A You mean just testified in general?

12 Q Well, testified and gave expert economic
13 testimony in one sort of matter or another?

14 A Yes.

15 Q And about how many times have you done
16 that?

17 A I'm going to guess about 10.

18 Q And do you feel as qualified to testify in
19 this proceeding today, at least as qualified to
20 testify in this proceeding today as in any of those
21 previous cases?

22 A Yes, I think so.

1 with respect to three categories of entities, so-
2 called webcasters, streaming broadcasters and
3 background music services, is that correct?

4 A Yes, different parts of the analysis apply
5 to those different parties to varying degrees, but
6 they're all dealt with to some extent.

7 Q And in contrast, your report does not
8 cover the circumstances of noncommercial radio, is
9 that correct?

10 A That is correct, yes.

11 Q Incidentally, did you have assistance from
12 an outfit named Lexicon in preparing your report?

13 A Yes.

14 Q What is Lexicon?

15 A Lexicon is an economic consulting firm who
16 was retained in order to provide research support
17 under my supervision for the work that was necessary
18 for the testimony.

19 Q And did they, in fact, perform that
20 service for you?

21 A Yes.

22 Q And did you supervise that work?

1 Q And do you feel that the analysis that
2 you've done in your written report is as rigorous and
3 as conclusive, at least as rigorous and conclusive as
4 the analysis that you've done in any of these prior
5 cases?

6 A Well, that's a hard question to answer.
7 I do the best that I can. Sometimes the facts are
8 very clear and you can give a very strong conclusion
9 based on the data that you have. Sometimes the data
10 is more limited or more ambiguous and you have to --
11 you have to deal with what you confront and I think in
12 my report, for example, I've been very clear that
13 there are certain aspects of the analysis where the
14 data is not terrific and I think I've been pretty
15 clear as to where I needed to make assumptions because
16 the data was not as ideal as you might like. So I
17 think it's very hard to give an overall
18 characterization of the entire testimony as somehow
19 being equally or greater than or less than rigorous
20 than some other context.

21 Q Well, looking at all of the expert reports
22 that you've done in the past, and placing them on a

1 spectrum between those which were very clear and which
2 you could reach very strong conclusions, at the one
3 extreme, and those were the data really weren't very
4 clear and you really couldn't come to strong
5 conclusions at the other extreme, where would you
6 place the report that you did here?

7 A I think there are some aspects of the
8 analysis here that are as strong as anything I've ever
9 done. I think there are other aspects and I think the
10 report is quite explicit on this, where the data are
11 not as good. So I can't make a characterization of
12 that sort for the testimony as a whole.

13 Q All right. In previous instances where
14 you've appeared as an expert witness, how many times
15 have you appeared for the Weil Gotshal firm?

16 A I think just the two we've already
17 mentioned unless I'm forgetting something.

18 Q Have they consulted you in any other
19 matters?

20 A I have worked on a consulting basis for
21 clients who also retain Weil Gotshal as legal counsel
22 in related matters.

1 A No.

2 Q Have you ever done any research, written
3 any papers with respect to sound recording performance
4 rights?

5 A No.

6 Q About how much have you personally spent
7 listening to webcasts of music?

8 A A few hours at most.

9 Q Where did you do that and under what
10 circumstances?

11 A I've done it at home. I've done it at
12 Lexicon. And the circumstances were mostly I was
13 curious to see what it was like and so I noodled
14 around a little bit.

15 Q Were the people that showed you how to do
16 it, help you through it?

17 A No, I don't think so.

18 Q So on your own you figured it out and did
19 it on your own?

20 A I didn't find it that difficult.

21 Q That really wasn't my question. Was there
22 anybody with you when you were doing this webcasting

1 Q About how many times has that happened?

2 A Well, we've mentioned the Cable case which
3 is in this limbo, there's been written testimony, but
4 it hasn't gone to trial.

5 MR. RICH: Let me just -- while I don't
6 have any objection to this question, I want to caution
7 the witness to the extent that I don't know what he's
8 about to reveal. He may be revealing consultations
9 that are nonpublic in nature, by the nature of the
10 consultation. I would ask that he so advise us and
11 that we do that on a restricted record, subject to
12 that.

13 THE WITNESS: I have worked for many years
14 for the Copyright Clearance Center for which Mr. Rich
15 also works. And I believe the other matter on which
16 I have worked is arguably confidential. Mr. Rich
17 would probably know that more precisely than I do.
18 There is one other matter.

19 BY MR. KATZ:

20 Q Now Professor Jaffe, have you previously
21 given testimony or consulted with respect to the
22 valuation of sound recording performance rights?

1 experience?

2 A When I certainly did it at home there
3 wasn't anybody there. I don't remember when I did it
4 at Lexicon whether someone was else sitting around
5 watching too or not.

6 Q Now in preparing your analysis here, did
7 you consult with anyone who did have previous
8 experience valuing sound recording performance rights?

9 A No, I don't think so.

10 Q Now in the course of preparing your
11 statement, did you analyze any actual transactions in
12 which sound recording performance rights were
13 licensed?

14 A No.

15 Q Certainly in doing an analysis like this
16 you would always prefer to start with voluntary
17 agreements, isn't that right?

18 A I don't think you can make that as a
19 context-free statement, no.

20 Q Certainly if you have in your possession
21 an indication that the value of the rights in the
22 context that you're being asked to value, there's no

1 reason to go far afield to look for another context,
2 is there?

MR. RICH: May I inquire whether this is
4 not really the subject of cross examination and hasn't
5 veered quite beyond the voir dire which is the
6 witness's qualifications to provide the expert opinion
7 he's rendering here?

CHAIRMAN VAN LOON: Can I have your
9 thoughts on that, Mr. Katz?

MR. KATZ: I'm trying to establish a
11 baseline for what this witness has done here, what he
12 thinks he's done and how he'd use his own work.

CHAIRMAN VAN LOON: Sustained.

BY MR. KATZ:

Q Now Professor Jaffe, in doing analysis
16 like this, if there were actual transactions in sound
17 recording performance rights, it would make sense to
18 take those into account, wouldn't it?

MR. RICH: Same objection.

CHAIRMAN VAN LOON: Sustained.

BY MR. KATZ:

Q In doing an analysis like this, it

1 Rich?

2 DIRECT EXAMINATION (CONTINUED)

3 BY MR. RICH:

4 Q Professor Jaffe, I'd like to begin the
5 substantive part of your oral testimony by reference
6 to the section of your written report which commences
7 at page 3 and continues until page 6 which is a
8 section in which you discuss the economic
9 justification for the compulsory license/arbitration
10 regime that we are dealing with and that we find in
11 both sections 112 and 114 of the Act.

12 Could you briefly summarize your analysis
13 in this regard as it's found in those pages of the
14 report?

15 A Yes. I believe from the perspective of
16 economics, the way to think about the setting we find
17 ourselves in is that the market for a performance
18 right, in this case the performance of the sound
19 recording has a set of properties, the effect of which
20 is that there's a trade off between the normal
21 presumption that competitive markets work well and we
22 get efficient outcomes by having goods and services

1 wouldn't make sense to base it on a relationship that
2 was inherently arbitrary, would it?

3 MR. RICH: It seems to me to be in the
4 same vein. Objection.

5 ARBITRATOR GULIN: A little closer, but --
6 (Laughter.)

7 MR. KATZ: It is not my objective to try
8 the Panel's patience and it has generally in my career
9 been and one of the things I do in voir dire to try to
10 establish how the witness views his own report and
11 bases, but if the Panel would prefer that I leave that
12 for cross examination, I'd be happy to do that.

13 CHAIRMAN VAN LOON: I think we'd love to.

14 MR. KATZ: I'll pass the witness.

15 CHAIRMAN VAN LOON: We'll anticipate it at
16 a time in the future. So savor it a little bit more.

17 MR. KATZ: I'll keep the list.

18 (Laughter.)

19 CHAIRMAN VAN LOON: So no further
20 questions on voir dire?

21 MR. KATZ: No, I accept the witness.

22 CHAIRMAN VAN LOON: Okay, thank you. Mr.

1 traded in a competitive market on the one hand, and on
2 the other hand, the transaction cost efficiency in
3 terms of doing licensing and dealing with making the
4 licensing deals. And the reason for that is that the
5 user, the potential licensee of the performance right
6 needs to get rights in the first instance, at least
7 from many different parties. There are multiple
8 owners of the distinct, the different compositions or
9 the different sound recordings that they may want to
10 use and the way that they use them is such that
11 dealing with those individual underlying rights
12 holders could be inefficient transactionally. There
13 just may be too many contracts that have to be signed,
14 too many pieces of paper to keep track of, too many
15 negotiations for that to be efficient.

16 So it's efficient, at least from that
17 transaction perspective to have the licensing
18 centralized to some extent through one or a small
19 number of collective agencies who handle the licensing
20 on behalf of a larger number of potential licensors.
21 But without other public policy intervention, such
22 centralization runs the risk that the rates will not

1 be competitive levels, but instead would be a monopoly
2 level. So if you had a centralized licensor acting on
3 their own, you would get potentially transaction cost
4 efficiency, but the risk and the likelihood that rates
5 would be significantly elevated because of market
6 power.

7 And I believe that the statutory framework
8 we find ourselves in at least from my perspective as
9 an economist ought to be understood as Congress'
10 resolution of that conflict by establishing the right
11 for one organization to act collectively with
12 protection against the normal anti-trust scrutiny that
13 such activity would generate, but providing -- sorry,
14 and providing a compulsory license with the proviso
15 that the fees would be determined by a panel like this
16 if they can't agree. I believe that what Congress is
17 trying to do is to get the benefit of competitive
18 pricing, avoid the problems of market power and at the
19 same time avoid the transactions costs inefficiencies
20 that would be associated if you didn't have
21 centralized licensing.

22 Q And what language in sections 112 and 114

1 economically makes sense.

2 As I discuss in my testimony there is
3 additional language in the legislative history and in
4 other contexts that I think reinforce that view, but
5 primarily I'm coming at it as an economist, trying to
6 understand it as an economist.

7 Q And just as a small sidepoint, is the
8 centralized licensing agency which is authorized and
9 is given an anti-trust exemption under the statute, is
10 it authorized to act on an exclusive or a nonexclusive
11 basis?

12 A Well, my understanding of the statute is
13 that it acts nonexclusively which means that the
14 underlying rights holders do retain the right to deal
15 directly with potential licensees if they choose to do
16 so.

17 Q And do you regard that economically as an
18 important limitation and if so, why? That is, the
19 limitation that the license authority be nonexcluded?

20 A I think it's conceptually very important.
21 Whether empirically it will turn out to be of
22 significance, we don't know yet. That is to say we

1 implements the statutory objectives that you've just
2 described?

3 A It's primarily the language about the
4 willing buyer/willing seller that we've heard a lot
5 about over the course of the proceeding.

6 Q What is the proper economic interpretation
7 to be given to this willing buyer/willing seller test
8 as you describe further in paragraph 11 of your
9 written direct testimony?

10 A Well, in my view, again, looking at it as
11 an economist, having sort of understood what Congress
12 was trying to do in terms of resolution of this
13 dilemma between market power and transaction cost
14 efficiency, the sensible interpretation of the willing
15 buyer/willing seller test is that what we're looking
16 to do through that test is to replicate the outcome
17 that would occur in a hypothetical competitive market.
18 If we could hypothetically centralize in order to
19 avoid the transaction inefficiencies, but still
20 somehow have competition as a hypothetical matter,
21 what fees would result and that hypothetical
22 competitive market test is the one which I think

1 don't know yet whether a significant number of
2 individual licensors will choose to act to license
3 their rights directly bypassing the collective
4 licensor.

5 But I think conceptually, it's important
6 that Congress put that there because it emphasizes the
7 role of competition and the importance of the
8 competitive standard by creating at least the
9 possibility that for some users, for example, for whom
10 these transactions cost problems might not be so
11 large, because of the nature of their use, they would
12 have this alternative, this competitive alternative of
13 going directly to the owners of the underlying rights
14 and bypassing the collective organization.

15 Q And I take it that's at least a
16 theoretical possibility which as we get to a little
17 later on you take account of in modeling one or more
18 forms of proposed license, is that correct?

19 A Yes. One of the things that I think is
20 important is that the structure of the license not be
21 such as to frustrate that possibility. In other
22 words, if the license that the collective organization

1 provides is structured in such a way to remove any
2 incentive that might be there for a licensee to go
3 directly to the holders of the rights, then that
4 desirable possibility of there being competition will
5 have been eliminated.

6 So I think although candidly we don't know
7 how significant, as I say empirically, this might be,
8 I think it is important to preserve that option by
9 structuring the license in such a way it preserves the
10 incentive to do that for those users for whom it's
11 practical and efficient.

12 Q Does the compulsory license process in
13 which we are here engaged and the functions of which
14 you've just testified find analogy in your experience
15 elsewhere?

16 A Yes.

17 Q Where is that?

18 A Well, we've talked on and off today and I
19 know earlier in the hearing about musical works and
20 about ASCAP and BMI and I believe even putting aside
21 yet, we'll get to it, the question of the relative
22 valuation of the two performing rights, in terms of

1 the structure, there is a very close analogy between
2 the statutory compulsory license coupled with
3 arbitration regime that Congress created with respect
4 to the 112 and the 114 rights and what is admittedly
5 a different statutory framework which is to say the
6 rate courts that have evolved with respect to ASCAP
7 and BMI which evolve as a statutory matter from the
8 anti-trust laws.

9 But as a practical matter, the way that
10 the practice has evolved in that area is that both
11 ASCAP and BMI are subject to this so-called rate court
12 which is essentially a quasi-regulatory proceeding
13 within the federal court system that operates as a
14 legal matter under the anti-trust laws. There were
15 these consent decrees which were brought to resolve
16 anti-trust cases, so in terms of the statutory
17 framework we're operating under the anti-trust laws,
18 but the consent decrees themselves specify how the
19 rate court is to determine whether the fees that ASCAP
20 and BMI are charging are to be acceptable or not. And
21 what has evolved in that, in both of those rate courts
22 is the concept of a reasonable rate and the court has

1 said that what the reasonable rate means in the
2 BMI-ASCAP context is the rate that would prevail in a
3 hypothetical competitive market, if such a market
4 could exist.

5 Q Now there's no -- the word reasonableness
6 does not appear in either section 112 or 114, even
7 though it appears in the legislative history to this
8 Act, is that correct?

9 A That is correct.

10 Q Yet listening to your definition of the
11 concept of reasonableness as it has been construed in
12 the ASCAP and BMI rate court, do you regard the
13 fundamental inquiry which this Panel is to engage in
14 under Section 112 and 114 as essentially similar to
15 the reasonableness inquiry which the ASCAP and BMI
16 courts engage in?

17 A Yes. I mean I think the word reasonable,
18 absent any context, could mean different things to
19 different people.

20 In the ASCAP-BMI framework, it has a very
21 specific meaning. The court has been pretty clear on
22 this. It means a hypothetical competitive market

1 rate. For the reasons I've explained, I believe that
2 that is also the appropriate interpretation and it's
3 not inconsistent with willing buyer/willing seller,
4 the appropriate interpretation of the willing
5 buyer/willing seller test, so that when I say
6 reasonable, which I've really derived from my
7 experience with the ASCAP and BMI rate courts, I
8 believe that as a matter of economics, that is
9 economically equivalent to the willing buyer/willing
10 seller standard that appears in 114 and 112.

11 CHAIRMAN VAN LOON: This Panel is not
12 mandated then to be unreasonable in the rate setting?

13 THE WITNESS: No.

14 CHAIRMAN VAN LOON: Okay. That's
15 comforting.

16 BY MR. RICH:

17 Q Because this word is something of a term
18 of art and has been used by various counsel examining
19 various witnesses to establish various points, just to
20 get a baseline with you, you occasionally use the word
21 "reasonable" or "reasonableness" in your written,
22 direct testimony, is that correct?

1 A I think it's more than occasional. I
2 basically made a decision that willing buyer/willing
3 seller was an awkward phrase, having explained that my
4 view was and my analysis is predicated on an
5 equivalence of that to the ASCAP-BMI rate court notion
6 of reasonableness. I think I'm actually -- I started
7 to say reasonably consistent.

8 (Laughter.)

9 I'm pretty consistent in my report in
10 using the word "reasonable" as a shorthand for this
11 concept of the hypothetical competitive market rate.

12 Q And so you and I will refer to it during
13 our continued examination.

14 Now I'd like to turn now next to an
15 examination of how one goes about determining such a
16 reasonable free market approximating set of rates,
17 beginning with the analysis at page 11, bottom of page
18 11 and forward in your testimony.

19 And I'd like to begin this section of our
20 dialogue by asking you to explain in slightly greater
21 detail the sentence appearing in paragraph 16 at page
22 12 where you state, trying to pick up the beginning.

1 right is that the public performance right has
2 properties of what economists call and it's not a good
3 choice of words, but I'll just mention it so you
4 recognize the jargon, what economists call a "public
5 good."

6 And in this context what is being referred
7 to there is the notion that the consumption of the
8 good by one party in no way precludes the consumption
9 of the same unit, if you like, of the good by another
10 party. So whereas if I sell you a ton of steel, I
11 can't also sell that same ton to Mr. Rich. If I sell
12 you the right to perform my sound recording, there's
13 nothing that stops me from selling that same right to
14 Mr. Rich.

15 And conversely, if I withhold from you the
16 right to perform my sound recording, I haven't saved
17 anything. I don't have more of a my stuff to then
18 sell to somebody else. Whereas, if I withhold from a
19 ton of steel that you'd like, I can either sell that
20 ton of steel to somebody else or perhaps not even make
21 it and save the labor and energy and so forth that
22 otherwise I would have put into making it.

1 Right in the first sentence, you state "as a matter of
2 economic analysis, it is typically not possible to
3 determine the reasonable or competitive fee level on
4 the basis of the fundamental underlying costs and
5 benefits."

6 Could you explain for the Panel in a
7 little greater detail what you are conveying by that
8 statement?

9 A Sure. What I'm trying to get at is as an
10 economist, if I were asked, can you estimate or
11 calculate the competitive market price for steel, it's
12 pretty straight forward, at least conceptually how you
13 do that. The market, the competitive market price for
14 steel is determined by the demand for steel and what
15 it costs to make steel. And if you took some
16 introductory economics course at some point in time
17 there were supply curves and demand curves and we
18 looked for the intersection of the supply curve and
19 the demand curve and that's the competitive market
20 price.

21 The thing that is different about steel,
22 conceptually, that is key from a public performance

1 But if I'm negotiating with you in a
2 willing buyer/willing seller context, to sell you the
3 right to perform in public my sound recordings, and
4 you say forget it, you're just asking too much money.
5 I'm going away. I'm not going to perform your sound
6 recordings, I don't save anything. I don't then have
7 something more I can sell to somebody else and I don't
8 have any savings in terms of my investment in making
9 the sound recording. Whatever I did or didn't invest
10 in making the sound recording it's still there. It
11 hasn't been changed by your decision not to purchase
12 it from me.

13 Now what that means is that this notion of
14 both a willing buyer/willing seller negotiation or I
15 believe equivalently trying to think about a
16 competitive market for the right, there's something
17 different there. We can't sort of go to this sort of
18 normal supply curve crosses demand curve analysis,
19 doesn't really answer the question for us because I
20 don't really have a supply curve for this stuff. In
21 effect, I can supply as much of it as anybody wants.
22 Or I cannot supply it and my costs are unaffected.

1 Now what that means is if you look at how
2 -- and this is a property not just of sound recording
3 performance rights, but of intellectual property
4 generally, copyrights, in most cases, patented
5 technologies and so forth, where what we're selling is
6 intangible.

7 If you look at how these markets work,
8 both in terms of just bilateral negotiations where
9 there is no statutory regime and we're just looking at
10 parties trying to decide whether to license some
11 patent or other kinds of royalties, or whether you
12 look at different contexts in which in this sort of
13 regulatory mode like the ASCAP rate court, a judicial
14 body or regulatory body has been trying to determine
15 an appropriate market fee, typically what they do is
16 they look at benchmarks. They look at comparables.
17 They look at something else that is arguably like the
18 thing we're talking about here. And the point I
19 wanted to make, maybe this was too long winded, was
20 just to say there's a reason why we do that. There's
21 a reason why we don't do what economists do all the
22 other time which is try to figure out what does this

1 rate.

2 Q All you're saying there is that that
3 benchmark for that product or service itself should be
4 presumptively reasonable before you get to any
5 possible adjustment factors?

6 A Yes, and I think that becomes clear as I
7 think about the subsequent steps. So if I find a
8 benchmark that I think is its own context for that
9 licensor and licensee is reasonable, then I have to
10 ask the question is that context analogous to or
11 related to or close to the situation that I have at
12 hand that I'm trying to evaluate? And obviously, all
13 else equal, you'd like it to be more closely related,
14 more analogous, more similar than the situation that
15 you're dealing with.

16 Life is unfair and often you deal with
17 imperfect benchmarks and the benchmarks are in one way
18 or another not ideal, but you want to try to
19 understand the relationship between the benchmark
20 situation and the situation you have at hand.

21 Unless the benchmark is literally
22 identical to the situation that you're dealing with,

1 stuff cost and what's the demand for it which is that
2 it has this intangible property and so its values in
3 some sense really just inherently whatever parties can
4 mutually agree to pay for it.

5 Q Now you indicate that in light of those
6 characteristics, one typically looks to what you term
7 comparable or benchmarks, yes?

8 A Yes.

9 Q Paragraph 17 of your testimony you
10 indicate the factors that one must take into account
11 in thinking about the process of devising benchmarks.
12 Can you describe analytically how one or how you
13 believe one has to go about this process?

14 A Yes. It seems to me the starting point
15 for a benchmark is that it has to itself constitute
16 what I call a reasonable fee, that is a competitive
17 market fee or fee relationship of some sort.

18 If we're looking at a transaction or a set
19 of transactions or a situation in which the fees for
20 the fee structures are not in fact competitive market
21 prices, then it's going to be very hard to use that as
22 a reference point to determine a competitive market

1 and my view would be typically if such benchmarks
2 exist, you don't have litigation. I mean if there
3 really is a situation out there that is reasonable and
4 well established and exactly the one that people care
5 about, usually they can rely on that benchmark and you
6 don't end up in litigation. So if you're in
7 litigation, usually there's a reason, the benchmarks
8 are not all that great.

9 If you're going to in any way extrapolate
10 from one benchmark to a different situation, you need
11 to decide what's the right sort of metric to use to
12 move from one situation to another. Should we assume
13 that licensee A should pay in dollars just the same
14 amount of money, the same absolute amount of money as
15 licensee B? Or should they pay the same percentage of
16 their revenues? Or should they pay the same amount
17 per some other economic activity. And as we're going
18 to see in a minute my view is since what we're talking
19 about here is a performance right, the sensible thing
20 to do is to say the benchmark is what they pay for
21 performance. But one way or another, you need to
22 establish that metric.

1 Having decided you've got a reasonable fee
 2 in a related context and an appropriate metric, then
 3 you can consider as Mr. Rich started to suggest the
 4 question of whether to use that reasonable fee in a
 5 benchmark to infer the reasonable fee in the context
 6 you care about, you have to make any adjustments. Are
 7 there any modifications that you'd want to make to
 8 allow for differences in the context, the benchmark
 9 context and the context that you're focusing on.

10 And then finally, as I say, typically,
 11 you've got more than one benchmark and you may well
 12 have benchmarks that seem somewhat inconsistent with
 13 each other. My view would be the task is not find the
 14 good benchmark and throw out the bad benchmarks. My
 15 view would be the task is decide how much weight to
 16 give to various different benchmarks all of which are
 17 flawed in some way or another, none of which are
 18 perfect analogies for the situation at hand. And so
 19 you need to determine how much significance to give to
 20 different benchmarks which are potentially conflicting
 21 in their indications.

22 Q Now proceeding at paragraphs 18 to 20 of

1 your written direct testimony, you describe the
 2 benchmark options which at least theoretically present
 3 themselves in this setting, namely, where we're
 4 dealing with rates and terms for relatively new
 5 copyright right and my question is how have you --
 6 what are these benchmark options and how have you
 7 weighed them relative to one another?

8 A Well, as is discussed there, and as I
 9 suspect we're going to get to on cross examination,
 10 what we're valuing is the sound recording performance
 11 right for these -- let me just use this short hand
 12 internet broadcasts which encompasses, as we've
 13 discussed, a couple of different subcategories. In an
 14 ideal world, we would look for benchmarks for the same
 15 right in that same context.

16 The problem we face here is that by
 17 definition because this right was only recently
 18 created, and this context is quite new, there cannot
 19 be extensive economic experience that we can observe
 20 that relates to buying and selling of this same right
 21 in this same context. Whatever experience we do have
 22 is going to be over a relatively short period of time,

1 involving relatively small dollar amounts and possibly
 2 and likely parties that are themselves in the process
 3 of trying to figure out what are the right benchmarks
 4 and how do I figure out what a reasonable fee would
 5 be. The market takes a while to resolve that issue.

6 In markets that have been established for
 7 a long time with repeated interactions between buyers
 8 and sellers, over time they develop an understanding
 9 of the equilibrium, if you like, reasonable,
 10 competitive market outcome and the experience will
 11 tend to coalesce around that experience.

12 In a new market, particularly one in which
 13 you have the asymmetry of a single seller dealing with
 14 many buyers with varying degrees of information, it's
 15 going to take a while for that to work itself out and
 16 therefore whatever evidence one does have about
 17 transactions in that market are at a conceptual level
 18 subject to significant reservations about their
 19 validity as a benchmark for a reasonable fee.

20 Q Let me have you pause there. You said
 21 that there is a certain asymmetry here, market
 22 characterized by one seller and many buyers, you said

1 especially.

2 How does that factor further contribute to
 3 the caution which I hear you expressing in relying on
 4 agreements reached in this particular market?

5 A Well, essentially what you have is a
 6 situation where you have one party who has all of the
 7 information that any seller has, so whatever deals
 8 have been made, whatever negotiations have taken place
 9 that haven't resulted in deals, there is one party
 10 who knows about all of them. And that's in this case
 11 the RIAA, acting on behalf of the rights holders.

12 On the other side, you have a multiplicity
 13 of parties, some of whom are start up companies, who
 14 have varying degrees of information, who have
 15 different objectives and different concerns about how
 16 this market evolves. So whereas on the one hand RIAA
 17 is in a position to think about the entire market
 18 every time it negotiates with one party, the counter
 19 parties, first of all, are not in a position to think
 20 about the whole market because they don't know what's
 21 going on and second of all, they don't care about the
 22 whole market. They only care about their deal. They

1 don't particularly care about the consequences that
2 this deal might have for market conditions or for that
3 matter for this CARP, whereas the RIAA does.

4 So you have an asymmetry of incentives and
5 an asymmetry of information which I think at a
6 conceptual level makes it unlikely that observations
7 drawn from that experience in the first few years
8 would be indicative of competitive market outcomes.

9 Q You talk in paragraph 19 that even where
10 there is good information available in the market
11 place, that there tends to be or there will always be
12 in your words a range of buyer valuations. How does
13 that – can you explain that concept a bit more and
14 how that concept fits with your framework of analysis
15 here?

16 A Yes, different buyers in this market,
17 potential licensees have different circumstances.
18 They're going to use the music in potentially
19 different ways. Streaming varies in its economic
20 significance to their broader business objectives.
21 Their financial constraints may be different. And
22 those different circumstances potentially are going to

1 lead them to different valuations of the right. Now
2 if they were dealing with individual licensors and
3 there were a multiplicity of licensors, that would
4 sort itself out and the market would sort of match up
5 licensors and licensees to maximize value. But when
6 they're dealing with a single licensor who has in his
7 mind, its mind maximizing not the value of this
8 transaction, but the overall value of the market,
9 there's a strategic asymmetry there wherein the
10 licensors can choose which licensees to deal with in
11 such a way as to create a track record of transactions
12 with a particular group of licensees that may not be
13 representative of the larger population of licensees
14 that may have different circumstances.

15 Q You state in the middle of paragraph 19
16 that "in a competitive market, the market price will
17 not be determined by the valuation of a small number
18 of users who place the greater value on the service or
19 product in question."

20 Do you see that?

21 A Yes.

22 Q Do you believe that that phenomenon is

1 capable of occurring in this market?

2 A Yes. Because of the incentive, on behalf
3 of RIAA to create a record of high value deals, I
4 think there is a likelihood that the experience that
5 you're going to see is going to be disproportionately
6 drawn from that high value end of this distribution or
7 this spectrum which is not how a competitive market
8 would play out.

9 Q Incidentally, a slight digression, you
10 indicated that you testified in this recent BMI-Music
11 Choice proceeding, is that right?

12 A Yes.

13 Q And there involved was the musical works,
14 performing right fee for Music Choice which itself
15 had been a party to a prior CARP proceeding. Is that
16 your understanding?

17 A There were far too many pronouns in your
18 sentence. They had been subject to a prior CARP
19 proceeding, not related to the musical works
20 performance rights.

21 Q But relating to a 114 license applicable
22 to them as subscription music services, is that your

1 understanding?

2 A I'm not sure I know the section number,
3 but they were subject to a previous CARP with respect
4 to their sound recording performance right.

5 Q Thank you, as always you're more precise
6 than I am.

7 Let me be less oblique and turn you to a
8 paragraph, one of the footnotes in your opinion which
9 is footnote 16 appearing at page 17. And I was
10 wondering the degree to which the observation you make
11 in that footnote now fortified by your experience in
12 the recently concluded BMI rate court relates, if it
13 does, to the comments you made about relying on
14 agreements in a nascent marketplace?

15 A Yes. In the BMI rate court, where what
16 was at issue was BMI's musical work performance fee,
17 BMI's basis for claiming that the fee should be 4
18 percent was primarily a transaction that had taken
19 place between DMX, a competitor of Music Choice and
20 BMI, and to a lesser degree a couple of other
21 transactions between DMX and Music Choice and BMI that
22 have occurred in the early 1990s when cable radio was

1 a new industry.
 2 Those musical works agreements from the
 3 early 1990s which BMI was relying on in the rate court
 4 case just completed, were part of the basis that the
 5 CARP that was dealing with the sound recording right
 6 on digital radio used in making its decision. So the
 7 CARP was looking at these early 1990s BMI cable radio
 8 agreements and BMI asked the BMI rate court to rely on
 9 those same agreements to support the 4 percent fee
 10 that it was requesting in rate court, essentially for
 11 a subsequent period of time.

12 And Judge Stanton rejected those
 13 agreements as a benchmark, I'd like to think on the
 14 basis of my testimony --

15 (Laughter)

16 -- that one of the problems with relying
 17 on those agreements was that they were formed in this
 18 early period in which BMI was able to extract in
 19 effect above competitive rates from these licensees
 20 and DMX in particular because of this early stage of
 21 the industry.

22 And so in my footnote here at which point

1 A Yes, that's true.

2 Q Now before we --

3 ARBITRATOR VON KANN: His rationale was
 4 what again? Can you just restate that for rejecting
 5 it?

6 THE WITNESS: Well --

7 ARBITRATOR VON KANN: I know you said
 8 there were early agreements.

9 THE WITNESS: Yes. It's a little
 10 complicated and his decision is terse on this point.
 11 There had been an early agreement for 2 percent of the
 12 combined revenue of Music Choice and the cable
 13 operator that delivers the Music Choice signal.

14 There was testimony that the 4 percent
 15 agreements were -- which was 4 percent just to Music
 16 Choice's or in this case, DMX's revenue, that the way
 17 they got the 4 percent was to take what had been 2
 18 percent of a bigger revenue base, including revenue
 19 associated with the cable operator and to gross it up,
 20 if you will, to create a higher percentage of a lower
 21 base that would produce, in effect, the same outcome
 22 and what Judge Stanton, I think, said was I believe

1 Judge Stanton hadn't yet given his opinion, all I
 2 indicate is that Music Choice was challenging the
 3 reasonableness of the fees that were the basis for
 4 that CARP decision. Judge Stanton has now issued his
 5 opinion and in effect has accepted that argument and
 6 turned instead to an alternative benchmark for the
 7 musical works fee for BMI.

8 Q You may have misspoken when you said BMI
 9 was challenging. You meant Music Choice was
 10 challenging?

11 A Yes, if I said that BMI was challenging
 12 them, I misspoke. What I meant to say was that the
 13 licensee, in this case, Music Choice, footnote 16, I
 14 say the reasonable of the rates is being challenged.
 15 It was being challenged by Music Choice and they
 16 prevailed in rate court on that point.

17 Q And Judge Stanton reached the conclusion
 18 he reached which was not to give significant value to
 19 this prior arm's length negotiated deal even though,
 20 am I correct, even though it was the case that DMX had
 21 available to it as an option resorting to the BMI rate
 22 court?

1 their initial ability to get not just 2 percent of
 2 Music Choice's revenue, but 2 percent of the cable
 3 operator's revenue as well as a reflection of BMI's
 4 market power in this early period in which actually
 5 BMI didn't yet have a rate court.

6 And so when they then converted the 2
 7 percent of a bigger base to 4 percent of a smaller
 8 base, they were preserving that artifact of market
 9 power from the early period, even though -- I don't
 10 believe he actually said anything about the fact that
 11 there was still a rate court, although there was
 12 certainly testimony to that effect, so he knew that.
 13 And so he concluded on that basis that that number was
 14 too high.

15 Maybe it's helpful, and we'll get to it
 16 later, but it's probably helpful at this point, the
 17 number that he chose, which was 1.75 percent, the
 18 upper end of my range, was a number which he could
 19 justify in two different ways. And in his opinion, he
 20 refers to both ways. One is as a rate that BMI had
 21 offered to Music Choice for its Internet activities.
 22 This is, again, musical works.

1 So Music Choice, as an entity, sends its
2 music over cable and satellite. It also has a small
3 webcast operation in effect. And BMI had offered 1.75
4 percent to Music Choice with respect to the webcast
5 operation. And I had testified I don't see why it
6 makes sense to say it should be 1.75 percent on the
7 Internet and four percent over a cable line. And that
8 was one of the things the judge picked up on. He also
9 managed to reconstruct 1.75 percent from a
10 modification of the original two percent, and he sort
11 of said it really works out to be about the same. And
12 so I think 1.75 is reasonable.

13 CHAIRMAN VAN LOON: Am I correct in
14 remembering that's the Bonneville decision that we --

15 ARBITRATOR VON KANN: No, it's not.

16 MR. RICH: That's the decision of U.S. v.
17 BMI application of Music Choice, which we also
18 provided.

19 THE WITNESS: Understandable there could
20 be confusion at this point.

21 MR. RICH: Yes.

22 CHAIRMAN VAN LOON: What I'm wondering,

1 moment on the issue of how one deals with new markets
2 -- new agreements in new markets, would you take a
3 look at footnote 12 of your written direct testimony
4 appearing at page 13, which is a reference to certain
5 amendments to the ASCAP consent decree?

6 A Yes.

7 Q What relevance does what you write in
8 footnote 12 have to the topic you and we and the Panel
9 have been discussing over the last little while?

10 A Well, as is discussed in footnote 12, the
11 ASCAP consent decree, which is the framework that
12 governs the determination of reasonable rates for
13 ASCAP in the ASCAP rate court, has now been modified
14 to, in effect, exclude as evidence of reasonable fees
15 transactions negotiated by ASCAP and users in the
16 first five years of a new medium. And the Department
17 of Justice, in explaining how this modification uses
18 language quite similar to what I was using a few
19 moments ago, basically saying that the users are
20 fragmented and inexperienced, and in addition, are
21 unlikely to lack -- may lack the resources to invoke
22 rate court proceedings.

1 It's -- we normally have a 4:30 break period due to a
2 variety of things. We've stretched things over. It's
3 now five, and we're in Roman III of the testimony
4 where we really get into the model. Whether it might
5 make sense to take a short break now and then be able
6 to come back at 5:20.

7 MR. RICH: Sure.

8 CHAIRMAN VAN LOON: Let's just do an early
9 forecast at least. As much as two hours.

10 MR. RICH: That's a guess.

11 CHAIRMAN VAN LOON: Okay. So we want to
12 do everything humanly possible to complete --

13 MR. RICH: Might be a little less, closer
14 to an hour and a half, but that's a little bit of a
15 guess.

16 (Whereupon, the foregoing matter went off
17 the record at 5:05 p.m. and went back on
18 the record at 5:26 p.m.)

19 CHAIRMAN VAN LOON: Please resume then,
20 Mr. Rich.

21 BY MR. RICH:

22 Q Professor Jaffe, staying for another

1 They add an additional point, which I
2 hadn't mentioned, which may be relevant for some of
3 the transactions that would occur in this market,
4 which is that a licensee that expects to have very
5 little revenue may well agree to a high percentage of
6 revenue fee knowing that in fact they're going to pay
7 very little money under it, but that that may not be
8 evidence that it is a reasonable percentage of revenue
9 for the market more broadly.

10 Q I take it the evidentiary bar, which is
11 reflected in these new amendments, reflects a series
12 of concerns consistent with those, which you, as an
13 economist, have outlined pertaining in this setting to
14 the weight -- the potential weight to be given to
15 license agreements reached in the early stages of this
16 market; isn't that correct?

17 A Yes.

18 Q Now, before we move on to the preferred or
19 the alternative benchmark, which you did settle, just
20 one other question about the agreements which the RIAA
21 has proffered. Even acknowledging the newness of a
22 series of agreements and the uncertainty and, from

1 your view, the potential unreliability, why not simply
2 adjust whatever rates are reflected in those
3 agreements to account for that uncertainty and thereby
4 make them reasonable? Why not do that process?

5 A Well, in order to adjust a fee, which is
6 something that I talk about in my testimony, and that
7 I've done, you need to have an economic basis for the
8 adjustment. If there's been inflation or if the
9 market is bigger or there's some quantifiable factor
10 that is different between the benchmark setting and
11 the setting you care about, you can make an adjustment
12 that reflects that quantifiable difference.

13 If you're starting from a fee which cannot
14 be presumed to be reasonable or a set of fees which
15 there's reason to believe are unreasonable, it's not
16 clear what the basis is for any adjustment, what the
17 metric would be that you would use to make the
18 adjustment. All you know is that the fee is likely to
19 be too high, but it's very difficult to quantify the
20 extent of unreasonableness, if you like, and to
21 therefore figure out some basis for making an
22 adjustment for that.

1 over the Internet, if we could try to stay in this
2 same medium, even though we need to look at a
3 different right, we have many of the same problems
4 that we have with respect to the sound recording being
5 licensed over the Internet, because even though the
6 right is not new -- there's been a right in public
7 performance of musical works for a long time -- the
8 medium is new, and the experience such as it is with
9 respect to licensing of musical works on the Internet
10 suffers from many of the same conceptual problems of
11 looking for transactions involving licensing of sound
12 recordings on the Internet.

13 It's a new medium, inexperience. What is
14 out there is, in effect, licenses that have been
15 offered by BMI and ASCAP, have been accepted by some
16 licensees but not by others, and which at least with
17 respect to the BMI license are currently being
18 litigated in BMI rate court. So we have sort of an
19 analogous somewhat unsettled situation with respect to
20 the musical works on the Internet.

21 In addition, I have just a computational
22 problem if I were to look at those fees which is that

1 Q Now, beginning at page 15 of your written
2 direct testimony, paragraph 21, you begin to outline
3 the benchmark fee model on which you rely, and you
4 begin by describing the factors which you took account
5 of in identifying an appropriate benchmark and the
6 conclusions you derived. Could you summarize for the
7 Panel the material appearing in 3(a) of your written
8 testimony?

9 A Yes. Well, for the reasons that we've
10 just been discussing, I was uncomfortable looking to
11 transactions for the same right in this same medium of
12 the Internet. As you well know, there is this related
13 right of the musical work, and as you know from
14 reading my testimony, I eventually went to looking at
15 the musical work in the over-the-air radio context as
16 my benchmark. Let me address, in effect, both of
17 those dimensions in which I, therefore, have to think
18 about the relationship of that benchmark to the
19 setting we care about.

20 And let me talk, first, about the Internet
21 versus over-the-air radio. With respect to the sound
22 -- sorry, with respect to musical works being licensed

1 what BMI and ASCAP have offered are percent of revenue
2 licenses with a minimum fee to a group of licensees,
3 many of whom have very little revenue and are probably
4 paying the minimum fees. And so I'd be uncomfortable
5 drawing broad economic conclusions about reasonable
6 fees from a set of market circumstances in which many
7 or most of the licensees are in fact just at the
8 minimum and are not really operating under the fee
9 formula, if you will.

10 Q Do you have an understanding of the
11 approximate level of that minimum?

12 A Yes. I know from the ASCAP web site, for
13 example, that for ASCAP it's \$264, I think. It's in
14 a footnote in my testimony.

15 Q Okay. So --

16 CHAIRMAN VAN LOON: Per year?

17 THE WITNESS: Per year, correct.

18 BY MR. RICH:

19 Q So this phase of what you've just
20 testified to addresses why you selected over-the-air
21 musical works performing rights versus the Internet;
22 isn't that correct?

1 A Correct.

2 Q And we'll come back to the adjustment
3 issue in a bit?

4 A Yes.

5 Q What's the second aspect of benchmarking
6 that you had to consider?

7 A So then the other major issue is looking
8 at musical works rather than looking at sound
9 recordings. And I approached this, at least
10 initially, as a conceptual matter in the context of
11 the willing buyer/willing seller competitive market
12 test that I want to apply. And I believe that there
13 is a strong basis at a conceptual level to conclude
14 that the value of the performing right -- I'm not
15 talking about the value in a CD or the value on
16 television or the value anywhere else -- but that the
17 value in the public performance right that we're
18 talking about, when looked through the lens of willing
19 buyer/willing seller competitive market for the sound
20 recording, is likely to be no greater than, and
21 probably less than, the reasonable rate for the
22 musical work.

1 And the reason for that is the underlying
2 logic of a willing buyer/willing seller framework.
3 From the buyer's point of view, these two rights, I
4 think Mr. Kempton said it this morning, it's not that
5 they're similar, it's that they're the same; they come
6 together. When you make a performance you use both of
7 them, and you use them simultaneously. So from the
8 point of view of the buyer, they can't have a
9 different valuation. One is in fact worthless without
10 the other. They are what an economist would call
11 perfect complements. They're like right shoes and
12 left shoes is the example we use in our economics
13 classes. Having one without other really is not of
14 any value to you. So from the buyer's point of view,
15 going into that hypothetical willing buyer/willing
16 seller negotiation, they're identical.

17 Now, from the seller's point of view, it's
18 a more complicated analysis. There are different
19 sellers. On the one hand, we're talking about perhaps
20 RIAA as agent for the sound recording owners and
21 ASCAP, BMI, and SESAC as agent for the musical work
22 owners. And we've heard a lot of testimony over the

1 course of this hearing about the cost of making
2 records and the risks of making records and so forth,
3 and there's no question that the production process,
4 if you like, for a sound recording is not the same as
5 the production process for a musical work. I mean
6 that's just obvious.

7 But the question is when those respective
8 intellectual property potential licensors go into a
9 hypothetical negotiation, are they in different
10 positions? We've already said the buyers are in the
11 same position. So if the sellers are in the same
12 position, on average, we would expect essentially the
13 outcome to be the same.

14 And I would argue they are essentially in
15 the same positions, which is that in both cases they
16 have created this intangible, either the musical work
17 or the sound recording. Whatever it cost to make it,
18 they've already spent that. Whatever risks that they
19 incurred in making it, they have incurred. Whatever
20 revenues they get from other sources that offset those
21 costs, they're getting those. And this negotiation
22 isn't going to change that.

1 So they're walking into a negotiation over
2 an intrinsically incremental use or incremental
3 application of this existing intellectual property.
4 I can't, as an economist, see why there would be any
5 difference in the positions -- their bargaining power,
6 their bargaining position, if you like, going into
7 that negotiation. What they know is that if they
8 don't sell it to these webcasters, they can't sell
9 that same right to somebody else. They can sell the
10 right to other people, but if this guy refuses, they
11 don't save anything.

12 So we've got, essentially, a bargaining
13 situation between a buyer who needs this right and a
14 seller whose costs and risks are sunk who is
15 essentially trying to extract however much they can
16 get out of this buyer, and there's going to be some
17 outcome of that bargaining. But what we've got is a
18 situation where fundamentally the buyer is the same
19 and has an identical need for both. The sellers are
20 different but are coming to that hypothetical
21 negotiation from a very similar economic situation.

22 And so I think, just bottom line, is that

1 there is a very strong economic basis for getting the
2 conclusion that the overall value in this willing
3 buyer/willing seller competitive market framework for
4 these two rights ought to be the same.

5 Now, I should say I'm going to talk in a
6 minute about the fact that the royalty is not the only
7 way that value is conveyed. The value is conveyed in
8 other ways as well, and we're going to talk about
9 that, and that's where the promotional value comes in.
10 But in terms of the overall value of the two, there's
11 a strong economic argument why they would be the same.

12 Q Why isn't the fact, if it's a fact, it's
13 certainly been suggested to be the fact, that there
14 was significantly greater investment and arguably risk
15 associated with creating the product, one product that
16 generates the performance right, the sound recording,
17 versus another which generates the music performing
18 right, namely the music publishing end of the
19 operation, why doesn't the relative cost/risk factors
20 there bear on the value issue, as you analyze it?

21 A Because the record labels do not, to any
22 extent, mitigate those costs or risks if they choose

1 not to participate in this particular application of
2 their intellectual property. Those costs and risks
3 and the associated revenues are what they are, and
4 they don't get more -- they don't get bigger and they
5 don't get smaller if they make a deal with this
6 particular set of users of the intellectual property.

7 It goes back to what I was saying before
8 about the steel versus an intangible asset. If it
9 costs me a lot of money to make a ton of steel, I'm
10 not going to sell it to you cheap, because by not
11 selling it to you, I can avoid incurring those costs.
12 But the fact that it costs me a lot of money to create
13 a sound recording is fundamentally neither here nor
14 there when I walk into the room to negotiate with you,
15 potential licensee, over how much revenue I can get
16 from you for that intellectual property.

17 Q In paragraph 23 of your testimony, you
18 reference approaches taken by the prior CARP -- the
19 prior Section 114 CARP and in Canada. I take it you
20 mention it because you view those to have some
21 relevance as well?

22 A Well, like anybody else, I like it when

1 other people agree with me, so I point it out. The
2 prior CARP conceptually took a similar approach in
3 terms of looking at the compositions. As we discussed
4 a moment ago, I think in terms of the number that they
5 used for the composition rate, they chose a number
6 which, in effect, has now been shown to be too high.
7 But, conceptually, they adopted the same approach of
8 looking at the musical works. And, again, in Canada,
9 as we had some discussion of earlier today, they
10 concluded that they would use an equal valuation of
11 the sound recording and the musical work.

12 Q Now, you indicated at an earlier part of
13 our conversation that an important predicate to the
14 benchmark is a threshold determination that that
15 benchmark fee in that original context itself has
16 indicia of reasonableness. Have you formed an opinion
17 whether the licensing marketplace in which ASCAP, BMI,
18 and SESAC license music performing rights for over-
19 the-air broadcast by radio stations is a competitive
20 marketplace?

21 A Yes.

22 Q And what is your opinion?

1 A My opinion, which I think is backed up by
2 the way the rate court itself talks about that
3 marketplace, is that what occurs in that marketplace
4 -- and I think Judge Gulin had some discussion of this
5 earlier today at a conceptual level -- is that
6 royalties are set often by negotiation with a backdrop
7 of the rate court as a recourse, in this case, for
8 either party if they are not satisfied with a
9 negotiated outcome. Sometimes there actually is a
10 rate court proceeding, and a rate is set by a rate
11 court. So what we have is sort of this mixture of
12 actual rate court outcomes and negotiated outcomes
13 which are negotiated with the backdrop or the backstop
14 of the rate court.

15 Now, rate court is expensive, and so my
16 view would be that it is only an imperfect backstop in
17 the sense licensees are going to agree to fees that
18 are somewhat higher than a reasonable level to avoid
19 the cost of going to rate court but not too much
20 higher, because at some point they would go to the
21 rate court and get a reasonable fee. So what I
22 believe is that the ASCAP and BMI rates backstopped by

1 the rate court are likely to be either reasonable or
 2 perhaps somewhat higher than reasonable but are
 3 certainly not likely to be lower than reasonable.

4 Now, then there is this slight
 5 complication of the third organization, which is
 6 called SESAC, which is different from the CISAC we
 7 discussed earlier today. This one is S-E-S-A-C. And
 8 don't ask me what it stands for, because I don't think
 9 I remember. SESAC is much smaller than BMI and ASCAP
 10 and does not have a rate court. It negotiates with
 11 licensees. Many licensees, in effect, need SESAC
 12 because they've got enough music that if you're going
 13 to have diverse programming, you really can't avoid
 14 using some of their music. So, in a sense, SESAC has
 15 market power even though they're small, because with
 16 respect to the music that they've got, if you, as a
 17 licensee, sort of need it, they're the only place to
 18 go. And they don't have a rate court.

19 So it's reasonable to expect that the
 20 SESAC fees are above the competitive level. However,
 21 they're a relatively small component of the total,
 22 because their repertoire is quite small. So it's

1 another reason why the over-the-air musical works fees
 2 may be somewhat higher than reasonable but are not
 3 lower than reasonable.

4 Q In creating your model and arriving at
 5 your proposed fee metric, did you make any explicit
 6 adjustment for the possibility that the
 7 ASCAP/BMI/SESAC fees are above reasonable fee levels
 8 in their own market?

9 A No, I did not.

10 Q Now, just on the point of SESAC and all,
 11 just so we're clear, because I think there may have
 12 been some ambiguity in the dialogue with the prior
 13 witness, could you describe for the Panel your
 14 understanding as to the respective operations of
 15 ASCAP, BMI, and SESAC, one to another; that is, the
 16 degree to which a user has fungibility or
 17 interchangeability between one or the other society?

18 A Well, my understanding is that the
 19 agreements that ASCAP and BMI and SESAC have with
 20 composers and publishers who own the musical works are
 21 non-exclusive in the sense that that owner of the
 22 musical work retains the right on their own to make

1 direct licensing of the performance rights with
 2 potential licensees. So a composer who is a member of
 3 ASCAP, if approached by a television station in
 4 saying, "Look, we'd like to cut our own deal with you.
 5 Will you directly grant us the performance rights in
 6 your compositions," that composer is not precluded by
 7 their ASCAP agreement from doing that.

8 However, they are precluded from being a
 9 member of BMI at the same time that they're a member
 10 of ASCAP. So a given publisher, a given composer will
 11 typically be a member of one of these organizations.
 12 There's not much reason to be a member of none of
 13 them, because, as Mr. Kempton said, in effect, you're
 14 just leaving money on the table by doing that. But
 15 would not be a member of more than one.

16 For that reason, these organizations --
 17 BMI, ASCAP, SESAC -- compete with each other for
 18 licensors. They compete with each other to sign up
 19 the composers and sign up the publishers and get a
 20 bigger repertoire. They don't actually compete with
 21 each other from the perspective of a licensee, from
 22 the perspective of a radio station or a television

1 station who's putting on diverse programming.

2 Basically, they need all three licenses.

3 The ASCAP license is not a substitute for a BMI
 4 license, because, at least in general, there may be a
 5 few exceptions to this, it's not possible for a
 6 general broadcaster to eliminate all of the music of
 7 one society or one organization from their
 8 programming. And so they need licenses from all
 9 three, and therefore they don't compete on the
 10 licensee side.

11 Q Now, you commented a bit on the effect on
 12 price levels in the music performing rights
 13 marketplace of the existence of the ASCAP and BMI rate
 14 courts, yes?

15 A Yes.

16 Q Coming back into the instant setting, the
 17 Panel has had many questions about the effect of the
 18 compulsory license here on the market power, if there
 19 be market power, that reposes in the RIAA. And I
 20 would ask you to comment and provide the Panel with
 21 your expert opinion on how they should be thinking
 22 about that issue.

1 A Well, analytically, the question is
2 straightforward. The question is, from the point of
3 view of a potential licensee who is talking to the
4 RIAA, perhaps, about doing a voluntary agreement for
5 the right to perform sound recordings and streaming,
6 the question is does the option of instead relying on
7 this Panel to set a fee and paying the fees set by
8 this Panel, is that option a good substitute, from the
9 potential licensee's perspective, for making a
10 voluntary deal with the RIAA?

11 If it is a good substitute, then almost by
12 definition RIAA does not have market power, because if
13 they try to demand a license fee that is above a
14 reasonable level -- let's put aside for a moment the
15 question of sort of whether the licensees actually
16 understand this whole process and have good
17 information about it and so forth; that's sort of a
18 separate issue. But if we assume that the licensees
19 know that the CARP exists, they know how it works,
20 they know exactly what rights it gives them, and those
21 rights are a good substitute for what it can directly
22 from RIAA, if RIAA were to ask for too high a fee,

1 they would say, "No. I'm going to take this other
2 option that is available to me, and it's a good
3 substitute for me, so I'm happy to do that."

4 But if that option of relying on the CARP
5 is not, for the licensee, a close substitute to what
6 it is RIAA is offering them in this voluntary
7 transaction, then RIAA still has market power despite
8 the existence of the compulsory license. And the
9 reason is because the licensee is going to sit there
10 -- if they are presented with a monopoly rate, they're
11 going to say, "Well, let's see, I can take this rate,
12 which I think is too high. That's one option. My
13 other option is to rely on the CARP." But if that's
14 not a close substitute, if that thing is not
15 equivalent or close to equivalent from the user's
16 point of view, they may well say, "Well, I've got that
17 option, but it's an inferior option, and so even
18 though I'm being presented with a monopoly price, I'm
19 going to accept it."

20 And so, conceptually, the question is
21 whether or not the reliance on the CARP and the rights
22 that that affords constitutes a good substitute from

1 the licensee's perspective for a voluntary deal
2 negotiated with the RIAA.

3 Q Can you conceive of instances in which a
4 licensee in this marketplace would find that the
5 availability of this CARP procedure is not a suitable
6 or close substitute?

7 A Yes. I think there are a number of
8 reasons at a conceptual level why that might be the
9 case. Whether and to what extent these apply to the
10 actual contracts that we've been presented with is a
11 factual question that I'm not prepared to address as
12 I sit here. But I think at a conceptual level, there
13 are a number of reasons to believe that the RIAA --
14 sorry, that the CARP and the rights it conveys would
15 not necessarily be a good substitute.

16 The first two are interrelated, and they
17 could operate separately or they could operate
18 together, but they're potentially related to each
19 other. And they have to do with uncertainty is one
20 and timing is the other. So by definition, if I'm
21 negotiating with RIAA and this CARP has not yet
22 commenced, one of the things RIAA offers me is a deal

1 today. And if it matter to me to get that deal today
2 and to be able to say I'm licensed with the RIAA, and
3 I've got it in hand, if that matters to me as a
4 licensee, almost irrespective of why it matters to me
5 as the licensee, if it matters to me as the licensee,
6 then that means waiting for the CARP may not be a good
7 substitute.

8 Now, related to that is this uncertainty
9 issue, because part of what waiting for the CARP means
10 is I don't know what the outcome of the CARP is going
11 to be. I don't know what the rate is going to be.
12 I'm incurring a liability. The only way I get to
13 broadcast my sound recordings without signing a
14 voluntary deal is stating, in effect, my willingness
15 to pay whatever comes out of the CARP. So I'm
16 incurring that liability without knowing its
17 magnitude.

18 And, again, that may make that not a good
19 substitute. I may have a boss who doesn't care about
20 the details of this but wants to see my budget and a
21 blank line to be filled in later. It may be a
22 problem. I may have customers who I'm working out

1 related deals with, the terms of which, the pricing of
2 which, either from my point of view or their point of
3 view, are going to depend on what's paid for this
4 right. Or I may have investors who I'm trying to
5 raise money from who want to see a business plan and
6 want to know what those numbers look like.

7 If, for whatever reason, an uncertain
8 number is inherently a bad substitute for a certain
9 number, even if that certain number is higher than I
10 think it should be, again, that's a reason why the
11 voluntary deal -- sorry, say it the other way, the
12 reliance on the CARP and what it can give me is not a
13 good substitute for the voluntary deal.

14 The last category is distinct from those
15 two of timing and uncertainty, and it relates to what
16 an economist would call bundling, which essentially is
17 the concept that what I'm getting from the RIAA when
18 I make a voluntary deal may not be just the same
19 rights that I get when I rely on the CARP. And in
20 particular, this is a medium in which many of these
21 licensees want to do other things besides just
22 streaming, some of which require voluntary licensees

1 from the record labels. And if the licensees are told
2 or perceive that they're going to have better success
3 getting those things if they do a deal for the rights
4 for 114, then the package that they're paying for when
5 they agree to a royalty is bigger than the package
6 that you get by relying on the CARP. It involves and
7 incorporates access, in some sense, to these other
8 rights. So, again, that would be a reason, at least
9 potentially, conceptually, why the statutory license,
10 the reliance on the CARP may not be a good substitute.

11 And then the final reason, again, the
12 empirical significance of this I don't have
13 information on, comes back to this issue of the cost
14 of the backstop. Licensees may view the deal that's
15 being offered by RIAA as somewhat unreasonable but
16 conclude that given the amount of money involved they
17 would rather pay that than participate in a CARP and
18 incur the legal fees and other costs associated with
19 doing that.

20 Now, in this context, that issue is a
21 little more complicated than in the BMI/ASCAP context,
22 because licensees do have an option of, in effect,

1 free riding, of saying, "Well, I'm going to rely on
2 the CARP outcome, but I'm not going to participate in
3 the proceeding." That can't be what everybody does.
4 Somebody's got to step up to the plate somehow or
5 there won't be a proceeding. So in some sense, that
6 can't be sort of the universal phenomenon.

7 And, certainly, any licensee who feels
8 that their situation is sufficiently distinct from
9 that of many other likely participants in the CARP
10 that their interests would not be represented well, is
11 going to say, "Well, I don't really have an option of
12 free riding. If I don't do a deal with the RIAA, I'm
13 going to have to participate in the CARP, because I
14 really can't rely on those guys to protect my
15 interests." And so what might happen would be
16 licensees who have somewhat unusual circumstances that
17 they view as different from what are going to be the
18 interests pursued by other parties in the CARP, again,
19 would have an incentive to do a deal and avoid the
20 cost of participating in this proceeding.

21 Q Now, at the outset of this set of
22 responses, you said putting licensing knowledge to one

1 side.

2 A Right.

3 Q I don't want you to put it to the side any
4 longer.

5 A Okay.

6 Q How does that bear on this aspect of --

7 A Well, I alluded to it earlier, and there's
8 really two dimensions to it. There's do the licensees
9 literally understand how the legal framework works?
10 Do they understand, for example, that they can rely on
11 the CARP without actually participating and incurring
12 legal costs? And do they understand that by filing
13 the appropriate paper, they can begin streaming
14 immediately, and they have no need to do anything else
15 in order to commence their operations?

16 As economists, we like to believe that
17 there's good information out there, and business
18 people learn what they need to learn. But, again,
19 that takes time; it doesn't happen instantaneously.
20 And so there's a threshold question of whether these
21 guys really understood that this option was available
22 and how it worked.

1 And then the other information issues that
 2 I alluded to earlier is do they have a good sense of
 3 what an appropriate fee is, what a reasonable fee is?
 4 This is a new market, they're new at it as well. And,
 5 typically, what we would observe in a new market is a
 6 process of give and take and success and failure and
 7 these things kind of playing themselves out as the
 8 marketplace works out what prices are going to be,
 9 what rates are going to be.

10 Q Let's return to the steps by which you
 11 built your model. You've testified now as to why you
 12 selected, in the circumstances, the over-the-air radio
 13 music performing rights fee. At paragraph 27 of your
 14 testimony, you address the issue of how you can
 15 reliably translate in an economically equivalent way
 16 that reasonable fee from that setting into this
 17 proceeding. Can you address what's involved there?

18 A Yes. As I think has been alluded to, the
 19 fees that are paid by over-the-air radio stations by
 20 ASCAP, BMI, and SESAC are calculated on the basis of
 21 a percentage of the so-called net revenue of the radio
 22 stations themselves. Now, I actually, when I started

1 this assignment, thought about, in effect, taking
 2 those percentages and of trying to apply them as a
 3 percentage of revenue to the current instance. But I
 4 concluded that that was a problematic thing to try to
 5 do, because the revenue of these licenses doesn't
 6 necessarily correspond in terms of its economic
 7 meaning to the revenue of the over-the-air
 8 broadcasters.

9 And there are really a couple of
 10 dimensions to that. One is that, just for starters,
 11 the revenue of any business, on average, has to cover
 12 all of its costs. That's what a competitive market
 13 does in the long run, is revenues, basically cover
 14 costs. The percentage of revenue that goes to this
 15 particular right in a competitive market is going to
 16 be affected by how big those other costs are. If
 17 there are a lot of other costs that have to be
 18 covered, the revenue's going to have to be bigger to
 19 cover those other costs, and the percentage that goes
 20 to this particular right out of that large revenue pie
 21 is going to be different.

22 More prosaically, or more practically,

1 even defining the appropriate revenue for webcasters
 2 may well be problematic because of the way they use
 3 streaming. And what a radio station does,
 4 essentially, is broadcast music, and so it's well
 5 defined what the revenue is for broadcast music and
 6 other things. It's well defined. What is the revenue
 7 associated with those performances? If I have a
 8 streaming webcaster who has a bunch of other things
 9 going on on their web site, it's not at all obvious
 10 how you figure out what is the right stream of
 11 revenue, even if you knew what the right number was.
 12 What is the right stream of revenue to apply that to?

13 So my view is that the reason we often see
 14 royalties for intellectual property, whether it's
 15 music or other things, tied to revenue is because we
 16 want some kind of scaling of the magnitude of use of
 17 the right. And revenue is a very convenient scaling
 18 factor, because it's easy to observe, it's easy to
 19 verify, companies typically have certified accountants
 20 who sort of vet and verify their revenue numbers. But
 21 it's nothing more than a proxy or an indicator of what
 22 is the scale of the licensed activity, because we want

1 to collect more money from licensees who are sort of
 2 doing more of this licensed activity?

3 Now, when I started thinking then about,
 4 well, what would be another measure of the scale of
 5 the licensed activity, I focused in on the
 6 performances themselves. So if I actually knew the
 7 reasonable fee that's paid every time a performance is
 8 made -- and by a performance what I mean is some
 9 amount of music -- and I'll come back to sort of how
 10 much -- is heard by one person? And it's not clear
 11 whether it should be a fixed duration of music or one
 12 song. There's no agreement in this realm -- and I
 13 think Judge Gulin will remember this from PBS -- on
 14 how do you measure pounds of music? There's no
 15 agreement on that. Some people focus on numbers of
 16 songs, others focus on minutes of music. So there is
 17 some ambiguity there.

18 But let's, for the moment, think of it as
 19 just an hour of music. A station that plays more
 20 hours of music to more people, is doing more
 21 performances ought to pay more for those rights. If
 22 we knew what is the competitive market price of a

1 performance in the over-the-air radio context, it
 2 seems to me that can be directly translated then to
 the Internet context, because we've honed it down to
 4 the performance itself. We're not looking at
 5 percentage of revenue where that involves a whole
 6 bunch of things that differ between the over-the-air
 7 context and the Internet context. We've really got it
 8 down to the very thing that we're licensing -- a
 9 performance of a chunk of music.

10 And we then began asking the clients a bit
 11 about how this might be implemented. And what we
 12 found out is that actually in the Internet context,
 13 quite fortuitously, the number of performances, at
 14 least in the sense of hours of music or hours of
 15 streaming, times numbers of people is something they
 16 actually measure anyway. That's not true in over-the-
 17 air radio. So licensing on this basis in over-the-air
 18 radio would be potentially problematic because they
 19 don't track this concept in the same way.

20 But over the Internet, because they have
 21 to purchase bandwidth, which is essentially how -- I
 22 mean I'm not going to go into this technically because

1 what do they, in effect, pay on a per listener hour
 2 basis?

3 And interestingly, although there is some
 4 variation in that number across markets, across
 5 licensees, there's actually not that much variation?
 6 Why? Because revenue and audience track each other
 7 reasonably well. That's why they were using revenue
 8 to begin with as a proxy, because the way the industry
 9 works if you have a bigger, you tend to earn more
 10 revenues. So there is in fact a reasonably close
 11 correspondence between revenue and audience, but we
 12 can calculate, even though the fees are based on a
 13 revenue formula, what they actually pay per
 14 performance, which we define as an hour of broadcast
 15 heard by one person.

16 Q And so having distilled out of the
 17 broadcast radio ASCAP/BMI/SESAC fee experience, a fee
 18 per listener hour, how does one translate that back
 19 into fees for the individual applicants sitting on --
 20 who are represented by the folks sitting on this side
 21 of the table in the sound recording performing rights
 22 setting?

1 I'm not a technical guy, but it's essentially how much
 2 are you sending out, which is how many people are
 3 listening for how long? We actually have a fortuitous
 4 circumstance where what I would argue is really the
 5 very best basis for licensing a music performance
 6 right is actually tracked and measured by the
 7 licensees. They call it aggregate tuning hours, but
 8 it's essentially how many people have been listening
 9 for how long?

10 Well, once we figured out that that was
 11 really something we could measure, then what we said
 12 was, well, even though on the over-the-air radio side
 13 that's not how the fee is calculated, we can
 14 nonetheless calculate what implicitly they pay every
 15 time they make a performance. So what we did was we
 16 went to the over-the-air radio stations that we could
 17 get data from, took their aggregate fees to BMI,
 18 ASCAP, and SESAC, which in fact do come from these
 19 percent of revenue formulas, divided by an estimate of
 20 the number of performances they make, what we call
 21 listener hours, the average audience times the number
 22 of hours that they're broadcasting, and we calculated

1 A Well, as I've indicated, I think there a
 2 number of reasons why that fee is sort of high as an
 3 indicator of reasonableness. In addition --

4 Q For the moment, though, mathematically,
 5 simply can you make clear what's the computational
 6 basis on which --

7 A Am I answering the wrong question?

8 Q You rarely do -- on which user X ends up
 9 paying fee Y? What's just the simple math?

10 A Okay. The simple math of it is we
 11 calculate a certain fee per listener hour which is
 12 calculated on the basis of over-the-air data. We then
 13 make some adjustments to that, but mathematically you
 14 can then just take that fee over the Internet side and
 15 get data on the number of listener hours that a given
 16 webcaster, for example, has, and you multiply that fee
 17 per performance, if you like, defined as a listener
 18 hour, times the number of performances per year that
 19 the licensee is making. And that produces the dollar
 20 outcome, the size of the check that they're going to
 21 write.

22 So in terms of thinking about the formula,

1 instead of setting a percentage of revenue, which is
2 then multiplied times revenue to get the actual dollar
3 amount for which a check has to be written, what we
4 are proposing is setting a fee per performance per
5 listener hour which is then multiplied times the
6 number of listener hours, and that yields the size of
7 the royalty obligation in dollars for any given year.

8 Q All right. Now pausing at this point,
9 we'll take the Panel through the more precise
10 methodology shortly -- you can go to the white board.
11 What relevance, if any, to the model you've just
12 described does actual or relative user profitability
13 by individual streamers have?

14 A None.

15 Q Am I correct that instead the fees
16 proposed by your model are payable strictly
17 proportional to a given licensee's success in
18 attracting listeners?

19 A Right. The idea of this model is what
20 we're licensing is is the right of public performance.
21 If my web site makes a lot of performances, I'm going
22 to pay a lot of money, and it doesn't matter whether

1 Q Does your model entail any form of subsidy
2 to this new industry?

3 A Not at all. It's based on what the over-
4 the-air radio, which is an ongoing business, in fact,
5 pays year in and year out. Hundreds of millions of
6 dollars are paid every year by over-the-air radio
7 essentially at this rate per performance for the
8 musical works:

9 Q Explain to the Panel a little bit later
10 why using the word you use, "scaling," it's far from
11 anomalous that in comparison to the hundreds of
12 millions of dollars paid by radio the typical fee
13 payable today would be less, correct?

14 A Correct.

15 Q I take it that's because, as you've
16 described --

17 A The audience is --

18 Q -- the numbers of performance, i.e. the
19 audience, reach is so much smaller today, is that
20 correct?

21 A That is correct.

22 Q But by definition, I take it, where the

1 I manage to earn myself a lot of money out of that or
2 not. Conversely, if I'm really not making very many
3 performances but have somehow figured out how to make
4 a whole lot of money even though nobody's listening,
5 I don't have to pay very much to RIAA, because I'm not
6 really using what they are contributing, the right of
7 public performance, very much.

8 And I think from an economic perspective,
9 that's an extremely attractive feature of this model.
10 It gets you out of all kinds of arguments that you
11 might otherwise have about which sources of revenue
12 should apply, do I need to worry about whether it's
13 the revenue of a viable webcaster or a non-viable
14 webcaster?

15 What I'm saying is what the market would
16 say, which is there's a price for this input, and if
17 you use a lot of it, you pay a lot. If you don't use
18 very much of it, you don't pay very much. And so the
19 fee is directly calibrated to the magnitude, the
20 extent of the use of the right which is in fact being
21 purchased from the record labels, the artists for whom
22 RIAA is the agent.

1 audience is equivalent to over-the-air broadcast
2 radio, the fees, subject to one adjustment you
3 propose, would be roughly equivalent industry-wide as
4 well, is that correct?

5 A They would certainly be comparable in
6 terms of order of magnitude. You're talking about
7 hundreds of millions of dollars.

8 Q All right. Let's now talk more
9 specifically about the methodology that you adopt for
10 computing the over-the-air license royalties on a per
11 listener basis. And I would invite you and the Panel
12 to look at Exhibit B.2 to Professor Jaffe's testimony.
13 All of this is further detailed in Appendix B, but
14 also, perhaps, you'd like to go to the white board and
15 describe both what elements you needed to pull
16 together the methodology and then how you applied it
17 to reach your per listener hour result.

18 A So I'm just going to use the numbers there
19 in B.2 but just give a little further explanation as
20 to how they relate to each other. We got data
21 ultimately -- and we can talk a little bit more about
22 how we ended up with this -- for 898 --

1 Q Hold on one second. Let's let the Panel
2 get to the right page here.

CHAIRMAN VAN LOON: We're all ready.

MR. RICH: Okay.

5 CHAIRMAN VAN LOON: I decided that this
6 model is the ice cream model. You pay more if you eat
7 more.

8 THE WITNESS: That's right. More scoops,
9 more fees. That's exactly right. We don't have any
10 all-you-can-eat variety.

11 So we have 898 stations. Who are these
12 898 stations? They are blanket license stations --

BY MR. RICH:

14 Q Describe what you mean by that.

15 A I'm going to.

16 Q Thank you.

17 (Laughter.)

18 A Blanket license --

19 Q I can just sit back.

20 A -- stations, basically, are who we could
21 get data from.

22 ARBITRATOR VON KANN: You could use the

1 all of the people we were working for at the time, all
2 of the clients, the companies that have over-the-air
3 stations who also were participating in this
4 proceeding and had retained us -- and they're listed
5 in my testimony -- and we got data from all of them on
6 their stations. And that gave us about 898 stations.

7 Those 898 stations, after -- we had to
8 drop a few, because there were a few data problems.
9 We couldn't tell if the numbers they were giving us
10 for royalties were for a complete year, some minor
11 data cleanup issues. But after dropping a small
12 number for whom there were data problems, the stations
13 that we used, these 898, paid \$143 million,
14 approximately, in royalties in 2000.

BY MR. RICH:

16 Q Professor Jaffe, just jumping ahead a
17 little bit, elsewhere in your testimony, you referred
18 to the general order of magnitude as you estimated of
19 all royalties which is roughly --

20 A It's on the order of \$350 million.

21 Q Thank you.

22 A So we thought of a good chunk of the whole

1 technique Mr. Cohen used with Michael Fine, which was
2 to say do you have anything to tell us?

(Laughter.)

4 And then you're off duty for about two and
5 a half hours.

6 THE WITNESS: So in the ASCAP -- let me
7 deal, first, with the blanket license issue. In the
8 musical work licensing realm, the consent decrees
9 actually require ASCAP and BMI to offer as an
10 alternative to a blanket license something called a
11 per program license in which instead of paying a
12 certain fee for the right to broadcast any music
13 anytime, you pay only for the programs that actually
14 use the music of the licensor. That license is used
15 primarily by stations that do something other than
16 play music all the time, for example, talk radio. So
17 we felt that the experience of royalties paid under
18 that license were not helpful to us in terms of
19 valuing the performances.

20 So we focused only on blanket licensees
21 who are the over-the-air stations that are essentially
22 playing music rather than something else. We went to

1 industry, although by no means -- we took those \$143
2 million that they paid in royalties and divided it by
3 an estimate of their total listener hours or about 65
4 billion listener hours.

5 Q Where did that come from?

6 A That comes from, essentially, ratings data
7 that is available from a source called Arbitron, which
8 I think we've already heard about in this proceeding.
9 We could talk in more detail about exactly how that's
10 use, but essentially what we get from Arbitron is an
11 estimate of the size of the audience averaged over a
12 broadcast week, which is 6 a.m. to midnight, seven
13 days a week. So we have an average audience, we know
14 how many hours that audience is listening over. So
15 the 65 billion is essentially the ratings times 18
16 hours a day times 365 days a year.

17 And it's a big number because, first of
18 all, there are a lot of hours in year, and second of
19 all, a lot of people listen to radio. If we divide
20 143 million by 65 billion, it turns out this is equal
21 to 0.00 --

22 Q Two, two.

1 A -- 22. Or equivalently, a 0.22 cents per
2 listener hour.

3 Q Now pausing on that for one moment, that
4 very number, am I correct, sir, to this point in the
5 analysis, that that number applied to streaming of
6 sound recording performing rights would produce a fee
7 industry-wide identical to the fees generated by
8 ASCAP, BMI and SESAC, assuming there were the same
9 number of listeners broadcasting the same number of
10 hours over the Internet? Is that correct? Is that
11 the logical culmination of that?

12 A That is the result. That is the logical
13 consequence of the way this is calculated.

14 Q So that if the order of magnitude of
15 performances measured by numbers of listeners over
16 numbers of broadcast hours over the Internet were
17 identical to what you have observed or estimated to be
18 the case for the over-the-air radio, the fees
19 generated, at least at the point 0.0022 level, would
20 be equivalent to the 300 plus million dollars you have
21 observed, as collected by ASCAP, BMI, and SESAC; is
22 that correct?

1 wouldn't use the per program license, because you'd
2 pay more in the aggregate than you'd pay by choosing
3 the blanket license.

4 ARBITRATOR VON KANN: This is an ASCAP or
5 BMI license for people who don't play a lot of music?

6 THE WITNESS: Exactly, but they do
7 sometimes play music, and so what they do is they can
8 pay -- it's sort of like an a la carte version. They
9 can pay for the specific programs that incorporate
10 music but not pay for the programs that don't.

11 ARBITRATOR VON KANN: Okay.

12 BY MR. RICH:

13 Q Now, Arbitrator Von Kann's question is a
14 good segue to something else which appears on Exhibit
15 B.2, which is what appears to be another calculation,
16 which is something called "fee per listener song."
17 Can you explain what that is and how you derived it
18 and what its function is?

19 A Yes.

20 Q This is, incidentally, carried -- covered
21 in paragraphs 39 to 45 of the written direct
22 testimony.

1 A Well, I wouldn't use the word "equivalent"
2 because of this issue of the per program licenses.
3 The \$340 or \$350 million includes both blanket and per
4 program licensees. But it is the case that in terms
5 of orders of magnitude we would generate from the
6 Internet medium, if the audiences were the same, fees
7 that would be comparable to those paid over the air
8 hundreds of millions of dollars.

9 Q Okay.

10 ARBITRATOR VON KANN: The term you just
11 used, "program licensees," refers to stations that
12 broadcast talk radio and other programs that are not
13 primarily music?

14 THE WITNESS: Right. I mean to be
15 precise, the per program license is a license form
16 which you choose. As a matter of economics, you don't
17 choose it, typically, unless you are not broadcasting
18 mostly music because of the way it's priced. It's
19 priced in such a way that it is attractive relative to
20 the blanket license if what you're doing is primarily
21 or to a significant extent not music. Whereas if what
22 you're doing is pretty much playing music, you

1 A Let me start by explaining why we did it,
2 and then I'll go to the specific numbers that appear
3 in B.2. The motivation for the listener song model is
4 similar to the motivation for the per program model on
5 the over-the-air side, which is to allow an option for
6 users whose music use is -- or whose use of licensed
7 music is more sporadic to pay just for the music that
8 they're using. And that could come about in a number
9 of different ways.

10 I think on the Internet the talk show
11 issue is probably not as big an issue, but there may
12 well be licensees who are streaming content which
13 consists significantly of material that they don't
14 need to license from the RIAA. I mention in my
15 testimony, and I think you've heard testimony from
16 Comedy Central, they have created much of the material
17 themselves that they are streaming. They don't need
18 the right -- they don't need RIAA to give them the
19 right to broadcast those sound recordings, because
20 they own it. So there ought to be --

21 Q There's another category to be a streaming
22 broadcaster for whom the per program license is

1 suitable, because it has a non-music intensive program
2 format, and by definition is carrying the same
programming over the Internet.

4 A That's another possibility. I don't know
5 how significant that is.

6 Q Okay.

7 A So what we want to do, and this goes back
8 to the point I made a long time ago about the non-
9 exclusive nature of the license, we want to create a
10 mechanism for people to get just the rights they need
11 and not have to pay for or pay at the same level as if
12 they were broadcasting music all the time.

13 Now, an obvious question, particularly
14 given that we've talked about it, would be, well, why
15 didn't we just do a, quote, "per program model" much
16 like they do over the air? There are two reasons for
17 that. One is it's not entirely clear that in the
18 streaming context the program has the same meaning
19 that it does over the air where the broadcast day is
20 clearly broken up into these programs.

21 More fundamentally, the problem with the
22 per program model is that if I'm a radio station and

1 performance is exactly the same as what I call a
2 listener song, subject to -- theirs is a little more
3 complicated, but the concept --

4 Q A little more expensive too.

5 A It is a little more expensive, and we'll
6 come back to that, but the concept of what they call
7 a performance is the same -- I like listener song
8 because it makes it clear that it's not just the
9 number of songs but also the number of people
10 listening. But they're the same concept.

11 Now how do we get to this? Well, we
12 derived this from the same fee data as for the
13 listener hour model, essentially, by just looking at
14 how many songs this universe of blanket license
15 stations broadcast per hour. So we took the data that
16 we had on these fees. We don't actually know for each
17 -- we don't have the program logs of these 898
18 stations, so we don't actually know for each station
19 how many songs they have, but we know their format,
20 which is a standard industry classification of the
21 type of station, like soft rock or adult contemporary
22 and so forth. And what we have are data on the

1 I want to avoid paying for a given program, I have to
2 eliminate every iota of ASCAP music from that program
3 in order to sort of take it out of the column I pay
4 for. I have no incentive and I get no benefit from
5 taking a program and eliminating 80 percent of the
6 music from that program. As long as there's any music
7 still in it, I pay the full rate under the ASCAP per
8 program model. So what we've done, again, is to try
9 and tie it more clearly to the performances
10 themselves, and we've done that on a per song basis.
11 So this is the listener hour model. It's hours of
12 broadcasting times the number of people who are
13 listening.

14 What we propose as a second alternative
15 for licensees that are clearly less than full-time
16 music -- and I'll come back to that -- that what they
17 could do instead is pay per listener song instead of
18 per listener hour. They would pay for each song
19 rather than for each hour. And to help the Panel in
20 terms of understanding things, my understanding is
21 that the RIAA, one of their options is what they call
22 a performance model, and I understand it, their

1 average number of songs typically broadcast by a given
2 format.

3 Q For the Panel's information, that appears
4 at Exhibit B.1, just prior to the exhibit you're
5 looking at. And what's the source of that data,
6 Professor Jaffe?

7 A The source of that data is an industry
8 organization called Broadcast Data Systems, or BDS.

9 Q And does B.1 set forth the average songs
10 per hour that form the basis for the computations?

11 A Yes.

12 Q Thank you.

13 A So for each format, we calculated the
14 average number of songs. There were a few stations
15 that were in this that we didn't have the format for.
16 So for the listener song model we dropped them. It
17 doesn't have any measurable impact on the result. But
18 as you see in B.2, there are actually only 858
19 stations that are blanket, and we also have song data
20 or format data.

21 They had about \$142 million in royalties,
22 and they had these 65 billion hours and on average

1 about 11 songs per hour. In the aggregate, that was
 2 715 billion songs. So when you divide this out, what
 3 you get is 0.0020, or equivalently, 0.02 cents per
 4 listener song. If you were to just start from this
 5 number, 0.22 cents per listener hour, and say it's
 6 about 11 songs per hour, so divide that by 11, you
 7 basically get the same answer. We did this to be a
 8 little more careful to be sure that the fees of those
 9 stations for which we had the format data were not
 10 somehow different, but it turns out it actually
 11 doesn't matter.

12 Q You said a while ago that a subset of all
 13 webcasters would, under your model, be entitled at its
 14 election to select the per listener song model. Could
 15 you say a few more words about that?

16 A Yes. If you look at B.1, for example,
 17 what you see is there some variation in songs per
 18 hour. Spanish stations have only seven. Putting them
 19 aside, it ranges from about nine to about 14 songs per
 20 hour depending on format. In the over-the-air format,
 21 or in the over-the-air medium, these guys are all
 22 paying the same fee regardless of how many songs they

1 these models while still having a real option for
 2 people who really are doing something quite different.
 3 They're really just not playing music all the time or
 4 they're not playing music all the time for which they
 5 need recording rights.

6 So what we said was the range of these
 7 formats is, you know, seven to 14 songs. We're going
 8 to say you can only access this listener song model if
 9 what you're saying you would pay for is less than
 10 seven songs per hour. Above that, you don't get to
 11 gain the system; you're stuck on the listener hour
 12 model. Whether you have eight songs or 14 songs, you
 13 pay the same amount. But if you have less than seven,
 14 what we would conclude from that is you're not really
 15 just playing music all this time. You're doing
 16 something else; you're in this other world.

17 And so we would propose that such licensee
 18 be allowed to pay per song in order to preserve this
 19 option, both to people doing non-music things and for
 20 people who already own the rights and maybe for people
 21 who want to go out and try to direct license some of
 22 the rights they need and therefore avoid making

1 play per hour. The license does not differentiate
 2 based on the number of songs.

3 But if when you translated it to the
 4 current contacts, you said, "Okay, we'll let you pay
 5 per hour or per song, and if you choose per song, you
 6 pay sort of per song based on the average number of
 7 songs," what would happen then would be those users
 8 who happen to have below the average number of songs
 9 would say, "Oh, great. I'll pay on a per song basis."
 10 And the ones who happen to have above the average
 11 number of songs would say, "Well, forget that. I'm
 12 going to stick to the listener hour basis." So even
 13 within the music-intensive stations for whom the
 14 blanket license is really designed, you'd reduce the
 15 overall fee level in an unfair way. You'd sort of be
 16 biasing the fee amount by allowing the licensees to
 17 self-select when the basis from which the fee level
 18 was chosen was this average which included both people
 19 with 14 songs and people with nine songs.

20 So what we wanted to avoid was having
 21 stations who are essentially playing music all the
 22 time being able to gain the system by choosing between

1 payments to RIAA.

2 Q Now, for the sake of completeness, you
 3 refer in paragraphs 41 and 76 of your written
 4 testimony to another alternative which you propose
 5 could be made available, something styled a segmented
 6 listener hour fee approach. And could you just say a
 7 few words conceptually about what that's designed to
 8 accomplish?

9 A Yes. The idea of the segmented listener
 10 hour --

11 ARBITRATOR VON KANN: What paragraph is
 12 this?

13 MR. RICH: I believe it's 41 and again 76.

14 THE WITNESS: It goes back again to this
 15 notion that I'm not really sure songs is the right
 16 measure of the amount of music. It's not completely
 17 clear that that's the right way to meter this stuff.
 18 An alternative would be just to say, "Look, you paid
 19 22 cents -- or 0.22 cents per listener hour. If you
 20 can show that half of your listener hours don't have
 21 music in them or don't have sound recordings for which
 22 you need a license from RIAA, then you only pay half."

1 And it's an alternative way of providing an option, a
 2 way of carving out parts of the broadcast that don't
 3 need to be licensed just on the basis of time, rather
 4 than counting the number of songs.
 5 Now, again, we want to avoid sort of the
 6 gaming of the system by people are who pretty much
 7 playing music all the time but just have little bits
 8 and pieces here and there that they want to try to get
 9 away with not paying for. So, again, we apply a
 10 cutoff. We propose 60 percent, that you couldn't use
 11 the segmented listener hour model unless you could
 12 show that you have music in no more than 60 percent of
 13 your aggregate hours. And it's just another way of
 14 providing a carve-out but measuring it on the basis,
 15 in effect, of minutes, if you like, fractions of an
 16 hour rather than numbers of songs.

17 MR. RICH: Might we take a two-minute
 18 break?

19 CHAIRMAN VAN LOON: Sure.
 20 (Whereupon, the foregoing matter went off
 21 the record at 6:36 p.m. and went back on
 22 the record at 6:44 p.m.)

1 BY MR. RICH:
 2 Q Professor Jaffe, you wanted to make one
 3 typographical correction?
 4 A Yes. I noticed over the break that
 5 although I think I said it, I hadn't written the word
 6 "billion" here. I said 714 billion songs, but I wrote
 7 715, so if you want to note that or maybe you already
 8 did.

9 CHAIRMAN VAN LOON: It's here in my notes.
 10 MR. KATZ: If you want to leave the
 11 billion out, I think we can do a deal.

12 (Laughter.)

13 THE WITNESS: I think that's approximately
 14 equal to your proposal, isn't it?

15 (Laughter.)

16 MR. KATZ: We'll get to that but not till
 17 late tomorrow.

18 BY MR. RICH:

19 Q Now, this does not quite complete your
 20 progression to the benchmark which you -- or the
 21 benchmarks which you propose this Panel adopt; is that
 22 correct?

1 A No, I'm afraid not.

2 Q I take it you further engaged in analysis
 3 which appears at paragraphs 51 to 65 of your written
 4 testimony of the relative valuation to be given the
 5 sound recording performing right versus the musical
 6 works performing right; is that correct?

7 A Yes.

8 Q Could you please summarize the analysis
 9 you undertook with respect to that, as reflected in
 10 that portion of your written testimony?

11 A Yes. As I think I explained in response
 12 to an earlier question, if these numbers were applied,
 13 the effect would be to reproduce for the Internet
 14 sound recording right the same fees proportional to
 15 performances as are paid in the over-the-air radio for
 16 the musical works. And as I think I've indicated, I
 17 think that that fee is too high. And in paragraph 52,
 18 I've indicated a number of reasons why I think it's
 19 too high. These fall into a number of categories,
 20 some of which we've discussed and some of which we
 21 haven't.

22 There's the issue of the market power that

1 is inherent in the ASCAP/BMI/SESAC fees. There's an
 2 issue that relates to the promotional value that is
 3 conveyed. And the key point here, which we're going
 4 to talk about more in a minute, is the differential
 5 value of promotion to the owners of the sound
 6 recordings as distinct from the owners of the musical
 7 works. And then there's the cost and risk factors
 8 which are enumerated in the statute, which, in a more
 9 general sense, in thinking about a willing
 10 buyer/willing seller framework, would enter into what
 11 a willing buyer was prepared to pay for these rights.

12 And then, finally, there's the legal
 13 detail that the statute imposes certain restrictions
 14 on this right in terms of how sound recordings can be
 15 broadcast, which presumably diminish, to some extent,
 16 the value of the right. So there's a whole set of
 17 qualitative factors which are listed in paragraph 52
 18 as to why this calculation produces too high a number.

19 I have quantified only one of those. The
 20 others I have not made an attempt to quantify or
 21 incorporate into the model in any way. They're out
 22 there. They continue to be reasons why I think the

1 fee proposal that we have proposed is high relative to
2 reasonable, but I have not made any attempt to adjust
3 for them. I have made an attempt to adjust for
4 promotional value.

5 Q So just to be totally clear about that,
6 you are aware of a number of statutory considerations
7 which the Panel has to take account of in setting
8 fees, correct?

9 A Yes.

10 Q Among those is promotional value, correct?

11 A Yes.

12 Q And we'll come to that in terms of how you
13 quantitatively attempted to address that issue. But
14 also there are other statutory factors of which you
15 are aware and which your bullet points, at least
16 three, four, and five, perhaps six, as I read them on
17 page 35, mention, but I take it your testimony is you
18 did not attempt methodologically or in a quantitative
19 way to adjust your model or deal with them; is that
20 correct?

21 A That is correct.

22 Q And is that because you view them as

1 respect to promotional value considerations.

2 A Okay. I would like to erase. Am I the
3 one who pushes the button, the one that says "copy?"
4 ARBITRATOR VON KANN: You can be
5 deputized.

6 CHAIRMAN VAN LOON: We'll be considering
7 tonight how much easier it's going to be for us to
8 come up with ways to quantify all these other factors
9 where the Economics Department couldn't do it.

10 (Laughter.)

11 THE WITNESS: It works. It correctly
12 represents my chicken scratch.

13 So I think there was a question, which was

14 --

15 BY MR. RICH:

16 Q Yes. Why you don't start analytically
17 with how you think about the promotional value as it
18 affects the fee setting here?

19 A The way I think about the promotional
20 value issue is that I've argued that the total market
21 value of the performance right of the sound recording
22 should be equal to the total market value of the

1 irrelevant?

2 A No. It's because I don't really have a
3 basis for quantifying them. I think I know which
4 direction they go, which is that in a willing
5 buyer/willing seller context they would tend to point
6 towards a lower fee, but I don't know by how much.

7 Q Are you urging that the Panel ignore those
8 factors?

9 A I'm not making any recommendation one way
10 or the other on how the Panel deals with the statutory
11 criteria.

12 Q Simply sitting where you sit, as an
13 economist, and given the information you have
14 available, you didn't find a way quantitatively to
15 take account of those factors; is that correct?

16 A Correct.

17 Q Now, let's turn to promotional value, and
18 would you describe -- and, again, if you want to use
19 the white board, we'll try to push a button and
20 preserve this much of it and give you the benefit of
21 another screen, but I'd like you to walk the Panel
22 through the nature of the analysis you understood with

1 performance right for the musical work. And I say it
2 in that long way each time to emphasize that I'm not
3 making any observation about whether Frank Sinatra is
4 more valuable than Hoagy Carmichael or whether in some
5 intrinsic sense one of the other of these is more
6 important or more valuable. I'm making a very narrow
7 statement that the public performance right on the
8 Internet for these two different parts of the
9 performance in a competitive market their total value
10 would likely be the same.

11 So if we represent that by just this bar,
12 so this is the musical work, and what I've said is I
13 believe the bar for the sound recording should be
14 equal. So this --

15 Q Once again, once again, what does each bar
16 represent, the totality of --

17 A I was about to tell you that. I was about
18 to write that.

19 Q Okay.

20 A So this height is the competitive market
21 value of the performance right. Now, my view is that
22 in a competitive market, we can think of this as the

1 total consideration that will pass from the licensee
 2 to the licensor when either of these two rights is
 3 licensed. But, in fact, that total consideration will
 4 typically come in two pieces. And the two pieces are
 5 the royalty that I pay you as licensee; that's one
 6 piece. The other piece is the additional profits you
 7 get because you sell more property because I have
 8 played your sound recordings in public. That's what
 9 we call promotional value. And in a competitive
 10 market, the more of that I'm delivering to you, the
 11 more promotional value I'm giving you, the less
 12 royalty I'm going to have to give you, because I'm
 13 giving you the consideration in another form.

14 Now, if the promotional value for these
 15 two were the same, we wouldn't need to worry about it,
 16 because presumably it's already built into the
 17 reasonable fee that we've observed for the musical
 18 work or the upper bound for the reasonable fee that
 19 we've observed for the musical work in over-the-air
 20 radio. But there is good reason to believe that it's
 21 not the same, that the value of promotion to the
 22 owners of the sound recordings is greater than the

1 value of promotion to the owner of the musical works.

2 And I'm going to talk in a minute about
 3 how I quantified this, but just to illustrate, roughly
 4 speaking, about two-thirds of the value that's
 5 conveyed for the musical works is in the form of the
 6 royalties that are paid, and about one-third is in
 7 promotional value. In distinction, with respect to
 8 the sound recordings, the promotional value is roughly
 9 -- and I'll show you the exact numbers in a minute --
 10 about twice as great.

11 So given my argument that the total
 12 consideration should be equal, what that means is that
 13 you pay less for sound recordings in a competitive
 14 market in the form of royalties than you do for
 15 musical works, not because they're less valuable but
 16 because you've already or you were in the process of
 17 conveying additional consideration in the form of
 18 promotional value, which because of the nature of the
 19 markets for the CDs, basically, is greater in the case
 20 of the sound recordings.

21 Now, this height here we can think of this
 22 as corresponding to the 0.22 cents I calculated

1 earlier, if expressed on a per performance basis. So
 2 what this says is we need to make a reduction in the
 3 equivalent per performance fee before we apply that to
 4 sound recordings to reflect this increase in
 5 promotional value.

6 Q All right. Now you, basically, almost
 7 solved an equation, didn't you, by filling in pieces
 8 and then figuring out what was left?

9 A Yes.

10 Q Why don't we start with the sound
 11 recording side. You did a promotional value
 12 computation for the --

13 A Actually, let's start on the --

14 Q You want to start on the other side?

15 A -- musical works side.

16 Q Okay. Start on the other side.

17 A I think it's easier.

18 Q Right.

19 A So with respect to musical works, what
 20 happens is these records are played on the radio, and
 21 as a result of that public performance more CDs are
 22 sold. When a CD is sold, both the composer and the

1 record company and the artist benefit from that, and
 2 that's the essence of the promotional value is that
 3 playing records over the radio increases the sale of
 4 CDs to the benefit of both the composers and the
 5 publishers of musical works and the recording
 6 companies and the artists who have an interest in the
 7 sound recording.

8 It just so happens that the way the CD
 9 market works per CD that benefit is much greater to
 10 the record company and the artist than it is to the
 11 composers and the publishers, and that is the effect
 12 that I've quantified in my analysis. So what we did
 13 was we went and we quantified this promotional value
 14 to the best we could. We started with an estimate
 15 that's described by Mr. Fine from Sound Scan of the
 16 fraction of CD sales where hearing the record over the
 17 radio was given by the respondent as the primary
 18 reason why that CD was purchased. And according to
 19 Mr. Fine's testimony, approximately 27 percent of CD
 20 sales that was given as the primary reason.

21 Q That's paragraph 70 of the written
 22 testimony.

1 A If we multiply that times the total number
2 of CDs sold per year, we get a number of CDs sold
3 which corresponds to the incremental CD sales from the
4 promotion on the radio. And then what we need to do
5 is for these two pieces calculate per CD how much the
6 musical work owners get and how much the sound
7 recordings get. And what drives this difference is
8 that the estimate that we have is that the composers
9 and the publishers get about 73 cents per CD. And I
10 tremble to use this word, but it's called a mechanical
11 royalty.

12 The record labels benefit from the sale of
13 CDs from the profits that they earn, the incremental
14 profits. And in addition, the artists, who are also,
15 in effect, rightsholders in the sound recording for
16 the purpose of this proceeding, get royalties for the
17 sale of CDs. Now, we've ignored the artist royalties,
18 because we don't have data on it, and looked just at
19 the profits earned by the record company per CD sold.
20 We have an estimate of that of \$1.65 per CD. When you
21 work that out -- and the details are in the testimony
22 -- what it works out to be, the aggregate per year is

1 that this piece here is \$157 million per year -- not
2 a small effect. Whereas this number over here for the
3 sound recording side is \$322 million per year.

4 We then went and said, "Okay, so that's
5 this piece. If we know this piece and the total is
6 the same, then we can figure out if there were a right
7 of public performance in sound recordings in over-the-
8 air radio that you had to buy in a competitive market
9 in this country, under my assumptions, how much would
10 a competitive market price that given these
11 relationships? So we've estimated -- and, again, the
12 details are described in the testimony -- that this
13 number, the total royalties paid, is about \$343
14 million a year.

15 If we take 500 minus 322, that's equal to
16 \$178 million a year, which is sort of an implied
17 royalty rate for sound recordings, this piece down
18 here.

19 Q You want to put "million" next to 343
20 also.

21 A Thank you. I hate it when Counsel
22 testifies. So then the final step is to look at this

1 number in relationship to this number. This is our
2 estimate of the aggregate fees paid to BMI, ASCAP, and
3 SESAC. This is our estimate, under our conservative
4 assumptions, of sort of the implied competitive
5 royalty for sound recordings. And now we can look at
6 the relationship between the two -- 178 over 343 is
7 equal to about 0.52.

8 So once we take account of the
9 differential promotional value and ignoring all the
10 other factors that I've cited as to why the musical
11 work fee might be too high, this analysis would
12 suggest that you could cut that fee almost in half
13 motivated solely by the promotional value
14 consideration alone, reflecting the greater
15 incremental benefit every time a CD is sold that
16 accrues to the owners of the right in the sound
17 recording as compared to the owners of the right in
18 the musical work.

19 Q Now, you said even limited to the
20 analysis, to this promotional value analysis, I
21 believe you testified that this was a conservative
22 projection. Can you simply reiterate why the bases on

1 which you state this is a conservative analysis?

2 A Yes. The most important way it's
3 conservative I've already mentioned, which is that we
4 ignored any value in promotion to the artists who are
5 equal parties here, in effect, with the record labels.
6 In effect, in our calculation, artist royalties are
7 treated as a cost borne by the record company that
8 just diminishes their profits. We haven't allowed for
9 that to enter into in any way the promotional value.

10 There are other ways in which the
11 calculation is conservative in that we just didn't
12 have data. And, in general, when we couldn't get
13 data, we made a conservative assumption. So, for
14 example, we had a number for the profitability of CDs.
15 We didn't have a number for profits on other records
16 like tapes. So we ignored the promotional value to
17 the sound recording from tapes, but we included 73
18 cents per tape for the composers.

19 So, in general, where we had incomplete
20 data, and we definitely had incomplete data, what we
21 did was we made assumptions that were conservative
22 with respect to calculation of this ratio.

1 MR. RICH: I just want to pause for a
2 technical cleanup. We distributed, I gather, on
3 Friday, a revised Exhibit 2 to Professor Jaffe, which
4 cleaned up one number and which reflects in chart form
5 the analysis. I wanted to make sure the Panel had had
6 that distributed to it. If not, we have extra copies
7 with us.

8 ARBITRATOR VON KANN: I don't think I got
9 it.

10 ARBITRATOR GULIN: Revised exhibit what
11 now?

12 MR. RICH: Two.

13 MS. SCHAEFFER: Just to clarify, this was
14 already in evidence just shortly after the April 11
15 deadline. We submitted a revision, but we also gave
16 it to the Copyright Office on Friday.

17 ARBITRATOR VON KANN: The one that I've
18 got it says, "Revised."

19 MR. RICH: And that would be it.

20 ARBITRATOR VON KANN: And it says, "May
21 18." Is that it?

22 MR. RICH: That would be it. Okay. We

1 when they publish the correction. If they don't put
2 in what they had the wrong the previous time, it makes
3 more sense. Keep us on what we ought to be
4 understanding.

5 BY MR. RICH:

6 Q Okay. Now, before we talk about the
7 implications of what you've just done for the model,
8 at pages 42 and 43 of your testimony, you avert to
9 international evidence on the appropriate discount.
10 I simply want you to briefly describe what measure you
11 took of the international evidence testified to
12 earlier by Mr. Kempton in analyzing this promotional
13 value aspect of the model.

14 A Well, there is an exhibit to my testimony,
15 which is Exhibit 1, which simply displays the ratios
16 that Mr. Kempton talked about earlier today that he
17 had calculated for these different countries, which I
18 used merely to get some comfort that the kind of
19 discount that I'm talking about here is actually quite
20 consistent with what is observed around the world
21 where we do observe a sound recording right and a
22 musical work right in the same country for over-the-

1 wanted to make sure everybody got it. Okay.

2 ARBITRATOR VON KANN: You don't have
3 anything that's been a revision since.

4 MR. RICH: Nothing since.

5 CHAIRMAN VAN LOON: Received May 18,
6 that's the one, right?

7 ARBITRATOR GULIN: That's the one.

8 BY MR. RICH:

9 Q Do you want to explain what the correction
10 is?

11 A The Panel may be curious, what did we have
12 to revise?

13 CHAIRMAN VAN LOON: No.

14 ARBITRATOR VON KANN: No.

15 MR. RICH: Okay.

16 THE WITNESS: No intellectual curiosity on
17 that.

18 MR. RICH: Not at 7:10 at night.

19 THE WITNESS: That's actually appropriate
20 because it's trivial.

21 CHAIRMAN VAN LOON: No, that's not really
22 the issue. It's like page 2 of the Washington Post

1 air radio. I didn't use these numbers in any way in
2 my calculation. I just presented them as a background
3 against which the possibility of a discount that I'm
4 calculating could be considered.

5 Q Why don't you then take us to what is
6 described as the summary section of your report -- the
7 Panel will be happy to know we're reaching the
8 summary. Beginning at page 47, what did you do based
9 on the analysis of this promotional value discount,
10 and what did it lead you to by way of a final proposed
11 set of fees?

12 A Yes. Well, as I've explained, the
13 promotional value calculation could be used to justify
14 a discount of close to 50 percent for the sound
15 recording relative to the musical work. I feel that
16 given the uncertainties in quantifying the promotional
17 value, I don't claim to know that the number is
18 exactly 0.52.

19 So what I suggest in my testimony, and
20 this is just based on judgment, is that a reasonable
21 range would be something like 0.4 to 0.7, which is to
22 say that the sound recording performance right could

1 be as much as 60 percent lower or could be only 30
2 percent lower. This is the ratio of the sound
3 recording right to the musical work right.

4 And then to be conservative, we proposed,
5 as a fee model, using this upper range. So, in
6 effect, what we did was calculate that the best we can
7 do with the data we have is that the discount could be
8 as large as 50 percent, but we only imposed a 30
9 percent discount.

10 So going back to the numbers that were on
11 the previous board, we had, for example, \$0.0022 per
12 listener hour. My recommendation is to reduce that by
13 30 percent or to multiply it by 0.7, equivalently.
14 If we multiply that by 0.7, what we get is 0.0015 per
15 listener hour, which, again, is just 0.15 cents per
16 listener hour. Or equivalently, we can take the
17 0.00020 per listener song times 0.7 would give us
18 0.00014 per listener song.

19 Q And in order to determine the actual fee
20 payable by any given streamer, am I correct that you
21 would take the 0.0015, let us say, per listener hour
22 and multiply it by the aggregate tuning hours of that

1 streamer?

2 A Correct. The aggregate tuning hours is
3 this you've measured that's in the industry which is,
4 in effect, the audience size times the number of hours
5 broadcast.

6 Q And, similarly, if the webcaster qualified
7 for the per listener song rate, it would entail -- am
8 I correct that it would entail taking 0.00014 times
9 that streamer's average number of songs per hour times
10 its aggregate tuning hours?

11 A No.

12 Q You say it, please.

13 A It's listener songs. Aggregate tuning
14 hours is listener hours.

15 Q Correct.

16 A So you would take the aggregate tuning
17 hours and convert that to an average audience, which
18 you can do. All you need to do is know how many hours
19 they broadcast, which in many cases is 24 hours a day,
20 seven days a week. That would give you the average
21 audience. You could then take the average audience
22 times the total number of songs. So, in effect, you

1 would back out the number of listeners from the
2 aggregate tuning hour to implement the listener song
3 model. To implement the listener hour model you don't
4 need to back out the audience. It is listener hours.
5 That's what aggregate tuning hours is, is listening
6 hours.

7 Q Now, it's been suggested that the fees,
8 which your model generates and which you propose
9 through your testimony, would generate diminimus
10 license fees and inappropriately diminimus license
11 fees throughout the industry. How do you react to
12 that?

13 A Well, I think we have to go back to that
14 this model scales on the number of performances, which
15 I think is exactly what it should scale on. For a
16 webcaster or broadcaster/streamer that basically
17 nobody listens to, this will generate small fees;
18 there's no doubt about it. But for a broadcaster/
19 streamer or a webcaster who manages to generate a
20 significant audience, this will generate significant
21 revenues.

22 You've got to remember there are 8,760

1 hours in a year, so if you have a significant audience
2 -- I mean it may seem like two-tenths of a cent is a
3 really small number, but if you have a significant
4 audience, the listener hours add up. And you could
5 look at numbers that are in the record, for example,
6 as an exhibit to Mr. Halyburton's testimony, of the
7 audiences of streamers and over the air, and you can
8 see exactly what fees this produces.

9 Q Would it assist the Panel, do you think,
10 to take a look at that exhibit and maybe you want to,
11 on the board, do a few computations, if I may?

12 A Sure.

13 Q This is already in evidence as Halyburton
14 5. I do note this document is restricted, and it may
15 be then for this section of the testimony, which will
16 be about five or seven minutes, I would guess, we
17 probably should close the hearing.

18 CHAIRMAN VAN LOON: Okay. We will go into
19 a closed session at this point and ask anyone who's
20 not authorized as Counsel to step outside.

21 (Whereupon, at 7:14 p.m., the proceedings
22 went into Closed Session.)

(Certification Page)

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1 performances, you pay a significant amount of money.
2 So you could argue that given that motivation, at
3 least there really is no need for a minimum fee within
4 this framework. My view, as an economist, is that
5 there is an appropriate role for a minimum fee, which
6 is basically tied to the administrative and
7 recordkeeping costs on the part of the licensor of
8 administering the fee. I mean it doesn't make sense
9 for the RIAA to have to license somebody and collect
10 from them sort of less money than it takes to just
11 keep track of them as a licensee. So I think there is
12 a role for a minimum fee tied to that notion of
13 essentially the administrative bookkeeping costs of
14 managing a license.
15 I think we've already mentioned, for
16 example, that ASCAP has a minimum fee of \$264 per
17 year, so I've suggested that a fee of on the order of
18 \$250, just to pick a round number, would be an
19 appropriate fee to take account of that recordkeeping
20 administrative cost consideration.
21 Q Thank you. Now, paragraph 78 --
22 CHAIRMAN VAN LOON: Can I just --

1 MR. RICH: For the Panel's information, I
2 have three brief areas remaining to cover: minimum
3 fee, the 150-mile issue, and the ephemeral copies
4 analysis, none of which should take very long.
5 CHAIRMAN VAN LOON: We're just getting
6 started and probably maybe should start the cross
7 tonight.
8 BY MR. RICH:
9 Q Professor Jaffe, at paragraph 77 of your
10 written testimony, you propose a minimum fee. Could
11 you briefly describe how you came up with that fee and
12 the rationale for it?
13 A Yes. The statute specifies a minimum fee.
14 Some of the language in the legislative history as to
15 why they specified a minimum fee suggests that at
16 least one concern was that depending on the model that
17 the Panel chose, you could have a situation where, for
18 example, a revenue-based model -- a webcaster with no
19 revenue could be doing a lot of performances and not
20 have to pay anything if you didn't have a minimum fee.
21 Now, my model takes care of that automatically.
22 Under my model, if you're making a lot of

1 MR. RICH: Please.
2 CHAIRMAN VAN LOON: Is that 254 ASCAP
3 alone?
4 THE WITNESS: I think it's 264, and that
5 is ASCAP alone, yes. But my view would be that, you
6 know, ASCAP has to administer the license. The fact
7 that they have a BMI license doesn't help ASCAP. BMI
8 has to administer a license so the --
9 CHAIRMAN VAN LOON: Does BMI have a
10 minimum fee also?
11 THE WITNESS: I believe so, although I
12 don't actually know the figure. But my view would be
13 that the minimum fee is sort of for one license. It's
14 not necessarily relevant that on the musical works
15 side you actually have to have several of them.
16 CHAIRMAN VAN LOON: Okay. And do you know
17 the number for SESAC, by any chance, their minimum?
18 THE WITNESS: I do not know the number.
19 MR. RICH: We'll be happy to provide that
20 information.
21 BY MR. RICH:
22 Q If you turn to paragraph 78 of your

1 testimony, you suggest one possible additional fee
 2 adjustment or one appropriate additional fee
 3 adjustment in relation to broadcast streamers, yes?
 4 A Yes.
 5 Q Could you describe that, please?
 6 A Yes. As I think the Panel is aware,
 7 Congress chose to, in effect, exempt broadcasters all
 8 of whom's broadcasts were within 150 miles, which
 9 suggests some understanding that local broadcasts over
 10 the Internet perhaps do not generate a fee obligation
 11 under this statute. From an economic perspective, to
 12 the extent that the listeners are within 150 miles,
 13 they have access, typically, to the over-the-air
 14 signal of the same stream for which there is no
 15 royalty obligation. It doesn't really make economic
 16 sense for the same broadcast to the same people to
 17 generate a royalty obligation if it goes over the
 18 Internet but not if it goes over the air.
 19 So I would suggest that
 20 broadcasters/streamers be able to exclude listeners
 21 within 150 miles, assuming they can demonstrate the
 22 proportion of their listening audience that falls

1 within that 150 miles, either through actual data or
 2 through some kind of survey or other instrument that
 3 would be a reasonable way of demonstrating that.
 4 Q And, mechanically, I take it, that would
 5 be implemented by a downward adjustment of the
 6 aggregate tuning hours applicable to those streaming
 7 broadcasters?
 8 A Again, since the whole model is based on
 9 just the number of performances, if you know that
 10 half, just for the sake of argument, of the
 11 performances are within 150 miles and you conclude
 12 it's appropriate to exclude them, you would simply
 13 reduce the fee by 50 percent.
 14 Q Okay. Finally, Section 6 of your
 15 testimony, beginning at page 51, addresses the Section
 16 112 issues, both for those entities that have 114
 17 liability as well as for the background music services
 18 who do not. Could you tell us conceptually how you
 19 approached this issue and at the bottom line what the
 20 implications of that approach are for fee setting?
 21 A Yes. My conceptual approach is based on
 22 my understanding -- I'm not an expert on this, but

1 based on Professor Zittrain's testimony, my
 2 understanding of how this works is that the economic
 3 function that the ephemeral copies effectuate is
 4 essentially just to facilitate performances, but they
 5 do not have an economic function over and above making
 6 it possible for there to be performances and to some
 7 extent maximizing the number of performances by making
 8 the music available, for example, at different baud
 9 rates and so forth.
 10 So what that means to me as an economist
 11 is that in terms of the competitive price for the
 12 rights, there really is only one competitive market
 13 value, which is the value of the performances. On the
 14 radio side, where I'm using it as a benchmark, there
 15 is no payment, there's no additional payment for
 16 ephemeral copies. The payments that I've used are all
 17 of the payments that are made in order to make these
 18 performances.
 19 So if there are two rights and if somehow
 20 viewed as necessary to break it down and attribute
 21 part of the value to one and part of the value to the
 22 other, my view is that the total of the two values

1 should be what I've calculated based on the over-the-
 2 air benchmark. My model does not directly address if
 3 there is a need to decompose it and say X percent of
 4 it is 114 and Y percent of it is 112. My model
 5 doesn't really answer that question. My model really
 6 only addresses the value of the package, the value of
 7 making the performances with all of the legal rights
 8 that are necessary to cause that to happen.
 9 I would note that it seems like the
 10 function that the ephemeral copies perform is
 11 subsidiary to the performances themselves, so that it
 12 would seem to me that if you are going to divvy it up
 13 somehow, it ought to be a relatively small proportion
 14 that goes to the ephemeral right as distinct from the
 15 performance right because of the subsidiary nature in
 16 terms of generating the value.
 17 Q Did you read Professor Nagle's testimony?
 18 A I did read Professor Nagle's testimony.
 19 Q Did you understand him to agree or
 20 disagree conceptually with the approach to ephemeral
 21 fee setting that you've just outlined?
 22 A In terms of there being essentially one

1 pot --

2 Q Yes.

3 A -- I think he basically agreed with that.

4 Q Yes. Did you otherwise agree with his
5 conclusions as to fee setting?

6 A Some of them but not all of them.

7 Q Would you like to expand on that?

8 A On Professor Nagle, specifically?

9 Q Yes.

10 MR. KATZ: Excuse me, is this in the
11 prepared direct testimony?

12 MR. RICH: It is not.

13 MR. KATZ: I move to strike it.

14 MR. RICH: We'll withdraw the question
15 unless the Panel would like to hear it.

16 CHAIRMAN VAN LOON: No.

17 BY MR. RICH:

18 Q Could you address -- as to ephemeral
19 copies in the 112 issue, finally, Professor Jaffe,
20 could you address how the Panel ought to be thinking
21 about that issue in respect to the background music
22 services?

1 start it if the Panel is interested in letting me
2 start.

3 CHAIRMAN VAN LOON: No, I think -- do
4 either of the co-panelists have anything to say on
5 this issue?

6 (Laughter.)

7 ARBITRATOR VON KANN: It's a nice place to
8 end for the day.

9 CHAIRMAN VAN LOON: Yes. Well, I think we
10 all have lots to think about, and we'll look forward
11 to everybody getting some rest and coming back at nine
12 o'clock in the morning to hear the cross. Thank you
13 very much.

14 (Whereupon, at 7:36 p.m., the CARP Hearing
15 was recessed until 9:00 a.m., Tuesday, August 28,
16 2001.)

1 A Yes. As I understand it, the situation
2 with the background music services is that Congress
3 has exempted them from the obligation to pay for the
4 performance right but not for the ephemeral copy
5 right. Again, the logic of my analysis would be that
6 the two rights have a certain value in combination.
7 I don't have the ability as an economist to sort of
8 say, "Why did Congress choose to exempt them from one
9 piece of it," but I have to presume that it was with
10 the intent of lowering the fee obligation. That would
11 seem to make sense. And, again, given the subsidiary
12 nature of the ephemeral copies in terms of the
13 economic function they perform, I think it would be
14 appropriate that what they pay would be a relatively
15 small fraction of what they would otherwise pay for
16 the package of the performance right and the ephemeral
17 right.

18 MR. RICH: That concludes our direct
19 examination.

20 CHAIRMAN VAN LOON: Do you have any cross?
1 (Laughter.)

22 MR. KATZ: I am certainly prepared to

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4 In the matter of: Docket No.

2000-9

5 Digital Performance Right in

6 Sound Recording and Ephemeral

7 Recording

CARP DTRA

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CARP Hearing Room

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LM-414

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Madison Building

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Washington, D.C.

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Tuesday

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August 28, 2001

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The above-entitled matter came on for hearing,

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

19

BEFORE

20

THE HONORABLE ERIC E. VAN LOON Chairman

21

THE HONORABLE JEFFREY S. GULIN Arbitrator

22

THE HONORABLE CURTIS E. von KANN Arbitrator

1 APPEARANCES: On Behalf of Clear Channel Communications, Inc.,
 2 National Religious Broadcasters Music License Committee, and Salem
 Communications Corporation
 3 KARYN ABLIN, ESQ. BRUCE G. JOSEPH, ESQ.
 4 THOMAS W. KIRBY, ESQ. DINEEN PASHOUKOS WASYLJK, ESQ.
 5 of: Wiley, Rein & Fielding 1776 K Street, N.W.
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 7 (202) 719-7000 On Behalf of American Federation of Television
 8 and Radio Artists
 9 ARTHUR J. LEVINE, ESQ.
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1 C-O-N-T-E-N-T-S
 2 WITNESS DIRECT CROSS REDIRECT RECROSS
 3 Adam Jaffe
 4 By Mr. Rich 6768
 5 By Mr. Katz 6581 6787
 6 EXHIBIT NO. DESCRIPTION MARK RECD
 7 39 DRX Rader email 6669
 8 41 DRX Jaffe Calculation 6717
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1 will go faster or something, but maybe people want to
 2 look at that. But I don't know. You know, maybe there
 3 can be done in a day.
 4 CHAIRMAN VAN LOON: And related to that,
 5 looking at the 5th, is Mr. Geffrey similarly an hour,
 6 an hour and a half direct? Mr. Geffrey, from Live
 7 365?
 8 MR. STEINTHAL: Is there
 9 CHAIRMAN VAN LOON: Is he going to be
 10 roughly an hour and a half also? --
 11 MR. STEINTHAL: I would think so, an hour
 12 and a half to two hours. Probably an hour and a half.
 13 I mean, I think the Panel, since Live 365 has been the
 14 subject of many comments along the way, may have more
 15 questions for him than others. I can't anticipate
 16 that. I made the mistake of not building that in
 17 before, so I would say an hour and a half to two
 18 hours.
 19 CHAIRMAN VAN LOON: And also, ballpark two
 20 hours cross or --
 21 MR. GARRETT: Maybe closer to two to two
 22 and a half.

1 CHAIRMAN VAN LOON: And while we're on the
 2 subject of that day, what would be your estimate of
 3 Alan's Morissette's direct?
 4 MR. STEINTHAL: I think her direct will
 5 only be about a half an hour. And I will say that it
 6 seems to be the case with the artists that we have to
 7 deal with their managers as well, and getting them
 8 slotted in at the time to confirm is sometimes a
 9 little bit more difficult. But her total direct I
 10 think will be about a half an hour. I know her
 11 statement is short and --
 12 CHAIRMAN VAN LOON: Yes.
 13 MR. STEINTHAL: -- the subject matter will
 14 be brief.
 15 CHAIRMAN VAN LOON: Okay. And with regard
 16 to cross?
 17 MR. GARRETT: I don't think it will go
 18 more than an hour.
 19 CHAIRMAN VAN LOON: So that suggests that
 20 one of the three witnesses from the 6th might be able
 21 to -- at a minimum to go on the 5th, if they were
 22 available, at least with the direct.

1 Excellent. Okay. So it sounds like we've
 2 got a lot of possibilities, depending on how things
 3 evolve next week. Great.
 4 MR. STEINTHAL: What is our start time on
 5 Thursday? Is it -- this Thursday afternoon?
 6 CHAIRMAN VAN LOON: Yes. Was it 12:00 or
 7 1:00? 1:00.
 8 So with that, we'll be more than happy to
 9 turn to the substance and begin the cross examination,
 10 and we're pleased that your manager has scheduled you
 11
 13 WHEREUPON,
 14 ADAM JAFFE
 15 was recalled as a witness and, having been previously
 16 duly sworn, resumed the witness stand, was further
 17 examined and testified as follows:
 18 CROSS EXAMINATION
 19 BY MR. KATZ:
 20 Q Good morning, Professor Jaffe.
 21 A Good morning.
 22 Q Let me go back to the beginning. About:

1 4:25 yesterday afternoon after your credentials, you
 2 started talking about transactional costs, isn't that
 3 right?
 4 A I don't know what time it was. I did talk
 5 about transactions costs yesterday.
 6 Q And you explained that one of the reasons,
 7 from an economic standpoint, why one would want to
 8 have a compulsory license in a context such as this is
 9 to minimize transactional costs. Isn't that right?
 10 A Well, no, I don't think that's right. I
 11 think what I said was that to minimize transactions
 12 costs there may be a benefit to centralizing the
 13 licensing. That that, in turn, generates a problem of
 14 market power, and that to resolve the problem of
 15 market power, from an economic perspective, one
 16 approach to that is the compulsory license.
 17 Q From a transactions costs standpoint, a
 18 user would need rights from many different owners of
 19 distinct musical compositions or sound recordings,
 20 isn't that right?
 21 A In many cases that is correct, yes.
 22 Q Well, in the context in which we're

1 dealing here, it would be inefficient for a webcaster
2 to deal with all of the different individual owners of
3 sound recording copyrights, isn't that right?

4 A For many webcasters that is likely to be
5 true.

6 Q The enormous number of different owners of
7 sound recordings would make it infeasible for a
8 webcaster to deal with all of them individually, isn't
9 that right?

10 A I don't know about enormous number. For
11 many webcasters, given -- the fact that they would
12 have to deal with many different parties, that may
13 well be inefficient from a transactions cost
14 perspective.

15 Q Just as with musical compositions, isn't
16 that right?

17 A It's analogous to the situation with
18 musical compositions, yes.

19 Q And musical compositions are owned by
20 hundreds or thousands of distinct music publishers,
21 isn't that right?

22 A Yes.

1 individually, could exercise market power. That is a
2 small enough number that there might be some concern,
3 but I have not analyzed that.

4 In my view, the market power that I've
5 been talking about here is the market power that
6 results when you have a single agent who is legally
7 authorized and given antitrust immunity to negotiate
8 on behalf of the multiple owners of the rights.

9 Q I take it, then, that you don't view sound
10 recordings as being owned by so many different people
11 that it would be infeasible for a webcaster to make
12 individual deals with major record companies, do you?

13 A Well, I don't think I ever used the word
14 "infeasible." So, no, I don't think it's infeasible.

15 Q Well, you said it would be inefficient.
16 Do you think it would be inefficient necessarily for
17 a webcaster to deal with five different record
18 companies?

19 A It could be, yes.

20 Q Are you aware that some webcasters have
21 chosen to deal with more than five different suppliers
22 of bandwidth?

1 Q And sound recordings are largely owned by
2 five different major record companies, isn't that
3 right?

4 A Well, that's why I wasn't -- couldn't
5 understand why you had the word "enormous" in your
6 question. It's a matter of degree, and, you know,
7 perhaps Congress shouldn't have granted antitrust
8 immunity to the RIAA to act collectively on behalf of
9 the record labels.

10 They did that, I believe, as a matter of
11 economics, because they were concerned about the
12 transactions costs that would arise if the
13 negotiations were all individual. Once you've granted
14 the antitrust immunity, from an economic perspective
15 the compulsory license really becomes necessary
16 because you've created the potential for market power.

17 Q Well, does the market power arise from the
18 fact that there are only five major record companies,
19 or does the market power arise from the fact that the
20 RIAA is the non-exclusive bargaining agent for them?

21 A In my view -- I haven't studied the extent
22 to which the five record companies, if acting

1 A I don't know one way or the other.

2 Q Would that strike you as irrational?

3 A No.

4 Q Would that strike you as infeasible?

5 A Certainly not.

6 Q Now, you've concluded that in order to be
7 a viable webcaster, you would need access to the sound
8 recordings of all of the major labels, isn't that
9 right?

10 A No, I don't think I've concluded that or
11 analyzed that.

12 Q There's no reason to believe that a
13 webcaster couldn't make do with licenses for only four
14 of the five major record labels, isn't that right?

15 A I don't know.

16 Q Or three of the five.

17 A I don't know.

18 Q Or one of the five.

19 A I don't know.

20 A The EMI catalog is particularly strong in
21 British invasion music from the 1960s. Is there any
22 reason why a webcaster wanting to put up one of these

1 narrow British invasion channels couldn't do it with
2 simply an EMI license?

MR. RICH: Objection. There's a lack of
4 foundation. If that question -- either it should be
5 established that the witness agrees with the predicate
6 or it should be asked in a hypothetical.

7 CHAIRMAN VAN LOON: Sustained.

8 BY MR. KATZ:

9 Q Are you familiar with the catalogs of any
10 of the major record labels?

11 A No.

12 Q Are you familiar with the extent to which
13 it would be necessary to delve into the catalog of
14 more than one major record label to establish a
15 webcaster of a narrow genre station?

16 A No.

17 Q Have you seen any analysis as to how many
18 major record labels a webcaster would need to deal
19 with in order to have a viable webcasting service?

20 A No. Because all of that is irrelevant.

21 Once the antitrust immunity is granted, and there is
22 a party that is authorized to -- to license on behalf

1 be better asked of the webcasters. I haven't analyzed
2 that issue.

3 Q You have no idea one way or another, do
4 you?

5 A I have not analyzed that.

6 Q Then, why do you conclude the RIAA has
7 market power if every single webcaster may have this
8 viable alternative, Professor?

9 A Well, I haven't seen anyone who has
10 suggested that that is the case. And I don't
11 understand why the statute would be written in the way
12 it was if the record industry thought that was the
13 case.

14 If the record industry really believed
15 that the way this thing ought to play out is -- is a
16 series of individual licenses, it wouldn't make sense
17 for them to request antitrust immunity.

18 So I think your premise is unlikely. I
19 haven't analyzed it. I don't know of anyone who has
20 suggested that it's how this industry works. But
21 you're right. I haven't studied it.

22 Q Now, Professor, you have been retained by

1 of the collective, it doesn't really matter whether
2 the transactions costs, which was the motivation for
3 granting that antitrust immunity, is real or not.

4 Q If a webcaster has the viable option of
5 dealing with one or two major record labels instead of
6 the RIAA, why doesn't that eliminate the RIAA's
7 supposed monopoly power?

8 A Well, vis-a-vis some specific webcaster
9 who, given the particular nature of their needs, that
10 might mitigate the market power. Nonetheless, as I
11 understand it, what this proceeding is about is to
12 determine the fees that would be appropriate for the
13 blanket license that is offered by the collective on
14 behalf of all of the labels.

15 And so the issue remains for that
16 particular product, what is the extent of market
17 power? And what is the role of the compulsory license
18 in mitigating it?

19 Q Are you aware of a single webcaster that
20 could not viably operate with licenses for only one or
21 two of the major record labels?

22 A Well, I think that's a question that would

1 a number of webcasters, isn't that right?

2 A Yes.

3 Q And you've had communications with these
4 webcasters?

5 A To some extent, yes.

6 Q Then, which ones did you ask whether or
7 not they could viably operate with licenses from fewer
8 than all of the major record labels?

9 A None.

10 Q Did you ever ask that question indirectly
11 of counsel and ask them to put it to the clients?

12 A No.

13 Q Now, would you agree, Professor, that one
14 of the public policy goals behind the copyright system
15 was to stimulate the creation of new works?

16 A Yes.

17 Q And do you believe that this Panel, in
18 setting its rate, should consider the impact that that
19 will have in encouraging the development of new sound
20 recordings?

21 A Well, from a public policy perspective,
22 which is distinct from trying to interpret the

1 statute, which is not really my job, I think that's
2 something the Panel could take into account. I don't
3 really see how it fits in the framework of the willing
4 buyer/willing seller test, which is the statutory
5 standard.

6 And as an empirical matter, I think it's
7 clear that the outcome of this Panel is not going to
8 affect the incentive to produce sound recordings.

9 Q Well, you testified yesterday about a
10 future world in which there will be billions of hours
11 of streaming music, isn't that right?

12 A I don't think I talked about a future
13 world. I talked about a hypothetical world.

14 Q And in that hypothetical world, won't the
15 rates set for that streaming influence a sound
16 recording manufacturer at the margin as to whether or
17 not to make the investment necessary to create another
18 sound recording?

19 A If we had a world in which there were
20 billions of performances, and that world was affected
21 by what happens here -- that is, it occurs between
22 1998 and 2001 -- then you could conceivably reach a

1 point where there would be a minor or marginal impact.
2 It would still be -- even at that point, the revenues
3 from the royalties would still be modest compared to
4 the overall revenues that are recovered from the
5 production of sound recordings.

6 Q Well, how do you know that, Professor?
7 Have you seen any analysis of what might happen in the
8 internet world over the course of the next two years?

9 A Over the course of the next 18 months.

10 Q Yes, sir.

11 A Yes.

12 Q Is that your area of expertise?

13 A Not specifically.

14 Q What have you read in that regard?

15 A Well, I've seen the data that we have,
16 which is limited, on the current audiences of the
17 webcasters and --

18 Q Have you seen the projections that some of
19 these webcasters have come up with with what they
20 expect to do next year and the year after?

21 A No, I have not.

22 Q Let's go back to the statutory standard.

1 Now, how does the statute express the standard that
2 this Panel is supposed to utilize in establishing
3 rates?

4 A Do you want me to quote it?

5 Q Well, what's your understanding?

6 A My understanding is that the test is the
7 -- what we've calling in shorthand the willing
8 buyer/willing seller test, and then it enumerates a
9 series of factors that the Panel has to take into
10 account in applying that test.

11 Q Well, what does the statute say about
12 willing buyer and willing seller? Do you remember?

13 MR. RICH: Might we not share a copy with
14 the witness? I don't know that this should be a
15 memory test on such a question.

16 CHAIRMAN VAN LOON: That would certainly
17 make sense.

18 MR. RICH: May I approach the witness?

19 CHAIRMAN VAN LOON: Please. Yes.

20 MR. KATZ: Excuse me, Mr. Rich. I'm
21 asking the questions. If the witness wants help, he
22 can ask me for it.

1 MR. RICH: The Panel simply advised me I
2 should share this with the witness. With all respect,
3 I take my orders from the Panel, not from you.

4 CHAIRMAN VAN LOON: It's simply a matter
5 of seeing --

6 MR. KATZ: The witness hasn't asked for
7 it. The witness hasn't asked for it yet. And if he
8 asks for it, I have no objection to giving it to him.
9 But let's let the witness --

10 MR. RICH: I am the witness' counsel. I
11 am entitled to make an inquiry of the Chair and the
12 Panel, and the Panel responded favorably that he
13 thought it was appropriate that the witness have a
14 chance to look at the statute. I don't think I need
15 to argue with counsel about that.

16 ARBITRATOR VON KANN: What is the pending
17 question?

18 MR. KATZ: I want the witness'
19 understanding of the statutory test. The witness
20 seems ready to give me an answer.

21 ARBITRATOR VON KANN: You'd like to
22 ascertain first his understanding before he looks at

1 the text?

2 MR. KATZ: If the witness has one, I think
I'm entitled to that.

4 MR. RICH: And I believe the pending
5 question prior, Your Honor, was what the language of
6 the statute was. So if the question is what his
7 memory skills are, I suppose he could ask him that
8 without the statute in front of him. If it's to be
9 probative, I would suggest he have the statutory
10 language in front of him.

11 CHAIRMAN VAN LOON: Well, which question
12 would you like to ask, Mr. Katz?

13 MR. KATZ: Well, I'd like -- I think the
14 witness is prepared to answer. He has opened his
15 testimony, and I'm interested in the witness'
16 understanding as to what this test is.

17 CHAIRMAN VAN LOON: So what is his
18 understanding of the -- of the legislative test.

19 MR. KATZ: If he has one.

20 THE WITNESS: Am I allowed to read my own
21 testimony before I answer the question?

22 CHAIRMAN VAN LOON: Of course.

1 MR. KATZ: Absolutely.

2 THE WITNESS: I believe the statute states
3 that the Copyright Arbitration Royalty Panel, as it
4 determined license rates and terms "that most clearly
5 represent the rates and terms that would have been
6 negotiated in the marketplace between a willing buyer
7 and a willing seller."

8 BY MR. KATZ:

9 Q And you don't disagree with that, do you?

10 A Quite the contrary. I spent quite a bit
11 of time yesterday explaining why I thought that was a
12 sensible standard.

13 Q And what the Panel has to do is to
14 establish rates and terms that most clearly represent
15 what would have been negotiated in the marketplace by
16 a willing buyer and a willing seller, isn't that
17 right?

18 A I think you read it correctly, yes.

19 Q And the marketplace is a marketplace in
20 which there are five major record companies, isn't
21 that right?

22 A No, I don't think you can draw that

1 inference, that that's what "the marketplace" means in
2 that context.

3 Q Why not?

4 A Well, we discussed this at some length
5 yesterday, and there's also quite a discussion in my
6 testimony about the legislative history and the other
7 background that -- that I believe if you analyze this
8 from an economic perspective, and understand the
9 discussion, for example, in the legislative history
10 about that this is a reasonable rate, which is --
11 which has a long history in copyright, and the -- the
12 logic of the compulsory license mechanism, in
13 conjunction with antitrust immunity, that the way to
14 interpret this is as a hypothetical relating to a
15 negotiation that leads to an outcome similar to what
16 would occur in a hypothetical, competitive market.

17 Q So you --

18 A I would grant you that the word
19 "competitive" doesn't appear there, and I haven't
20 claimed that it does. What I gave was my perspective
21 on this as an economist as to what is a coherent
22 interpretation of that phraseology.

1 Q Well, the word "hypothetical" doesn't
2 appear there at all, and the word "competitive"
3 doesn't appear there at all. And the word "stable"
4 doesn't appear there at all, does it?

5 A No.

6 Q It refers to "the marketplace," isn't that
7 right?

8 A You're just quoting. I'm not going to
9 argue with you about your quoting of the language.

10 Q But that's what the Panel has to do. The
11 Panel has to focus on the marketplace and think about
12 what willing buyers and willing sellers would do,
13 isn't that right?

14 A Are you asking me anything other than
15 whether you've quoted the language correctly?

16 Q Isn't that right? That's what the Panel
17 has to do?

18 A The Panel has to -- I'm not going to tell
19 the Panel what the Panel has to do. The Panel is
20 going to interpret the statute. I'm giving the Panel
21 the benefit of my economic perspective on that, and
22 the Panel is going to decide whether they accept it or

1 not. I don't have any pretensions that I am the --
2 the font of statutory interpretation. The language is
what it is.

4 Q And a willing seller is a seller that has
5 the right to withhold the product, isn't that right?

6 A In a hypothetical competitive market,
7 that's correct, yes.

8 Q That would be one of the differences
9 between what the Panel looks at here and the real
10 world in which the owners of sound recording
11 copyrights have no right to withhold a product, isn't
12 that right?

13 A Yes.

14 Q Now, you concluded that you wanted to look
15 at a hypothetical competitive market. Now, what would
16 it mean to have a competitive market for sound
17 recording copyrights?

18 A Well, what it would mean -- and, again,
19 this would be hypothetical -- would be that you would
20 have multiple parties who, like the RIAA, can offer a
21 blanket license to the right of performance of sound
22 recordings for the major record labels.

1 Q So this --

2 A And those competing licensors would each
3 be trying to sell their version of this blanket
4 license in competition with each other.

5 Q Now, a copyright owner, under the law, has
6 an exclusive right to the works and the copyright --
7 copyrighted work that he owns, isn't that right?

8 MR. RICH: May I ask the Panel -- through
9 the Panel, Mr. Katz, a clarification of "under the
10 law." Are we talking about under Section 114, absent
11 Section 114, solely under 106, without reference to
12 other provisions of the Copyright Act? The question
13 is vague as posed.

14 CHAIRMAN VAN LOON: Mr. Katz, do you want
15 to clarify?

16 MR. KATZ: I don't understand the
17 objection. I asked a very easy to understand
18 question, and he made an objection which seemed to
19 have nothing to do with my question. My question is
20 about the scope of the copyright. If the witness
21 doesn't understand that, he can tell me so.

22 ARBITRATOR VON KANN: The question again

1 was?

2 MR. KATZ: That the copyright grants the
3 owner the exclusive right with respect to the work.

4 ARBITRATOR VON KANN: And your question
5 is, under the state of the law as it now exists --

6 MR. KATZ: Yes.

7 ARBITRATOR VON KANN: -- if they --

8 MR. RICH: I find the question

9 unintelligible, because --

10 CHAIRMAN VAN LOON: Overruled.

11 MR. RICH: Thank you.

12 THE WITNESS: Well, I'm not a lawyer. My
13 understanding of how copyrights work is that the owner
14 of the copyright in general controls how that
15 copyright is to be used or not used. It seems to me,
16 though, that sort of by definition, if Congress has
17 said there's a compulsory license, then at least as a
18 practical matter there's a sense in which the owner of
19 that particular copyright -- in this case the right of
20 public performance of sound recordings over these
21 digital media -- is not, as a practical matter,
22 exclusive because other people can use it without that

1 -- without the explicit approval of that -- the rights
2 holder.

3 BY MR. KATZ:

4 Q Well, but statutory licenses to one side,
5 the idea of copyright is to grant monopolies and the
6 rights with respect to specific creative works, isn't
7 that right?

8 A So you are now talking about copyrights
9 other than the one that's at issue in this proceeding.

10 Q I'm talking about copyrights in general,
11 Professor. Isn't that your understanding?

12 A Well, subject to what we've just been
13 talking about in terms of limitations that are placed
14 by the statute.

15 Q Let's assume that there's no compulsory
16 license for the moment and just go back to a
17 hypothetical competitive world. In that hypothetical
18 competitive world, copyright owners have monopolies
19 with respect to their own individual creative works.

20 Now, is there any reason why an individual
21 would choose to compete with himself by licensing
22 different people to license his creative work in

1 competition with one another?

2 MR. RICH: Object to the form of the
3 question. The question was preceded by a statement by
4 counsel which was not adopted by the witness about
5 monopoly power of the copyright owners. It was
6 followed by a question based on that premise.

7 CHAIRMAN VAN LOON: Could we hear the
8 question again, please?

9 MR. KATZ: Do we have the capability to
10 read back questions here, or is it easier for me to
11 reformulate it?

12 CHAIRMAN VAN LOON: It would be easier to
13 reformulate it.

14 MR. KATZ: I mean, I can repeat it. I
15 asked the witness to assume we're in a hypothetical
16 world now in which copyright owners have exclusive
17 rights to their works. Can you think of any reason
18 why a rational copyright owner in that world would
19 choose to compete with himself by licensing multiple
20 people to license his owned -- exclusively-owned work?

21 MR. RICH: That's a different question to
22 which I have no objection.

1 competitive return to the aggregation and licensing
2 function that they are performing, and they would each
3 collect that money and they would send it to authors,
4 and the authors would all -- or the rights holders
5 could all recover the value as they see it, and they
6 could insist on any value they want, because, as you
7 say, they could control those works.

8 But we could still have a competitive
9 market in this hypothetical. We could still have a
10 competitive market for the aggregate licensing
11 function, and I think that that is a hypothetical that
12 one can meaningfully think about.

13 BY MR. KATZ:

14 Q Do copyright owners do that now, license
15 multiple people to license their work?

16 A No. And the reason they don't is because
17 the transactions costs problem, which make that
18 hypothetical unrealistic in the real world, and also
19 the structure of the way the licensing organizations
20 have evolved, make that some combination of infeasible
21 and unattractive.

22 Q Well, remind me -- if there are five

1 THE WITNESS: I don't see how -- if I'm a
2 copyright owner, I've written a book, or something
3 else that's copyrightable. I don't see how my
4 authorizing multiple agents to license that on my
5 behalf is competing with myself, any more than if I'm
6 trying to sell my house I might list it with multiple
7 listing services and try to sell it in that way. The
8 multiple listing service is, in effect, an agent for
9 me.

10 I think the way that market would work,
11 subject -- and this is hypothetical because of the
12 transactions costs issues it raises, the way that
13 market would work would be that I, as a rights holder,
14 would deal with as many different licensing agencies
15 as provided me with appropriate returns on my
16 intellectual property.

17 Each of those competing licensing agencies
18 would sell blanket licenses at a rate which covered
19 the underlying value of the works, which may well
20 reflect a monopoly to the owners of those individual
21 works, because they do monopolize them.

22 And, in addition, it would reflect a

1 owners of sound recording copyrights, why do
2 transactional costs make that unfeasible?

3 A Well, I thought -- I'm sorry. I thought
4 we were talking now about rights holders in general.
5 You had asked me to step back and talk about the
6 copyright law, so my -- my last few answers were
7 responsive to that posing of the question.

8 Q Well, so you're assuming a world in which
9 there are hundreds of different owners of these
10 copyrights. Was that an assumption that you built
11 into my hypothetical? When you started talking about
12 transactional costs making it infeasible, so where did
13 that come from?

14 A Now you've asked about five questions, so
15 should I explain my previous answers, or should I --
16 or do you want to start over?

17 Q Where did this impracticality from
18 transactions costs come from?

19 A It is not an assumption that when we're
20 talking about copyrights in general, which was your
21 question, there are thousands of owners of such
22 copyrights. That's not an assumption; that's a fact.

1 If you want me now to discuss specifically copyrights
2 for sound recordings, I'd be happy to do that, but
3 that was not your previous question.

4 Q All right. Well, let's go back to this
5 general situation. We have thousands of copyright
6 owners. Are you aware of any that have chosen to
7 license their works by having multiple people offering
8 the works for them in competition with one another?

9 A Well, you keep putting the "in competition
10 with one another," and to me that -- I don't know what
11 you mean by that. If what you mean by that is that
12 the agents are competing with each other to be the
13 licensor, that's one thing. If what you mean by that
14 is that the underlying rights holders are somehow
15 competing with themselves, as I explained, I don't
16 think multiple licensing implies that.

17 Q Well, you tell me, how is your competitive
18 market going to work? I own the copyright on a
19 valuable song and a valuable sound recording. And I
20 want to maximize the value for that. Now, how am I
21 going to, in a theoretical world, license that?

22 A Well, in a theoretical world, there could

1 holder actually does indeed have an incentive to make
2 sure that they sign up with everybody who is doing
3 this, because otherwise there's a possibility that if
4 I don't sign up with Jack, and Jack turns out to be
5 very successful in marketing this product, that I'm
6 going to lose a potential revenue stream, because
7 Jack's customers aren't going to be producing revenues
8 that I get.

9 So if we could solve the transactions cost
10 problem of this multiple licensing, in fact, what
11 would happen is you'd have multiple licensing agents,
12 each of which would have, if you like, sub-license or
13 intermediate license agreements with essentially all
14 users. They would offer those in competition with
15 each other.

16 The price at which that sells in the
17 marketplace to the radio station or the webcaster
18 would be the sum of what all of the underlying
19 individual rights holders demand for their works,
20 because they can demand whatever they want. The guy
21 who wrote or the guy who, you know -- Bruce
22 Springsteen performed -- created a given performance.

1 be -- and I don't think there would be hundreds -- but
2 there could be a non-trivial number of people who are
3 in the business of offering blanket licenses, and, in
4 effect, managing the flow of monies from the users of
5 those licenses back to the rights holders.

6 So I, for example, as an owner of a sound
7 recording or a catalog of sound recordings, could say
8 I want to receive X cents or X fractions of a cent
9 every time my work is publicly performed. And I will
10 license anybody who wishes to be my agent to transfer
11 that to broadcasters on the condition that every time
12 my song is performed I get that amount of money.

13 And so I, and you, and everyone else in
14 this room could go in the business of collecting such
15 licenses from sound recording owners and then offering
16 to radio stations or to webcasters that for a lump sum
17 fee they can broadcast all of -- any of the sound
18 recordings in my repertoire, and I will collect the
19 money, and I will distribute it to the various people
20 who have signed up with me in order to create this
21 repertoire.

22 Now, in that world, an individual rights

1 He can ask whatever he wants for that performance, or
2 his record label can.

3 So we'd add up what all of those
4 individual guys demand. We'd put on top of it, in
5 effect, what it costs to operate this system. I've
6 got to have a big computer, and I've got to keep track
7 of this, so I'd have some costs as the agent. And
8 that would be the competitive price for this blanket
9 license.

10 And one can imagine that as a hypothetical
11 benchmark, and it has nothing to do with and is in no
12 way inconsistent with the underlying rights holders
13 holding a monopoly on their creative works.

14 Q But, Professor Jaffe, if there are five
15 major record companies that control sound recording
16 copyrights, and if this is the efficient way to
17 license their work, why aren't they doing that in the
18 real world?

19 A I didn't say it was the efficient way.

20 Q Isn't the efficient way for the owner of
21 monopoly rights, to exploit his monopoly, to tightly
22 control the licensing in that desirable good?

1 A Well, it depends on what you mean by
2 "efficient." As we've discussed, there are
3 transactions costs associated with licensing. And
4 just because there are only five, that makes the
5 transactions costs less than if there were 5,000. But
6 it doesn't mean that the transactions costs are not an
7 issue.

8 And, therefore, the question of whether
9 the efficient, overall way to license these works is
10 through a whole set of bilateral arrangements or
11 through some kind of centralized mechanism is -- is
12 sort of a factual question as to how complex that
13 would be and how much it would cost.

14 Congress, in my view, has, in effect, cut
15 through that set of factual questions, and has said
16 there's going to be a compulsory license and there's
17 going to be -- where there can be -- an agent who acts
18 on behalf of the record companies.

19 I suppose if the law could have been
20 passed, and then the five record labels could have all
21 said, oh, we don't need the RIAA, go away; we're not
22 going to give the RIAA authority to license on our

1 behalf; we're each going to see what we can do
2 individually, even in the presence of the compulsory
3 license, that could have happened. They chose not to
4 do that. So we have what we have.

5 Q I'm sorry, Professor. The individual
6 record companies have chosen not to license on their
7 own? Is that your testimony?

8 A I didn't say that. They have not made the
9 choice to withhold from the RIAA the ability to
10 negotiate on their behalf, is what I said. They could
11 have, but that's not the choice they made.

12 Q In the marketplace, willing sellers of
13 sound recordings have not chosen to create these
14 multiple competing agencies; isn't that right?

15 A That is correct.

16 Q Now, in thinking about a willing seller in
17 this marketplace for sound recordings, would a willing
18 seller consider the possibility that people listening
19 to streams will, in fact, intercept those streams,
20 turn them into downloads, and then recirculate them?

21 A Yes.

22 Q Would a willing seller in this marketplace

1 think about the possibility that hackers will be able
2 to hack into some of these servers with enormous
3 numbers of sound recordings on them, intercept those
4 files, and circulate those?

5 A If that's a real possibility, yes.

6 Q Would a willing seller consider the
7 possibility that the multiplicity of webcasters, the
8 ease of entry into webcasting, and the focus of some
9 webcasters on very narrow genres, that that
10 combination might create so many choices in the
11 marketplace that some people will buy fewer CDs than
12 they had before?

13 A Yes.

14 Q In this marketplace, would a willing
15 seller consider with respect to promotional
16 possibilities, that there's really no way to control
17 the specific songs that a webcaster is going to stream
18 or the specific geographical area in which those songs
19 will be accessible?

20 A I guess I don't really see how that
21 affects the promotional value, so I'm not sure -- I
22 mean, you ask me might they consider. I suppose they

1 might, but I don't see what it is there they'd be
2 considering.

3 Q If they felt that it was important to
4 control promotional playing of music with respect to
5 geographical area and timing, then that's something a
6 willing seller would consider; isn't that right?

7 A I think you just asked me, if they thought
8 this was important, would they consider it. And I
9 guess the answer to that is yes.

10 Q Now, would a willing seller in a market
11 like this consider the fact that these ventures are
12 new and risky for the buyers; and, therefore, there's
13 some chance that the buyer won't last very long?

14 A Again, I don't see how that affects the
15 willingness to sell. But if you've got something in
16 mind that I haven't thought of, and if you want to
17 posit that they think it's important, they might
18 consider it.

19 Q Well, can you think of any reason why a
20 vendor entering into a long-term contractual
21 relationship, with payments to be made at various
22 dates over the future, might consider the riskiness of

1 the venture in deciding how to price that deal or
2 whether to go into the deal at all?

3 A Well, as long as the payments are
4 structured in such a way to be reasonably tied to the
5 use of the right over the course of the agreement -- I
6 mean, and we're not talking about really long-term
7 agreements here; we're talking about two two-year
8 periods -- and as long as you can tie the payments to
9 the use of the right, I don't see why you'd care
10 whether after using it for some period of time and
11 paying for that period of time the guy goes away.

12 Q Well, let's look at a little history here.
13 What period of years is this panel setting
14 rates for?

15 A '98, '99, 2000 and 2001.

16 Q And these webcasters, who've been using
17 the compulsory license since 1998, have they paid
18 anything so far to the record companies?

19 A No.

20 Q And are there any webcasters who have
21 disappeared over the course of the last two years?

22 A Yes.

1 with the use of the -- with the use of the property.
2 It could be some two-up basis as long as there wasn't
3 too big a lag that allowed for somebody to use the
4 property and then disappear without paying.

5 Q Now, would a willing seller in entering
6 into a contract with the buyer in a brand new market,
7 which some people believe has enormous potential
8 upside, take that into consideration in the
9 negotiation?

10 A Yes, I think they might, for example, sell
11 the rights at a lower rate than they would otherwise
12 sell it in order to foster the development of the
13 potential that's there with the knowledge that if the
14 new medium does develop, they will have the
15 opportunity later on to recoup greater royalties.

16 Q Or would he, perhaps, seek some terms in
17 the agreement which would give him a share of that
18 upside if it developed during the course of the
19 agreement?

20 A He might seek that, yes.

21 Q Now, Professor Jaffe, in doing the
22 analysis that you were called upon to do here, in

1 Q And do you suppose a willing seller back
2 in 1998 might have considered that possibility in
3 setting rates?

4 A Well, you've mixed two things together.
5 If we're talking about the reliance on the compulsory
6 license, it's true that you get to perform and delay
7 payment. If we're talking about a hypothetical
8 willing buyer or willing seller negotiation, then
9 presumably you are negotiating a contractual
10 arrangement perspective. And I don't see in that
11 context why the willing seller would be concerned that
12 I'm negotiating a two-year deal, but the guy who I'm
13 negotiating with might die before the deal is over.
14 As long as I time the payments -- which in a willing
15 buyer, willing seller, freely negotiated framework I'd
16 be able to do -- as long as I timed the payments to
17 reflect the use of the work, I don't see why I would
18 care.

19 Q So a willing seller in that situation
20 would protect himself by including, perhaps, advanced
21 payments?

22 A Well, or timed in some way to coincide

1 assessing what rates and terms most clearly represent
2 the rates and terms that would have been negotiated in
3 the marketplace between a willing buyer and a willing
4 seller, the best approach would have been to have used
5 actual agreements between sound recording licensors
6 and webcaster licensees; isn't that right?

7 A If you had available agreements that you
8 believe to represent reasonable rates for users that
9 are comparable to the users that are being licensed by
10 the proceeding, I think that would have been the best
11 thing to do.

12 Q If you had rates and terms negotiated in
13 the marketplace between willing buyers and willing
14 sellers, you'd use them; isn't that right?

15 A Not necessarily, for the reasons that I
16 just explained.

17 Q So even though the panel's mission is to
18 establish the rates and terms that most clearly
19 represent the rates and terms that would have been
20 negotiated in the marketplace between a willing buyer
21 and a willing seller, you would not prefer to use
22 rates that have been negotiated and terms that have

1 been negotiated in the marketplace between willing
2 buyers and willing sellers?

A No, I don't think I said that. What I
4 said was, if you have a set of agreements between the
5 RIAA and webcasters, those may or may not be good
6 evidence of willing buyers and willing sellers in the
7 marketplace. If they are, then that would be great.
8 If they're not, you shouldn't use them.

9 Q So what you would need to do is scrutinize
10 those agreements and see if they were really
11 agreements made between willing buyers and willing
12 sellers; isn't that right?

13 A You would want to scrutinize those
14 agreements, as I described yesterday, to see whether
15 the rates and terms that they contain are, in fact,
16 likely to be indicative of the rates in a
17 willing -- between willing buyers and willing sellers
18 in the marketplace within the overall framework of the
19 statute. I mean, there is other stuff in there that
20 explains what Congress, in my view, meant by that.

21 Q Now, what did you do to analyze the
22 agreement between the RIAA and its licensees to

1 determine whether or not those were, in fact, rates
2 and terms negotiated in the marketplace between
3 willing buyers and willing sellers?

A Well, at the time I wrote my direct
5 testimony, since the contracts all contain
6 confidentiality provisions, I didn't know anything
7 about them, so I couldn't scrutinize them. I
8 explained, both in my written testimony and yesterday,
9 why conceptually there would be reasons to be cautious
10 there, but I didn't have them available to scrutinize.

I do now have them available as well as
12 various information regarding the circumstances under
13 which they were negotiated. And I've just begun to
14 review that information. I'm not prepared as I sit
15 here to testify with respect to that.

16 ARBITRATOR GULIN: Can you tell us what
17 you'd be looking for?

18 THE WITNESS: Yeah. I mean, I think what
19 I would be looking for would be to see whether the
20 concerns at a conceptual level that I expressed
21 yesterday were, in fact, manifest. Is there evidence
22 that some of the -- or some of the licensees didn't

1 understand the process? Is there evidence that some
2 of the licensees cared a lot about getting a deal
3 signed quickly, and felt that waiting for the panel
4 wasn't an adequate substitute? Is there evidence that
5 the licensees felt that they were getting something
6 by doing a voluntary deal with the RIAA for the
7 streaming rights that they couldn't otherwise get? Is
8 there evidence that there were people who felt that
9 reliance on the CARP was either going to be expensive
10 or problematic for them because their circumstances
11 are sort of different than the typical circumstances
12 that were likely to be the focus of the CARP?

13 Those are factual questions. If there is
14 significant evidence of those kinds of reasons why the
15 statutory license wasn't going to be a reasonable
16 substitute, then I would be inclined to say that those
17 agreements don't reflect willing buyers and willing
18 sellers for this narrow right in the context of the
19 statute.

20 ARBITRATOR GULIN: Now, what if you didn't
21 find substantial evidence in those things?

22 THE WITNESS: Well, I think as I indicated

1 to Mr. Katz, if you didn't find that evidence, then I
2 think you would say, we've got agreements that are
3 closely related to the ones that -- or that involve
4 closely related rights to the ones that we're
5 licensing here. And if the circumstances were
6 comparable, then that would be the best evidence.

7 I wouldn't -- I'd be the first to say I
8 wouldn't go to musical works and over-the-air radio if
9 I had available to me evidence of reasonable rates for
10 sound recordings on the Internet.

11 ARBITRATOR GULIN: Let me ask you one
12 other question. And that is, which would be, in your
13 view, a better benchmark, the RIAA webcaster
14 agreements or an agreement between a webcaster and an
15 individual label? All else being equal.

16 THE WITNESS: Well, I think if you
17 had -- well, first of all, if we're talking about an
18 agreement with an individual label, it would have to
19 be for the same rights; not an agreement with a label
20 for something else.

21 I think if we had an agreement with an
22 individual label -- I'd have to think about that. I

1 guess that would be -- some of the -- there's sort of
2 less -- less concern in the sense of the collective.

I think you'd fundamentally ask, in effect, the same
4 question about whether they thought that their other
5 option was a viable option.

6 If their only other option was to deal
7 with the RIAA, then I'm not sure I would believe that
8 the individual label was, in effect, competing with
9 the RIAA. But potentially that could be useful.

10 ARBITRATOR GULIN: Thank you.

11 ARBITRATOR VON KANN: Let me just ask a
12 follow-up there.

13 One of the things I find a little
14 difficult about our mission is the reference to "a"
15 willing buyer and "a" willing seller. Now the fact is
16 that there's many buyers, and they are not all
17 identical. And that's not unique to this market I'm
18 sure.

19 You referred a moment ago to the fact that
20 some buyers might be very interested in getting
21 something resolved quickly. I would suppose in lots
22 of markets that's the case. Some buyers have a

1 averaging out would sort of lead you to kind of a fair
2 market price. And our problem is we're too early in
3 the process.

4 Is that what you're saying? Because it
5 doesn't seem to me that being eager to close a deal is
6 immediately a disqualifier from being a willing buyer.
7 That's my question.

8 THE WITNESS: I understand. I think there
9 are two slightly different issues that arise when
10 thinking about, for example, the timing issue. One is
11 an issue, sort of, of comparability-- were where those
12 guys -- the ones that RIAA need to deal
13 with -- comparable and were the situations comparable
14 to the situations where you have to assign a rate?
15 Because, otherwise, you might have some pause about
16 making that transfer. But that's actually the more
17 minor issue.

18 I think -- the issue that I was focusing
19 on was -- the statute doesn't say, that most clearly
20 represent the rates and terms that were negotiated in
21 the marketplace; they say would have been negotiated
22 in the marketplace. So there's clearly some

1 greater -- they're more games players. They're
2 willing to hang on for a while and see what happens to
3 prices. Maybe I'll be able to buy it cheaper, maybe
4 I won't. Other people say, I've got to get this
5 settled. I need to get on. I need to tell my
6 investors and my stockholders.

7 So the fact that there's some difference
8 in the extent to which buyers are eager to get it
9 settled and move doesn't strike me as unusual or evil
10 or anything else; it's probably just human nature.

11 I guess when you said a moment ago in
12 looking at these agreements, if you saw evidence, for
13 example, that some of them cared a lot about getting
14 a result quickly, that wouldn't seem to me to indicate
15 that the person isn't necessarily a willing buyer;
16 he's just a willing buyer of a particular type-- a
17 willing buyer who doesn't like to wait around a lot.

18 And I guess the problem might be
19 that -- focusing on that single factor for a moment.
20 What you'd want to know, I suppose, is -- I guess in
21 a normal situation you'd have some of those folks, and
22 you'd have some that wait awhile. And somehow the

1 contemplation of this being hypothetical.

2 And then later on it says, you may
3 consider actual agreements that have taken place. It
4 doesn't say you should consider, which to me suggests
5 that Congress had this same notion that, well, that
6 might be good information, but you've got to look at
7 it with a skeptical eye and analyze it.

8 And my issue on the timing -- you're
9 absolutely right, that in a marketplace, in general,
10 there are different people who have different
11 valuations for various reasons. My issue on the
12 timing was very specifically related to the question
13 of whether or not one can presume that because of the
14 existence of the compulsory license, what would
15 otherwise be a clear presumption that the RIAA is
16 acting with market power is, in fact, mitigated or
17 eliminated.

18 So while as I agree with you in general
19 there's different people, they have different timing,
20 and that's not something we worry about; in this
21 specific context, if we're going to rely on the RIAA
22 agreements, we've got to get by the presumption that

1 absent the compulsory license the RIAA would have
2 market power. If the compulsory license is a good
3 substitute, I think that solves the market power
4 problem. And so the question is, is it a good
5 substitute? And in that very specific context the
6 timing becomes more important, potentially; again,
7 factual question.

8 ARBITRATOR VON KANN: Okay, thank you.

9 BY MR. KATZ:

10 Q As usual, the panel asks better question
11 than I would, and thereby speeds me up. But let me
12 dip into this area a little bit anyway.

13 Professor, you would expect that if the
14 panel is going to set a reasonable rate, that the
15 people who negotiate deals with the RIAA in advance of
16 the panel's decision would be people who feel they can
17 get something better than a reasonable royalty rate;
18 isn't that right?

19 A No, I don't think that's right.

20 Q Well, why not? Why would somebody sign a
21 deal if they didn't feel they were going to get
22 something better than a reasonable royalty rate?

1 they're well informed, which is a separate issue, I
2 think it's fair to conclude that they believed that
3 that was more advantageous than relying on the
4 reasonable rate to be set by this panel.

5 Q And so in that situation what the RIAA is
6 doing is providing these webcasters with a more
7 desirable option than the reasonable rates to be
8 established by the panel; isn't that right?

9 A The overall package of what they're
10 getting from the RIAA is more desirable from the
11 perspective of a licensee than what the licensee
12 expects to get from the panel, assuming the licensee
13 is well informed.

14 Q And the panel should take that into
15 account in scrutinizing these licenses, which is that
16 these licenses are presumably licenses which provide
17 the webcasters with better terms than the reasonable
18 terms that the panel will be setting, everything
19 included; isn't that right?

20 A Well, I don't think that's right. I
21 assume by the use of the word "terms" you mean terms
22 in the sense of terms and conditions to be set by the

1 A Because, as I just explained, they may
2 feel that the thing that they're getting, when you
3 consider the entire circumstances, is better than
4 waiting for the panel. I would agree with you that,
5 at least with respect to buyers who are well informed,
6 if they agreed to sign a deal with the RIAA, they felt
7 that that was better for them in total than relying on
8 the panel.

9 That doesn't mean that they believe that
10 the rate itself was reasonable. It may mean -- and,
11 again, this is a factual issue. It may mean that they
12 concluded they would rather pay an unreasonable rate
13 than wait for the outcome, than pay the cost of
14 sitting through this proceeding, than whatever the
15 other considerations that I addressed.

16 Q But in that case they have concluded that
17 they've been offered something by the RIAA that's more
18 advantageous for them than a reasonable rate as to be
19 set by the panel; isn't that your testimony?

20 A The entire package of what they're
21 getting, which may include access to the record labels
22 and other things, I think -- and again, assuming

1 panel. And I don't think that that's right. I think
2 that part of what the webcaster may desire is, as I
3 said, the resolution of the uncertainty. I don't
4 think that means that the "terms", in any meaningful
5 sense of the voluntarily negotiated agreement, are
6 superior to the terms and conditions that the licensee
7 expected to get from the proceeding.

8 Q Let's put to one side this issue of
9 information, which we'll get to in a minute. But
10 you've agreed with me, have you not, that the entire
11 bundle that the webcaster was able to get from the
12 RIAA, for whatever reason, was deemed by that
13 webcaster to be more advantageous for him than a set
14 of reasonable rates and terms to be established by the
15 panel.

16 A Yes.

17 Q And therefore, conversely, the panel in
18 doing its job should understand when it reviews these
19 bundles of terms and provisions negotiated by the RIAA
20 with the webcasters, that these were viewed by those
21 webcasters as more advantageous than the reasonable
22 rates and terms which the panel will be setting.

1 A Well, you said something about a bundle of
2 terms and conditions. I don't think it's a bundle of
3 terms and conditions. It's really a bundle of
4 circumstances, which may include, for example, a
5 belief on the part of the licensee that they're not
6 going to have access to the record labels for other
7 rights that they need if they don't do this voluntary
8 deal. And if that -- if you put that into the mix as
9 part of the bundle of what the licensee was evaluating
10 and judging to be more advantageous, then I agree;
11 they thought it was more advantageous.

12 Whether the panel -- how the panel takes
13 that into account is up to them. My view would be
14 that if that is what made the bundle more
15 advantageous, then I don't see how the panel takes it
16 into account, other than to conclude that that
17 particular transaction doesn't really provide evidence
18 regarding what would have been negotiated in the
19 marketplace between a willing buyer and a willing
20 seller for the right that the panel is attempting to
21 value.

22 Q Unless somebody could do some sort of

1 Q Have you ever made a study of the speed at
2 which information migrates over the Internet?

3 A No.

4 Q Have you looked at any of the Web sites of
5 DIMA, or the webcaster organization, or any of the
6 other organized groups of webcasters as to what
7 they've said about the CARP process and about
8 negotiating with the RIAA?

9 A No, I don't think I have.

10 Q Have you discussed with any of your
11 webcaster clients what information they had and what
12 information they were making available to other
13 webcasters about the prospects for going through the
14 current process?

15 A To a limited extent, yes.

16 Q And what do you know in that regard?

17 A Well, again, this was not a systematic
18 endeavor to analyze this. But people say, we think
19 what the RIAA is proposing is ridiculous, but we know
20 there are people out there that don't seem to
21 understand what's going on. I'm not relying on any of
22 that kind of anecdotal impression, but I have had some

1 adjustment and price that out, couldn't one?

2 A Yes. As I think we discussed yesterday,
3 in principle one could think about trying to make an
4 adjustment for that. I don't -- when you talk about
5 the inclusion of such intangibles, I wouldn't know how
6 to make the adjustment. I think the chairman
7 yesterday suggested that he did, I think. But in
8 principle one could --

9 CHAIRMAN VAN LOON: That was irony.

10 THE WITNESS: Oh, I missed it.

11 In principle one could try to adjust for
12 that, yes.

13 BY MR. KATZ:

14 Q Let's turn to the information side for a
15 moment.

16 You gave some testimony yesterday that
17 information tends to spread slowly among participants
18 in a market.

19 A I think what I said is it's not
20 instantaneous. I don't know quite what you mean by
21 slowly. But I did say it's not necessarily
22 instantaneous.

1 those conversations.

2 Q Have you looked at the Web sites for DIMA
3 and for webcaster.org to see what they're telling
4 webcasters?

5 A I don't think so.

6 Q Let me turn, now, to the analysis that you
7 did here of ASCAP, BMI and SESAC agreements in the
8 over-the-air marketplace.

9 Now, you agree, don't you, that an
10 argument can be made that any determination of the
11 relative overall value of musical composition
12 performing rights and sound recording performance
13 rights is inherently arbitrary?

14 A No, I don't think I agree with that.

15 Q And why is that?

16 CHAIRMAN VAN LOON: Let me ask you to keep
17 your voice up.

18 THE WITNESS: I'm sorry.

19 Why do I think it's not arbitrary?

20 BY MR. KATZ:

21 Q Why do you disagree with my proposition,
22 Professor?

1 A Well, I think that we have evidence on the
2 value of the royalties that are paid in certain
3 contexts, and we have data that can be used to draw
4 some inferences about the value of promotion. As a
5 matter of economics, those can be combined to estimate
6 the overall value of the performing right in the
7 musical work. So I don't think that that's -- I
8 forget your exact words, but it was something like
9 essentially arbitrary.

10 Q Well, yes. But can an argument be made
11 that the determination of the overall value of musical
12 composition performance rights and sound recording
13 performance rights is arbitrary?

14 MR. RICH: Object to the form. Argument
15 can be made about anything, which is the predicate of
16 that question.

17 ARBITRATOR VON KANN: A plausible
18 argument? A good argument?

19 MR. KATZ: Why don't I leave it to the
20 professor. He seemed to disagree with that. And I
21 want to see if he really does.

22 CHAIRMAN VAN LOON: Overruled.

1 be made that any determination of the relative overall
2 value of the two rights is inherently arbitrary."

3 Now, what did you mean by that?

4 A What I meant by that is that, from the
5 user's point of view -- which is what's being
6 discussed here -- what I really need is the right to
7 perform. And in principle, that has a value to me.

8 From my point of view, I don't really care
9 how that's divided up between a value that's
10 associated with the right to perform the musical work
11 and a value that's associated with the right to
12 perform the sound recording.

13 So any determination of that relative
14 value from the buyer's point of view is, basically,
15 arbitrary. You could say from the buyer's point of
16 view that the sound recording has all the value and
17 the musical work right has no value. Or you could say
18 that the musical work has all the value, and the sound
19 recording has none. I wouldn't care as the user. It
20 doesn't matter to me. What I care about is the total,
21 since I need both.

22 Q And where is it in this paragraph that you

1 THE WITNESS: I mean, what I believe is
2 that there are elements of arbitrariness in any such
3 evaluation as there are in many economic calculation,
4 but -- and I suppose someone could make some argument
5 that the whole thing is arbitrary, but I can't think
6 of what that argument would be. I think if you've got
7 data that's available that is economically relevant,
8 and you use it in a sensible and conservative way, the
9 result is not arbitrary.

10 BY MR. KATZ:

11 Q Professor, do you have your prepared
12 statement in front of you?

13 A Yes.

14 Q Let me ask you to turn to paragraph 23 on
15 page 16.

16 You talk here about sound recordings and
17 musical works. You say, "The musical work is
18 inextricably intertwined with the sound recording
19 itself in producing the value of the public
20 performance. In most cases, to make the performances
21 at issue, a user needs both rights."

22 And then you say, "Indeed, an argument can

1 explain that this is the user's perspective as opposed
2 to yours?

3 A Well, this previous sentence, is "The
4 musical work is inextricably intertwined with the
5 sound recording itself in producing the value of the
6 public performance." So we're talking about creating
7 the value of the public performance. And then it
8 says, "To make the performances at issue, a user needs
9 both rights."

10 Q Yes. And where does it explain that this
11 argument is an argument that the user would make and
12 not an argument that you would make?

13 A Well, the previous sentence is talking
14 about the user.

15 Q But you certainly yourself don't feel that
16 a determination of the relative overall value of the
17 two rights is inherently arbitrary.

18 A Well, I think in the context of the
19 willing buyer/willing seller standard for
20 value -- there are other standards that one could use
21 for value. But within the context of the willing
22 buyer/willing seller standard for value, for the

1 reasons I explained yesterday, I think there's a
2 strong argument that they're equal. And, therefore,
3 it's not arbitrary as to how you divide it.

4 Q Well, I omitted the footnote. So let's
5 look at the explanatory footnote after the inherently
6 arbitrary sentence.

7 And in the explanatory footnote you say,
8 "As discussed further below, the idea that the overall
9 value of the two rights cannot be distinguished
10 doesn't imply the royalty rate should be the same."

11 Now, what do you mean there when you say
12 that the overall value of the two rights cannot be
13 distinguished?

14 A Again, it's referring to the concept
15 above, that the user needs both; and, therefore, has
16 a value for the combination of the two but doesn't
17 really care about which one is worth more.

18 Q And, therefore, any efforts to compare the
19 value of the sound recording right and the value of
20 the musical work right is inherently arbitrary; isn't
21 that right?

22 A No.

1 the right of public performance and sound recordings.

2 Q So if we're talking about markets, we're
3 talking about existing markets for musical
4 compositions and sound recordings. And in the markets
5 in which there are established values for musical
6 compositions and sound recordings, are there identical
7 demand and cost characteristics?

8 A Well, you may be talking about existing
9 markets, I'm not. I'm talking about existing markets
10 as well as markets that are developing or that could
11 hypothetically develop. And in those markets, which
12 are the ones that the statute asked us to think about,
13 I think that the demand characteristics for the sound
14 recordings and the musical works are identical. And
15 for the reasons I articulated yesterday and the way
16 that it is relevant for the willing buyer/willing
17 seller tests, the costs are also identical.

18 Q Let's look at the cost side. It costs
19 more to produce a sound recording than a musical
20 composition; isn't that right?

21 A It costs more to produce a sound recording
22 than a musical work, but it does not cost more to

1 Q Why not?

2 A I don't have anything to add than what
3 I've already said.

4 Q All right.
5 Markets for musical compositions and sound
6 recordings have very different demand and cost
7 characteristics; isn't that right?

8 A No, that's not.

9 Q Markets for musical compositions and sound
10 recordings have the same demand and cost
11 characteristics; isn't that right?

12 A Are you talking about -- is that a
13 shorthand for markets for the right in public
14 performance of each of those things, or are you
15 intentionally dropping the right of public performance
16 and talking about the musical works and the sound
17 recordings themselves?

18 Q Well, is there an established market for
19 the value of performance rights in those things?

20 A There is an established market in certain
21 contexts for the right of public performance and
22 musical works. There is not an established market in

1 produce a performance of an existing sound recording
2 than it does to produce a performance of an existing
3 musical work.

4 Q Well, that's like saying that any
5 intangible property has no marginal cost; isn't that
6 right?

7 A It's closely related. I'm not sure I
8 would say any intangible property has not marginal
9 cost. But I would agree that my point about the cost
10 being irrelevant is one that would apply to many cases
11 in which intangible property is licensed.

12 CHAIRMAN VAN LOON: If there's a point of
13 agreement between you, that's probably the perfect
14 time to take the morning break.

15 MR. KATZ: It's not a bad one, but we'll
16 have a logical stopping place in about five minutes,
17 if you'll give me five more. Or we can stop now if
18 the panel prefers.

19 CHAIRMAN VAN LOON: Well, sure, if you
20 would like to go for five minutes.

21 MR. KATZ: We're in the middle of a string
22 here.

1 When computer software has been written,
2 there's no marginal cost involved to making it
3 available to another user; isn't that right?

4 THE WITNESS: I wouldn't say there's no
5 marginal cost. I would say there's a little marginal
6 cost that's typically low.

7 BY MR. KATZ:

8 Q And, therefore, the same analysis that
9 you've done here, that a licensor will always license
10 at whatever price is available, would apply to the
11 licensing of all computer software; isn't that right?

12 A Well, the premise in your question about
13 the conclusion I've drawn is just false. I didn't say
14 that. I said that there is a negotiation between a
15 buyer with a certain valuation and a user of -- sorry,
16 start over.

17 There is a negotiation between a potential
18 buyer of the intellectual property and a potential
19 licensor of the intellectual property. I certainly
20 did not suggest that the result of that is that the
21 licensor will necessarily agree to anything specific.
22 They will agree to what they choose to bargain for.

1 be created for the next negotiation?

2 If you want to reflect on that, Professor,
3 we can take our break now, and you can think about it.

4 CHAIRMAN VAN LOON: Why don't we take the
5 break? At any point that you have questions or want
6 the question rephrased or asked again, you're entitled
7 to that.

8 Let's take our break and come back at 10
9 'til.

10 (Whereupon, the foregoing matter went off
11 the record at 10:31 a.m. and went back on
12 the record at 10:50 a.m.)

13 CHAIRMAN VAN LOON: Okay. We're ready to
14 proceed then.

15 BY MR. KATZ:

16 Q Professor, I left you with a question.

17 A Yes.

18 Q And if you have an answer to that, please
19 feel free to give it. If you prefer me to formulate
20 another question, I'll try and do that.

21 A No, I do have an answer.

22 CHAIRMAN VAN LOON: Can you remind us the

1 The point that I was making was that going
2 into that negotiation, the position of the licensor of
3 the musical work is the same as the position of the
4 licensor of the sound recording; that is, they've
5 created this intangible, and they want to get out of
6 this negotiation what they can get.

7 And I'm not making an empirical prediction
8 that any particular seller of a sound recording
9 performance right is going to get the same amount as
10 any particular seller of a musical work performing
11 right. All I'm saying is that, going into that
12 hypothetical negotiation, their positions are the
13 same, which is that they've got this intangible
14 they've created that they want to now get as much
15 revenue for as they can.

16 Q But don't sellers in negotiations like
17 that consider their cost structure in producing the
18 next unit of work for the next licensing negotiation?

19 A I'm sorry. Could you just repeat that?

20 Q Doesn't the willing seller in a
21 negotiation like that consider the cost structure that
22 will be entailed and the next unit of profit that will

1 question?

2 THE WITNESS: Should I remind you of the
3 question or should we let Mr. Katz do that?

4 CHAIRMAN VAN LOON: It's probably better
5 to let Mr. Katz do that.

6 BY MR. KATZ:

7 Q My question was, in substance, Professor
8 Jaffe, in the real world of willing buyers and willing
9 sellers negotiating intellectual property rights,
10 don't the sellers consider the costs that they
11 incurred in developing that intellectual property and
12 the costs that they can expect to incur in developing
13 the next unit of intellectual property for the next
14 negotiation?

15 A Let me start my giving the answer that the
16 economics of bargaining gives as a formal manner, and
17 then I'll comment on whether I think that really
18 applies in the real world.

19 The economic of bargaining is actually
20 quite clear on this point. What the economics of
21 bargaining says is that, when a buyer and a seller
22 meet in negotiation they each have what we call a

1 reservation price. And for the buyer the reservation
2 price is the price below which they simply will not
3 go. No matter what happens, they will walk away from
4 negotiations rather than --

5 Thank you. I said that backwards. The
6 buyer's reservation price is the price above which
7 they will not go. They'll walk away from the
8 negotiation rather than go higher than that price.
9 And the seller has a reservation price which is a
10 price below which they will not go. They'll walk away
11 from negotiations rather than go below that price.

12 And that further, the reservation price of
13 each party is determined by their next best
14 alternative. In other words, if they do walk away
15 from this negotiation, what can they do with the thing
16 that we were negotiating over. So if I'm a seller and
17 I'm selling my house, and I know that I can sell it to
18 this person for X, or I can put it for auction, and
19 I'll get X, I won't go below that price.

20 Now, in the case of intellectual property,
21 as we talked about yesterday, there really is no next
22 best alternative with respect to the licensing of the

1 people find that counterintuitive. I think that if
2 we're talking about a seller licensing intellectual
3 property in a context that represents a very
4 significant component of the overall economic picture
5 for that intangible, it's probably likely that that
6 zero reservation price isn't really the right way to
7 look at it.

8 Suppose I developed a new drug, and I got
9 a patent on that drug. And I'm thinking about
10 licensing that patent to some other company to all of
11 Europe. Well, the formal theory would say -- and I'm
12 going to sell it myself in the United States. The
13 formal theory would say, my reservation price is
14 essentially zero, because if I don't license
15 it -- assuming I have no ability myself to use it in
16 Europe. The formal theory would say if I don't
17 license it for Europe I'm just giving up the European
18 market, and any amount I can get is better than
19 nothing.

20 I think probably realistically in that
21 context what I'm talking about, a major chunk of
22 what -- when I developed the property I probably

1 property to a particular property for a particular
2 use. If that particular party doesn't want to use the
3 property -- I mean, I have other things I can do with
4 the property. I can license it to other people, but
5 I can do that anyway. I can license to all those
6 other people whether or not I license to this party.

7 So in terms of my next best alternative,
8 my next best alternative really gives me no
9 incremental revenue relative to making the deal here.
10 So what the theory would say as a formal matter is
11 that the reservation price of the seller is zero, and
12 then what's going to happen in the negotiation is
13 they're going to arrive at some point between zero and
14 the buyer's reservation price. And where they end up
15 will be determined by the bargaining between the
16 parties and the so-called bargaining power of the
17 different parties.

18 So in that formal sense in terms of the
19 literature, the answer to Mr. Katz question is, the
20 seller doesn't consider these sunk costs when
21 licensing intellectual property.

22 Now, that's controversial, and a lot of

1 thought was the market, that's probably -- that may
2 not be realistic even though that's what the theory
3 says.

4 But if we're talking about a very
5 incremental licensing of the property who is not going
6 to generate a revenue that is a large component of the
7 overall revenue, or even which wasn't even anticipated
8 as a revenue component at the time that the property
9 was created, then I think the insight of the formal
10 theory -- which is, well, if I don't license it to
11 them, it's really just a lost -- probably has more
12 bite. And you approach at least the theoretical
13 prediction that the cost would be irrelevant.

14 Q In the context of sound recordings here,
15 wouldn't the willing seller consider the possibility
16 that Internet use of sound recordings may become
17 important in the future, and that by licensing the
18 right too low, he would make it difficult for him to
19 capture sufficient revenue in future negotiations for
20 future sound recordings?

21 ARBITRATOR VON KANN: While you think
22 about that, I'd like to get a piece of paper I left on

1 my desk.

2 THE WITNESS: Sure.

3 CHAIRMAN VAN LOON: But you can go ahead

4 with your answer, if you have it ready.

5 THE WITNESS: So solely in terms of

6 revenue now, I think that it's true that a potential

7 seller is going to take a long-run view and think

8 about revenue from subsequent transactions. The fact

9 that there's a large potential down the road it seems

10 to me could cut either way.

11 You could say I'm going to sell it -- I'm

12 going to hold out for a high price now and hope that

13 that has precedential value either as a legal matter

14 or in some psychological way down the road, or

15 conversely you can say, I'm going to follow the

16 build-the-market strategy and sell it at a lower price

17 than I otherwise would now in order to help develop

18 that market, which I know I will capture a portion of

19 later on.

20 So I think if there is an expectation

21 about future revenue, that would be part of the

22 thinking, but I don't know which way it cuts.

1 replace and existing and predictable revenue stream,

2 isn't that something that a willing seller will take

3 into account in one of these negotiations?

4 THE WITNESS: Yes.

5 BY MR. KATZ:

6 Q Now, in the world of physical goods, the

7 owners of sound recording copyrights receive higher

8 revenues than the owners of musical composition

9 copyrights; isn't that correct?

10 A By physical goods here, you mean basically

11 CDs and other recordings?

12 Q Yes, hedrons as opposed to leptons, as I

13 sometimes say. Physical matter as opposed to

14 electronic communications. And, in fact, that's one

15 of the calculations you put in your report; isn't that

16 right?

17 A Yeah. I just wanted to be clear. I don't

18 know why you were being oblique in terms of physical

19 matter and you didn't just say recordings. So I

20 wanted to understand. So you're just talking about

21 CDs and other recordings?

22 Q Well, they're all recordings, but in terms

1 BY MR. KATZ:

2 Q If there's concern that this may be a

3 revenue stream which is going to replace an existing

4 revenue stream, isn't that something a willing seller

5 will take into account?

6 MR. RICH: Can I get clarification for

7 Mr. Katz as to what "this" is in reference to.

8 MR. KATZ: I don't understand the

9 objection.

10 CHAIRMAN VAN LOON: I must say I don't

11 either.

12 MR. RICH: "This" is to replace, I don't

13 know what "this" is in reference to in the question.

14 ARBITRATOR GULIN: Hypothetically, he just

15 told us.

16 MR. RICH: If the witness understands,

17 that's fine. I don't know what "this" is.

18 THE WITNESS: Could you just read it again

19 so I can hear it again?

20 MR. KATZ: Sure. If the seller is

21 concerned that the revenue stream, which it will be

22 getting from the licensing, is in substance going to

1 of physical goods as opposed to electronic

2 communications of these recording, the revenue stream

3 is greater for the owners of the sound recording

4 copyrights than the musical work copyrights; isn't

5 that correct?

6 A And I just want to be sure I understand

7 the question, what you're -- is there something other

8 than CDs and cassettes that you're talking about.

9 Because if there is, I need to think about it. If

10 there isn't, then I know the answer.

11 Q Well, there is vinyl and mini disks, and

12 maybe there are some people buying 45's. But in terms

13 of what one buys in a music store as opposed to what

14 one streams over the Internet -- downloads over the

15 Internet -- you don't disagree that the revenues are

16 higher for the sound recording --

17 A If that's what we're talking about, then

18 I agree, the revenues for the creators of the sound

19 recording is greater than the revenues for the

20 composers and the publishers.

21 Q And you don't disagree that the cost of

22 creating the sound recording is greater than the cost

1 of creating the musical composition, do you?
 2 MR. RICH: Objection, asked and answered.
 3 ARBITRATOR VON KANN: Is it a difference
 4 in your question? I wasn't clear what it was.
 5 MR. KATZ: Well, I asked a question about
 6 revenues. I'm not asking a question about costs.
 7 ARBITRATOR GULIN: He answered that
 8 question quite a while ago.
 9 MR. KATZ: I don't think he's disagreed
 10 with me, and I want to give him another chance.
 11 You don't disagree with that?
 12 THE WITNESS: I don't disagree with that.
 13 BY MR. KATZ:
 14 Q And to make a sound recording requires,
 15 among other things, the featured artist; isn't that
 16 right?
 17 A In many cases, yes.
 18 Q And background musicians?
 19 A In many cases, yes.
 20 Q And a producer?
 21 A I don't know.
 22 Q And a sound engineer?

1 A I don't know.
 2 Q And a composer?
 3 A Presumably, yes.
 4 Q And maybe others?
 5 A Perhaps.
 6 Q And they're not all paid the same thing,
 7 are they?
 8 A No.
 9 Q And you wouldn't expect them to be paid
 10 the same thing, would you?
 11 A Not necessarily, no.
 12 Q Now, in looking for your hypothetical
 13 marketplace you testified that you ruled out the
 14 ASCAP, BMI and SESAC webcast agreements, which are for
 15 a percentage of revenue; isn't that right?
 16 A I wouldn't say I ruled them out. I felt
 17 that there were many of the same concerns that we
 18 talked about with respect to the RIAA agreements, and
 19 then in addition there were some practical numerical
 20 problems with using that information. But I did not
 21 use them.
 22 Q But you don't disagree that in a

1 conceptual sense the rights there are closer to what
 2 this panel is being asked to value than the rights in
 3 the agreements that you did look at?
 4 A I forget how many negatives you had in
 5 that sentence. I don't disagree that they are closer.
 6 Q Now, then you looked to ASCAP, BMI, SESAC
 7 agreements with over-the-air radio stations, and you
 8 concluded you could do some analysis with those,
 9 making some adjustments and making some comparisons;
 10 isn't that right?
 11 A Yes.
 12 Q Now, radio is a mature market with
 13 predictable revenues and costs; isn't that right?
 14 A Yes.
 15 Q And radio stations require large, initial
 16 investments in FCC licensing and in broadcasting
 17 facilities; isn't that right?
 18 A They require investments. I don't know
 19 how large they are.
 20 Q More so than webcasting; isn't that your
 21 understanding?
 22 A I don't know.

1 Q Have you read anything about the
 2 investment required, initial investment required, in
 3 setting up a webcasting business?
 4 A I guess I've seen some numbers for the
 5 clients about the cost that they've incurred before
 6 recovering any profits, which is investment from an
 7 economic perspective. But other than that, I haven't
 8 looked at that in a systematic way.
 9 Q Now, for radio stations, adding listeners
 10 entails little marginal costs, but can result in
 11 increased revenue; isn't that right?
 12 A It depends on how they're added. If
 13 they're added by increasing market share within a
 14 given market, that has little marginal cost, depending
 15 on whether you had to pay a better DJ or whatever to
 16 do it, or if they're added by expanding the market,
 17 that may require a larger antenna and so forth.
 18 Q Assuming that the radio station makes no
 19 change in its content or operations and builds no new
 20 transmission facilities, each additional user is
 21 likely to lead to additional revenue at no additional
 22 costs; isn't that right?

1 A That is correct.
 2 Q In the radio world, spectrum is a scarce
 commodity; isn't that right?
 4 A In some senses, yes.
 5 Q And there's a natural limit to the number
 6 of radio stations that will be permitted in any
 7 particular geographical area; isn't that right?
 8 A Yes.
 9 Q And in the radio world there is
 10 competition between music stations and non-music
 11 stations; isn't that right?
 12 A I don't know.
 13 Q You haven't made a study of that?
 14 A No.
 15 Q And a substantial part of the radio
 16 audience consist of people in automobiles who have
 17 limited other entertainment alternatives; isn't that
 18 right?
 19 A Yes.
 20 Q The revenue for radio stations is
 21 primarily from the sale of audio advertising; isn't
 22 that right?

1 A Yes.
 2 Q Indeed, for radio stations that's
 3 substantially all of their revenue; isn't that right?
 4 A Yes.
 5 Q Traditional radio broadcasts are analog,
 6 and there's a limit to how much the quality of the
 7 audio in those broadcasts will be improving in the
 8 future; isn't that right?
 9 A I know that the answer to the first part
 10 of your question is yes. I don't know the answer to
 11 the second part of your question.
 12 Q Now, Internet streaming on the other hand
 13 is a new industry with no established profitable
 14 business model; isn't that right?
 15 A Yes, I think that's fair.
 16 Q At the moment, webcasting is characterized
 17 by a large number of participants, many of which will
 18 probably turn out not to be viable; isn't that right?
 19 A I think whether the number is large is
 20 compared to what. I would agree that many of them
 21 will not turn out to be viable.
 22 Q There's been a tendency in broadcast radio

1 over the years for stations to consolidate into a
 2 number of large networks; isn't that right?
 3 A I'm not sure what you mean by network. I
 4 think there has been a tendency in terms of ownership
 5 in recent years for consolidation.
 6 Q Indeed, a number of
 7 webcaster -- broadcaster -- clients that you represent
 8 here are large groups of radio stations; isn't that
 9 right?
 10 A That is correct.
 11 Q And isn't it likely that over the longer
 12 term in the Internet space there will be some
 13 consolidation of webcasting among a smaller number of
 14 stronger webcasters; isn't that right?
 15 A Was your question, is it likely?
 16 Q Yes.
 17 A Yeah, I think it's probably likely.
 18 Q Now, for a webcaster, adding additional
 19 listeners will entail substantial marginal costs and
 20 uncertain additional revenue; isn't that right?
 21 A For a webcaster, adding additional
 22 listeners certainly incurs a marginal cost. How

1 substantial it is, I'm not sure I would opine about.
 2 And I agree that the revenue associated with that
 3 additional listenership would be uncertain.
 4 Q And, in fact, a webcaster may choose to
 5 actually make it more difficult for users to access
 6 its service in order to cut down the number of
 7 listeners; isn't that right?
 8 A It's possible.
 9 Q Now, the revenue from webcasters comes
 10 from multiple sources; isn't that right?
 11 A Well, for the most part it doesn't come at
 12 all. But in a theoretical or potential sense, it
 13 comes from multiple sources.
 14 Q There isn't much, but it's coming from
 15 multiple directions. Some of them do electronic
 16 commerce and make some money from that.
 17 A Yes.
 18 Q Some of them develop data on their users
 19 and are able to receive some compensation by selling
 20 that data.
 21 A Are you asking me if I have personal
 22 knowledge of these things occurring or whether --

1 Q Is that your understanding, Professor?
 2 A That's my understanding, yes.
 3 Q And is it also your understanding that the
 4 webcasters are able to sell visual advertising space
 5 on their Web pages or on their player?
 6 A Yes.
 7 Q And is it also your understanding that
 8 webcasters can sometimes sell advertising space on the
 9 user's desktop in the form of icons that are
 10 downloaded along with their tuner software?
 11 A I don't know.
 12 Q Now, the webcast transmissions are digital
 13 music; isn't that right?
 14 A Yes.
 15 Q And there's substantial possibility of
 16 improvement in the sound quality of digital music in
 17 the future; isn't that your understanding?
 18 A Yes.
 19 Q And it is possible to capture digital
 20 streams of music utilizing software tools in a way
 21 that really isn't feasible with radio; isn't that
 22 right?

1 A Well, I'm not sure what you mean by your
 2 question. When you say in a way that isn't feasible,
 3 I agree with you; you can't do it with software
 4 typically for over the air. There are ways of
 5 recording over-the-air broadcasts which are analogous
 6 to the digital capture but they're not the same.
 7 Q Well, are you aware, for example, that
 8 there's a utility called BitBop which will enable you
 9 to enter an artist's name, and then it will
 10 automatically copy to your personal computer any songs
 11 being streamed by that artist?
 12 A I've heard about that. I don't know any
 13 of the details or how it work or whether it really
 14 works or not.
 15 Q There's no way to do that with analog
 16 radio broadcasters there.
 17 A That's correct.
 18 Q Now, when you looked at the ASCAP, BMI,
 19 SESAC licenses with these radio broadcasters, every
 20 case those licenses were for fixed sums based on
 21 percent of revenues; isn't that right?
 22 A Yes.

1 Q And that's true of every single ASCAP,
 2 BMI, SESAC radio license that you've seen; isn't that
 3 right?
 4 A Actually, I should qualify that. What I
 5 collected were the numbers, the dollar amounts. I
 6 actually did not see the agreements. It is my
 7 understanding from my general knowledge that the BMI
 8 and ASCAP licenses are percent of revenue licenses.
 9 I don't actually know myself how SESAC licenses, so
 10 what I got from the stations was just the dollar
 11 amounts.
 12 Q And the ASCAP, BMI webcast licenses were
 13 also based on percent of revenues; isn't that right?
 14 A The offered BMI, ASCAP webcast licenses
 15 are a percentage of revenue; that's correct.
 16 Q And some people have headed into those
 17 licenses; isn't that right?
 18 A It's my understanding that some have.
 19 Q Now, in theory, ASCAP, BMI and SESAC could
 20 have used the data sources that you used to calculate
 21 license fees on a per listener hour basis; isn't that
 22 right?

1 A In principal, yes.
 2 Q And to your knowledge, that's never been
 3 done.
 4 A Not to my knowledge, no.
 5 Q And do you have any basis to know whether
 6 or not that performing rights organizations would have
 7 been willing to license on the basis of listener hours
 8 as opposed to share of revenue?
 9 A I think it's -- I can say from my
 10 experience they have typically wanted to stick with
 11 the percentage of revenue model. I don't have any
 12 information that specifically relates to their view of
 13 a listener-hour model, but I think it is fair to say
 14 that they have historically wanted to stick with the
 15 percentage of revenue formulation.
 16 Q Now, in doing your analysis, you used only
 17 stations that have a blanket form of license with
 18 ASCAP, BMI and SESAC; isn't that right?
 19 A That's correct.
 20 Q And you ignored stations that didn't have
 21 licenses with all three organizations; isn't that
 22 right?

1 A Well, I think it would make sense to do
2 that. As I sit here, I don't remember if there were
any such stations.

4 Q Now, in doing your calculation you
5 received data for 1998, 1999 and the Year 2000; is
6 that correct?

7 A I think that's correct, yes.

8 Q But you ended up using only the Year 2000
9 data; isn't that right?

10 A Yes.

11 Q Now, for 1998 and 1999 you had actual
12 end-of-the-year final data; isn't that right?

13 A Yes.

14 Q Which you didn't use.

15 A That's correct.

16 Q But for the Year 2000 you had only
17 estimates and projections with the final true-up not
18 having been made yet; isn't that right?

19 A Yes, we had the agreed upon -- these
20 projections are made under the license, and we talked
21 to the parties involved. And it seemed clear that
22 there was no reason to believe that these true-ups

1 would go one direction or another. And we wanted to
2 keep the analysis simple. And the 2000
3 royalties -- the per subscriber calculation based on
4 the 2000 royalties is likely to have produced a higher
5 number than the number that would have been produced
6 based on the 1998 and 1999 data. Cleaning up and
7 making sure these data were all good was a major task,
8 and we didn't feel we could complete it for all three
9 years. So what we did was conservatively rely on the
10 2000 data, which produces a higher per subscriber
11 number than you would get if you looked individually
12 at '98 and '99.

13 Q Now, the actual collection and initial
14 analysis of the data was done by Lexecon?

15 A Yes, under my supervision.

16 Q And they dealt with various people at
17 these radio groups?

18 A That's correct.

19 MR. KATZ: Let me show you a document that
20 was produced to us in discovery, and it bears Bates
21 numbers 00850 and 851. We will label it RIAA
22 Exhibit 39 DRX. Don't ask me what that means. And I

1 note that there's a restrictive legend on this
2 exhibit; although, I'm not going to ask about any
3 specific numbers, so you may or may not want to clear
4 the courtroom.

5 [Whereupon, RIAA Exhibit 39 DRX
6 was marked for evidence]

7 BY MR. KATZ:

8 Q Professor Jaffe, I've shown you
9 RIAA Exhibit 39, which is a piece of electronic mail
10 from Christina A. Rader of March 27 of this year. Is
11 that something that you've seen before?

12 A Yes.

13 Q Who is Christina Rader?

14 A She's an analyst of Lexecon.

15 Q And do you know who she was writing to
16 here?

17 A It appears that she was writing to Karen
18 Ablin and Wiley Rein at the law firm.

19 Q So this is from Lexecon to the law firm.
20 And do you understand what she's asking for here in
21 the second paragraph, "Confirmation of the approximate
22 revenues that we calculated are close to the actual

1 revenues; by close, meaning no more than twice as big
2 as the approximated revenue."?

3 A Yes, I do understand.

4 Q What was going on here?

5 A Well, this relates to data that we got
6 from Clear Channel. And in the original data we got
7 we were unsure in some cases -- because Clear Channel
8 has been going through some acquisitions -- whether
9 the data that we had was for a complete year or just
10 for a partial year that they had owned the station.
11 And because we need to use this to calculate on an
12 annual basis fees relative to broadcasts, we need to
13 know what is the time period that the revenue covers.

14 This was all happening in a back and forth
15 where we were trying to verify the data. One of the
16 things that we were doing as a way of trying to check,
17 we had hundreds of stations, and it was hard to check
18 every number precisely or every -- we didn't want to
19 have to send them 800 questions. We wanted to sort of
20 focus in on where the issues were.

21 So we looked at whether the -- taking the
22 fee numbers they'd given us. Because we hadn't asked

1 for revenue numbers. All we got from the radio
2 stations was were there ASCAP, BMI and SESAC fees
3 because they didn't want to have to provide their
4 actual revenue.

5 We know approximately what the revenue
6 formulas are. So what we could do is we could say,
7 okay, if they've told us the fees are \$100,000, that
8 ought to correspond to revenues of approximately
9 \$3 million. So could you tell us, is \$3 million
10 approximately the revenue of this station on an annual
11 basis or not. Because if it's not, then that would
12 imply that the data we have is for an incomplete year.

13 So this was part of a checking process
14 that we went through just to make sure that we
15 understood the data and that it was complete. And it
16 related to a relatively small number of stations.

17 Q This was a check to satisfy yourself that
18 the data that they were giving you for these license
19 fees was reasonably accurate; isn't that right?

20 A Well, it wasn't an issue of accuracy; it
21 was an issue of how we interpret it. I believe the
22 numbers that they gave us were correct in terms of

1 of stations where the data couldn't be used either
2 because we couldn't figure out exactly which stations
3 it corresponded to in terms of call letters and so
4 forth or other -- other -- just data problems that we
5 have using the data.

6 Q Clear Channel is one of the nation's
7 largest radio broadcast groups; isn't that right?

8 A Yes.

9 Q And one would assume that a radio
10 broadcast group as large as that would negotiate the
11 lowest rates with the performing rights organizations;
12 would you not?

13 A No.

14 Q Why not?

15 A Well, the rights -- the rates are not
16 negotiated on that basis. The rates for the vast
17 majority of the stations that we have, and certainly
18 the Clear Channel -- most of the Clear Channel
19 stations are negotiated on an industry-wide basis by
20 a radio committee. And so there is no individual
21 negotiation by these groups.

22 Q So, in fact, the radio broadcasters are

1 their financial records, but we needed to know did it
2 correspond to five months or eight months, or did it
3 correspond to a full year.

4 Q Now of the 900 or so radio stations that
5 used, about three-quarters of them were Clear Channel
6 stations; isn't that right?

7 A I don't remember as I sit here. It was a
8 majority. I don't remember the exact fraction. It
9 would be in my work papers.

10 Q If opposing counsel represented in a brief
11 that 653 of the stations were Clear Channel stations,
12 you wouldn't have any basis to disagree with that,
13 would you?

14 A I just don't -- I don't remember the exact
15 number as I sit here.

16 Q Now, Clear Channel didn't give you
17 complete data for every single station in their group,
18 did they?

19 A No, they didn't.

20 Q And you used the data that they gave you;
21 isn't that right?

22 A That's correct. There were a small number

1 able to form large organizations to negotiate with the
2 performing rights associations; isn't that right?

3 A Yes.

4 Q And there's no reason why the webcasters
5 couldn't do the same thing, is there?

6 A I don't know.

7 Q Now, in doing your analysis, as you
8 testified yesterday, you eliminated those stations
9 that have the per program licenses as opposed to the
10 blanket licenses; isn't that right?

11 A Yes.

12 Q And the rates for the per program licenses
13 are higher than for the blanket licenses per unit of
14 music; isn't that right?

15 A I don't know if that's true or not,
16 actually.

17 Q Well, didn't you testify at one point
18 yesterday that it wouldn't make sense to get a per
19 program license and then put a little bit of
20 music -- ASCAP music -- in one program, because then
21 you'd end up paying a higher rate than if you just had
22 the blanket license to begin with?

1 A No. The way it works is, under the per
2 program license, you pay a percentage of the revenue
3 that's associated with those programs that have not
4 been cleared; that is, those programs that either
5 contain, say, ASCAP music if we're talking about the
6 ASCAP license, or in some cases, programs where you
7 just don't know one way or another, and so you're
8 going to pay for it to avoid infringing.

9 Per unit of revenue associated with a
10 program, you pay more under the per program license
11 than under the blanket license. So if I have a
12 one-hour program that generates \$1,000 in revenue, for
13 that \$1,000 in revenue I'm going to pay a higher
14 percentage if I pay for that program than if I had
15 just paid on all of my programs.

16 But it's also the case that these program
17 stations are, for the most part, not music stations.
18 And so even the programs that they choose to pay for
19 probably have less per program than -- and we don't
20 know how much music they have per program. So it's
21 really -- you can't express in some sense the per
22 program fee per unit of music in any convenient way.

1 Q It's not a measure of the number of radios
2 turned on, is it?

3 A I believe that's correct.

4 Q In Arbitron households, every member of
5 the household keeps his own diary and records his own
6 listening habits; isn't that right?

7 A Yes.

8 Q Then you determined the average number of
9 listeners to each of your stations per quarter hour;
10 isn't that right?

11 A It's not really per quarter hour. The
12 designation that's used is the AQH or average quarter
13 hour. That's a term of art. But it is intended by
14 Arbitron and is used within the industry as a measure
15 of the average audience size averaged over the
16 broadcast day, 6am to midnight.

17 Q And what exactly is the AQH?

18 A I believe it's the number of people who
19 within a 15-minute period listen to a given station
20 for at least five minutes.

21 Q So if a person listens to a station for
22 five minutes and a quarter hour, he's included in the

1 They're not really paying for units of music; they're
2 paying for hours of programming.

3 Q But they are paying a higher percentage of
4 revenue on those programs under the per program
5 license than they would under a blanket license.

6 A For those programs, yes.

7 Q Now, having taken these data, and having
8 selected this group of radio stations, you then took
9 the daily Arbitron quarter-hour ratings for those
10 selected stations; isn't that right?

11 A I don't think they're daily. They're
12 average quarter hours from Arbitron.

13 Q And any station that wasn't listed in the
14 Arbitron ratings was excluded; isn't that right?

15 A That is correct.

16 Q And those would be some of the smaller
17 stations.

18 A That's correct.

19 Q Now, the Arbitron ratings, that measures
20 the number of listeners to the station?

21 A It is a measure of the number of
22 listeners, yes.

1 average quarter hours?

2 A That's my understanding, yes.

3 Q And then you multiply that by four to get
4 the number of people listening per hour?

5 A Yes, I think that's right.

6 Q So a person would count for a listener
7 hour even though he might have been listening no more
8 than 20 minutes; isn't that right?

9 A Well, the problem that you have is that
10 you're trying to get a measure of sort of average
11 audience on kind of an instantaneous basis, but they
12 don't collect the data that way. This average quarter
13 hour is the tool that Arbitron has developed, which
14 the industry relies on as a measure of audience size.

15 There is another measure they use, which
16 is called the cum, which measures sort of the total
17 amount of time that a particular, unique individual
18 listened over a week. And you can use that measure,
19 combined with information about how long people
20 listen, to develop an alternative measure of average
21 audience size. And we actually looked at both
22 initially for a few stations; got very similar

1 results.

2 So the way this is done is, it is
3 interpreted within the industry -- and we see this in
4 the subsequent numbers, for example. They calculate
5 weekly listening hours for their own purposes in
6 exactly the same way that I did it, using exactly the
7 same data that I do.

8 So there is a -- there are some
9 assumptions you have to make about how to go about
10 doing this. But what we did was follow the industry
11 standard for calculating audiences and listenerships.

12 Q When you refer to the industry, that's the
13 radio broadcast industry; isn't that right?

14 A Yes.

15 Q It's not the recorded music industry; is
16 it?

17 A That's true.

18 Q And it's not the webcasting industry; is
19 it?

20 A That's correct.

21 Q And what you did was, you assumed if a
22 person was listening for five minutes in a

1 directly from your clients?

2 A Because we had about two weeks to do this,
3 and it was clear to us that the clients didn't have it
4 in as convenient a format that we could get it from
5 BIA by just purchasing a CD.

6 Q Then you used aggregate data from
7 Broadcast Data Systems to estimate the number of songs
8 a station plays per hour, based on aggregated
9 nationwide data for a different sampling of stations;
10 isn't that right?

11 A Yes.

12 Q Again, why didn't you use the actual data
13 from your actual clients in terms of how many songs
14 they played per hour?

15 A Because it would have been an overwhelming
16 data task to collect all that information from 898
17 stations.

18 Q And you dropped stations from your sample
19 if they had formats, according to BIA, that didn't
20 have average songs reported by BDS; isn't that right?

21 A We dropped them for the purpose of the per
22 song analysis. We kept them in the listener-hour

1 quarter-hour block, that is one quarter of a listening
2 hour; isn't that right?

3 A Yes.

4 Q And you did your calculation on that
5 basis; isn't that right?

6 A Yes. And I amend my earlier answer.
7 Actually, the recording industry does use these data.
8 As I understand it, they use these data in trying to
9 look at which stations they should be talking to in
10 terms of promoting their music. They rely on the same
11 Arbitron data we use in terms of ratings, in terms of
12 their interaction with the radio industry on the
13 promotion side.

14 Q They use it to compare one station with
15 another; isn't that right?

16 A Compare one station with the others for
17 the purpose of knowing how big the audiences are.

18 Q Now, then you used information from BIA
19 Financial Networks to ascertain the format of the
20 stations that you were using?

21 A Yes.

22 Q Why didn't you get that information

1 analysis because we didn't need to know the formats
2 for the listener-hour analysis. It was a small number
3 of stations.

4 Q Now, if a station was listed by BIA as
5 having a certain format, you assumed it had that same
6 format for every hour of broadcast; isn't that right?

7 A Yes.

8 Q So you assumed that there were, for
9 example, no interruptions from news bulletins or
10 weather emergencies or service outages; isn't that
11 right?

12 A Well, those are different things. To the
13 extent that there are news bulletins and weather
14 forecasts, on average that would affect the average
15 number of songs on a station of this format, and that
16 would be reflected, on average -- which is all I care
17 about, because I don't care about any one station.
18 That would be reflected in the averages that we used
19 from BDS. If there were some emergency where a
20 station shut down for a week, I guess we would have
21 missed that.

22 Q Well, what about a music station -- and I

1 suggest WXRK in New York as an example -- which plays
2 music most of the day but plays a talk show in the
3 morning with next to no music on it? You would
4 include all that time, including the talk show, in
5 your calculations for that station; wouldn't you?

6 A Well, the thing is to remember is what I
7 care about is the average. I don't care about any one
8 station. I've got 900 stations, and I want to be
9 right on average. If stations of a given format
10 sometimes has talk shows, then the effect of that on
11 average would be reflected in my data. If the
12 stations that I have are, for some reason, very
13 unrepresentative in terms of that kind of
14 interruption, I could be off by a small amount.

15 Again, this affects only the listener song model, has
16 no effect on the listener-hour calculations anyway.

17 Q Have you done any analysis as to how much
18 your data can be affected by that kind of error?

19 A Well, the range of songs per hour for the
20 different formats is not all that wide; it varies
21 from -- for the stations for which we have any
22 significant number, it varies from about .9 to about

1 Q What did you do to take into account songs
2 that were not copyrighted or for which the copyright
3 had expired?

4 A I did not make any adjustment for that.

5 Q There are songs on the radio that are not
6 copyrighted. Isn't that right?

7 A That's correct, or they're in the public
8 domain.

9 Q And there are some stations which play
10 large numbers, which devote much of their time to
11 music which is not copyrighted. Isn't that right?

12 A There are some such stations. Yes.

13 Q That's not something that you factored
14 into your analysis.

15 A That's correct.

16 Q And then you calculated the number of
17 listener songs from your audience data and from your
18 song data. Isn't that right?

19 A Yes. That was the 714 billion number that
20 we were amused by yesterday.

21 Q And is that comparable to the number of
22 songs that you used on the radio stations using the

1 14. So the error that could come about from measuring
2 songs per hour is limited in that respect.

3 Q Well, what if they're running talk shows
4 half the day?

5 A Who is running talk shows? All of them?

6 Q What if one of your stations that you
7 include as a music station, is running talk shows for
8 half the day?

9 A One station would have no impact on -- no
10 measurable impact on the result.

11 Q Suppose several were doing it, Professor?
12 Did you make a study of that?

13 A It would have to be more than several.

14 Q Do you know how Broadcast data Systems
15 treats stations that interrupt a regular format to
16 utilize some other format?

17 A No, I don't.

18 Q There you multiply your calculated number
19 of listeners by the calculated number of songs to
20 calculate the number of what we call performances,
21 what you called listener songs. Isn't that right?

22 A Yes.

1 Arbitron data?

2 A I don't understand the question.

3 Q Well, utilizing Arbitron data, you drew
4 some conclusions about the number of people listening
5 to radio stations, did a calculation for a number of
6 songs, and came up with a calculated number of
7 listener songs which you could then work out for
8 individual stations. Isn't that right?

9 A I don't know what you mean by "work out
10 for individual stations."

11 Q Okay. You showed us an example yesterday
12 with one of the Susquehanna stations, didn't you, how
13 you could work out the listener songs for a particular
14 station. Isn't that right?

15 A Yes.

16 Q And that's based on the number of people
17 listening to one particular song. Isn't that right?

18 A It's based on the average audience and the
19 total number of songs broadcast.

20 Q And you compared that to the RIAA data for
21 performances in the Webcast context. Isn't that
22 right?

1 A I don't know what you mean by the RIAA
2 data. I took what I understand to be one of the RIAA
3 fee proposals of .4 cents for performance and applied
4 it to that calculated number of performances.

5 Q You viewed one person listening to a song
6 on the radio as comparable to one stream of the
7 Internet. Isn't that right?

8 A Yes.

9 Q And that's assuming that each stream on
10 the Internet is listened to by one person. Isn't that
11 right?

12 A Yes.

13 Q Have you ever seen any data on the average
14 number of people who listen to a single Webcast from
15 a single computer over the Internet?

16 A No, I haven't.

17 Q You did some of your Webcast listening at
18 Lexicon with other people present. Isn't that right?

19 A I actually don't remember whether anybody
20 was present or not.

21 Q Did you by any chance see the Spinner user
22 testimonial from Paul C. who said, "I've started using

1 LIBRARY OF CONGRESS+ + + + +
2 COPYRIGHT OFFICE+ + + + +
3 COPYRIGHT ARBITRATION ROYALTY PANEL+ + + + +

4 In the matter of: Docket No.
2000-9
5 Digital Performance Right In
6 Sound Recording and Ephemeral
7 Recording CARP DTRA
8 1 & 2
9 CARP Hearing Room
10 LM-414
11 Library of Congress
12 Madison Building
13 101 Independence Ave, SE
14 Washington, D.C.
15 Tuesday
16 August 28, 2001

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

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

1 your site for background music during get-togethers"?

2 A I did not.

3 Q Let's look at your example for Susquehanna
4 KFOG/KFFG. Do you still have available to you the
5 chart that was handed to you yesterday?

6 MR. RICH: We have tat,

7 MR. KATZ: Thank you, Mr. Rich. I
8 appreciate that. Thanks very much.

9 I am advised that these data may be
10 restricted, and this may be an appropriate point to go
11 into closed session.

12 CHAIRMAN VAN LOON: They are indeed
13 restricted. And you plan to go into specific numbers
14 out of here?

15 MR. KATZ: I do.

16 CHAIRMAN VAN LOON: In that case, we will
17 need to close the record, go into closed session, and
18 ask anyone who does not have access to restricted
19 material to step outside, and let's put the sign on
20 the door.

21 (Whereupon, at 11:39 a.m., the proceedings
22 went into Closed Session.)

1 APPEARANCES: On Behalf of Clear Channel Communications, Inc.,
2 National Religious Broadcasters Music License Committee, and Salem
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1 CHAIRMAN VAN LOON: Yes, let's go back on
2 the public record.
(Whereupon, at 12:07 p.m., the proceedings
4 went back into Open Session.)

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1 CHAIRMAN VAN LOON: Were you planning to
2 offer Exhibit 41 DRX?

3 MR. KATZ: Yes. I move Exhibit 41.

4 MR. RICH: We have no objection?

5 CHAIRMAN VAN LOON: Admitted.

6 (Whereupon, the document
7 previously marked for
8 identification as RIAA Exhibit
9 41 was received in evidence.)

10 BY MR. KATZ:

11 Q Professor Jaffe, I want to turn to the 52
12 percent adjustment that you did to your calculated
13 rate based on promotional considerations. You began
14 by saying that your understanding was that 27 percent
15 of record sales, physical record sales, were induced
16 by radio. Isn't that right?

17 A To start with, there's a premise in your
18 question that I did an adjustment based on 52 percent,
19 which is not correct. As to the 27 percent of record
20 sales induced by radio, as I testified, that's based
21 on the testimony of Mr. Fine.

22 Q Mr. Fine's testimony, as I understand it,

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1 was that 27 percent of record sales are influenced by
2 radio play. Is that your understanding?

3 A I believe the 27 percent corresponds to a
4 question that those were purchases where radio play
5 was the primary influence in determining the purchase.

6 Q Is it your inference that but for radio
7 the number of records purchased would be 27 percent
8 less?

9 A I think that's a reasonable estimate. The
10 primary factor doesn't necessarily imply that. On the
11 other hand, there may be other purchases for which
12 radio was a factor, some of which would be lost if the
13 radio promotion were not there. So I think on
14 balance, using that as an estimate, recognizing it's
15 only an estimate, the inducement effect is reasonable.

16 Q Have you seen any studies, Professor
17 Jaffe, indicating that radio doesn't make people buy
18 more records, it simply changes the ones that they
19 decide to buy?

20 A No, I have not.

21 Q Have you seen any studies indicating that
22 if all of the radio stations went away and there was

1 no radio at all, people would in fact probably buy
2 more recorded music?

A I have not.

4 Q But your assumption is that when people
5 indicate that 27 percent of the record purchases were
6 influenced by radio that but for radio they would have
7 made 27 percent fewer purchases of music. Isn't that
8 right?

9 MR. RICH: Objection. That's a
10 mischaracterization of the witness's prior three or
11 four answers.

12 ARBITRATOR GULIN: Sounded exactly like it
13 to me.

14 BY MR. KATZ:

15 Q I certainly didn't mean to do that, Mr.
16 Rich, so if I've done that, Professor Jaffe, please
17 correct me.

18 A What I've done is used as an estimate the
19 answer to this question which is that it's the primary
20 factor. I think that probably some of those cases
21 where it was the primary factor, the record purchase
22 still would have occurred but for that primary factor.

1 basically consistent with other information that I've
2 seen.

3 Q And that's what you used because the only
4 promotional benefit that musical composition copyright
5 owners receive from radio play of music is this 73
6 cent for CD mechanical royalty. Isn't that right?

7 A There's actually a slight additional
8 complication. I also included in the composer's
9 promotional value a mechanical royalty associated with
10 the sale of singles, which is a modest additional
11 amount.

12 Q So you wanted to make sure you picked up
13 all of the benefits that the musical composition
14 copyright owners received and, theretofore, you
15 included the mechanical royalties from both CD sales
16 and single sales. Isn't that right?

17 A I wanted a reasonable estimate of the
18 promotional value in the aggregate. Yes.

19 Q What about additional royalty payments
20 that the musical composition rights owners would
21 receive from additional live performances of popular
22 songs?

1 On the other hand, there's probably other cases in the
2 aggregate where radio was a secondary factor and that
3 had some effect as well. So on balance, I think that
4 27 percent is a reasonable estimate. I don't put it
5 forward as anything more than an estimate.

6 Q But again, your assumption is that but for
7 radio, the industry as a whole would sell 27 percent
8 fewer disks. Isn't that right?

9 A It's not an assumption. My use of Mr.
10 Fine's testimony is that were it not for radio there
11 would be 27 percent fewer recorded songs in the
12 aggregate.

13 Q And then you did a calculation as to the
14 benefits that the owners of musical composition
15 copyrights would receive from that 27 percent of
16 record sales. Isn't that right?

17 A Yes.

18 Q And you calculated that at approximately
19 73 cents per CD, the mechanical royalty. Isn't that
20 right?

21 A I actually didn't calculate that. That's
22 a published number that I utilized that seems

1 A So what you're saying is that the radio
2 play induces additional live performances?

3 Q Don't you believe that?

4 A I don't know.

5 Q Have you ever seen any data on that?

6 A I haven't. No.

7 Q Is it your supposition that if playing a
8 song on the radio increases the number of CD sales,
9 it's likely to increase the number of times the song
10 is performed in concert?

11 A I don't know.

12 Q Is it your supposition that if it
13 increases the number of CD sales, it will increase the
14 number of jukebox plays?

15 A I don't know.

16 Q Is it your supposition that if it
17 increases the number of CD sales, it'll increase sheet
18 music sales for a popular musical composition?

19 A Seems unlikely to me, but I don't know.

20 Q Why does that seem unlikely to you,
21 Professor Jaffe?

22 A I should just say I don't know.

1 Q Does it make sense to you that this air
2 play, this sustained play, for a musical composition
3 will also make it more likely that there'll be a Muzak
4 version of that musical composition which would result
5 in additional royalties to the musical composition
6 copyright owner?

7 A I don't know.

8 Q Isn't the popularity of a song likely to
9 lead to additional Muzak-type recordings?

10 A I don't know.

11 Q And isn't the popularity of the song
12 likely to lead to additional cover recordings of the
13 same song by other artists?

14 A Those are just CDs in another form, aren't
15 they?

16 CHAIRMAN VAN LOON: Please keep your "I
17 don't know" up.

18 THE WITNESS: It seems to me that's just
19 a CD in another form, in which case there'd be a
20 royalty to the composer and profits to the record
21 companies in the aggregate.

22 BY MR. KATZ:

1 Q At the moment, let's just stick with the
2 musical composition owners, which was the first step
3 in your analysis. Isn't that right? And isn't one of
4 the ways that a musical composition owner can benefit
5 from the popularity created for a sound recording is
6 that other recording artists will want to record that
7 same musical composition and in future years the other
8 musical composition owner will benefit?

9 A Yes. And the only point I was making was
10 I've included the major category of promotional value
11 to the extent I've excluded other categories in which
12 there's a benefit to the composers but no benefit to
13 the owners of the sound recording, and potentially
14 that could be a bias in my calculation. I don't know
15 how big it is.

16 To the extent I've included other
17 categories in which both the composers as a group and
18 the sound recording owners as a group both benefit,
19 that doesn't bias the calculation because what I care
20 about is the relative promotional value, too.

21 Q But the sound recording owner isn't going
22 to benefit if there's never any promotion of the

1 Q Profit to some other record company
2 because it's a different sound recording. Isn't that
3 right?

4 A But we're talking about the aggregate of
5 the industry here. We're not licensing the individual
6 titles.

7 Q Yes, but isn't the owner of that music
8 composition going to benefit from the air play of the
9 first sound recording from sales or performance fees
10 from additional sound recordings in the future and
11 that's a promotional benefit received from the air
12 play given to the original sound recording?

13 A I've lost you.

14 CHAIRMAN VAN LOON: Could you restate the
15 question, please?

16 BY MR. KATZ:

17 Q Let me try. We're trying to calculate the
18 benefits received to the owners of musical composition
19 rights from air play given sound recordings. Isn't
20 that right?

21 A Yes, as well as the promotional value to
22 the owners of the sound recording. Yes.

1 second sound recording, is there?

2 A I don't understand your question. If the
3 second sound recording generates royalties for the
4 composers, it's got to be sold and, when it's sold,
5 some sound recording owner is going to earn profits on
6 that.

7 Q But that sound recording owner earning
8 profits had nothing to do with the original sound
9 recording. Isn't that right? He derived no
10 promotional benefit from that.

11 A But it's the same performance, the same
12 broadcast, that we're talking about that generated
13 that promotional value.

14 Q It's the same broadcast of somebody else's
15 intellectual property. Isn't that right?

16 A But what we're licensing here is the body
17 of all sound recordings. So as a group, the owners of
18 sound recording are in the same position with respect
19 to that second CD as the composers.

20 Q Well, what you're licensing is the entire
21 body of sound recordings in one particular year.
22 Isn't that right?

1 A Yes.

2 Q And these benefits will be received in
3 some future year by some future recording. Isn't that
4 right?

5 A This is all hypothetical. You're
6 suggesting that the five major record labels that
7 we're talking about aren't going to be around in that
8 future time period?

9 Q It may be some minor label that does the
10 cover recording. Isn't that possible?

11 A It's conceivable.

12 Q Anyway, you didn't factor it into your
13 analysis, did you?

14 A That's correct.

15 CHAIRMAN VAN LOON: Is this a good
16 breaking place?

17 MR. KATZ: This is a logical stopping
18 place. And I would estimate about an hour after
19 lunch. I don't think any more than that.

20 CHAIRMAN VAN LOON: Okay. Two things
21 about lunch. The reason why we usually break at 12:30
22 is technically the cafeteria is not open to non-

1 employees until 12:30. But I doubt that there'd be
2 any entrance police that would give anybody a hard
3 time. The more important relevant thing for you,
4 Professor Jaffe, is we have a rule.

5 THE WITNESS: I understand.

6 CHAIRMAN VAN LOON: Since you're now in
7 the midst of cross examination --

8 THE WITNESS: The code of silence.

9 CHAIRMAN VAN LOON: Right. Don't comport
10 with your counsel during this period.

11 THE WITNESS: I will not.

12 MR. STEINTHAL: I think they think we work
13 here at the cafeteria by now anyway.

14 CHAIRMAN VAN LOON: I'm sure they all
15 recognize us. So why don't we plan to take our break
16 and come back at 20 past one.

17 (Whereupon, off the record at 12:19 p.m.
18 to reconvene at 1:20 p.m.)

19
20
21
22

1 A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N
2 (1:24 p.m.)

3 CHAIRMAN VAN LOON: Okay, so we're ready
4 after the lunch break to resume cross examination.

5 CROSS EXAMINATION (CONTINUED)

6 BY MR. KATZ:

7 Q Professor Jaffe, I'd like to turn briefly
8 to your footnote 47 in your prepared testimony at page
9 45.

10 (Pause.)

11 A Okay.

12 Q This is a discussion of mechanical
13 royalties, isn't that right?

14 A Yes.

15 Q You indicate that there is a statutory
16 mechanical royalty rate of .0755 dollars per song,
17 isn't that right?

18 A Yes.

19 Q But you characterize this not as the
20 absolute rate, but as the ceiling, isn't that right?

21 A Yes.

22 Q Because in some cases, musical composers

1 will negotiate with record companies lower rates.
2 Isn't that right?

3 A Yes.

4 Q Can you think of any reason why an owner
5 of a copyright in a musical composition might be
6 willing to negotiate a lower rate than the statutory
7 rate existing?

8 A Well, in the context that's discussed here
9 in terms of mechanical royalties, as I understand it,
10 this applies typically in situations where the
11 composer is also the performer songwriter,
12 singer/songwriter and the negotiations over the
13 mechanical royalty are therefore part of a broader
14 negotiation between the record company and the
15 performer regarding the terms of their arrangement.
16 And so they might well negotiate a reduction in the
17 mechanical royalty as part of an overall relationship
18 that they have.

19 Q Isn't it the case that sometimes the owner
20 of a copyright would be willing to negotiate a lower
21 than statutory mechanical rate to encourage a record
22 company to make a new recording of an old composition?

1 A That's possible, yes.
 2 Q Wouldn't it make sense in economic terms
 3 for a composer who owns the copyright in an old song
 4 that hasn't been recorded in some years, to encourage
 5 a record company to make a new recording of that song
 6 by offering a discounted rate?

7 A It might, yes.

8 Q That would be an economically logical sort
 9 of bargaining, isn't it?

10 A Could be, yes.

11 Q Well, in that same sense, Professor Jaffe,
 12 isn't the rate to be set by this Panel going to
 13 operate as a ceiling on the royalties to be paid by
 14 webcasters to record companies?

15 A I guess I'd be careful about the phrasing
 16 in this same sense. I don't know how significant it
 17 might be, but I suppose it is a possibility that once
 18 the Panel has set the statutory rate that individual
 19 parties would be free to negotiate an arrangement that
 20 was lower than that, so in that sense it would be a
 21 ceiling.

22 Q If, for example, a record company thought

1 setting a rate which was too high?

2 A I don't think that that follows because
 3 those side negotiations over particular sound
 4 recordings would still be in the context of the
 5 overall rates being jointly negotiated by the RIAA.
 6 So I don't think that the possibility that there might
 7 be some opt out and some direct licensing of
 8 individual titles would change or would provide a
 9 discipline on the magnitude of the rate for the core
 10 blanket license.

11 Q Well, your understanding in preparing your
 12 analysis is that webcasting presents tremendous
 13 promotional value for record companies. Isn't that
 14 right?

15 A I don't think I used the word
 16 "tremendous", no.

17 Q Well, you didn't use the word
 18 "tremendous", but you want to suggest an adjective for
 19 me?

20 A That there is significant promotion.

21 Q Significant promotional advantages. Isn't
 22 that right?

1 that there was great promotional value to having one
 2 or more of its sound recordings streamed by a
 3 particular webcaster, and the webcaster for whatever
 4 reason wasn't doing that, was resistant to doing that,
 5 wouldn't it make economic sense for the record company
 6 to offer a reduced royalty rate or even to waive
 7 royalties entirely to encourage the webcaster to play
 8 those songs, to get that promotional value?

9 A I think it would. Whether that would
 10 actually work within the framework of the statutory
 11 license would depend on how that license was
 12 structured, because if a license is structured as a
 13 blanket fee, it's not clear that the webcaster would
 14 be able to get an effective reduction in royalties for
 15 playing the sound recordings of a particular company.
 16 But I would agree with you that the incentive to do
 17 that might exist.

18 Q And I take it then that that marketplace
 19 effect, assuming that the panel found a way to set a
 20 rate which would permit that kind of individual
 21 bargaining, I take it then that the marketplace would
 22 provide some kind of protection against the Panel

1 A Yes.

2 Q And suppose accidentally, inadvertently,
 3 by error, a rate were to be set by the Panel which was
 4 so high that webcasters in large numbers were refusing
 5 to do webcasting. They were deciding to do something
 6 else with their internet resources. And were just not
 7 willing to do webcasting anymore at the royalty rate
 8 set by the Panel.

9 In that situation, wouldn't you expect
 10 record companies to then come forward and try and
 11 capture that promotional value by offering
 12 individually or collectively if they were permitted to
 13 do this collectively, to offer their music for
 14 streaming by webcasters at lower rates or no-rate at
 15 all?

16 A Well, I think what you're saying is that
 17 even a monopolist won't charge an infinitely high
 18 price, so if the Panel were to somehow set the price
 19 above the monopoly level, the industry acting as an
 20 monopolist would have an incentive to say oh my God,
 21 that was too high. We don't want it that high because
 22 we actually can make more money at a lower rate than

1 that. And they would therefore voluntarily agree to
 2 reduce the rate down to, in effect, the monopoly level
 which is the level that maximizes their profit. I
 4 don't see that as being likely to be relevant in terms
 5 of the Panel's deliberations.

6 Q Or an individual record company that felt
 7 differently from others might enter into that
 8 relationship with webcasters on its own?

9 A It's possible that an individual label
 10 would do that. The extent to which that provides
 11 discipline on the overall blanket license depends on
 12 the practicality of a significant number of webcasters
 13 relying solely on the sound recordings owned by single
 14 label. And I think we discussed that earlier. I said
 15 we'd rule that out, but I don't have any reason to
 16 believe that the viable model for most webcasters.

17 Q What about the other way around? Is there
 18 any reason why record companies and webcasters would
 19 ever negotiate a rate higher than the statutory rate?

20 A Well, I guess it's a semantic issue. I
 21 could imagine a situation where again, because of a
 22 bundle of circumstances, a webcaster might agree to a

1 rate for the statutory rate that is greater than they
 2 could get under the compulsory license, but presumably
 3 they would only do that because they thought they were
 4 getting something more than what just the compulsory
 5 license conveyed. So I don't know semantically
 6 whether you'd call that a higher rate for this right
 7 or not.

8 Q It would look like a higher rate, but in
 9 terms of the total value that was received, the
 10 webcaster would not have any reason to pay more than
 11 the statutory rate, isn't that right?

12 A For the rights conveyed by the statutory
 13 license, the webcaster would have no incentive to pay
 14 more.

15 Q So the rates to be established by the
 16 Panel is a ceiling, but not a floor, as a practical
 17 matter?

18 A Well, as a practical matter, as I said, I
 19 think it's both a ceiling and a floor because the
 20 likelihood of them setting a rate above the monopoly
 21 price seems to me so remote as to be irrelevant, but
 22 as a theoretical matter, I suppose you could

1 characterize it as a ceiling, but not a floor.

2 Q Professor Jaffe, I want to turn back to
 3 paragraph 52 of your statement, page 35, and
 4 succeeding paragraphs and this is where you try to
 5 discuss the criteria set forth in the statute in
 6 Section 114(f)(2)(B)(ii). Isn't that right?

7 A Yes, and other things, but this is where
 8 I deal with the criteria.

9 Q The statute specifically refers to
 10 relative creative contribution, technological
 11 contribution, capital investment, cost and risk, isn't
 12 that right?

13 A I believe that's correct.

14 Q With respect to creative contribution,
 15 there is no substantial creative contribution from a
 16 webcaster with respect to the music performed, is
 17 there?

18 A Well, you'll notice that doesn't appear in
 19 my list because I wasn't quite sure what it meant. I
 20 think that in some broad sense, creative contribution
 21 could include a creative way of making these options
 22 available so that the user finds it more useful, more

1 interesting, more fun and that could be creative. But
 2 I'm not, as you'll note, I didn't really opine on
 3 that.

4 Q Now in terms of technological
 5 contribution, you feel that the webcasters have
 6 contributed significantly to technological
 7 development?

8 A Yes, I think so.

9 Q And what have they contributed?

10 A Well, as I discuss in the testimony and
 11 this is not something I focused on. There's been
 12 other testimony in the proceeding, but they are
 13 developing software and hardware for doing this. Some
 14 of them have taken out patents. They're creating with
 15 the help of others the software and hardware that
 16 makes this work and I think that given that it wasn't
 17 there before, that's a technological contribution.

18 Q Are you familiar with Professor Zittrain's
 19 testimony that all of the technology, all of the
 20 hardware and software that you need to do webcasting
 21 is available off-the-shelf?

22 A I'm not aware of that, no.

1 Q Are you familiar with his testimony that
2 not only is all of the hardware and software that you
3 need available off-the-shelf, but that the software
4 that you need is available in the form of free tools?

5 A No.

6 Q Now you refer to patents. What patents
7 have any of the webcasters received?

8 A I don't know specifically. I just know
9 that there are patents.

10 Q Do they relate to the technology of
11 streaming music, or do they relate to marketing?

12 A I don't know.

13 Q Paragraph 62 of your statement, on page
14 40, you refer to the risks faced by licensees and you
15 note that some streamers have failed and you say in
16 contrast while the record companies face risks in the
17 creation and promotion of any single record, they're
18 able to spread these risks over their portfolio of
19 recordings.

20 Some of the streaming webcasters are parts
21 of large corporations, isn't that right?

22 A Yes.

1 business that's at issue here, the performances of the
2 sound recordings, if all they're doing is streaming
3 then they are risky and that's not diminished by the
4 fact that they happened to be owned by a company that
5 can spread those risks over other activities.

6 Q Well, if all a record company was doing
7 was making its recordings available for streaming over
8 the Internet, that would be pretty risky too, wouldn't
9 it?

10 A Yes.

11 Q Let me turn briefly to ephemeral rights.
12 (Pause.)

13 Professor Jaffe, are you familiar with
14 Professor Zittrain's testimony the other day that it
15 isn't necessary to make any ephemeral copies to do
16 webcasting?

17 A I reviewed Professor Zittrain's written
18 filing. I actually have not reviewed the transcript
19 from Friday.

20 Q If it's true that it isn't necessary to
21 make a single ephemeral copy to do webcasting, would
22 that change your analysis of ephemeral rights at all?

1 Q And in some cases, streaming is one of a
2 number of investments they've made in the internet
3 space, isn't that right?

4 A In some cases, yes.

5 Q And isn't a company like MTV or AOL-Time
6 Warner able to spread its own risks over a portfolio
7 of investments?

8 A Well, now you come down to a question of
9 what did Congress mean by this criterion. The point
10 I was making was that if we view the sound recordings
11 and the performance of the sound recordings as the
12 business at issue, with respect to that business the
13 record companies are not engaged in a financially
14 risky business because they have a portfolio of sound
15 recordings and can earn profits from that portfolio on
16 an on-going basis.

17 Now it's true that if a particular
18 webcaster is owned by a big company that does a whole
19 lot of different things, in the aggregate, that big
20 company can diversify those risks just like the
21 stockholders for that matter of any one company can
22 diversify their risk. But still with respect to the

1 A Well, I don't think it would as long as
2 the premise on which my conclusion was based remains
3 true which is that when you do make ephemeral copies,
4 you are doing so only for the purpose of effectuating
5 performances and perhaps maximizing the number of
6 performances.

7 I think if there's a way of doing it that
8 doesn't involve ephemerals, it's still the case that
9 when you do use the ephemeral right, if all you're
10 doing is facilitating a performance, then I think the
11 value of the ephemeral is still tied up with, if you
12 will, the value of the performances.

13 Q Well, if the impacts of making the
14 ephemeral copy is to save costs for the webcaster,
15 wouldn't that suggest that there's some value from the
16 ephemeral rights which a licensor might want to
17 capture?

18 A Yes.

19 Q Reasonable businesses will pay for
20 technologies or rights which are well worth their cost
21 of operation, will they not?

22 A Yes.

1 Q Professor Jaffe, I want to suggest some
2 adjustments to the calculation that you did in your
3 testimony and my question in each case is really not
4 going to be your assessment of the validity of the
5 adjustment. It's hypothetical.

6 But I'd appreciate your explanation as to
7 how you would adjust your numbers to take advantage of
8 the adjustment I suggest to you.

9 Let me ask you to begin with the .02 cents
10 per listener-song that you calculated for musical
11 composition performance rights in the over-the-air
12 broadcast space. And these are adjustments, I'm going
13 to suggest to that calculation to apply it to sound
14 recordings in the internet space.

15 A Okay.

16 Q Are you with me so far? The first
17 adjustment I suggest is that there's no quantifiable
18 promotional effect for webcasting. I ask you assume
19 that the Panel at the end of the day concludes there's
20 anecdotal evidence. There's suggestions of promotion,
21 but it's hard to quantify. There's anecdotal
22 evidence. There's suggestions of capture of streams,

1 but that's hard to quantify and at the end of the day
2 it all cancels itself out.

3 How would one take that into account in
4 adjusting the .02 cents per listener-song calculation
5 that you came up with?

6 (Pause.)

7 A I believe what you have to do with the .02
8 cents per listener-song, since it derives from the
9 over-the-air world in which I've estimated part of the
10 consideration for the musical works is coming in the
11 form of promotional value, I adjusted that downward
12 because I believe that the promotional value for the
13 sound recordings exceeds the promotional value for the
14 musical works.

15 If you were to conclude that there was no
16 promotional effect for the sound recordings on the
17 internet, since my number reflects some amount of
18 promotional value for the musical works over-the-air,
19 you would have to make an upward adjustment within my
20 methodology that could be made by looking at the total
21 consideration that I estimated. I think it was like
22 \$500 million relative to the royalties paid

1 over-the-air, \$340 million.

2 The difference being the promotional value
3 that the musical works get over-the-air and so if you
4 wanted to convert that to a zero promotional value
5 world, you could make an upward adjustment in
6 proportion to that ratio.

7 Q And that would be about a 45 percent
8 upward adjustment?

9 A I don't know.

10 ARBITRATOR GULIN: Let me understand. The
11 hypothetical is is there's no promotional value on
12 radio or there's no promotional value by streaming or
13 both?

14 BY MR. KATZ:

15 Q My hypothetical and I will invite the
16 witness's comment on this was that radio is whatever
17 it is, but in the internet world we assume that
18 there's no promotional effects either for the musical
19 composition rights owner or the sound recording rights
20 owner.

21 A Actually, I hadn't really -- Judge Gulin's
22 question clarifies the applicability of my answer. My

1 answer would apply if you believe that the promotion
2 of value in over-the-air radio not only is what it is,
3 but is correctly captured by my analysis, in other
4 words, my numbers are a reasonable approximation of
5 the true promotional value in over-the-air radio, but
6 that when you go to the sound recordings on the
7 internet, that value is not there. If that were the
8 conclusion, then you could make that adjustment and
9 I've confirmed on my calculator that that is
10 approximately a 45 percent increase.

11 CHAIRMAN VAN LOON: And just so I can
12 follow the math on that. I had remembered you had a
13 .52 and then you talked about a range, I thought of .6
14 to .7. Then to be conservative, you went to the .7
15 and so it was a 30 percent.

16 THE WITNESS: Okay, but to be clear what
17 Mr. Katz is asking me about is the number before that
18 30 percent discount is even applied, so what my
19 analysis did was I started from the over-the-air
20 number. I said based on the numbers I could justify
21 a discount of say close to 50 percent, but I'm not
22 going to do 50 percent. I'm going to do 30 percent.

1 And that was because my argument is that the
2 promotional value to the sound recordings is greater
3 than to the musical works.

4 The hypothetical that Mr. Katz put to me
5 was let's go back to the over-the-air world because I
6 applied a discount and let's assume that not only do
7 we not only have greater promotional value of sound
8 recordings vis-a-vis musical works, but there just is
9 no net promotional value after allowing for
10 displacement which I think was part of your question
11 on the internet.

12 And then instead of applying my discount,
13 you actually have to apply a premium to reflect the
14 fact that in my benchmark, what you have is a
15 situation in which the rights holders are getting
16 royalties and are also getting some promotional value
17 and if you find, under this hypothetical that that
18 portion of the consideration doesn't exist on the
19 internet, it would be appropriate if you accept my
20 math and my model to do that upward adjustment.

21 BY MR. KATZ:

22 Q Professor Jaffe --

1 zero zero two dollars or .02 cents per listener song
2 and then the first proposed adjustment was a .45
3 multiplier on the assumption that there's no
4 quantifiable promotional effect for webcast.

5 MR. RICH: You are asking the witness to
6 write down your hypotheses on the board?

7 I don't think -- if I may to the Panel, I
8 don't think this witness should be used as a foil for
9 Mr. Katz' theorizing. I just don't think that's
10 appropriate.

11 MR. KATZ: That's fine, Mr. Rich. I'll
12 write it.

13 (Pause.)

14 CHAIRMAN VAN LOON: It is per song, right?

15 BY MR. KATZ:

16 Q Now here's my second hypothetical
17 adjustment, Professor Jaffe, remember we had some
18 testimony earlier about the Arbitron data on average
19 quarterly hours in which a person listening for 5
20 minutes was a listener for a quarter hour?

21 A I don't think that's an accurate
22 characterization. We used the AQH which is the way in

1 ARBITRATOR GULIN: Can you tell me exactly
2 how you got to the 45 percent?

3 THE WITNESS: I just divided \$500 million
4 which was my estimate of the total consideration
5 received by the -- if you go back to my exhibit, I
6 estimated that the royalties were about \$343 million
7 and the promotional value to the musical works holders
8 was \$157 million.

9 So the total consideration being received
10 by the musical works rights holders was about \$500
11 million. So I'm taking that \$500 million relative to
12 the royalty portion alone of 343 and under Mr. Katz'
13 hypothetical, if you wanted to reproduce the total
14 consideration in a world in which no net promotional
15 value is being delivered, you'd increase the royalty
16 to sort of pick up that lost promotional value.

17 BY MR. KATZ:

18 Q Professor Jaffe, the way the room is set
19 up, the white board is behind you and not behind me,
20 but I would suggest it might be useful for the Panel
21 to note these as we go down and let me ask you to note
22 on the white board that we started with the point zero

1 which Arbitron derives the instantaneous audience.

2 Q And as you testified, what Arbitron does
3 is report somebody who listens for 5 minutes in a
4 15-minute block as an average quarterly hour listener.
5 Isn't that right?

6 A Yes. And if there are 50 people who
7 listen for 1 minute in that 15 minute block, they're
8 all ignored and not counted at all.

9 Q Right. Now and those 50 people listening
10 to 1 minute probably didn't hear one entire song, did
11 they?

12 A I don't know.

13 Q Let me ask you to assume now that one
14 concluded that a quarter hour should not be considered
15 a person who listens for perhaps no more than 5
16 minutes, but a person who listens for an entire
17 quarter hour, that you need to have 15 minutes to make
18 up a quarter hour.

19 If you wanted to make that adjustment, how
20 would that affect your calculation?

21 A I don't know.

22 Q Well, if we turned, if what you've

1 calculated is based on 12 times the number of people
2 who listen for 5 minutes, wouldn't that result in a
3 tripling of your proposed rate if we were to go --

4 A No. Because the -- first of all, what
5 you're proposing is that ratings be measured in a way
6 that is totally different from the way everybody
7 measures ratings. If you want to revisit that and you
8 want to suggest that Arbitron should do it
9 differently, I would certainly agree that there are
10 other ways it could be done.

11 There's nothing magic about the average
12 quarter hour, although as I mentioned, we did do a
13 check based on the cum. which really is measuring
14 actual accumulated time listened and we got very close
15 results so as I sit here, if you want to change the
16 definition of how you do ratings, I would agree that
17 might change the answer, but I can't tell you as I sit
18 here, how it would change it.

19 Q So you can't think of any way that would
20 adjust your 5 minute quarter hours to 15 minute
21 quarter hours?

22 A Five minute quarter hours is a

1 mischaracterization of what it is. Arbitron has a
2 particular way that they have developed because they
3 believe it's accurate of measuring instantaneous
4 audience that does use this 5-minute test, but I don't
5 think it's right to say that somehow that is tripling
6 the listening. That's just not correct.

7 CHAIRMAN VAN LOON: Can I clarify just for
8 my understanding on the measure. Picking up what you
9 said a minute ago, if someone listened for 4 minutes,
10 but then channel surfed, they don't get counted?

11 THE WITNESS: They don't get counted at
12 all. If you listen to 4 minutes on one station and 4
13 minutes on another station, and 4 minutes on another
14 station during that 15-minute period, they never show
15 up on any of the stations, so they're simply not
16 counted in the total audience of radio at that time.

17 CHAIRMAN VAN LOON: And on the other hand,
18 if they listen to the same station for 14.5 minutes --

19 THE WITNESS: They're counted once.

20 CHAIRMAN VAN LOON: They're counted as a

21 15.

22 THE WITNESS: Right. And my understanding

1 Is that Arbitron in dealing with -- they've done a lot
2 of research on this about how to measure audiences and
3 I suspect that they've concluded that this is a
4 reliable way of doing it. They do have this other
5 measure. We cross checked and you get very similar
6 results.

7 CHAIRMAN VAN LOON: So anybody that's
8 counted essentially is anyone who listens from 5.1
9 minutes, so to speak, to 14.9 or the full 15, but you
10 don't know --

11 THE WITNESS: Right, it's done station by
12 station.

13 CHAIRMAN VAN LOON: Okay, I understand.
14 Thank you.

15 BY MR. KATZ:

16 Q In the internet world, there's no
17 instantaneous audience measure of consequence, is
18 there?

19 A I don't know of one.

20 Q You're going to actually measure. Your
21 proposal is to actually measure the number of hours
22 people are receiving streams on their computer, isn't

1 that right?

2 A Or to utilize a measure that is created
3 for other purposes, yes.

4 Q So five minutes in the computer world will
5 count as five minutes, isn't that right?

6 A Yes.

7 Q But five minutes in the radio world counts
8 as 15 minutes, isn't that right?

9 A I don't think that's an accurate
10 characterization of how the AQH works.

11 Q Well, it may not be an accurate
12 characterization, Professor Jaffe, if the way you view
13 the Arbitron numbers in the radio world, but if a
14 person listens to a radio from 3 o'clock to 3:05,
15 that's going to count as a quarter hour, isn't that
16 right?

17 A And if they listen from 3 to 3:15 to four
18 different stations it doesn't ever show up in my
19 numbers anyway.

20 Q And those are the data that you chose to
21 use, isn't that right?

22 A No, they're the data that everybody

1 chooses to use.

2 Q Everybody in the radio world, Professor
3 Jaffe, isn't that right?

4 A Everybody who is concerned about audiences
5 of radio.

6 Q But in the internet world, 3 o'clock to
7 3:05 is 5 minutes, isn't that right?

8 A Yes.

9 Q And you propose to charge it as 5 minutes,
10 isn't that right?

11 A Yes.

12 Q Here's my third proposed adjustment.
13 Suppose the Panel were to conclude at the end of the
14 day that it isn't one person listening to a computer
15 on average, it's two people listening to a computer on
16 average or maybe some other multiple.

17 How would that affect your data?

18 A Well, as we discussed earlier, I believe
19 that the Arbitron data is a listener concept, not a
20 number of radios turned on.

21 Before I recommended an adjustment on that
22 basis, I'd want to confirm that, but that is my

1 Q Are you aware that there's a lawsuit
2 pending in which a group of publishers are claiming
3 that a mechanical license is required to do streaming?

4 A No, I'm not aware of that.

5 Q Now are you familiar with the testimony
6 yesterday from Mr. Kempton that in his experience,
7 typically, when both the mechanical license and a
8 performance license was required, that the mechanical
9 license would typically be about half as much as the
10 streaming license?

11 MR. RICH: Objection, that's a
12 mischaracterization of Mr. Kempton's testimony.

13 THE WITNESS: My recollection was that --
14 I'm sorry.

15 CHAIRMAN VAN LOON: Wait, do you have a
16 response to that?

17 MR. KATZ: I suggest that was a correct
18 characterization of Mr. Kempton's testimony.

19 ARBITRATOR VON KANN: This witness, I
20 believe, was present for much of Mr. Kempton's
21 testimony. We can perhaps have him explain it in
22 terms of his understanding of what Mr. Kempton

1 memory. Assuming that that is correct, and assuming
2 you believed you knew the number of listeners on
3 average who are there when a computer is turned on and
4 people are listening to streaming, I think it would be
5 appropriate to adjust for that average number of
6 listeners, if it's greater than one.

7 Q And mathematically, how would you do that?

8 A You could multiply my fee by the average
9 number of listeners that are believed to be present
10 when a stream is listened to.

11 (Pause.)

12 Q So if the Panel were to conclude that
13 there were on average two listeners per computer, that
14 would be two times adjustment to your data?

15 A If that was what the Panel decided the
16 facts were, that adjustment could be made.

17 Q Here's the fourth one. Are you aware that
18 there are songwriters who claim that a mechanical
19 license fee is due for streaming, in addition for
20 paying performance fees for streaming?

21 A I think I do have some vague recollection
22 of that. I don't know the details.

1 testified to.

2 CHAIRMAN VAN LOON: Is that correct you
3 were here?

4 THE WITNESS: I was here, yes. And again,
5 Mr. Kempton is the best expert on what Mr. Kempton
6 observed. But my understanding of it was he said that
7 when there was a mechanical right and a performance
8 right, that there was a range and the range was that
9 the mechanical was between 20 and 33 percent of the
10 total and that related to, I believe, a situation.

11 It's not really a mechanical right, but it's a
12 reproduction right in an audiovisual context in which
13 both a performance right and what is an analogy to a
14 mechanical right, a reproduction right or a
15 synchronization right is also required, that there was
16 a range from 20 percent to a third associated with the
17 mechanical or reproduction right.

18 BY MR. KATZ:

19 Q Now in the context of a willing buyer and
20 a willing seller, do you think that the willing
21 sellers and the willing buyers would take into account
22 in one of these hypothetical negotiations the

1 possibility that there might be another right that
2 would have to be licensed?

A Yes.

4 Q Now suppose the Panel were to conclude
5 that there should be some adjustment for the
6 possibility that the musical composition performance
7 right which might be sufficient in the radio world was
8 not sufficient in the internet world and that there
9 would be the requirement in addition of a mechanical
10 license from the songwriters, how would you adjust
11 your calculation to take that into account?

12 A Well, I think what you'd have to do is
13 you'd have to reduce the fee for the sound recording
14 to reflect this additional right which is needed in
15 this context, but not needed in the over-the-air
16 context that's used as a benchmark.

17 Q Why would you reduce the sound recording
18 right and not the musical composition right?

19 A This Panel isn't setting the musical
20 composition right for the internet. It's setting the
21 sound recording performance right and in a competitive
22 market, as you indicated, that's going to be affected

1 what I need is on the one hand a sound recording right
2 and on the other hand a musical works right, from the
3 buyer's point of view, they're of equivalent value.
4 If there's some third piece that comes in there, maybe
5 would have no effect, but if it has any effect at all
6 it would be to diminish the rate that would be paid in
7 a fair market for all of the other rights.

8 Q Well, why shouldn't the sound recording
9 right be equal to the combination of the musical
10 composition performance right and musical composition
11 mechanical right if, as you've testified, you feel
12 that the sound recording rights and the musical
13 composition rights should be viewed as essentially
14 equivalent values?

15 A Well, it's possible that what would happen
16 or what should happen when this new mechanical right
17 is introduced is that the performance right in the
18 musical works would take all the hit. I wouldn't rule
19 that out, but in my benchmark setting there is no
20 requirement for this mechanical right and so relative
21 to the benchmark, the introduction of the mechanical
22 right in the internet context, if you were to add it

1 by the other rights that you have to get to do what
2 you're doing.

3 And if there is an additional right that
4 the buyer is going to have to get that isn't -- that
5 doesn't exist in the benchmark context, in order to do
6 the performance that we are valuing, I think you'd
7 have to reduce the appropriate fair market fee for the
8 sound recording performance right and presumably also
9 for the musical work performance right in order to, in
10 effect, make room for that additional right that is
11 needed in order to do the performances that are
12 creating the value.

13 Q Now your assumption at the beginning here
14 is that the sound recording right should be valued
15 about the same level as the musical composition right,
16 isn't that right?

17 A Where there is only one legal right that
18 is needed on each side that's correct, yes. Just to
19 be clear on that, the way I've dealt with the
20 ephemerals is to say it doesn't really matter whether
21 there is one or two rights. The value of the
22 performance is the value of the performance and if

1 on, you'd be paying too much for the musical works in
2 the internet context and there's no reason why the
3 sound recording rights should somehow reflect that.

4 So going back to my benchmark setting,
5 this right is not needed, so what I've got is the
6 entire value of the musical work performance. I don't
7 think because someone says okay, now you need another
8 right for that, you would ever increase what you would
9 pay for this third right, the sound recording
10 performance right. You might not change it at all on
11 the theory which I think would be plausible that the
12 hit for that ought to come out of the performance
13 right for the musical works on the internet. That
14 would be sort of a plausible view in which case there
15 would be no adjustment, but I can't think of any
16 reason why you would adjust upward, the sound
17 recording part of it.

18 Q Well, your premise at the beginning was
19 that the sound recording rights and the musical
20 composition rights were approximately of equal value,
21 no reason why one should be worth more than the other,
22 isn't that right?

1 A Within this willing buyer/willing seller
2 framework, yes.

3 Q That's your assumption going in, that
4 there's no basis to assume that people would pay more
5 for sound recording rights than musical composition
6 rights or vice versa. Isn't that right?

7 A Yes.

8 Q And wouldn't you expect that willing
9 buyers and willing sellers in the course of these
10 negotiations, viewing it from that perspective, if the
11 musical composition rate were to go up, would expect
12 the sound recording rate to go up?

13 A It depends if the musical work rate has
14 gone up to a level that is not reasonable and not
15 reflective of a competitive market rate, then if
16 you're trying to set the sound recording performance
17 right at a reasonable competitive market rate it would
18 be lower.

19 If the new higher musical work rate that
20 you posit is, in fact, a competitive market reasonable
21 rate, then I think it would be an inappropriate
22 benchmark for the sound recording performance rate.

1 question because I thought that that's what I did. So
2 maybe you could explain why, what it is I'm missing.

3 Q Well, your assumption was that the musical
4 composition rights owners and the sound recording
5 rights owners should receive approximately the same
6 compensation, correct?

7 A Yes.

8 Q My suggestion is suppose the Panel were to
9 conclude that instead of that equality, the
10 appropriate relationship should be that the record
11 company that owns the sound recording copyright, the
12 principal artist and the person who owns the musical
13 composition copyright should all receive approximately
14 the same compensation. How would that adjustment be
15 reflected in your calculation?

16 A Just to make sure I understand your
17 question, what you're saying is which I understand is
18 true as a legal matter, the record company owns the
19 sound recording copyright and the artist is somebody
20 else. They don't own that copyright. And you're
21 asking me to assume that what ought to happen is the
22 sound recording copyright owner, the artist as

1 But what you basically said is take an existing rate,
2 predicate it on no mechanical. Now we decide there's
3 a mechanical. Assume that existing performance rate
4 for the musical works remains constant when we've
5 acquired another right which is not a valid assumption
6 and add the mechanical on and then look for
7 equivalence. That doesn't make any sense to me.

8 Q Let me ask you this, Professor Jaffe,
9 suppose the Panel were to conclude that the principal
10 recording artists and the record company and the
11 composer were each entitled to approximately the same
12 return, the same royalty. How would that affect your
13 calculation?

14 A So you're intentionally excluding the
15 publisher, the publisher of the musical work?

16 Q Well, we could include the publisher of
17 the musical work. But suppose they concluded that the
18 principal recording artist, the record company and
19 those who own the musical composition rights were each
20 entitled to approximately the same compensation. How
21 would that affect your calculation?

22 A I must be missing something in your

1 distinct from that owner, and the joint owners of the
2 copyright and the musical work, the publishers and the
3 composers, should each get an equal share so that
4 there should be in effect additional contribution for
5 the artist over and above what goes to the owner of
6 the sound recording as a copyright matter. Is that
7 what you're getting at?

8 Q Well, not that that ought to happen, but
9 that the Panel concludes for whatever reason that that
10 would be the correct result. How would that be
11 reflected in your calculation?

12 A I can't do that off the top of my head
13 because the way I've thought about the promotional
14 value has always been that despite the fact that the
15 record company owns this copyright, given the way the
16 statute is set up, the record company and the artists
17 are in effect have a joint interest in the sound
18 recording performance royalty.

19 So if you're going to tell me that that's
20 not the right way to think about it, that somehow the
21 record company alone is the owner of the -- is the
22 recipient of the value and then there's an additional

1 kicker for the artist, I guess I'd have to think about
2 that. I can't do that off the top of my head.

3 Q Let me ask you one last possible
4 adjustment and that is we looked at KFOG earlier and
5 your calculation, your expected calculation of the
6 musical composition royalty for KFOG was about 35
7 percent of what they actually ended up paying. Do you
8 recall that?

9 A Yes.

10 Q And let me ask you to assume that that --
11 that if the Panel were to decide at the end of the day
12 that that was a systematic error throughout your
13 calculation, how would you adjust your numbers to
14 correct for that?

15 A I don't know.

16 Q Thank you, Professor. That's all I have.

17 CHAIRMAN VAN LOON: Do you have some
18 Redirect, perhaps?

19 MR. RICH: We may, in advance of which we
20 would enjoy a brief opportunity to consult and decide
21 what we have. It will not be lengthy, that I know.

22 CHAIRMAN VAN LOON: Then we'll count this

1 the hearing transcripts, is that correct?

2 A Portions, yes.

3 Q From your review of the actual evidence,
4 have you found any support for, as a factual premise,
5 for making any of the adjustments which Mr. Katz, on
6 a hypothetical basis suggested you consider with him?

7 A No.

8 Q Now, conversely, in developing your own
9 model, and here I would refer you among elsewhere, to
10 paragraph 52 of your written direct testimony
11 appearing at page 35.

12 I believe you testified at various times
13 to the conservative assumptions which underlie your
14 model. Am I correct?

15 A Yes.

16 Q And I would ask you to review with
17 reference, at least to paragraph 52 and any other
18 references you think appropriate, the various places
19 or factors which you believe would have warranted in
20 principle, a further downward adjustment in the fee
21 which you did not, for whatever reason, quantify. Can
22 you go through that, please?

1 on your time.

2 MR. RICH: That's okay.

3 CHAIRMAN VAN LOON: Would you like 5
4 minutes, 10 minutes?

5 MR. RICH: I would say if we could have
6 until 2:30 that would be appreciated.

7 CHAIRMAN VAN LOON: Until 2:30. Okay.
8 (Off the record.)

9 REDIRECT EXAMINATION

10 BY MR. RICH:

11 Q I have very little Redirect. At the end
12 of his examination, Mr. Katz asked you to consider a
13 series of hypothetical adjustments to your model, yes?

14 A Yes.

15 Q And you have reviewed at this point
16 considerable portions of the hearing record as it's
17 been developed to date, have you not?

18 A Yes.

19 Q Including most, if not all, of the written
20 direct cases that have been presented?

21 A The written, yes.

22 Q And you've read significant portions of

1 A Yes. There are really sort of two
2 categories, I guess of ways in which I think the
3 number that we calculated is conservative. One is
4 that in the actual calculations and adjustments we
5 made, we made a number of numerically conservative
6 assumptions which I've talked about at various points,
7 so that even within the framework of my approach, I
8 think that I am conservatively estimating what the
9 level of the fees would be. That's sort of one
10 category.

11 The broader category is that I believe
12 there are a number of reasons why the benchmark fee
13 ought to be adjusted downward and I've only quantified
14 and therefore incorporated one of them. So I haven't
15 in any way taken account in the numerical calculations
16 of these other factors which are listed on page 35.

17 I think the important ones being the
18 likely elevation of the benchmark fees due to the
19 market power of BMI and ASCAP and the likely impact on
20 the willing buyer/willing seller negotiation of the
21 statutory factors and the balance of the statutory
22 factors identified, certainly relative to the

1 benchmark situation in which you have, as we've
2 already discussed, a well-established collective of
3 radio stations bargaining in a stable environment with
4 these musical works owners. I think that in
5 comparison, the risks and the costs being borne by the
6 webcasters in a hypothetical willing buyer/willing
7 seller negotiation would likely result in an outcome
8 where they would pay less than the radio stations, but
9 I've not incorporated that in the analysis.

10 Q Now yesterday, when you took the Panel
11 through your promotional value computation, which I
12 take it is set forth in Exhibit 2 or revised Exhibit
13 2 to your testimony, and which led you to ultimately
14 make a 30 percent downward adjustment, am I correct,
15 you indicated yesterday that there were some
16 conservative computational determinations you made in
17 connection with that as well. Is that correct?

18 A Yes.

19 Q And is that what you were referring to a
20 few moments ago when you said there were two types of
21 factors here that led to a conservative approach on
22 your part?

1 A That was part of it. There were also
2 conservative assumptions built into the fee model
3 itself, in terms of how we utilize the over-the-air
4 radio data.

5 Q And can you describe that a bit for the
6 Panel, what you're referring to?

7 A Well, for example, there was a brief
8 discussion this morning about our reliance on the 2000
9 information. We know that the royalties paid by the
10 radio stations have been rising faster than their
11 audiences, so the ratio of royalties to audience in
12 2000 is almost surely higher than it was in 1998 or
13 1999 and so certainly with respect to those periods
14 that would be a conservative assumption and we don't
15 have any data for 2001, so I don't really know what
16 would be happening in 2001.

17 And I guess that's the main one that I
18 remember.

19 Q Now coming back to promotional value for
20 a minute, Mr. Katz had a dialogue with you suggesting
21 the possibility that there might be additional
22 promotional value identifiable to composers or owners

1 of musical works than merely results from the payments
2 of mechanical royalties. Do you remember that?

3 A Yes.

4 Q At least in a general sense, does the
5 manner in which you computed the promotional value
6 discount account for such possible phenomena?

7 A Well, the way I think about it is we have
8 an approximation. We looked at what is clearly the
9 largest and most important source of profits and
10 royalties. There are some categories left out, some
11 of which like the jukeboxes generate potentially some
12 royalties for the composers, but on the other hand, we
13 left out a major category of benefit to the
14 beneficiaries in this proceeding. I will no longer
15 call them the rights holders of the sound recordings
16 since Mr. Katz has emphasized that that's just the
17 record companies, not the artists. But the artists
18 are nonetheless equal beneficiaries in this proceeding
19 and I did not incorporate into my promotional value
20 analysis any benefit to them associated with royalties
21 in the sale of CDs.

22 Q Now Mr. Katz asked you a series of

1 questions surrounding on your methodology the decision
2 to drop certain stations for incomplete data. Do you
3 recall that?

4 A Yes.

5 Q What, if any, bias did this create in your
6 methodology?

7 A I was concerned. Whenever you have only
8 a sample of the universe you'd like to look at, that
9 isn't necessarily a problem, as long as it's
10 representative. What you worry about is that the
11 stations that aren't in the data you're looking at are
12 systematically different from the ones you're looking
13 at.

14 So we did some analysis of that and within
15 the data we have, the only systematic trend that we
16 found was that stations in larger markets tend to have
17 a higher ratio of fees to subscriber -- fees to
18 audience than stations in smaller markets. Basically,
19 it appears that the way the advertising market works
20 is if you have a bigger audience, you get more
21 revenues, but if you have a bigger audience and a
22 bigger market, you get disproportionately more

1 revenues.

2 So the stations in which the fee per

3 performance in my language is highest are those in the

4 biggest markets. And it turns out that because these

5 large groups like Clear Channel, for example, have

6 tended to focus on these big markets, the stations

7 that are in my sample over-represent the big markets

8 relative to the universe of all stations. So in fact,

9 the bias in my data from having only part of the radio

10 universe is almost surely that I'm overestimating the

11 average performance fee that is paid by the universe

12 of all radio stations.

13 Q Let me ask you finally about the

14 demonstrative in which you ran some numbers using KFOG

15 as an illustration. Do you have that in front of you?

16 A Yes.

17 Q That's this document for the Panel's

18 benefit.

19 Mr. Katz introduced into evidence some

20 year end true-ups with BMI and ASCAP, suggesting that

21 the actual fees payable were something in excess of

22 \$1,000 by KFOG for Year 2000. Do you recall that?

1 A Yes.

2 Q And in the -- I think this next few

3 questions, thank you, Mr. Steinthal reminds me

4 probably should go on the restricted record.

5 CHAIRMAN VAN LOON: Okay, we need to again

6 close the session and ask those without clearance to

7 leave and ask that the sign be put on the door.

8 (Whereupon, at 2:42 p.m., the proceedings

9 went into Closed Session.)

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1 LIBRARY OF CONGRESS+ + + + +

2 COPYRIGHT OFFICE+ + + + +

3 COPYRIGHT ARBITRATION ROYALTY PANEL+ + + + +

4 In the matter of: Docket No.

5 2000-9

6 Digital Performance Right In

7 Sound Recording and Ephemeral

8 Recording CARP DTRA

9 1 & 2

10 CARP Hearing Room

11 LM-414

12 Library of Congress

13 Madison Building

14 101 Independence Ave, SE

15 Washington, D.C.

16 Tuesday

17 August 28, 2001

18 The above-entitled matter came on for hearing,

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

20 BEFORE

21 THE HONORABLE ERIC E. VAN LOON Chairman

22 THE HONORABLE JEFFREY S. GULIN Arbitrator

THE HONORABLE CURTIS E. von KANN Arbitrator

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1 CHAIRMAN VAN LOON: Please continue.
 2 RECROSS EXAMINATION
 3 BY MR. KATZ:
 4 Q Professor Jaffe, do you know any
 5 executives or managers at any of the major record
 6 companies?
 7 A No.
 8 Q Have you ever had any discussions with any
 9 of them?
 10 A No.
 11 Q Have you ever read anything about the way
 12 the major record companies operate?
 13 A I don't recall.
 14 Q Do you have any familiarity with the kind
 15 of agreements that the major record companies have
 16 reached with licensees over the years?
 17 A No.
 18 Q Do you have any basis to know in the real
 19 world whether there is any decision maker at a major
 20 record company who would willingly enter into a
 21 license on the terms that you suggest from your model?
 22 A Was the question do I have any basis?

1 Q Yes.
 2 A Yes.
 3 Q And the basis is you think it's a good
 4 result, so you think that they would consider it a
 5 good result?
 6 A The basis is there's strong economic
 7 evidence that it reflects market prices. I believe
 8 that businessmen, if they can get market prices will
 9 take market prices for their goods.
 10 Q And so you believe if we brought in a
 11 major decision maker from a record company he would
 12 willingly agree to accept the rates that you propose
 13 here?
 14 A I think if he were in a real market
 15 situation where we had a competitive market and that
 16 was the price that the market was offering, he would
 17 take it.
 18 Q Do you think that if we brought in a major
 19 decision maker from one of the major record companies
 20 he would willingly agree to license webcasters on the
 21 terms that you propose?
 22 MR. RICH: Objection, asked and answered.

1 MR. KATZ: I suggest he did not answer my
 2 question.
 3 MR. RICH: He answered it as he felt
 4 appropriate.
 5 CHAIRMAN VAN LOON: Why don't you give
 6 another answer.
 7 THE WITNESS: I don't know what the
 8 question means because if you're asking me do I think
 9 if you bring him in this proceeding and ask him will
 10 he do it, I don't know.
 11 (Laughter.)
 12 I don't see that as having any significant
 13 relevance to the statutory test which is a
 14 hypothetical willing buyer/willing seller framework.
 15 BY MR. KATZ:
 16 Q The statutory test is not hypothetical
 17 willing buyer. The Panel is supposed to conclude what
 18 willing buyers and willing sellers will do in the
 19 market place.
 20 MR. RICH: Is that a question? It's a
 21 statement from Mr. Katz.
 22 BY MR. KATZ:

1 Q Isn't that right, Professor Jaffe?
 2 A That is not correct.
 3 Q All right.
 4 A May I explain? You misquoted the statute.
 5 The statute says what a willing buyer and willing
 6 seller would have, which is inherently a hypothetical
 7 concept. It does not say will or did.
 8 Q Would have paid in the marketplace. Isn't
 9 that right?
 10 A That's correct.
 11 Q And is it your belief that if we asked a
 12 major executive of a record company he would agree
 13 that he would willingly in the marketplace, as it
 14 exists, agree to license on the returns?
 15 A I have no idea what an executive would
 16 say.
 17 Q Thank you, Professor Jaffe.
 18 ARBITRATOR VON KANN: I would ask then if
 19 they paid more than your rate, should I credit that
 20 answer?
 21 (Laughter.)
 22 CHAIRMAN VAN LOON: Judge Gulin, I believe

1 you had a few questions.

2 ARBITRATOR GULIN: I do have a few
3 questions. Professor Jaffe, I think I understand your
4 methodology, you'll be happy to know.

5 THE WITNESS: I am happy to know.

6 ARBITRATOR GULIN: But I'm unclear on a
7 few things. I think I see the forest, but there are
8 a few trees I don't see.

9 (Laughter.)

10 THE WITNESS: Trees can fall.

11 ARBITRATOR GULIN: Let's go back to the
12 last exchange you just had with Mr. Katz. The
13 hypothetical free market that you envisage, I think
14 you said a number of times, is one in a competitive
15 environment. And I think you've said also just to be
16 clear that that competitive hypothetical market would
17 not be one where the record labels themselves were
18 cutting these deals because there's too much power
19 among those five record labels, the five majors.

20 Did I understand you to say that or no?

21 THE WITNESS: To be honest, I really
22 haven't thought about the question. If we hadn't

1 kind of hypothetical world where there's no compulsory
2 license, but there are also no transactions costs, so
3 we don't really need to centralize licensing. We can
4 have this competitive licensing world I talked about
5 this morning in cross examination. That's kind of my
6 ideal world.

7 But as a practical matter, I didn't find
8 that world. I used a benchmark which comes from a
9 particular institutional framework of the ASCAP-BMI
10 world, subject to rate court. My view is that and
11 I've testified to this effect in rate court, that what
12 the rate court ought to be doing is thinking, at least
13 conceptually, about that same hypothetical competitive
14 world. Of course, I don't really know exactly what
15 the rate court does or doesn't do. So I'm using a
16 specific benchmark from a particular institutional
17 context which isn't directly connected to that
18 hypothetical. It's just presumed to be a reasonable
19 indicator of this more abstract concept. That's
20 really how I've done it.

21 ARBITRATOR GULIN: Let me ask you about
22 this concept that you've discussed a number of times

1 created the statutory licensing regime and we hadn't
2 created a licensor with anti-trust immunity, do I
3 think that five labels is enough that they would
4 compete against each other and you'd get a competitive
5 market. I think the answer is probably no because I
6 think that many webcasters do, in fact, need them all.
7 There may be some who can deal with one label or two
8 labels, but many webcasters really need the whole
9 repertoire and so they're not going to be able to play
10 one off against the other. But given that we're in
11 the world we're in where there is a statutory license
12 and an authorized agent, I really haven't focused on
13 that in detail.

14 ARBITRATOR GULIN: Okay, well that perhaps
15 leads me to my next question and that is in the
16 hypothetical competitive market that you envisage, is
17 that one in the absence of a compulsory license?

18 THE WITNESS: I think that's actually --
19 I probably wasn't clear enough on this.

20 There are sort of two levels to the way I
21 think about this. There's the highest conceptual
22 level, sort of the starting point and that is this

1 and that is the assertion that the value of the
2 performance right in works is at least as great as
3 that in the sound recordings.

4 Would I be correct in saying that that
5 assertion is based upon your own internal analysis?
6 In other words, it's not based upon any kind of
7 empirical study. It's sort of an Einsteinian mental
8 experiment that he was famous for doing. It's not the
9 result of an actual survey or study or any kind of
10 concrete data, but rather it's something that makes
11 sense to you. It's a sensical type of assumption that
12 you've adopted. Is that about right?

13 THE WITNESS: I think that's about right.
14 I mean to be honest we have spent a lot of time trying
15 to figure out if there are places in which you can
16 actually look at the sound recording performance
17 right, compare it to what's actually paid for a
18 musical work performance right, in an analogous
19 context and do this empirically.

20 It's not, you know, the records versus the
21 sheet music. That's clearly the wrong thing. The
22 international comparisons were one place that we

1 looked at for that, which I've relied on only in kind
2 of a general way that it seems consistent.

3 ARBITRATOR GULIN: I thought you said that
4 you didn't rely upon it for your analysis.

5 THE WITNESS: The numerical conclusions,
6 that's right.

7 And similarly, if I can find other places
8 where you can really get data, I'm looking for it.
9 But I think your characterization certainly
10 numerically, your characterization of my starting
11 point of this equality as one that comes from
12 reasoning rather than data is correct.

13 ARBITRATOR GULIN: Well, it's important
14 then I think for us to understand exactly and
15 precisely what your reasoning is.

16 What my notes indicate throughout this
17 process as the reasons that you've given, essentially
18 are that from the buyer's perspective, the buyer
19 requires both rights and very much like a buyer would
20 need left and right shoes, they're perfect complements
21 to each other. And that the sellers incur no
22 incremental cost in either situation, either with

1 respect to the seller of either right. So that in a
2 sense the buyers are in the same position and the
3 sellers are in the same position.

4 Is that pretty much --

5 THE WITNESS: Yeah, I think that's right.

6 ARBITRATOR GULIN: If a webcaster was
7 simply trying to value a number of rights that fit
8 within those parameters -- let's say a webcaster in
9 order to operate needs to have both of those
10 performance rights and he needs to have a certain
11 computer operating system. Now it may be that there
12 are perhaps some substitutes for that computer
13 operating system, but it basically needs a certain
14 type of computer operating system. That all costs
15 about the same. It seems to me that the computer
16 operating system still fits within those parameters.
17 From the seller's point of view there's no incremental
18 cost in selling the operator system. From the buyer's
19 point of view, he needs all three, so they complement
20 each other. I don't think you would say that because
21 of those factors they all have equal value. So where
22 am I going wrong here in my thinking?

1 THE WITNESS: Well, I think there are two
2 differences. One is that the sense in which he needs
3 quote all three things is not completely analogous
4 because he only needs one operating system. He's
5 going to make multiple performances and the more
6 performances he makes, the more probably -- I mean all
7 else equal -- money he's going to make. In some
8 sense, he's going to want to perform more times in
9 order to have more business. And the sound recording
10 right and the musical works right are going hand in
11 hand in every one of those performances, so it's a
12 variable, if you like, and it's being used repeated
13 times and every time he needs both, whereas he only
14 needs one operating system.

15 The other difference which I really
16 haven't thought about a lot, is that the operating
17 system, at least typically is not sold specifically
18 for a particular medium or a particular context, so
19 it's part of a larger market and there's a market
20 price in this larger market. And so while it's true
21 in some sense the seller of the operating system also
22 has this zero marginal cost, he's not really pricing

1 it that way. He's not pricing it for this typically
2 at least, for this particular application. He's
3 pricing it for the market to recover and he has to
4 recover his costs from the market as a whole. If you
5 really had a situation where things evolved that there
6 were an operating system that were in wide use, and
7 somehow a particular set of users for that could be in
8 a position to say well, give it to us for less or we
9 just won't use it, I hadn't really thought about how
10 that would work.

11 ARBITRATOR GULIN: Let me ask you about
12 your demonstrative that you created yesterday with the
13 two bars. And these bars, as I understand them,
14 represent the total value for the musical work
15 performance right and the total value for the sound
16 recording musical right, musical work being on the
17 left, sound recording being on the right.

18 THE WITNESS: Correct.

19 CHAIRMAN VAN LOON: And there's a billion
20 dollars right there on those two columns.

21 THE WITNESS: In over-the-air radio.

22 ARBITRATOR GULIN: In over-the-air radio.

1 And a portion of the total value consists for the
2 musical works of promotional values in the form of
3 mechanical royalties. And that worked out to 73 cents
4 per CD. And on the right hand side, for every CD that
5 is sold as a result of broadcasting on the radio,
6 there's a promotional value that inures to the sound
7 recording owners of \$1.65 in the form of profits, I
8 guess.

9 THE WITNESS: That's correct.

10 ARBITRATOR GULIN: Now my question is and
11 actually, I think I know the answer to my question,
12 but I want to make sure I know the answer to my
13 question and that is does it matter in this analysis
14 that the mechanical royalty is not a free market rate
15 and therefore the promotional value that is on the
16 left side here, is the result of a statutory license
17 which is not a fair market statutory license, whereas
18 the promotional value on the right side to the sound
19 recording owners is purely the result of whatever the
20 market will bear.

21 THE WITNESS: Right.

22 ARBITRATOR GULIN: In terms of what kind

1 I'm using it for this indirect purpose and for that
2 purpose it's just a given fact.

3 ARBITRATOR GULIN: That's what I thought.

4 I think I have one final question and that has to do
5 with ephemeral copies.

6 Again, I think with respect to your view,
7 I guess it's your view that the rate for ephemeral
8 copies essentially should be zero. I know it's not
9 precisely that, but that's what it's tantamount to, is
10 that you say that there should be no additional
11 compensation paid as a result of a 112(e) license
12 above and beyond what's already been paid for 114.
13 You can divide them up any way you want, but in the
14 final analysis, if you set a rate for 114, then 112
15 should be zero.

16 THE WITNESS: If you set a rate for 114,
17 that is equal to the total value of the performances
18 in a context in which there is no need to get an
19 ephemeral right, pay additional royalties to get an
20 ephemeral right, then the ephemeral right should be
21 free.

22 I'm perfectly happy with an alternative

1 of profits they can reap. Does that make any
2 difference, the fact that one is -- clearly, we're
3 talking about apples and oranges in that respect, but
4 does the fact that we're talking about apples and
5 oranges there have any effect on the analysis?

6 THE WITNESS: No, I understand the
7 question.

8 ARBITRATOR GULIN: Okay.

9 THE WITNESS: In my view, it doesn't
10 really matter because what we're really saying is if
11 we imagined just sort of hypothetically the musical
12 works owners sitting down to negotiate royalties with
13 the radio stations, the mechanical royalty is what it
14 is. And it's for their purposes just a fact that
15 every time a CD is sold they get 73 cents and
16 therefore that matters to them. So the fact that
17 that's not a free market rate for this analysis really
18 doesn't matter.

19 For other purposes that might be quite
20 important. If you were going to try to use that
21 directly to figure out in it's own right how much
22 musical works there were that would be a problem, but

1 interpretation which says my model values the
2 combination of the two rights and you could say the
3 ephemerals constitute a portion of that, but it's not
4 an amount over and above what is paid to effectuate
5 performances in a benchmark world in which there is no
6 payment that needs to be made for ephemerals.

7 ARBITRATOR GULIN: Well, if one tries to
8 think about why Congress would have enacted
9 legislation like this, it would have been much simpler
10 to simply say what you wanted them to say and that is
11 that the 114 right includes the right to make copies,
12 but they didn't do that.

13 THE WITNESS: I expected this question on
14 cross examination.

15 (Laughter.)

16 ARBITRATOR VON KANN: Mr. Katz already
17 knows the answer, the record is clear.

18 ARBITRATOR GULIN: So by having a separate
19 right and directing the Panel to set a separate fair
20 market value for that right, I'm having a little
21 trouble reconciling that with what you're saying.

22 And I guess if one were to look at

1 legislative history, one might come up with some hints
 2 as to why they were separated such as the fear of
 3 leaking, that type of thing. So I guess I'll just ask
 4 you if you have anything else to add to this analysis
 5 as to why you can think that Congress would have done
 6 what it did. And I know that's not your bailiwick
 7 here to construe legal language, but I think it does
 8 go to the heart of your economic analysis, so if you
 9 have any other comments you can share with us.

10 THE WITNESS: I've thought about that and
 11 I don't have a great answer. I think Professor Fisher
 12 from a legislative history perspective has a view on
 13 this which is sensible to me, but as an economist, I
 14 really -- given what I know about how everything
 15 works, I can't see why you'd separate the two.

16 Now it may well be that without straying
 17 too far from my bailiwick, I might suggest that
 18 Congress didn't totally think out how all this was
 19 going to work and what its economic consequences were
 20 when it set up this framework.

21 ARBITRATOR GULIN: You want this on the
 22 transcript?

1 the response is to something that's in my head about
 2 the thesis. And they relate to two main areas, both
 3 of which Judge Gulin has touched on, but I want to
 4 explore a little bit further.

5 The first one is this notion that you, as
 6 you explained to Judge Gulin, have sort of deduced
 7 logically rather than from data, that the economic
 8 value of the performance right in sound recording
 9 cannot exceed the economic value of the performance
 10 right in musical works. I really need to understand
 11 that, because I think that's a fairly critical
 12 foundation to your entire analysis.

13 Now you indicated first of all, as you
 14 thought this through logically you said well, I'll
 15 look at it from the point of view of the buyer and
 16 from the buyer's point of view, according to my notes,
 17 the value of the two is essentially the same. They're
 18 the perfect complement, the right shoe, the left shoe,
 19 you need them both to do the same act. And I'm having
 20 difficulty with that.

21 It seems to me the fact that you need two
 22 inputs to do the same act doesn't tell me anything

1 (Laughter.)

2 THE WITNESS: I don't know. All I can
 3 tell you is when I analyze it as an economist, I can't
 4 find the reason to separate the two.

5 ARBITRATOR GULIN: Thank you. That's all
 6 I have.

7 CHAIRMAN VAN LOON: Judge Von Kann?

8 ARBITRATOR VON KANN: I have some
 9 questions and this may take a little longer than Judge
 10 Gulin's. I'm sorry, but I think you're a very
 11 important witness in this proceeding. I don't want
 12 you to disappear and then for me to think a little
 13 while later why in the heck didn't I ask that?

14 And I want to preface this by saying I
 15 don't want you in any way to take from my questions
 16 that I have any particular view about whether or not
 17 to accept your testimony. I'm simply trying to
 18 understand it and test it a little bit and probe it
 19 and make sure that I can think through with you now
 20 because I'm certain that I'm going to later read this
 21 transcript and try to analyze it and questions will
 22 occur to me. So this is my moment to find out what

1 about their relative value. In the morning, when I
 2 get up to perform the act of driving my car to the
 3 Library of Congress, I need a fuel pump in there and
 4 I need a transmission. The cost of the transmission
 5 is greatly in excess of that of the fuel pump and the
 6 fact that I need two things to accomplish a particular
 7 act doesn't seem to me and that's what I'm having a --
 8 there's a disconnect. So what? You need both things.
 9 How does that lead to a conclusion that they're of the
 10 same economic value?

11 CHAIRMAN VAN LOON: But on a closer
 12 analogy, just to pick up is right on your analysis on
 13 ephemeral, where you say on the rental car, you need
 14 the car and you need the keys. But you're not going
 15 to sit here and argue that the value of each one of
 16 those are necessary, are equal, even though clearly if
 17 you don't have the keys you can't start the rental car
 18 and if you don't have the car, but you have the keys.

19 THE WITNESS: I think the way I approach
 20 this is thinking about this hypothetical willing
 21 buyer/willing seller negotiation and what has come
 22 together in the questions that you've asked are two

1 different concepts. One is what is it worth to the
2 buyer? And the other is what is it worth period.

And those are two different concepts. So
4 I started by what is it worth to the buyer, and I
5 would submit to you, take the car keys and the car or
6 the fuel pump and the transmission. And this is
7 artificial, but if we just think about it
8 hypothetically that if I said to you, "Judge von Kann,
9 I know you want to get in your car and drive to the
10 Library Congress, but I've taken away your fuel pump,
11 and I'm the only one who can put it back in. And how
12 much would it be worth to you at this moment to get me
13 to put it back in?"

14 Or alternatively, I said to you, "Judge,
15 I've taken away" -- this is artificial -- "I've taken
16 away your transmission, and I'm the only one who can
17 put it back in. How much would it be worth for you to
18 put it back in." The question posed that way, just
19 narrowly, what is it worth to you, sort of one side of
20 the transaction, or the keys and the rental car, the
21 answer actually would be the same, because the issue
22 to you is the same -- "Do I get to where I'm supposed

1 to be or don't I?" And that's really all you would
2 care about.

3 That doesn't answer the unqualified
4 question, which is the one we ultimately want to get
5 to of what is the value, period, because that involves
6 an interaction of the buyer's valuation and the
7 seller's valuation. One of the experts, I forget
8 which, earlier in the proceeding talked about, you
9 know, diamonds and water. How can it be that diamonds
10 sell for more than water when obviously we need water
11 more than we need diamonds? It's because the market
12 price is the interaction of supply and demand, and
13 there's a lot of supply of water and a very tiny
14 supply of diamonds.

15 So my comment about left shoes, right
16 shoes, perfect complements, is only the start point of
17 saying from the buyer's perspective, they're the same
18 because they're -- not only are they equally
19 essential, but they're always used in tandem. And I
20 would submit that we don't face it in this way with
21 respect to a fuel pump and a transmission, but in fact
22 the same principle would apply.

1 Now, then we have to take the next step.

2 We have to think about the other side.

3 ARBITRATOR VON KANN: The seller side?

4 THE WITNESS: The seller side.

5 ARBITRATOR VON KANN: I was going to ask
6 you about that.

7 THE WITNESS: Okay.

8 ARBITRATOR VON KANN: Let me break it up,
9 first, with the buyer --

10 THE WITNESS: Can I just finish about the
11 fuel pump and the transmission --

12 ARBITRATOR VON KANN: Yes.

13 THE WITNESS: -- just briefly? I mean I
14 think the point about the fuel pump and the
15 transmission is you're right, their value is not the
16 same. The reason is because on the supply side one
17 costs a lot more to make, and so in the market, even
18 though in some sense the car needs equally both of
19 them, they don't end up having the same value. So
20 that's where that disconnect comes in.

21 ARBITRATOR VON KANN: Okay. Let me ask
22 you about the seller side. You talked there about the

1 fact that --

2 CHAIRMAN VAN LOON: Can I just ask for a
3 second, were you finished on that?

4 ARBITRATOR VON KANN: Were you finished on
5 the buyer side of it?

6 THE WITNESS: I think so.

7 CHAIRMAN VAN LOON: Yes, okay.

8 THE WITNESS: I mean assuming I answered
9 your question, I think I was finished.

10 ARBITRATOR VON KANN: I think you did.
11 Now, you spoke about the seller's perspective on this.
12 You indicated that both the musical works and the
13 sound recording copyright holders are in the same
14 position. They've created a product. Their costs are
15 sunk, their risks have occurred. They're now seeking
16 an incremental use, and there's no significant
17 additional cost for that incremental use, so they come
18 to the negotiation from very similar economic points
19 of view, according to my notes.

20 THE WITNESS: Right.

21 ARBITRATOR VON KANN: Is that about right?

22 THE WITNESS: Yes, that's very good.

1 ARBITRATOR VON KANN: Now, the one thing
 2 that it seemed to me that you left out of that
 3 equation, and maybe this is something I'm
 4 misunderstanding, is demand, as we were just talking
 5 about. Would it not -- let's suppose for the moment
 6 that the Panel could conclude from the evidence we've
 7 heard here that putting aside a few genres, like
 8 probably classical music where people demand Mozart,
 9 not particularly the Chicago Symphony performance of
 10 Mozart, that in general, with respect to the music
 11 that is going out on these streams, the demand is for
 12 particular sound recordings, not for particular
 13 composers. People don't want just any rendition of
 14 "Crazy;" they want Patsy Kline's rendition of "Crazy."
 15 They don't want just any rendition of "My Way;" they
 16 want Frank Sinatra's. They don't want just any "I
 17 Will Always Love You;" they want Whitney Houston.
 18 So whoever holds the copyright to that
 19 particular recording has a very valuable commodity,
 20 and it is because of the particular recording of it as
 21 opposed to the composition of it, which has been done
 22 by several other people and nobody was all that

1 excited. Wouldn't the holder of the copyright and the
 2 sound recording say, in effect -- let's say they're
 3 sitting down -- and we're doing lots of hypothetical
 4 negotiations -- they're sitting down with a particular
 5 webcaster and the webcaster is crying poverty and
 6 saying, "I've got to pay ASCAP, and I've got to pay
 7 you. I can't pay everybody. I've only got so much
 8 money." And the guy from Sony says, "Yes, but I've
 9 got Whitney Houston or I've got whoever it is," you
 10 know. "He's just got Dolly Parton, but I've got the
 11 Whitney Houston record." Why wouldn't the sound
 12 recording copyright holders be able to exploit and
 13 therefore command greater royalties, because the
 14 demand in this area seems to be much more oriented
 15 toward the particular renditions than to the
 16 underlying composition?
 17 THE WITNESS: That's a really good
 18 question. I'm going to answer it. Let me preface my
 19 answer by saying I'm not sure that your premise is
 20 correct, but I'll accept it for the purpose of the
 21 answer, okay? If we were talking about hypothetical
 22 negotiations over individual sound recording

1 performance rights or groups, you know, all of Dolly
 2 Parton's records or a line of music, there is no
 3 question that when you are bargaining over the ones
 4 people really want, you would be able to get more than
 5 the ones people don't want. And it would work both
 6 within sound recordings and between sound recordings
 7 and musical works if your premise that the sound
 8 recordings are worth more is correct.

9 But that's not actually what we're talking
 10 about here. What we're talking about is a blanket
 11 license for any sound recording as compared to a
 12 blanket license for any composition. And it may be
 13 the case that when they broadcast "Crazy" nobody gives
 14 a hoot who wrote that song -- I actually don't know
 15 who wrote it.

16 CHAIRMAN VAN LOON: Willie Nelson.

17 THE WITNESS: Okay.

18 CHAIRMAN VAN LOON: We know from previous
 19 testimony.

20 THE WITNESS: But the legal structure is
 21 such that somebody wrote it, and somebody has the sort
 22 of hypothetical right, if you will, to block that

1 broadcast of Dolly Parton if they don't get paid. I
 2 mean it may be that what the carburetor does in some
 3 physical sense is subsidiary to what the transmission
 4 does -- or it was the fuel pump that you had, whatever
 5 -- in the car. But if you can't start the car without
 6 it, you know, at that point of valuation, it really
 7 does take the same status.

8 So I think that if we had my hypothetical
 9 world in which we really built up the blanket license
 10 by adding up the value of all of the underlying rights
 11 plus a processing fee for being the aggregator and the
 12 administrator, you know, surely the more valuable
 13 things would get more money. And that will happen, to
 14 some extent, on this side just because within the
 15 sound recordings presumably it gets performed more
 16 often and so forth.

17 But given the structure that Congress has
 18 given us of valuing these blanket licenses on the one
 19 side or the other where they're both needed, I don't
 20 think, as a matter of economics -- and I'm not making
 21 a philosophical or, you know, kind of aesthetic
 22 judgment here about value. I'm just analyzing the

1 economic consequences of sort of thinking about
2 willing buyer/willing seller. I think you do get to
3 this equality, and it may be unfair to Dolly Parton
4 and Frank Sinatra, but I think it is what economics
5 would give you.

6 ARBITRATOR VON KANN: One last question in
7 this area, and then I'll move to another. You drew
8 your model starting with the basis of -- your
9 calculation of a rate starts with the royalty rate for
10 musical works for over-the-air broadcasts. Now, the
11 thing that -- well, it strikes me in some ways as
12 problematic to start deriving the royalty rate that we
13 need to from a realm where one party, the musical
14 works copyright holder, gets a royalty. The other
15 guy, the sound recording rights holder, doesn't. So
16 already we're starting in a realm that is the opposite
17 of the one that we have to get to at the end.

18 And what you didn't look at, or at least
19 I didn't hear you discuss much, the fact that there is
20 another realm where they do both share, and that is
21 the sale of records. And we had your two bars up
22 there, and we know that when a particular record is

1 THE WITNESS: Thank you. I think the more
2 important reason, though, actually, is that it's about
3 something different. It's not about the right of
4 public performance; it's about selling copies. And
5 there all of the considerations that the RIAA wants to
6 bring to bear with respect to the performance where I
7 think they're irrelevant do in fact apply. The fact
8 that it costs a lot of money to make a record, in
9 equilibrium, the market for records has to reflect
10 that.

11 And so what you're seeing, I think, in the
12 market for records, even if you didn't have the
13 statutory anomaly, I suspect that you would observe
14 anyway that the record companies and the artists make
15 more from the sale of each CD than the composer
16 because in economic equilibrium they have to recover
17 the costs of making those things, and it's expensive.

18 But that's a different market than what
19 we're talking about here. What we're talking about is
20 not the market for the copies, the records; we're
21 talking about the market for a right of public
22 performance, which, for the reasons we've already

1 sold, in fact the record companies derive
2 substantially greater profit from that than the
3 copyright holders in musical works.

4 And I'm trying to think through whether
5 that's really consistent with the notion that they are
6 of equal value. Why don't I look at the real world
7 and say, wait a minute, when a given record is sold,
8 it takes away the lion's share of that sales proceed?
9 It ain't the musical works holder. Why isn't that
10 somewhat contra-indicative of your thesis?

11 THE WITNESS: I think there's two reasons,
12 one more important than the other, but I'll start with
13 the one that I was discussing a minute ago with Judge
14 Gulin, which is that the mechanical royalty for the
15 composers with respect to the CDs is a statutory
16 royalty, so it doesn't necessarily reflect the market
17 -- what market forces would produce. But I think the
18 more important --

19 ARBITRATOR GULIN: Well, it's a statutory
20 royalty where the criterion is not fair market value.

21 THE WITNESS: Fair enough.

22 ARBITRATOR GULIN: Okay.

1 talked about, I think is therefore incremental and
2 bears a different relationship in terms of the supply.

3 ARBITRATOR VON KANN: Are you familiar
4 with other areas in which -- and nothing immediately
5 springs to mind, so I can't give you an example --
6 where the holders of two different intellectual
7 property rights -- I suppose they could be copyrights
8 or patents or something else -- for which there are
9 various subsidiary rights, are, with respect to some
10 of those rights, equal, and with respect to others,
11 quite disparate? Do you follow my question?

12 THE WITNESS: I do, I do. It's a good
13 question.

14 ARBITRATOR VON KANN: Is that an unusual
15 thing? I would have thought, but it may not be true,
16 that one would expect sort of the same relationship to
17 apply to the different kinds of bundles of rights that
18 each holder could exercise, but that may not be
19 correct.

20 THE WITNESS: Well, I'd like to think
21 about that some more, and if I come up with more,
22 you'll hear about it. Off the top of my head, let me

1 give you one possibility. If we think about, for
 2 example, patented drugs, I think what you would find
 -- this is a crude generalization -- that when a new
 4 drug is patented and is sold under brand name while
 5 the patent is in force, there's a wide variation in
 6 prices among different drugs. Basically, they have a
 7 monopoly on a particular chemical compound, and they
 8 price it to the maximize the monopoly profit. So they
 9 charge more for things that people really need and
 10 where there are no substitutes and so forth.

11 Once the patent expires and there's
 12 competition, all of them kind of drift towards a more
 13 similar price, which is related to the marginal cost
 14 of making another pill. So I don't know that it's a
 15 perfect analogy, and I admit, I just thought of it off
 16 the top of my head, but that would be a situation
 17 where sort of in the first instance I price to recover
 18 my costs and more if I can get a monopoly. But then
 19 in subsequent uses, I may well price it something more
 20 like marginal cost, which may be equal across
 21 different --

22 ARBITRATOR VON KANN: It strikes me as

1 more of a explanation of the salutary effects of
 2 competition than it is --

3 THE WITNESS: Yes. Maybe it's not the
 4 best analogy.

5 ARBITRATOR VON KANN: Okay. Let me turn
 6 to the other area, which is the famous --

7 CHAIRMAN VAN LOON: Before you switch to
 8 the other area, could I just follow up a little bit on
 9 this? You've attributed the difference in the cost
 10 per CD to 73 percent and the 165, for example, to the
 11 difference in cost. There may be some in price right
 12 there as well.

13 THE WITNESS: The old technology.

14 CHAIRMAN VAN LOON: Right. But could part
 15 of it also be attributable -- if we go back to either
 16 the judge wanting to get here in the morning and he's
 17 got to get his car started or the others, those are
 18 all situations where you've posited, essentially --
 19 you've got something to do, you've got to do it right
 20 now. I need both of them right now. And where the
 21 time element is critical to the negotiation.

22 Whereas if we move from the theoretical

1 world either to the world of how you get your car or
 2 how you put together the right for performing rights,
 3 it's really a matter of business structure and of
 4 sequencing. Before we get the record, you're going to
 5 go and have a negotiation or there's going to be a
 6 certain context and a certain market that creates a
 7 certain price for the works. And it could be earlier
 8 or it could be later but a different time, a
 9 negotiation and a structure and where the demand, the
 10 competitors, the market is different. And, similarly,
 11 when you're buying the car, obviously --

12 THE WITNESS: Yes.

13 CHAIRMAN VAN LOON: -- I mean if you go to
 14 a repair shop, you might go one place for the pump and
 15 the other place for the transmission. But even coming
 16 back to this, I mean why -- I'm still having a lot of
 17 trouble really understanding why they're equal.

18 THE WITNESS: Let me try and let me deal
 19 with this timing issue, because I actually think that
 20 that -- I may have misled you with my analogies.

21 Because when I posited the judge needing to get here
 22 right now and I'm the only who can do it, that was an

1 artificial way of reproducing a situation where,
 2 basically, the buyer needs what I've got, and I'm the
 3 only one who can provide it. I don't actually think
 4 the timing issue is essential to that. That was just
 5 kind of a way of cooking the example to sort of create
 6 that, "He's got to deal with me, and he doesn't have
 7 other alternatives."

8 Which the way Congress has set up the
 9 statutory license regime and frankly the way the de
 10 facto regime has evolved under the consent degrees on
 11 the musical works side, we've developed this model of
 12 blanket licenses, and there are transactions costs
 13 reason why we've done that, which we've talked about.
 14 But whatever that is, we've developed that world of
 15 blanket licenses. And in each case, there is only one
 16 party that can give you the blanket license that you
 17 need. In the RIAA, it's RIAA. On the musical works
 18 side, there's both ASCAP and BMI, but you really need
 19 them both. So it's not fundamentally different.

20 So I don't think the timing is essential.

21 What's essential is that the buyers are the only ones
 22 -- the buyers need this stuff, and the sellers are the

1 only ones who can provide it. And the buyers are an
2 important -- no, strike that; that's not really
3 important. So that we've got this necessity of
4 dealing with the owner -- the party that's able to
5 deliver the blanket license.

6 Now, there may be something to the time
7 issue in what you've suggested in that I think it is
8 -- I do share your intuition that when intellectual
9 property is created, whether it's a record or a book
10 or a movie, there's a sense in which the creators look
11 to the initial forms of sale of that as their primary
12 mode to recover the costs of making it. And then they
13 subsequently do think about, you know, you license the
14 movie overseas, the book comes out as paperback. You
15 know, there are these sort of subsidiary applications,
16 if you will, of the initial creation, which do have
17 this flavor of being more incremental.

18 So I think there is something to that
19 intuition that probably fits here in a fairly general
20 way. And I guess what I'm saying is that, to be
21 clear, I can't -- I'm not predicting the outcome of
22 this hypothetical negotiation in a concrete way. All

1 I'm saying is to me it seems like the buyers come in
2 with the same valuation for both, if we imagine two
3 parallel negotiations, and the sellers come in from a
4 similar economic position so that I would expect, sort
5 of on average, in some sense, similar outcomes.

6 And maybe what you're saying is that one
7 way to think about the similarity of the position of
8 the composers and the record companies and artists is
9 that in both cases what we're talking about is one of
10 these down-the-line applications of their original
11 creation of intangible property or intellectual
12 property. And I don't think that's inconsistent with
13 kind of the way I set it up.

14 CHAIRMAN VAN LOON: I'm thinking about it,
15 actually, a lot more fundamentally in terms of the way
16 that the scheme's been set up. Because the other
17 dimension of time is that we have these two elements
18 and the way that Congress has set it up is in fact the
19 time frame for negotiating the value in musical works
20 is here, has been here, it goes back a long time, and,
21 in essence, as you say in your testimony, we've got to
22 market over 50, 70 years, whatever it is that has come

1 to that number. Now, all of -- and so maybe the car
2 has a transmission or maybe it has a fuel pump.

3 Now, there's a new ball game. There's a
4 new thing coming on top of that that has to be added,
5 and, at least arguably, it's the last little old
6 lady's house in the tract that the developer wants to
7 buy for the mall, I mean at least in theory.

8 THE WITNESS: Right.

9 CHAIRMAN VAN LOON: Other things are in
10 place. It's something now that needs to be added, and
11 it's being done in a fundamentally different time
12 frame.

13 THE WITNESS: But, see, that's where I
14 come back to the fair market value concept. I mean if
15 Congress had wanted to allow the owners of the sound
16 recordings to act like the little old lady who owns
17 the last house that's needed and get the whole value,
18 they could have done that. They could have created
19 the new right but not created a compulsory license, in
20 which case none of us would be here, and I believe
21 that RIAA would have successfully negotiated licenses
22 at fees at least as high as the ones that they've

1 actually negotiated. I don't believe that the result
2 would be that we would have no webcasting, but I think
3 we'd have a lot of less, and that's not what Congress
4 did. Congress said, "I want a fair market value on
5 that last piece."

6 So then -- I started to say "we," I guess
7 it's really you have the hard problem of figuring out
8 what is that value? And to me, you want to --

9 CHAIRMAN VAN LOON: That's actually a
10 "we," because we're relying on a lot of insight and
11 thoughts in helping us, from you and from the other
12 people in this room, to help get us there.

13 THE WITNESS: Sure. I was being flippant.
14 I think it's essential when you're solving that
15 problem of fair market value to eliminate the element
16 of holdout of the last crucial piece, and to render
17 that last piece on the same terms as all the other
18 pieces. I mean that that's the essence.

19 CHAIRMAN VAN LOON: Let me interrupt you
20 there, because you're right. And in my example, I may
21 have done the same thing that you did in your
22 hypothetical when you said, "I'm the last -- I'm the

1 person --

2 THE WITNESS: Okay, fine.

3 CHAIRMAN VAN LOON: -- the last one
4 standing now." I mean I threw that. At the end, we,
5 clearly, it's not a holdout situation, it's not that,
6 but it is a matter of sequencing in time between
7 setting the economic value for these two rights and
8 one coming along after the other one, for all
9 practical purposes, as has been.

10 And while you're thinking of that, I want
11 to just throw in the same caution that Judge von Kann
12 did, and that is we're working on a lot of these ideas
13 and nowhere near making up our mind on anything, but
14 we're trying to probe and understand each direction.

15 THE WITNESS: And, look, I don't think
16 there are any absolute airtight answers to any of
17 these questions, but my view would be that the fact
18 that we're coming along at this later point in time
19 that nonetheless what you want to do is attempt to
20 sort of remove that from the analysis and render the
21 sound recording right -- sound recording performance
22 right a treatment that is sort of the same, if you

1 CHAIRMAN VAN LOON: Are we all here?

2 Before we move on to the statutory interpretation area
3 that Judge von Kann wants to ask you about, there was
4 one other question that I had related to the
5 comparable value of the performance right and the --
6 I'm sorry, the performance right in works versus
7 recordings. And if you wanted to look at your
8 testimony, page 19, there's two different places there
9 on that page. The first is up at the top of page 19,
10 I guess, the first full sentence, "Nonetheless, the
11 fees paid to ASCAP and BMI constitute the upper
12 bound." And then, again, sort of the last full
13 sentence on that page, "All available evidence that
14 indicates that, all else equal, the righted issue in
15 this proceeding should command a lesser performance
16 royalty than the works right."

17 ARBITRATOR VON KANN: Mr. Chairman, be
18 sure you keep your voice up, please.

19 CHAIRMAN VAN LOON: Fair enough. First of
20 all, even though that assertion's in there and it
21 comes several other times, am I right in
22 understanding, as a practical matter, given the two

1 will, as the treatment of other rights, other goods,
2 other inputs, and attempt to think about this sort of
3 fair market value.

4 Now the question is how do you do that?
5 And I think it is hard. I do think that the musical
6 work -- look, if we had great market data on sound
7 recording performance rights for fair market values,
8 I wouldn't be doing this. It's just we don't have it
9 because it is a new right, and so we've got to look to
10 something else and then think about what we think
11 their relationship is to the other.

12 CHAIRMAN VAN LOON: You want to take some
13 different direction.

14 ARBITRATOR VON KANN: Should we go or
15 should we break?

16 CHAIRMAN VAN LOON: Why don't we take a
17 ten-minute break, bathroom stretch? It does feel,
18 somehow, I think, Denise got the air conditioning
19 moderated, so --

20 (Whereupon, the foregoing matter went off
21 the record at 3:38 p.m. and went back on
22 the record at 3:53 p.m.)

1 bars in the analysis that you used, you've treated
2 them as equal even though you've asserted the one is
3 less?

4 THE WITNESS: Except for the adjustment
5 that I've made for the difference in promotional
6 value.

7 CHAIRMAN VAN LOON: Right.

8 THE WITNESS: The point that's being
9 addressed here is the market power that's probably
10 present in the benchmark setting so that we're
11 actually comparing not to a reasonable fee but to a
12 fee that may be above a reasonable fee. That's the
13 upper bound concept, but I haven't made any attempt to
14 reduce it to reflect that.

15 CHAIRMAN VAN LOON: Yes. Well, that
16 really gets to the heart of my question, which is I
17 see on the previous page, on 18, you talk about the
18 fees being collectively negotiated by ASCAP and BMI as
19 being significantly in excess of the reasonable level.
20 That's your words here. But is that the sole basis?
21 Is there any other basis for the analysis that the
22 works right is more valuable, putting aside the --

1 THE WITNESS: I understand the question.

2 CHAIRMAN VAN LOON: -- European
comparable, I mean that whole thing, in your analysis?

4 THE WITNESS: Just to be clear, what I'm
5 saying is if we knew the reasonable, in my language,
6 the competitive market royalty for the musical work,
7 if God told us that --

8 CHAIRMAN VAN LOON: Okay.

9 THE WITNESS: -- then my view would be
10 they should be equal. I'm not saying one is greater
11 than the other. They should be equal, if we really
12 knew the competitive market fee for the musical work.

13 CHAIRMAN VAN LOON: Okay.

14 THE WITNESS: But we don't know that;
15 we've got a benchmark. And so we're working from that
16 benchmark to the reasonable fee for the sound
17 recording performance right, and I'm worried about
18 aspects of that benchmark and various aspects of the
19 relationship of that benchmark to our current
20 situation. So, okay, I should be more precise. If we
21 really -- if God told us the value of the musical work
22 in this context, that is on the Internet --

1 court, and the other is that when we think about this
2 willing buyer/willing seller on the Internet as
3 opposed to over the air.

4 So this is an issue of Internet versus
5 over the air, not an issue of musical work versus
6 sound recording, I think, that the statutory factors
7 of cost and risk and so forth might well affect that
8 willing buyer/willing seller negotiation so that the
9 webcasters who are struggling to make a buck might not
10 be willing to pay as much as the established over-the-
11 air radio stations who know that they can make money
12 off of this.

13 But all of those are not things I have
14 tried to adjust for. I've just put them out there for
15 you as reasons why I think that our analysis is
16 conservative, and I think suggesting that to the
17 extent that there may be some things on the other side
18 that I couldn't take account of, you know, perhaps
19 they balance.

20 CHAIRMAN VAN LOON: And so if we were
21 going to perpetuate a blasphemy that God, in this
22 instance, is Congress and so the world that we have

1 ARBITRATOR VON KANN: Could you get him to
2 tell me the royalty too, by the way?

3 (Laughter.)

4 But not till January 27. If he could fax
5 an opinion along with it, that would be also very
6 helpful.

7 MR. KATZ: There's nothing in the statute
8 about reliance on revelation, Judge von Kann.

9 THE WITNESS: Okay. So if we knew the
10 value of the musical work on the Internet, the
11 reasonable fair market value of a musical work on the
12 Internet, I would say equality.

13 CHAIRMAN VAN LOON: Okay.

14 THE WITNESS: The upper bound language
15 comes in not at that conceptual level but with
16 reference to my specific benchmark, which is not the
17 reasonable fee for a musical work on the Internet.
18 It's the actual fees paid in the over-the-air radio.
19 And I believe that there are some reasons why that is
20 too high as a benchmark, and that's where the upper
21 bound concept comes in. One of those reasons is the
22 imperfect discipline of market power of the rate

1 that at least this Panel has to struggle with the
2 givens from on high, as what Congress has dictated
3 and/or the whole system of government, in this case
4 the rate court, that would say that whatever these
5 numbers are negotiated by ASCAP, BMI, and SESAC, those
6 are the numbers. And in that context, you wouldn't
7 adjust it up or down for market power? You would say
8 that's the number that God's told you, and so at least
9 in that framework the value of the performance right
10 and the recordings would be equal to those numbers as
11 opposed to something less than those numbers but
12 before you control for the promo value and all that?

13 THE WITNESS: Yes. I think you could look
14 at it that way.

15 CHAIRMAN VAN LOON: Okay. We have some
16 additional questions in another area.

17 ARBITRATOR VON KANN: Yes. I'd like to --
18 my last area, but I've got several questions there,
19 has to do with this famous sentence: "In establishing
20 rates and terms for transmissions by eligible non-
21 subscription services, new subscription services, the
22 Copyright Arbitration Royalty Panel shall establish

1 rates and terms that most clearly represent the rates
 2 and terms that would have been negotiated in the
 3 marketplace between a willing buyer and a willing
 4 seller." We've alluded to that from time to time.
 5 There are certainly other parts of the
 6 statute that are very important. I don't want to
 7 slight them, but for the moment I want to focus on
 8 that sentence. And I want -- you've talked somewhat
 9 about the kind of marketplace that you think the Panel
 10 should be looking at in carrying out the dictates of
 11 that provision. And I want to make sure I understand
 12 what you are counseling us in this regard.
 13 First of all, I think you have said that
 14 it is important that we try to -- I'm trying to come
 15 up with the right word -- imagine? No. Hypothecate?
 16 Maybe. We try to put ourselves in the setting, as
 17 much as we can, of a truly competitive marketplace,
 18 which means, number one, we eliminate the RIAA's power
 19 to negotiate the deal on behalf of all record
 20 companies, because that's just too much market power,
 21 and it will distort the marketplace, correct?
 22 THE WITNESS: Or we imagine multiple

1 RIAs, all of whom are competing to do that. That
 2 would be an alternative way of thinking about it.
 3 ARBITRATOR VON KANN: Okay. I think you
 4 said that you're not prepared to say today that the
 5 five major labels would have that same effect. You
 6 think they maybe well would but that at least we're
 7 taking the RIAA out as the sole person you go to to
 8 get one of these licenses, right?
 9 THE WITNESS: Yes.
 10 ARBITRATOR VON KANN: And I think you also
 11 said, in answer to a question from Judge Gulin, that
 12 we also take out the compulsory license, because it
 13 also distorts the marketplace, correct?
 14 THE WITNESS: Yes.
 15 ARBITRATOR VON KANN: So this marketplace
 16 that I'm going to imagine is one in which individual
 17 webcasters would be negotiating with individual record
 18 companies without a compulsory license in the picture,
 19 correct?
 20 THE WITNESS: Well, I guess the difficulty
 21 I have with formulating it that way is that we need to
 22 address how we're going to think about the

1 consequences of the transactions costs in that market.
 2 So I think there's two ways you could think about
 3 that, and, again, this is conceptual or hypothetical.
 4 One is that negotiating with the five labels --
 5 ARBITRATOR VON KANN: And other
 6 individuals.
 7 THE WITNESS: -- and other individual --
 8 independents and so forth, and we'll presume, although
 9 I have some reservations on this, that that's a big
 10 enough number that they do effectively compete. And,
 11 and this is the hard part, that webcasters are able to
 12 get all of the rights that they need in a framework in
 13 which the labels are truly competing against each
 14 other. And what that means is that I, as a webcaster,
 15 need to be in a position that if you, Record Label
 16 Number One, won't offer me a reasonable deal, I can go
 17 instead to Record Label Number Two and get what I
 18 need. If I, as a webcaster, as a practical matter,
 19 need both of you, then negotiating separately with all
 20 five of you, in even the absence of the RIAA, is not
 21 going to produce a competitive market outcome, because
 22 I need all of you, and so I can't play you off one

1 against the other. I don't get the benefits of
 2 competition. That's why I hypothecated, to use --
 3 that's probably not a word -- this notion of --
 4 ARBITRATOR VON KANN: Hypothesized, is it
 5 not?
 6 THE WITNESS: I hypothesized this notion
 7 of a world in which you have multiple competing RIAs
 8 or multiple competing aggregator agents who are each
 9 in the business of licensing the complete package of
 10 rights, which they get, in turn, from the underlying
 11 rights holders. If you had that, then you'd really
 12 have competition, because if you, RIAA Number One,
 13 won't give me a reasonable deal, I'll just go to
 14 Number Two, and I can get what I need from them,
 15 because they've got it all too. And that would be
 16 truly a competitive market.
 17 And in that market, the underlying rights
 18 holders would get the value of their contribution; and
 19 these aggregators would get just a fee for basically
 20 the aggregation function, if you will, or the
 21 coordination function that they're performing. I
 22 don't think you replicate that by just saying no

1 statutory license, no compulsory license and go
2 negotiate separately with the five record companies,
3 as long as there's a significant number of webcasters
4 who truly need either all of the repertoire or a large
5 portion of the repertoire in order to do what they
6 want to do.

7 ARBITRATOR VON KANN: That was what
8 Congress was content to let the webcasters do for
9 interactive services, right?

10 THE WITNESS: That's my understanding,
11 yes.

12 ARBITRATOR VON KANN: That's the deal.
13 You can either get your license with as many labels as
14 you can strike a deal with or you don't. I guess I'm
15 wondering how -- it strikes me, frankly, as difficult
16 to construe this sentence as having Congress ask us to
17 imagine that the two industries we're dealing with are
18 not the way they are.

19 We're not -- I think you're almost
20 suggesting that to carry this out we'd have to sort of
21 break up the five major record companies and impose
22 some kind of regime in which everybody out there who

1 had a significant repertoire had to give the
2 webcasters a license that somehow isn't a compulsory
3 license. I just -- I can't fathom that. It seems to
4 me what Congress did was they set up two regimes, one,
5 the interactive service. There ain't no compulsory
6 license. If you can get a deal, you can get a deal;
7 if not, you're out of luck. And then for this area,
8 we'll make it a compulsory license, but, Panel, try to
9 come up with a rate that's pretty much what would have
10 happened out there in the world in a willing
11 buyer/willing seller marketplace. It seems to me
12 unlikely that they meant to reconstitute the cast of
13 sellers and buyers. So I'm having a little difficulty
14 with the notion --

15 THE WITNESS: Well, I can sympathize with
16 that. And, you know, as I said, this is more my
17 starting point for thinking about it. I've actually
18 proposed to you a way of getting to an answer that
19 doesn't really require you in any mechanical way to go
20 there.

21 I guess the way I think about the analogy
22 to the interactive situation is that if you were to

1 think about your task as replicating what would occur
2 in a circumstance similar to the interactive
3 situation, then I have a hard time understanding why
4 Congress would go to all the trouble to create a
5 compulsory license in an Arbitration Panel if what
6 they hoped to do was to replicate what would happen if
7 they just let people make deals without a compulsory
8 license. Because they clearly showed that they know
9 how to do that.

10 And they made a decision, it seems to me,
11 to treat this situation differently, I think, because
12 -- and I'm only giving an economic interpretation of
13 this; I'm not reading legislative history or anything
14 like that; I'm just giving an economic interpretation
15 to it -- in the interactive framework, it's much more
16 plausible that what somebody could do would be a very
17 targeted kind of business where they only need to deal
18 with one or two licenses and create a particular kind
19 of service.

20 Whereas if we're going to do this broad
21 thing of streaming, particularly if it's
22 rebroadcasting or if it's streaming stuff that is

1 already being broadcast over the air that has this
2 property of using many different sound recordings,
3 that that one-on-one negotiation was not likely to be
4 practical so they sort of -- they kind of twiddled
5 with two things in parallel. They said that one-on-
6 one negotiation isn't likely to be practical, so we'll
7 create a compulsory license with one licensor sort of
8 to get an efficient way of doing that. But we
9 understand that when we do that we create a danger of
10 market power, so we'll create an arbitration
11 proceeding to make sure that the rates don't reflect
12 market power.

13 I mean I understand your reluctance to get
14 too theoretical in terms of what Congress is thinking
15 about that. I put that forward really just as a
16 background against which I think you should think
17 about your task more than a technique you can use to
18 really answer the question.

19 ARBITRATOR VON KANN: Let me then ask you
20 something which, to my knowledge, no witness has yet
21 addressed in this hearing that I can remember; maybe
22 I missed it. And that is the question of when does

1 this hypothetical negotiation occur? And I'm going to
 2 throw out a hypothesis to you, which is the following:
 3 That it occurs very soon after October of 1998,
 4 because that's when the law took effect, and if there
 5 is no compulsory license, then these folks have no
 6 webcasting business until they get agreements. So
 7 they would be eager, I would think, to sit down with
 8 the various record companies quickly and have this
 9 negotiation and try to reach agreements so that they
 10 can get their businesses up and running.

11 And so my question to you is, isn't the
 12 most logical construction of this negotiation that
 13 we're supposed to posit is that it's not one that
 14 occurs in August of 2001 or probably even 2000; it
 15 occurs in late 1998 or perhaps early 1999 in order for
 16 these services to get rolling? Does that make sense?

17 THE WITNESS: Yes, I think it does. I
 18 might think that since they created sort of these two-
 19 year periods that you were to address, perhaps you
 20 would think about there being one negotiation the
 21 beginning of the first period and a second negotiation
 22 the beginning of the second period. But I don't have

1 a strong view on that. I think that highlights why
 2 it's important, at least I think, in terms of
 3 accomplishing the objectives, to take the market power
 4 out of the picture, because these parties, in the
 5 absence of a compulsory license in 1998, as you say,
 6 really needed this license. If there were a
 7 competitive market, lots of different people competing
 8 to offer them that, they would quickly do a deal with
 9 one of them and get going. If there's not a
 10 competitive market, then they're kind of held up and
 11 potentially the market power becomes a problem.

12 ARBITRATOR VON KANN: Certainly, it seems
 13 to me, at least I think it does, to make sense, in
 14 thinking about this hypothetical marketplace, that we
 15 have to imagine and try to divine what rates would
 16 have emerged from it, that you take out the RIAA's
 17 monopoly power, and you take out the compulsory
 18 license, both of which are major market distorting
 19 events. So I agree with you about that.

20 Now, the third thing I wanted to ask about
 21 is -- I alluded to it a little bit earlier -- this
 22 notion of a willing buyer and a willing seller. And

1 let me ask you some questions about that that have
 2 occurred to me and see if you can help give me some
 3 guidance. It seems to me, see if you agree, that a
 4 record label in this hypothetical marketplace
 5 negotiation, would probably give a better price to a
 6 Yahoo or a Clear Channel or an AOL because of the
 7 number of royalty-generating performances that such
 8 big players could deliver. If I can get a deal with
 9 Yahoo, if it's going to produce, I don't know how
 10 many, tens of thousands or maybe millions of
 11 performances against which my royalty is going to be
 12 multiplied, I'm probably willing to give them a better
 13 rate than I give some fairly small webcaster from whom
 14 I'm not going to get all that much royalty. Why
 15 should I bend over backwards for this guy? Also, the
 16 Yahoos and AOLs of the world have got more market
 17 power in many ways.

18 So my assumption is that if one of these
 19 negotiations is with a webcaster who's a big player,
 20 they're probably going to walk away from the table
 21 with a better price than little mom and pop webcaster
 22 who are barely holding on on the periphery. Does that

1 make sense from an economic point of view?

2 ARBITRATOR GULIN: Judge von Kann, let me
 3 clarify for my own mind. Are you talking about in the
 4 context of the negotiations that took place prior to
 5 the Panel?

6 ARBITRATOR VON KANN: No.

7 ARBITRATOR GULIN: Or you're talking about
 8 the absence of --

9 ARBITRATOR VON KANN: I'm talking about
 10 this negotiation.

11 ARBITRATOR GULIN: Okay. I get you.

12 ARBITRATOR VON KANN: The negotiation
 13 between this willing buyer and the willing seller --

14 ARBITRATOR GULIN: That would have taken
 15 place.

16 ARBITRATOR VON KANN: Right, that would
 17 have taken place. And I'm assuming that if Warner
 18 Music Group gets a call from Yahoo and says, "We'd
 19 like to sit down and get one of these licenses," that
 20 the people at Warner are going to jump, and they're
 21 going to go into that negotiation with enthusiasm. I
 22 think Warner's perhaps a complicated example, but

1 let's take Sony for the moment, Sony. And that at the
2 end of the day Yahoo is likely to walk out of the door
3 with a better price than XYZ small webcaster got the
4 day before.

5 THE WITNESS: Well, I guess I think your
6 analysis, as a description of negotiations, probably
7 has a lot to it. I guess my view would be, for the
8 reasons I've articulated, I'm sort of giving a more
9 complicated economic interpretation to this language,
10 which is based in part on the other language in the
11 statute and on legislative history and in part on
12 economic analysis, which connect it to a competitive
13 market.

14 And in a competitive market, the big guys
15 don't necessarily get better deals than the little
16 guys because competition among the possible providers
17 tends to drive everyone's price down. Now, there may
18 be some element of volume discounts and so forth that
19 persists even in a competitive market, but I think it
20 would be much less than what you are accurately
21 characterizing in terms of a literal bargaining
22 situation between real buyers and real sellers.

1 competitive market the big guys don't tend to get
2 better deals, but we all know Wal-Mart negotiates a
3 volume price, and that's how they drive the moms and
4 pops out of business. I mean isn't that the real
5 competitive market? And so the point that Judge von
6 Kann is making is there in spades? The big car
7 dealers, if they've got a volume of 1,000 chevys a
8 month, they get different numbers from the factory,
9 and they sell cars at less than the small dealership.

10 THE WITNESS: Well, what a lot of that
11 reflects, though, is that markets aren't all
12 competitive. I mean the automobile market is
13 certainly not competitive in the economic sense. You
14 have a relatively small number of sellers who have a
15 degree of market power. Wal-Mart certainly does get
16 preferential deals for branded goods where the seller
17 also has market power, and there's sort of this
18 negotiation going on. When they're buying, I don't
19 know, lumber to build a new store, they may get a
20 better deal than you or I do just going to the lumber
21 yard, but they don't get a better deal than any run of
22 the mill contractor who actually uses a reasonable

1 ARBITRATOR VON KANN: Here's what I'm
2 trying to wrestle through: The statute sort of
3 implies that a willing buyer -- pick any one, they're
4 all the same, it makes no difference -- and a willing
5 seller -- pick any one, who cares -- they'll sit down
6 and an hour later we'll have a price. Well, that's,
7 you know, naive. There are many different kinds of
8 buyers, many different -- I guess there's a difference
9 between what the major label might be able to get out
10 of a deal versus an independent. And we've talked
11 about the fact that some buyers might have a great
12 interest in certainty and time. They want an
13 agreement now. Others are prepared to sit back.

14 So it seems to me that in thinking about
15 these negotiations, there would probably be, if there
16 were in fact many different negotiations, there'd be
17 various rates that would emerge from those. I
18 wouldn't expect them to be identical, would you?

19 THE WITNESS: In actual negotiations,
20 probably not, no.

21 CHAIRMAN VAN LOON: Can I just -- on that
22 one, I mean you just said a minute ago, in a true

1 amount of lumber. So part of that reflects non-
2 competitive situations, although I wouldn't deny that
3 there is some element of volume pricing that persists
4 even in competitive markets.

5 ARBITRATOR VON KANN: Here's what I'm
6 trying to figure out, in a sense. I'm assuming -- and
7 it may not be true, we'll have to see what the total
8 evidence shows -- but that this is -- the web
9 streaming industry is one not unlike a lot of others
10 we see on the scene today in which some -- a handful
11 of large players are basically trying to stake out
12 substantial market share and prominence and
13 visibility, and probably either absorb a lot of the
14 small players through mergers or acquisitions or drive
15 them out of business so that at the end of the day, as
16 in so many other areas, including the record industry
17 itself and movies and newspapers and many, many --
18 we're looking at a much smaller number of players down
19 the road. And everybody seems to say, to some extent,
20 this is probably going to happen.

21 And then in that context a buyer, like an
22 AOL or a Viacom or a Clear Channel or an MTV, may be

1 prepared to pay and have the resources to pay more
 2 than a small operator, because it's part of its
 3 strategic plan to basically establish market share and
 4 drive other people out. So on the one hand, a big
 5 player might be prepared to pay, in effect, more than
 6 fair market price. I'll double that price -- I won't
 7 double it, but I'll increase it by ten percent,
 8 because I know these other guys can't afford that, and
 9 they'll fold, and they'll crumble.

10 And at the end of the day, I'll pick them
 11 up. I'll pick up their listeners and their business.
 12 I can afford it. I've got enough resources behind me
 13 to pay a little bit more than the fair market price.
 14 Is that a phenomenon that you would think would go on
 15 in this hypothetical marketplace that we're trying to
 16 imagine, that some of the bigger players might, in
 17 effect, overbid the price?

18 THE WITNESS: So I guess you're asking me
 19 a hypothetical about my hypothetical.

20 ARBITRATOR VON KANN: Right.

21 THE WITNESS: I guess I've constructed the
 22 hypothetical for a purpose, which is to try to think

1 you can give me is assuming that I were to try to
 2 carry out this mandate of the statute, I think that
 3 one could conclude on this evidence, perhaps, that
 4 there would be a range of royalty rates that would
 5 emerge from these negotiations probably, because a
 6 number of factors. Some buyers were really eager to
 7 get this thing now, others a little less so. Some
 8 have greater resources, others have less. Maybe some
 9 can deliver volume, a lot higher number of listeners,
 10 and they'll get a little break. It could be a lot of
 11 different factors which would cause variations among
 12 the rates that might emerge from these negotiations.

13 And the question is how do you figure out
 14 where in that range is the one that's a willing buyer
 15 and willing seller that Congress had in its head and
 16 that we should then enshrine as the marketplace rate,
 17 the single, sole marketplace rate that everybody needs
 18 to pay, putting aside for a moment the question of
 19 distinguishing different kinds of services, which is
 20 another complication, but for the moment, I think
 21 within even the same kind of service, there would
 22 likely be in the real world a series of results. How

1 about how to effectuate what I see as the policy goals
 2 of this kind of statute. I don't think that it would
 3 make sense to construe the structure for thinking
 4 about accomplishing the goals of this objective as one
 5 in which we're going to allow sort of, in effect,
 6 anti-competitive behavior, because what you've
 7 described is essentially anti-competitive behavior.
 8 That doesn't mean it's necessarily morally
 9 reprehensible or anything, but it is intrinsically
 10 anti-competitive behavior.

11 I think that the policy purpose of the
 12 statute, as I've said, is to try to sort of get the
 13 benefits of competition while keeping transactions
 14 costs down. So in thinking about what that implies
 15 about a royalty, I guess I would not bring into the
 16 analysis royalties that would be brought about by that
 17 kind of anti-competitive behavior. Which isn't to say
 18 that in some actual negotiations they wouldn't occur;
 19 I just think that it's not helpful to the exercise
 20 we're undertaking to accomplish the objective here.

21 ARBITRATOR VON KANN: I think what I'm
 22 trying to think through for myself with whatever help

1 do we work from that to a single rate? I mean,
 2 obviously, you could do various things. You could add
 3 them all up and take an average, you could take the
 4 mean point, you could take the highest or the lowest.

5 What help would you give us in -- if we
 6 concluded that there was going to be a range and
 7 somehow we pegged it at X to Y, what advice, what
 8 counsel or instruction or insight would you give us as
 9 to how we determine the particular rate within that
 10 range that most clearly represents the marketplace
 11 rate, assuming that the marketplace was a reflection
 12 of many different buyers with different exigencies?

13 THE WITNESS: No, I understand. And as
 14 you said, putting aside the issue of distinguishing
 15 specific groups that you think are different and
 16 putting aside, I think, the issue of marketplace data
 17 that, for reasons we've talked about, you think is
 18 unreasonable or is not indicative of a reasonable
 19 rate. So at the end of that analysis, suppose you got
 20 a range of rates that you believe are acceptable as
 21 indicia of reasonable, at least for some range of
 22 users. I don't think there is a real answer to that

1 question from economics.
 2 I think you have sort of two things you
 3 can do or a combination of two things. You pick a
 4 point in the range, which is often the middle, I mean
 5 that's -- people do that, and/or you look to the
 6 statutory factors which you're asked to consider and
 7 say whether you think on balance they point in one
 8 direction or the other, which might lead you to pick
 9 either the upper end or the lower end of the range of
 10 reasonable outcomes that you've identified.

11 I mean the distribution of values of
 12 different buyers is only one of many reasons why at
 13 the end of the day there's going to be a range. I
 14 mean it's just numbers are imprecise and the world is
 15 imprecise. So the problem of choosing within a range
 16 is a common one that panels like this often have to
 17 confront, and there isn't really -- economics doesn't
 18 really have much help in that.

19 ARBITRATOR VON KANN: Okay. I think that
 20 that is --

21 CHAIRMAN VAN LOON: Would that leave one
 22 to conclude that essentially economics has no real

1 ARBITRATOR VON KANN: Let me just pursue
 2 one more. Going back a little bit to this idea of are
 3 we talking sort of about theoretical buyers and
 4 theoretical sellers or the real ones that are out
 5 there, doesn't -- when the statute goes on to say, "In
 6 determining such rates and terms, the Copyright
 7 Arbitration Royalty Panel shall base its decision on
 8 economic, competitive, and programming information
 9 presented by the parties, including," and then it
 10 lists the various factors, doesn't that suggest that
 11 what Congress was saying was don't deal with this like
 12 an economic textbook might, which is just theoretical
 13 little entities labeled B for buyer and S -- look at
 14 these players in this marketplace confronting the
 15 things they're actually confronting, look at what's
 16 really going on out there, look at the economic,
 17 competitive, and programming information about them,
 18 which the parties have presented to you, and figure
 19 out what they would likely do in this hypothetical
 20 marketplace if it wasn't constrained by the compulsory
 21 license and the RIAA's market power? Do the best you
 22 can but look at these guys, these players in the real

1 guide, and we've got a range? It's, basically, we
 2 could flip a coin? We could do that or we could
 3 basically pick anything that we thought there was a
 4 rational basis? And from an economic analysis point
 5 of view, there is no right or wrong, so to speak, so
 6 long as we're not arbitrating capricious.

7 THE WITNESS: You would never do that.
 8 Putting aside the statutory factors which you might
 9 use to put you in one way or the other, the way I
 10 think about a range is, from a statisticians point of
 11 view, that there's just uncertainty. There's
 12 imprecision in measurement. The answer could be
 13 anywhere between here and here. The safest thing to
 14 do to be sure you're really within the range is to be
 15 either in the middle or close to the middle.

16 So in that sense, I don't think -- you
 17 flip a coin, but I guess I'm not sure that that's a
 18 deep insight. You probably could have figured that
 19 out yourself without economics, that if you're truly,
 20 at the end of the day, it could be anywhere between
 21 here and here, you probably didn't need me to help you
 22 with that.

1 world.

2 THE WITNESS: Well, I don't disagree with
 3 that. I think you yourself, though, put in two
 4 important non-real world provisos, which is no license
 5 and no market power, and so we have to -- I don't
 6 think any of use are suggesting that we get this from
 7 other than real world information. And as I've said,
 8 if I thought we had information on real world
 9 transactions for these very same rights in this very
 10 same context that in fact were purged, as you've
 11 suggested, of both the market power of RIAA and the
 12 effects of the compulsory license, that would be where
 13 I would start. I'm just not convinced that we really
 14 have data of that sort, and that's why I've fallen
 15 back on what is sort of inferential or inductive kind
 16 of reasoning from other benchmarks to get where we
 17 need to go.

18 ARBITRATOR VON KANN: If that's the
 19 framework in which we're supposed to analyze it,
 20 doesn't that really -- doesn't that give the services
 21 here quite an uphill battle in the sense that
 22 obviously if they couldn't get licenses for this

1 music, they couldn't operate their services. As if we
 2 take the compulsory license piece out, then, like the
 interactive service, if you don't get the deal, you
 4 can't operate. They needed those licenses very badly.
 5 Now, did RIAA or did the record labels equally need
 6 the deals? I don't know. I'm not so sure. That is
 7 something we would have to assess. But I think one
 8 could make a case that the buyers would go to those
 9 negotiations a lot more hungry than the sellers, and
 10 it strikes me that that is going to impact the price
 11 that's going to come out of that negotiating room.

12 THE WITNESS: Well, again, I think if you
 13 remove market power, then you've got hungry buyers and
 14 you've got lots of sellers, hopefully, who are -- you've
 15 got something that is zero marginal cost to produce.
 16 If they're really competing with each other, they
 17 should be -- it's gravy to the bottom line if they can
 18 make some of these deals and get that incremental
 19 revenue. I don't see why they're not, in some sense,
 20 equally hungry once you remove the market power
 21 element to get a deal done.

22 ARBITRATOR VON KANN: Why wouldn't the

1 know, at that level, we'll take some of this money and
 2 see whether our worst fears were right or not." But
 3 why wouldn't a lot of the record companies be inclined
 4 to say, "Well, thank you very much. We'll just
 5 continue to sell our little hard CDs, we'll see what
 6 happens out there, and meanwhile we'll work like crazy
 7 to create our own Internet services, and we're not
 8 particularly interested in licensing to you, frankly;
 9 it's not all that exciting to do." Whereas the buyers
 10 would say, "We need these licenses or we've got no
 11 business."

12 THE WITNESS: Well, I guess I'd say a
 13 couple things about that. I don't really understand
 14 how you can be worried -- you can simultaneously think
 15 that nobody's really listening, and it's going to
 16 destroy the CD market. Presumably, if it's going to
 17 destroy the CD market, it's only going to be because
 18 people listen a lot.

19 ARBITRATOR VON KANN: A foolish
 20 consistency is the hobgob of a little mind. You're
 21 right, they aren't consistent, but they could be
 22 entertained at the same time, perhaps.

1 answer to why they're not equally hungry be as
 2 follows: Rightly or wrongly, they're panicked about
 3 losing sales to the displacement effect. They're
 4 convinced that the future is one in which nobody needs
 5 plastic anymore. We'll just get all of our music on
 6 that wonderful little electronic gadget. They may be
 7 totally irrational about this. Maybe they are, maybe
 8 they aren't. I'm not sure we'll be able to figure it
 9 out; maybe we can.

10 But let's assume that their mindset is one
 11 of great fear about seeing a precipitous decline in
 12 record sales, and only marginally excited about the
 13 promotional value since at the moment the listenership
 14 numbers are pretty low. There aren't a lot of
 15 advertisers flocking to it, and they're not really
 16 sure that the promotional pluses outweigh the specter
 17 that they see of people deciding we can live without
 18 CDs.

19 Why aren't those sellers going to be
 20 fairly tepid about their enthusiasm for signing with
 21 -- I mean at some point, the price gets exciting
 22 enough and enticing enough that you say, "Well, you

1 THE WITNESS: I guess I think -- and,
 2 again, I'm not doing statutory interpretation, I'm
 3 just telling you what an economist thinks would make
 4 sense.

5 ARBITRATOR VON KANN: Okay.

6 THE WITNESS: I think to interpret the
 7 willing buyer/willing seller test, you really got to
 8 stay within the realm of sort of what rational -- I
 9 mean I realize the word isn't there -- but you've got
 10 to stay within the realm of what rational willing
 11 buyers and willing sellers would do, because if you
 12 allow to enter the analysis sort of what irrational
 13 buyers and sellers would do, then anything could
 14 happen. I don't really see how you could ever sort of
 15 use that as a tool.

16 And, I guess, the other thing I would say,
 17 and maybe I'm overstepping my bounds in terms of keep
 18 insisting that I don't interpret statutes or figure
 19 out congressional intent, is they created a compulsory
 20 license. Presumably they had a reason to do that, and
 21 I think the reason for the compulsory license was that
 22 there was a nascent industry here that they thought we

1 wanted to create a copyright regime in which this
2 nascent industry, if there is money to be made there,
3 could get off its feet if it's going to work.

4 And, I guess, I would think it would be,
5 at least from a policy and economic perspective,
6 inconsistent with the overall sense of what the
7 statute is trying to do to set rates that has sort of
8 encompassed the idea that the sound recording owners
9 in this case would have wanted to and in some sense
10 should be allowed to pretty much just withhold these
11 rights from general use. It just seems to me that's
12 inconsistent with a statutory framework predicated on
13 a compulsory license.

14 ARBITRATOR VON KANN: It wouldn't
15 necessarily be irrational, would it, for the record
16 companies to say --

17 COURT REPORTER: Judge von Kann?

18 ARBITRATOR VON KANN: All right. Sorry.
19 It wouldn't be irrational for the record companies to
20 say, "We have concluded that the potential of
21 webstreaming for decreasing our revenues are greater
22 than their potential for increasing our revenues, and

1 therefore we're not going to play, we're not going to
2 license people to do that." That might be faulty, I
3 mean they might have made a mistake in their analysis,
4 but that wouldn't strike me as an irrational way to
5 approach the problem if they indeed went through some
6 kind of analysis.

7 THE WITNESS: But, again, I have the same
8 problem. If we're going to encompass buyers and
9 sellers that have made mistakes and do their analysis
10 improperly and what would they do, again, I have the
11 same problem. I don't know how at the end of the day
12 you'd rule out anything. And so I would think that if
13 you wanted -- the way to go about this willing
14 buyer/willing seller is to say, well, sure, people do
15 make mistakes in the real world. In the real world,
16 people sometimes act irrationally. But we're going to
17 think about what would a willing buyer and a willing
18 seller do in the marketplace with the facts as we can
19 determine them if they were acting rationally in that
20 set of facts? And that, to me, is a more reliable way
21 to approach it than to try to figure out what they
22 might have done because of mistakes or other --

1 CHAIRMAN VAN LOON: Isn't another way to
2 say that, that the fundamentals of economic teaching
3 is willing buyer/willing seller assumes a willing
4 buyer and willing seller who wish to make a sale if
5 they can agree on price?

6 THE WITNESS: And who are well-informed
7 and acting rationally. I mean I think that that's the
8 way an economist would come at that. I can't -- you
9 know, I don't know what Congress had in mind, but
10 that's how an economist would come at it.

11 ARBITRATOR VON KANN: I think the best
12 answer to my proposition, which I thought you would
13 give me, is, well, but they made deals for interactive
14 licenses, and that's much more of a threat, and that
15 apparently didn't stop them. So at some price level,
16 you get to some price where, obviously, the
17 demonstrated history that record labels are willing to
18 sign a deal, even though they are worried to some
19 extent about those factors. Well --

20 ARBITRATOR GULIN: If you had the best
21 answer, why did you ask the question?
22 (Laughter.)

1 ARBITRATOR VON KANN: I wanted to see what
2 other answers might be out there.

3 THE WITNESS: I guess I flunked.

4 ARBITRATOR VON KANN: No. Okay.

5 CHAIRMAN VAN LOON: I have two very short
6 most administrative matters. One is on your minimal
7 fee, you picked 250, and then your footnote says but
8 ASCAP is 264, and there's BMI and there's SESAC. Is
9 there any real rational basis, any reason to pick your
10 250 other than it was close to ASCAP?

11 THE WITNESS: I think this is one of these
12 range situations. I think that if you accept my
13 premise that within the per performance model the
14 function of a minimum fee is to compensate the
15 licensor for the administrative and bookkeeping costs
16 of keeping track of another licensee who might
17 otherwise not be generating significant revenue, I
18 think that clearly puts you in the range of hundreds
19 of dollars rather than thousands of dollars.

20 But I don't have enough information, and
21 I went to ASCAP because that's a market data point.
22 They have to administer licenses, they have to do the

1 bookkeeping and recordkeeping that is at least
2 analogous to what RIAA would have to do to administer
3 a single license, and so it seems like it's a market
4 data point on what kind of a fee would reflect that
5 administration cost. But, you know, beyond that I'm
6 not -- I am first to admit I can't pin it down
7 terribly exactly.

8 CHAIRMAN VAN LOON: But given your
9 analysis of the two parallel costs and what it would
10 take if your webcaster needs songs from ASCAP and BMI
11 and SESAC, that the rational would be, at a minimum,
12 to take the minimum fee from those three and add them
13 up.

14 THE WITNESS: No, I don't think so,
15 because I'm looking at it from the point of view of
16 the licensor. So what I'm saying is ASCAP is saying,
17 "For me to process a license it doesn't make sense
18 unless I get at least 264" -- I don't know how they
19 got the number, 264, and I picked 250 just because it
20 was a rounder number. "I need at least that, because
21 I have to keep them in my computer, and I have to send
22 them statements every month, and so forth."

1 And so the costs of ASCAP are analogous,
2 I think, to the cost of the RIAA. And the fact that
3 the licensee also has to deal with BMI doesn't change
4 the fact that what it's indicating is that from the
5 licensor's perspective, the cost of administering a
6 license is, at least appears to be in this case, about
7 \$250. So I don't think it would necessarily make
8 sense, if you accept this administrative cost
9 justification, to say, well, they have to pay it to
10 three different people on the musical works side, so
11 we should triple it.

12 Now, maybe there are other reasons why the
13 number could be something other than 250, but I don't
14 think the mere fact that from the licensee's point of
15 view there's three of them undermines the logic that
16 from the licensor's perspective -- it's the licensor's
17 costs that we're trying to compensate here, the
18 licensor's costs of administering and processing the
19 license, and I think RIAA's would be analogous to
20 ASCAP's even though they're only one of --

21 ARBITRATOR GULIN: The licensor being the
22 collecting agency may have more administrative work to

1 do but possibly not three times as much.

2 THE WITNESS: You mean just because they
3 have --

4 ARBITRATOR GULIN: Just because they have
5 more.

6 THE WITNESS: -- more. I suppose that's
7 true, if it's -- I don't think it would be
8 proportional to the number of -- and you could argue,
9 actually, since there's only five -- we've already
10 heard that there are a lot fewer underlying rights
11 holders on the sound recording side than on the
12 musical works side, so it could be that actually the
13 administrative costs in this case would be lower for
14 that reason. Even though RIAA is the whole ball game,
15 they probably have fewer licensors that they're
16 distributing to than ASCAP does, even though ASCAP is
17 only 45 or so percent of the total, just because the
18 ownership in the musical works is more fragmented.

19 CHAIRMAN VAN LOON: Okay. Last one.
20 Ephemeral. You say a very small share, one page,
21 another page, a very small fraction. How small is
22 very small? Can you give us a number and give us a

1 rationale?

2 THE WITNESS: Well, that's a compound
3 question.

4 CHAIRMAN VAN LOON: Yes.
5 (Laughter.)

6 We get to do that and get criticized for
7 it.

8 THE WITNESS: I can give you a number. I
9 don't know that I can particularly give you a
10 rationale. I mean what I have in mind is something on
11 the order of the five or ten percent kinds of numbers
12 that have been talked about. I think even RIAA has
13 talked about ten percent, although they would add it
14 on the top rather than viewing it as part of the
15 total. It seems to me that something in that range is
16 the kind of the number that we're talking about.

17 CHAIRMAN VAN LOON: And the rationale then
18 is because RIAA said it?

19 THE WITNESS: The rationale is because
20 it's not very big, and it seems to me it shouldn't be
21 very big, but I'll admit I don't have more than that.

22 ARBITRATOR VON KANN: Just one on the 250.

1 That can't possibly be the true cost of administering
 2 a license for a year for a license holder, can it? I
 3 mean \$250 is, what, half hour of a secretary or
 4 something these days? It's a tiny, tiny number. It
 5 doesn't -- I mean do you really think that that's a --
 6 if we could somehow bring in, I don't know, the CFO of
 7 ASCAP or something and he would look at his rent costs
 8 and his employee costs and his computer costs and
 9 everything, do you really think it is realistic to
 10 think that for \$250 a year they can manage anything
 11 for somebody? It just strikes me as --

12 THE WITNESS: Well, I'm thinking of this
 13 not as the average cost but of the incremental cost of
 14 having one more licensee. I've already got a
 15 computer, which I need to handle the guys who are
 16 paying me real money, and I've already got an
 17 accounting staff, and I've already got an office, so
 18 I'm paying the rent anyway, because there are people
 19 who are paying me real money. The question is how
 20 much does it cost me to have one more guy in the
 21 system who's not going to pay me very much money
 22 because they're not doing very many performances?

1 That's the way I'm thinking about it.
 2 ARBITRATOR VON KANN: I guess if you got
 3 100,000 of these licenses and that's generate \$250,000
 4 or even larger numbers probably, maybe it is enough
 5 when you divide it all up. It just strikes me as so
 6 small that it's almost hard to believe, but maybe.
 7 CHAIRMAN VAN LOON: Judge Gulin?
 8 ARBITRATOR GULIN: Yes, just two more
 9 questions before we give you back to the
 10 professionals. One is kind of, I think the Chair
 11 called it, a housekeeping or administrative matter.
 12 After calculating the listener hour rate, you then
 13 thought that, well, for those webcasters and
 14 simulcasters that have low music intensity, it might
 15 not be fair to use that metric, so you came up with a
 16 listener song rate. But then you said, "Oh, but we
 17 don't these guys to be gaming this, so if their music
 18 intensity goes under or goes above a certain level,
 19 they're no longer eligible for that particular rate.
 20 And you chose that cutoff to be seven songs per hour.

21 THE WITNESS: Correct.
 22 ARBITRATOR GULIN: Can you tell me how you

1 got that?
 2 THE WITNESS: Yes. Seven is the smallest
 3 number in terms of an average for a format of the
 4 blanket stations that we looked at. If you look, I
 5 think it's --

6 CHAIRMAN VAN LOON: Yes. Spanish is 7.08,
 7 and it's the lowest on Exhibit B.1.

8 THE WITNESS: So I'm not saying there
 9 isn't a single radio station out there that has a
 10 blanket license that has fewer than seven; there might
 11 be. But in terms of averages over formats, seven is
 12 the lower end of the range of the blanket stations.

13 ARBITRATOR GULIN: Okay.

14 CHAIRMAN VAN LOON: Latino songs are
 15 longer.

16 ARBITRATOR VON KANN: We'll get to it
 17 tomorrow. It always take a little longer to do.

18 ARBITRATOR GULIN: Want to revisit one
 19 last time your hypothetical market?

20 THE WITNESS: Okay.

21 ARBITRATOR GULIN: Which consists of
 22 buyers who are webcasters and simulcasters and sellers

1 who in the market you envision are a 1,000 little
 2 RIAAs all selling blanket licenses for all artists, I
 3 guess. And I want to think about that in the context
 4 of a negotiation that would go on between a
 5 simulcaster and one of these many RIAAs. There is, of
 6 course, a 500-mile exemption for broadcasters so that
 7 they can digitally broadcast 500 miles -- I'm sorry
 8 150 miles, excuse me, from their transmitter and be
 9 exempted. Now, I assume that is the basis for your
 10 conclusion that there should be a zero rate for
 11 simulcasts with respect to listeners within 150 miles.
 12 Is that true? Is that how you came to the conclusion?

13 THE WITNESS: I totally understand the
 14 question; I'm thinking about the answer, because in
 15 fairness -- let me just -- in honesty, as I said, this
 16 hypothetical market is kind of up there at the top,
 17 and then I get into the nitty gritty of how I actually
 18 do it. And I think, in honesty, with respect to that
 19 specific issue, I've never though about the connection
 20 back to the top.

21 ARBITRATOR GULIN: Well, now's your
 22 chance.

1 THE WITNESS: So now's my chance.
2 ARBITRATOR GULIN: These two entities get
3 together, and I guess, by definition, according to
4 you, the result would be a zero rate for up to 150
5 miles.

6 THE WITNESS: I have to say I don't think
7 that would follow. I mean I think the argument for
8 the zero rate is more just the anomaly that otherwise
9 would exist vis-a-vis over the air combined with some
10 sense, admittedly vague, of what Congress was trying
11 to do with the exemption they created for broadcasts
12 that were entirely within 150 miles.

13 But I think if you press the logic of my
14 hypothetical world, if what the law says, "You need
15 this right even if you're within 150 miles, as long as
16 some of your broadcasts go farther," and if you have
17 this competitive market, there's no reason why the
18 sellers in that competitive market would give that
19 right away unless you think that sort of otherwise
20 they would just go over the air and not do any
21 simulcast. Because then, of course, the sellers don't
22 get anything, because if it's over the air, the sound

1 recording doesn't earn a royalty.
2 But if you believe that there are
3 webcasters who are going to webcast broadly or in this
4 case simulcasters who are going to simulcast broadly,
5 and they need the right within 150 miles, I don't
6 think you can use my hypothetical market test to
7 justify that zero rate.

8 ARBITRATOR GULIN: So if at the end of the
9 day the Panel finds that the law that we must apply is
10 in fact that we have to find a fair market rate for
11 simulcasting to listeners within 150 miles of the
12 broadcaster's transmitter, we can't rely upon your
13 analysis to come up with zero; we'd have to do
14 something else.

15 THE WITNESS: That sounds right as I sit
16 here. I mean the analysis would suggest perhaps a
17 lower rate because of the option of just sticking with
18 the over-the-air broadcasts where these competitive
19 sellers get zero.

20 ARBITRATOR GULIN: Okay.

21 THE WITNESS: But I don't think I can
22 claim --

1 ARBITRATOR GULIN: All right.

2 THE WITNESS: -- that my model would drive
3 you to zero.

4 ARBITRATOR GULIN: If you come back and we
5 see you again, maybe you can give that some thought
6 and come up with a --

7 THE WITNESS: I might do that.
8 (Laughter.)

9 ARBITRATOR VON KANN: Do which, come back
10 or give it thought?

11 (Laughter.)

12 THE WITNESS: Hopefully both.

13 CHAIRMAN VAN LOON: Let's take the
14 temperature. I suppose there's an opportunity for
15 some redirect and some recross, a re-re of each. Do
16 you --

17 MR. RICH: I couldn't possibly hope to
18 illuminate this subject further at this point, so we
19 have no further questions.

20 CHAIRMAN VAN LOON: Okay. So, Mr. Katz?

21 MR. KATZ: I have, I think, less than ten
22 minutes.

1 CHAIRMAN VAN LOON: Okay.

2 RECCROSS EXAMINATION

3 BY MR. KATZ:

4 Q Professor Jaffe, the Panel's questions
5 have stimulated one thought in my mind, which I'd like
6 to try out on you.

7 CHAIRMAN VAN LOON: Only one?

8 MR. KATZ: Well, one that I'd like to try
9 out on him.

10 CHAIRMAN VAN LOON: Oh, okay.

11 MR. KATZ: I'm completely satisfied on all
12 the others.

13 BY MR. KATZ:

14 Q And that's this, Professor Jaffe: You
15 testified about sound recordings and musical works but
16 that performance rights had equivalent values because
17 the webcaster needs both of them. One without the
18 other is worthless, and therefore, in that situation,
19 they would likely result in equivalent prices, and you
20 saw no differences on the supply side that would
21 affect that. Is that a fair characterization?

22 A Yes. I would say it in a different order.

1 I would say that the buyers need both of them, and the
2 supply side is coming at it in a similar situation so
3 that the result of these parallel hypothetical
4 negotiations would likely be the same.

5 Q And you analogized this to the person that
6 needs both the fuel pump and the transmission or both
7 the car and the keys in the sense that if you need two
8 things, and you need both of them, and neither one is
9 worth anything without the other, you'll probably end
10 up paying an equivalent price to both because you need
11 both of them.

12 A I didn't say that, no.

13 Q Well, what did I miss there?

14 A By any means.

15 Q What did I miss there? Wasn't that your
16 use of the analogy of the fuel pump and the
17 transmission?

18 A Well, my whole point, which I was trying
19 to explain, was that the point about need both is only
20 getting at half the question, which is the buyer's
21 side. From the buyer's point of view, I argued in a
22 constrained and artificial example where you needed it

1 right now and I was the only one who could provide it,
2 the fuel pump and the carburetor have the same value.
3 But those are not goods where the suppliers of those
4 things come to the market with the same valuation, so
5 I wouldn't expect --

6 Q I understand.

7 MR. RICH: Let him finish.

8 THE WITNESS: So I would not expect the
9 market value of those two things to be the same just
10 because the buyer needs them equally.

11 BY MR. KATZ:

12 Q Now, I really want to take your
13 hypothetical here, and I thought it was a useful
14 hypothetical. This is the person who really needs the
15 car to operate, and he's missing a couple of things,
16 and they have different market prices because of
17 supply side reasons and so forth in a normal market.
18 But this is somebody who needs it right now. And the
19 person who can withhold the fuel pump and the person
20 who can withhold the transmission both are in an equal
21 bargaining situation here, because they're both
22 necessary, and they're both necessary right away, and

1 there are no other competing sources of supply.

2 Wasn't that your example?

3 A Well, we went through a number of
4 different versions of it. There was a version of it
5 where to try to clarify the separation between --
6 there's the buyer's valuation, there's the seller's
7 valuation, and then there's what comes out of that.
8 I think we did have one hypothetical where I
9 hypothesized a seller who -- or a pair of sellers of
10 the carburetor and the fuel pump who were in the same
11 position, but I actually don't remember how far we
12 went with that one. But certainly in the real world,
13 the sellers of carburetors and the sellers of fuel
14 pumps are not in the same position.

15 Q But I really want to understand your
16 hypothetical, Professor, and not the real world. And
17 you can make one up if need be.

18 A Okay.

19 Q But wasn't it the thrust of your answers
20 to Judge von Kann that it's not irrational that there
21 might be circumstances in which people who are
22 suppliers of things in a normal marketplace would have

1 very different costs, because they cost more to
2 produce, among other reasons. But that there might be
3 an unusual situation in which if there was a buyer who
4 needed both of them and needed both of them under
5 circumstances in which there weren't other offerers,
6 might view these things as things for which you would
7 pay the same amount of money, because he needs both of
8 them and he needs them both right away, and there are
9 no other sources of supply. Wasn't that the point you
10 were trying to make by analogy to your suggestion that
11 musical works and sound recordings would have similar
12 value for webcasters?

13 A What I'm not understanding about your
14 question is the hypothetical about the car was
15 intended to deal only with the buyer's valuation and
16 the possibility that a buyer would value two things
17 the same. And I tried very explicitly to say that
18 that's a separate issue from the seller's willingness
19 to sell it, and it's a separate issue from what the
20 outcome will be. And that car analogy was not about
21 two different sellers; that's not what it was about.

22 And just so we have the intellectual

1 property rights correctly allocated here, I think it
2 was actually Judge von Kann's hypothetical example,
not mine.

4 ARBITRATOR VON KANN: Not yet copyrighted,
5 but I'm rushing out of here as soon as we're over.
6 (Laughter.)

7 BY MR. KATZ:

8 Q It was a very useful hypothetical, but let
9 me pick up a thread from Judge Van Loon and see if it
10 helps here. And this is the story of the old lady
11 with the last lot that's necessary for a building.
12 And is it a similar analogy the situation in which you
13 want to build a building and there are several lots of
14 different sizes, and ordinarily in a ordinary
15 marketplace different values, but you need all of
16 them, and you can't build the building unless you have
17 all of them. And, therefore, the little old lady who
18 owns the last lot has bargaining power which might be
19 as great as any of the others. And that's another
20 example which came up; isn't that right?

21 A Is the question, did that come up?

22 Q Well, isn't that another analogy that you

1 Q Okay. My buyer here is the person who
2 wants to put up the building.

3 A Okay.

4 Q My seller are these owners of property.

5 A Okay.

6 Q The sound recording rights holders are
7 those with the big lots that would ordinarily command
8 high prices in a normal market. The musical works
9 owners is the owner of the small last lot that would
10 ordinarily command a lower price in a normal market.
11 But this is not a normal market. You've got a buyer
12 that's willing to pay a lot of money, because he needs
13 all of those properties. In that situation, doesn't
14 the owner of the last small lot have bargaining power
15 which may enable him or her to get a price equivalent
16 to those of the others?

17 A In the absence of competitive domain or
18 some other mechanism that turns it into a fair market
19 value or a willing buyer/willing seller regime as
20 we've been discussing. Is that what -- is that --

21 Q Yes, sir.

22 A Sure. And if you let them hold up,

1 could give to the fact that you viewed the sound
2 recording rights and musical work rights as having
3 equivalent value because you need both of them? You
4 can't go into business without both of them, and there
5 are no other competing sources of supply.

6 A I don't understand that as an analogy to
7 my equivalence of the sound recording and the --

8 Q Well, in all fairness, Professor, why not?
9 Isn't that exactly that same situation where you've
10 got a buyer who wants to put up a building, he's
11 blocked unless he owns all of those distinct
12 properties. And from the property owners' point of
13 view, they're in a position to negotiate a price which
14 may be, for all of them, well above market price, all
15 of them equally necessary, and all in a similar
16 bargaining position. Isn't that an analogy --

17 A Well, I don't understand what's analogous
18 to what? Who's analogous to which? I just don't see
19 where you're pairing it up to the sound -- who are the
20 buyers, who are the sellers, which is the sound
21 recording analogy, which is the musical work analogy.
22 I don't follow.

1 they'll hold up.

2 Q And isn't that equivalent to your saying
3 that musical works owners and sound recording owners
4 will get equivalent royalties, notwithstanding the
5 fact that in most other contexts more money goes to
6 the record companies, because you need both of them
7 and there are no other sources of supply?

8 A No, I don't think it's equivalent.

9 COURT REPORTER: I didn't hear your
10 answer.

11 THE WITNESS: I do not think it's
12 equivalent, because my basis for deriving that
13 conclusion was something totally different. They're
14 just -- I mean they happen to be the same answer, but
15 they're not equivalent, because they don't come from
16 the same mode of analysis.

17 BY MR. KATZ:

18 Q But no one would --

19 A To continue your analogy and explain why
20 it doesn't fit, if I have a small lot and you have a
21 big lot, even though they're both equally necessary to
22 the buyer, your alternative uses for that big lot are

1 much more valuable than my alternative uses for my
2 small lot. So we are not in equivalent positions, so
3 that would not be an analogy to the situation that
4 I've described with respect to the music performance
5 rights.

6 The buyer may not care. The buyer may
7 have the same valuation of both because he needs all
8 of them, but, clearly, your alternative uses for your
9 big lot are much more valuable than your alternative
10 uses for my small lot, and in that circumstance I
11 wouldn't predict that the outcome of these
12 hypothetical negotiations would be the same, because
13 the circumstances of the sellers are not the same.

14 Q Well, let me add to the hypothetical then
15 the proposition that none of these lots has value
16 comparable to the kind of value that they can get from
17 the building owner in this case. So the large lots
18 would ordinarily be more valuable than the small lots,
19 but compared to what they can get from the building
20 owner in this case, there's a windfall situation in
21 which everybody will be receiving a windfall as long
22 as everybody goes along. In that situation, don't we

1 A Well, either the size matters or it
2 doesn't. If the size matters, then one is more
3 valuable than the other. If the size doesn't matter,
4 then their both not worth anything. You can't --
5 you've to make it one hypothetical or the other.

6 Q All right. Here's my hypothetical,
7 Professor. We have market values of \$500 and \$1,000
8 and a building owner who's willing to pay millions of
9 dollars for the property if he can get both of them.

10 A Okay.

11 Q In those circumstances, aren't those two
12 owners, the one of whom might be able to command
13 double the value in the ordinary marketplace, be able
14 to command a substantially higher -- be able to
15 command no more than the owner of the smaller lot?

16 A And for the purpose of this use, that is
17 what is the fair market value of this land for use in
18 this building, which is the analogy to what this Panel
19 needs to derive, in fact the values of those two lots
20 are essentially the same. The fact that one cost
21 twice what the other did, when that's a tiny fraction
22 of the value we're talking about, is irrelevant. So

1 have an equivalence of bargaining power situation
2 similar to that of the musical works owners and the
3 sound recording performance rights owners?

4 A So what you're saying is, effectively,
5 we've got two landowners, both of whom have a marginal
6 cost of zero, because their alternative uses are just
7 tiny compared to selling here, and that's effectively
8 saying that the marginal cost is zero, and a buyer who
9 needs both.

10 Q Right.

11 A I think that would be analogous, and it's
12 appropriately analogous, because the two underlying
13 things have the same value, namely zero to the seller
14 and the same value to the buyer.

15 Q Although until that buyer came along, they
16 might command very different values in the marketplace
17 --

18 A Well, you just told me their values are
19 zero.

20 Q -- because one is bigger than the other,
21 although neither has substantial value compared to
22 what this unusual buyer is willing to pay.

1 I would say the appropriate outcome there would be to
2 say both pieces of a fair market value, for example,
3 of half a million dollars, and their values really are
4 the same. The fact that one of them, in some other
5 context, has a greater value is irrelevant, which is
6 exactly the point that I'm making.

7 Q So in a situation like that, the person
8 with the last property is able to capture that fair in
9 a fair market way, even though ordinarily the property
10 would have comparatively less value.

11 A Well, we've gone back and forth between
12 fair market and holdout. I don't understand what
13 you're trying to get at.

14 Q Let me ask you one other thing here, which
15 is looking back at the statute, which says that in
16 determining rates and terms the Panel is supposed to
17 consider, among other things, the relative roles of
18 the copyright owner and the transmitting entity of the
19 copyrighted work with respect to relative creative
20 contribution, technological contribution, capital
21 investment cost and risk. Suggests that in
22 considering whether or not musical works and sound

1 recordings should both be commanding the same amount
2 of royalty or hypothetical royalty, that they could
3 consider, among other things, the relative creative
4 contribution, technological contribution, capital
5 investment cost and risk of sound recording creators
6 and musical composition creators.

7 A Well, as an economist, I think there's one
8 of two ways to look at that list, and I can't tell you
9 which is the right way to look at it. One way to look
10 at it is it's explaining how to implement the willing
11 buyer/willing seller standard. And if that's what it
12 is, I know what that means, and I'll tell you in a
13 second what I think that means. The other possibility
14 is that that's somehow a set of things that you're
15 supposed to take into account, perhaps as we discussed
16 a second ago, when you've got a range of values, an
17 additional set of considerations.

18 But to the extent that what it's talking
19 about is implementing the willing buyer/willing seller
20 standard, then I think you have to think about it in
21 the context of these negotiations, and those factors
22 would enter would enter the way they would enter into

1 these negotiations, which is on an incremental basis.
2 So if on an incremental basis you could point to the
3 kinds of differences you're talking about, I think
4 they would affect the willing buyer/willing seller
5 outcome. But I don't think they would affect the
6 willing buyer/willing seller outcome if what you're
7 talking about is their relative contribution to the
8 creation of the original CD, as distinct from their
9 contribution to the sound recording performance right,
10 this incremental use of intellectual property that's
11 previously been created.

12 MR. KATZ: That's all I have.

13 ARBITRATOR VON KANN: Let me just make
14 sure I got that last sentence. You think that when
15 those factors are analyzed, the focus should not be on
16 how much cost, risk, so on did you have in creating
17 the CD in the first place but rather how much cost,
18 risk and so on is connected with giving us the right
19 to perform this CD on our web stream, in effect.

20 THE WITNESS: If you're talking about
21 incorporating those factors within the willing
22 buyer/willing seller analysis, if you read the statute

1 to mean that's sort of a separate set of things, then
2 as an economist I don't really have an opinion about
3 whether that's an incremental or some other kind of
4 analysis, because I don't really know what Congress
5 meant.

6 But if what Congress meant was these are
7 the kinds of things that affect a willing
8 buyer/willing seller analysis, as an economist I know
9 what that means, because I can think about that
10 economically. And what that's going to mean in that
11 context would be an incremental analysis.

12 ARBITRATOR VON KANN: And does the
13 incremental analysis apply on the webcaster side as
14 well? Don't tell us how much it costs to rent this
15 building, don't tell us how much it costs to buy the
16 computer in the basement. Tell us how much it costs
17 to put that additional record out on the stream.

18 THE WITNESS: I guess the way I would
19 think about it is it's incremental in the sense of
20 streaming is incremental to other activities. I'm not
21 sure I'd do it one performance at a time, but
22 certainly if this webcaster is doing streaming and is

1 doing other stuff on the web and has got some other
2 businesses, it would be the costs and investments and
3 risks that they incur by sort of adding streaming to
4 whatever else they might have done.

5 ARBITRATOR VON KANN: Why do you draw the
6 line there?

7 THE WITNESS: Because in both cases, what
8 we're talking about is a blanket license. So what the
9 seller is selling is the license to make as many
10 performances as you want. And the business that the
11 streamer is thinking about when they go to that
12 willing buyer/willing seller negotiation is their
13 streaming business. If they're deciding, "Do I walk
14 away from the table and not do a deal" in this
15 hypothetical, what they're abandoning by doing that is
16 streaming. They wouldn't have to abandon this other
17 stuff, but they would have to abandon all of their
18 streaming if they can't make a deal for this blanket
19 license. So it would be, in effect, all of the costs
20 and risks and so forth associated with their streaming
21 activities.

22 ARBITRATOR VON KANN: Okay.

1 CHAIRMAN VAN LOON: Mr. Rich and Mr.
2 Steinthal, am I right we have Mills first tomorrow
morning?

4 MR. STEINTHAL: I believe it's Mills and
5 then --

6 CHAIRMAN VAN LOON: Juris?

7 MR. STEINTHAL: -- Juris. And I know we
8 were checking on whether someone else would be
9 available to start, but I don't have an answer to
10 that, because I've been here all day.

11 CHAIRMAN VAN LOON: Right. And if I
12 recall, at this very hour tomorrow we'll also be
13 having a discussion of any issues related to our order
14 of the 14th.

15 MR. STEINTHAL: Right. And the BMI issue,
16 right?

17 CHAIRMAN VAN LOON: Yes. Professor Jaffe,
18 we are very, very much thankful for all of the insight
19 and answers you've given us today. It's been very
20 interesting and thank you for your endurance.

21 THE WITNESS: Well, if I'm no longer under
22 oath, I'll say it was my pleasure.

1 (Laughter.)

2 CHAIRMAN VAN LOON: Thank you all, and
3 we'll see you in the morning.

4 (Whereupon, at 5:14 p.m., the CARP
5 proceeding was recessed until 9:00 a.m., Wednesday,
6 August 29, 2001.)

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