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In the matter of: 5  
5  
The Digital Performance 5  
Right in Sound Recordings 5 Docket No.  
and Ephemeral Recordings 5 2005-1 CRB DTRA  
(Webcasting Rate 5  
Adjustment Proceeding) 5  
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Volume 26

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Wednesday,  
June 28, 2006

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

BEFORE:

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

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I-N-D-E-X

<u>Witness</u>	<u>Direct</u>	<u>Cross</u>	<u>Redirect</u>
Dr. Adam Jaffe			
By Mr. Sugarman	6		138, 162
By Mr. Handzo		62	

E-X-H-I-B-I-T-S

SX Exhibit

<u>No.</u>	<u>Document</u>	<u>Marked</u>	<u>Received</u>
74	CARP decision 2001	71	
75	Data Analyzed by Dr. Jaffe re: payments for sound recordings and musical works 2001	117	121
76	BRS website document	133	

Services Exhibit

<u>No.</u>	<u>Document</u>	<u>Marked</u>	<u>Received</u>
173	Four page document re: calculations for Figure 2, Musical award fees for webcasters	138	

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

2 9:36 a.m.

3 CHIEF JUDGE SLEDGE: On the  
4 record. Mr. Steinthal.

5 MR. STEINTHAL: Your Honor, as I  
6 said yesterday, Mr. Sugarman from our office  
7 will take Dr. Jaffe through his testimony.

8 CHIEF JUDGE SLEDGE: Thank you.  
9 Mr. Sugarman.

10 MR. SUGARMAN: Good morning, Your  
11 Honors. Sir, you would state your name.

12 CHIEF JUDGE SLEDGE: You need to  
13 call your witness.

14 MR. SUGARMAN: I call Adam B.  
15 Jaffe.

16 Whereupon,

17 ADAM B. JAFFE, PH.D.  
18 was called for examination by Counsel for the  
19 DiMA, having been first duly sworn, assumed  
20 the witness stand, was examined and testified  
21 as follows:

22 DIRECT EXAMINATION

1 BY MR. SUGARMAN:

2 Q Would you state your name please?

3 A Adam B. as in Benjamin Jaffe.

4 Q And would you briefly describe  
5 your education after high school?

6 A Yes. I have an undergraduate  
7 degree in Chemistry and a Masters degree in  
8 Public Policy from MIT and a Ph.D. in  
9 Economics from Harvard.

10 Q And now describe your work  
11 experience from the time you finished your  
12 full-time schooling until now.

13 A Sir, after I completed my Ph.D., I  
14 joined the faculty at Harvard and I was on the  
15 faculty at Harvard first as an Assistant  
16 Professor and then as an Associate Professor  
17 until 1994. In 1994, I moved from Harvard to  
18 Brandeis University where I was first an  
19 Associate Professor and then eventually a full  
20 Professor in Economics. I then became Chair  
21 of the Economics Department at Brandeis and  
22 since 2003, I've become the Dean of Arts and

1 Sciences at Brandeis.

2 Q Have you had an government  
3 affiliations or service?

4 A Yes. While I was on the faculty  
5 at Harvard in 1991, I took a leave of absence  
6 from Harvard and served on the staff of the  
7 President's Council of Economic Advisors here  
8 in Washington.

9 Q Have you been associated with any  
10 publications either as a writer or an editor  
11 or the like?

12 A Yes, I have written dozens of  
13 scholarly articles in peer review journals.  
14 I've written two books, one of which is about  
15 the patent system. I've been an editor on the  
16 Board of Editors of the *American Economic*  
17 *Review* which is the leading economics journal  
18 in the United States as well as the *RAND*  
19 *Journal of Economics* and the *Journal of*  
20 *Industrial Economics* which are more  
21 specialized journals that deal with industrial  
22 organization and industrial economics.



1 Q Are the books and articles that  
2 you've written listed in your CV which is  
3 attached to your report?

4 A Yes.

5 Q Have you done consulting and  
6 testifying work?

7 A Yes.

8 Q Would you generally describe that  
9 work?

10 A Yes, since the late '80s when I  
11 was on the faculty at Harvard I have done a  
12 variety of consulting, most but not all of  
13 which has involved other expert witness work  
14 or projects that would have led to expert  
15 testimony if the cases went that far, in a  
16 number of regulatory arenas here in Washington  
17 and in the states in litigation in matters  
18 dealing with antitrust issues, with contract  
19 issues and to a significant extent with  
20 intellectual property issues both copyright  
21 and patent, both on behalf of the owners of  
22 intellectual property and behalf of users of

1 intellectual property.

2 Q Getting to the issues in this  
3 matter and focusing first on the standard  
4 willing seller/willing buyer, would you  
5 explain how you would interpret the willing  
6 seller/willing buyer standard that's  
7 applicable to this proceeding?

8 A Yes. Well, I'm an economist. I'm  
9 not a lawyer or a legal historian. I approach  
10 this thinking about what is the public policy  
11 arena that we're operating and the public  
12 policy situation that Congress was dealing  
13 with when it was contemplating how to handle  
14 the sound recording performance right in the  
15 digital context. And the essence of that  
16 situation is that you have a set of users,  
17 I'll call them generically webcasters, who  
18 under the Copyright Law have to secure the  
19 right to publicly perform a wide variety of  
20 sound recordings in order to do their business  
21 and there are a really large number of parties  
22 who fundamentally own all those different

1 rights, so that in an unregulated market  
2 context, the transactions costs of securing  
3 all the rights needed in order to engage in  
4 the webcasting business would be very  
5 significant and would either be a significant  
6 cost or possibly an impediment to the  
7 development of that market depending on how  
8 severe those problems in practice really  
9 turned out to be.

10 Now a solution to that problem  
11 which we see in a number of analogous arenas  
12 is that a licensing agent or agents act on  
13 behalf of the many different owners of the  
14 property rights and correctively negotiates  
15 the right to make the performances that the  
16 user needs. The problem that that creates is  
17 that when you have one or a small number of  
18 entities who are negotiating the delivery of  
19 this right on behalf of the whole universe is  
20 there's not going to be market power. They're  
21 likely to be able to extract prices above a  
22 competitive level for that services and in

1 general, both economists and public policy  
2 analysts of a variety and sort believe that  
3 the economy works best when things are priced  
4 at a competitive level and when something like  
5 competition governs the prices of which things  
6 are sold. So that if you had the market power  
7 that a single licensor could extract, that  
8 would be an economically efficient, sorry,  
9 economically inefficient avenue.

10 So one way to deal with that is to  
11 allow the existence of such a single entity to  
12 have a compulsory license so that everyone  
13 knows that they will have the right, they have  
14 the right, they can get the right, they don't  
15 have to worry about the transactions necessary  
16 to make the broadcast they want to make, but  
17 some kind of regulatory process is set up to  
18 ensure that the prices that ultimately prevail  
19 in that market replicate what would have  
20 occurred hypothetically if there could have  
21 been a competitive market if the transactions'  
22 costs didn't preclude these prices being set

1 competitively.

2           So from that perspective when I  
3 look at the framework the Congress has created  
4 which is a compulsory license such that if the  
5 parties cannot agree on what the prices are  
6 that will transfer within that compulsory  
7 license, there is a proceeding with a  
8 particular set of procedures and the  
9 legislative history for the bill talks about  
10 reasonable rates which in a very closely  
11 related context involving musical works that  
12 are licensed by composers and publishers, the  
13 courts have explicitly interpreted to mean the  
14 rates that would prevail in a hypothetical  
15 competitive market for the right.

16           Q     So boiling that down, what is your  
17 view as to what the willing buyer/willing  
18 seller standard means?

19           A     You know I don't -- I think I  
20 failed to use the phrase willing buyer/willing  
21 seller in my previous answer. One of the  
22 problems an economist has with that concept is

1 that on some level any transaction no matter  
2 what the circumstances that surround could be  
3 thought of as a transaction involving a  
4 willing buyer and a willing seller because  
5 otherwise the transaction wouldn't have  
6 occurred. So in some sense to just say  
7 willing buyer/willing seller from an economist  
8 perspective doesn't in and of itself give you  
9 enough of a framework and that's why I would  
10 bring to it this broader perspective of what  
11 Congress was likely trying to do and say that  
12 what Congress was likely trying to do is to  
13 say that at the end of the day we should try  
14 to come up with royalties or prices in effect  
15 that would replicate what those prices would  
16 be in hypothetical competitive market for the  
17 same price.

18 Q Realizing that you can't get  
19 yourself into the head of the members, is  
20 there, Congress, is the action that they took  
21 in any way related to the conclusion that you  
22 reached that it should be hypothetically

1 competitive as opposed to a market where  
2 market power is exercised?

3 A Well, I did mention though what I  
4 just said a history which talks about  
5 reasonable rates. I think from an economist's  
6 perspective what I would say is if what  
7 Congress wanted to do was to have a compulsory  
8 license and then have the rates in those  
9 licenses be monopolistic, they sure created an  
10 inefficient and costly way to achieve that  
11 result because if that was the result they  
12 wanted all they would have had to have done  
13 would have been to say the owners of sound  
14 recording are hereby granted an antitrust  
15 exemption to get together and collectively set  
16 the rate for this right, this public  
17 performance right, and SoundExchange or some  
18 other entity would have done that.

19 The transactions' costs would have  
20 been minimal. You wouldn't have even needed  
21 a compulsory license in some sense because  
22 they would have just set a price and people

1 who wanted to pay at that price could have  
2 used it and people who didn't want to pay at  
3 that price could have chosen not to do it.  
4 They wouldn't have needed this, I think we all  
5 admit, somewhat expensive procedure in order  
6 to set the price if their goal was to try to  
7 set a monopoly price. So I think as an  
8 economist the only logical conclusion I can  
9 draw is that they were trying to do what  
10 Congress has done in many other arenas which  
11 is in regulating the economy to try to in  
12 various ways maintain this goal of having  
13 prices reflect competitive norm.

14 Q You mentioned "other arenas" and I  
15 think you've particularly referred before to  
16 the rate setting process in the musical works  
17 arena.

18 A Right.

19 Q Could you describe that?

20 A We'll certainly come back to that  
21 later on, but when there is a public  
22 performance of music there are, as you know,



1 two public performance rights that need to be  
2 secured in order to that. There's the right  
3 to the performer, so to speak, the singer or  
4 the instrumentalist or the other parties  
5 actually making that performance, but there's  
6 also a right in the underlying musical work  
7 that is owned by the composer and the  
8 publisher of who were originally involved in  
9 creating that composition. And we have had  
10 for a long time a framework in the United  
11 States in which the right to publicly perform  
12 these musical works is transferred from  
13 composers and publishers to users through  
14 collective agencies who are analogous to  
15 SoundExchange. There happens to not be a  
16 single one but actually three who divide up  
17 the repertoire and they each have some of the  
18 repertoire which they transfers.

19 And for the two largest of those  
20 entities, the two that have each of them  
21 almost half of the overall repertoire what has  
22 evolved under the antitrust laws is an

1 institution that's called Rate Court which is  
2 actually a branch of the Federal District  
3 Courts in the Southern District of New York  
4 and it's a mechanism in which essentially  
5 there is something like a compulsory license  
6 and if the parties can't agree on the fee for  
7 that license, the Rate Court has an hearing in  
8 which the parties present evidence and the  
9 Rate Court decides what the rate is going to  
10 be. And as I mentioned, the Rate Court  
11 endorsed by the Second Circuit has explicitly  
12 said that their job is to determine what the  
13 rates would be in a hypothetical competitive  
14 market for these rights.

15 Q Are you familiar with the  
16 Librarian's decision in the CARP?

17 A In CARP 1?

18 Q CARP 1? Well, the CARP related to  
19 CRV?

20 A Yes I am.

21 Q Is there anything in the  
22 Librarian's decision that impacts on your

1 conclusion that the willing buyer/willing  
2 seller standard is a hypothetical competitive  
3 market?

4 A Yes, the Librarian did in the  
5 context of determining whether or not the  
6 decision the panel had made in the previous  
7 case not to consider a series of agreements  
8 that had been made prior between RIAA and some  
9 users, the Librarian did accept the notion  
10 that it was not inappropriate to reject those  
11 agreements because they were likely not  
12 competitively priced and that in some sense  
13 the goal should be to find reference points  
14 that could be thought of competitive.

15 Q In your testimony, your written  
16 testimony, you chose what I'll say is a  
17 benchmark approach. Could you explain why you  
18 did that?

19 A Well, it's actually quite common  
20 not just in regulatory proceedings but in  
21 private business when parties are trying to  
22 figure out how to price intellectual property,

1 a very common way that that occurs is by  
2 reference to something that is typically  
3 called a benchmark, some other piece of  
4 intellectual property which can be thought of  
5 as analogous or relevant.

6 More generally from an economic  
7 perspective, you know, I can ask a question  
8 "What else could you do if you didn't want to  
9 have to rely on a benchmark?" You might start  
10 by saying, "Couldn't you analyze the  
11 underlying economics, the underlying costs and  
12 benefits to the user or demand for this good  
13 and try to based on fundamental economic  
14 principles derive what you think the  
15 competitive market priced for this particular  
16 commodity, if you like, this right would be.

17 The problem with that approach is  
18 it really doesn't work very well for  
19 intellectual property for two reasons. One is  
20 that intellectual property has a very  
21 particular cost structure which is that once  
22 the property has been created there is a zero

1 marginal cost of transferring it to another  
2 user and that's something that a standard  
3 economic cost model has a difficult time  
4 figuring out how to deal with. That's on the  
5 cost or the seller's side.

6 On the buyer's side, you have the  
7 problem that it is frequently the case, not  
8 always, but particularly in sort of an  
9 entertainment context where the user is buying  
10 this intellectual property for the purpose of  
11 themselves delivering an intangible product,  
12 not a car or a shoe, but a broadcast. What is  
13 typically the case is that the different  
14 inputs that go into that are sort of  
15 inextricably intertwined in the way they  
16 constitute the value creation making it very  
17 difficult on just economic principles to  
18 apportion the value that's being created in a  
19 webcast to the different things that go into  
20 it and therefore it's really not possible to  
21 derive from first principles the economically  
22 appropriate competitive price. So you sort of

1 have no choice but to fall back on this notion  
2 of let's look for a benchmark, let's look for  
3 some other circumstance which we can argue  
4 gives us the information that we want.

5 Q When you said "zero marginal  
6 cost," what does that mean?

7 A What that means is that it costs  
8 something originally to create a sound  
9 recording, to make, I don't know most of them  
10 still call them records even though they're  
11 not CD or digital downloads. But once it's  
12 been made, it doesn't cost the record label or  
13 SoundExchange effectively anything. There may  
14 be certain small transfer costs but in general  
15 it doesn't really cost anything to make that  
16 available to another user, for example,  
17 webcaster in contrast to, for example, shoes  
18 and tires and chairs, things that to give one  
19 more to one more person there's a cost. You  
20 need to make that additional chair or that  
21 additional shoe and intellectual property is  
22 different in that regard.

1 Q Would you give an example of a  
2 situation where the value of the buyer is not  
3 inextricably interwoven with the other  
4 factors?

5 A Sure. If we wanted to for some  
6 reason analyze the market for, a thing I  
7 worked on once, the switches in car doors that  
8 allow you to, that causes the light in the car  
9 to go on when you open the door and if for  
10 some reason that was something that you wanted  
11 to figure out what should its competitive  
12 market price be, well at least in principle  
13 you can ask the question what is the  
14 contribution to the value of a car of the fact  
15 that when you open the door the lights go on.  
16 You could have a car that doesn't have that  
17 and presumably it would be not quite as  
18 desirable to buyers. The car is more valuable  
19 if it has that feature and in principle at  
20 least, you could use that to try to figure out  
21 together with information on what it costs to  
22 make those switches you could use that to try

1 to estimate the competitive market price for  
2 those little switches.

3 Now in contrast in this  
4 circumstance and I'm thinking about a webcast,  
5 I cannot construct even as a hypothetical a  
6 webcast that does not contain the right to  
7 make public performances of sound recording  
8 because without that right, there is no  
9 webcast. On the other hand, there are other  
10 things, in particular the right to make a  
11 public performance of the musical work that  
12 are just as essential. Without the right to  
13 perform the musical work, there is just no  
14 webcasting. It just can't happen and without  
15 bandwidth, there is no webcasting. It just  
16 can't happen.

17 So it's the nature, the economic  
18 nature, of webcasting that it's not possible  
19 sort of based on economic model to take the  
20 value of the webcast in its entirety and sort  
21 of break it up into its pieces and say based  
22 on economic, just economic analysis, well that



1 overall value, this percentage of it, comes  
2 from the sound recording and this percentage  
3 of it comes from the musical work and this  
4 percentage of it comes from bandwidth and this  
5 percentage of it comes from the DJ and so  
6 forth. The nature of the good makes that  
7 impossible.

8 Q Now would you explain, identify,  
9 the benchmark that you chose and explain why  
10 you chose it?

11 A So the benchmark that I chose was  
12 what is paid by the same entities, the  
13 webcasters that I'm working for, for the right  
14 to make public performances of the musical  
15 works which as I've indicated is bound up in  
16 and inextricably connected to the right to  
17 make the public performance of the sound  
18 recording.

19 Q Explain why.

20 A Right. Sorry. So the reason I  
21 chose this benchmark is it has two very  
22 desirable properties. The first is there is

1 a basis to believe that at least in an  
2 approximate sense it itself represents a  
3 competitive pricing level because if I started  
4 from a benchmark that was itself not  
5 competitive, then it would be either difficult  
6 or impossible to figure out what the  
7 implications of that are for my goal here  
8 which is a competitive pricing level for the  
9 sound recording performance. So the first  
10 virtue of the musical work royalty is there's  
11 reason to believe it's competitive and the  
12 reason there is to believe it's competitive is  
13 because as I already indicated it is set in a  
14 context in which if the parties to those  
15 agreements didn't believe they were getting  
16 approximately a competitive royalty, in either  
17 direction if the webcaster thought that the  
18 royalty that was being asked by the performing  
19 rights organizations that licensed that right  
20 was too high, they could go to the Rate Court  
21 and ask for a lower level and if the  
22 performing rights organization thought that

1 the webcasters were insisting on a rate that  
2 was too low, then they symmetrically could go  
3 to the Rate Court and ask instead to have the  
4 Rate Court set a rate.

5 So there is an institutional  
6 mechanism which stands in the background  
7 behind the agreements that have actually been  
8 struck. The numbers that I'm using, we'll  
9 come back to this later, are not actually  
10 numbers that come out of Rate Court decisions.  
11 They are numbers that come out of voluntary  
12 agreements between the parties. But those  
13 agreements were made in an institutional  
14 context in which everybody knew that if they  
15 couldn't reach agreement Rate Court was the  
16 recourse and in which the Rate Court has  
17 stated if we have to set rates, what we're  
18 going to try to do is find the competitive  
19 level. So those rates are for a competitive  
20 or at a competitive level.

21 Now that's important but of  
22 course, not sufficient. The other important

1 question is what is the economic relationship  
2 between the value of the musical works  
3 performing right and the sound recording  
4 performance right. So like any good economist  
5 when I think about a price, I think about both  
6 sides of the market. There's the buyer and  
7 there's the seller.

8 If I can convince myself and  
9 ultimately I hope you that both with respect  
10 to the buyer and with respect to the sellers  
11 the market for the musical works performing  
12 right is similar or identical to the market  
13 for the sound recording performance right. As  
14 an economist, I would conclude that if I  
15 observe a competitive price for that right, I  
16 can infer that the competitive price for the  
17 sound recording right would be the same.

18 So let's take that in two steps.  
19 Let's first talk about the buyer. So as I  
20 indicated, the buyer ultimately doesn't really  
21 care specifically about either of these  
22 rights. What the buyer cares about is the

1 right to make a public webcast and having one  
2 of these rights but not the other you can't  
3 make public webcasts. It doesn't matter which  
4 right you have. If you have only one of them,  
5 you can't do it and if you have both of them,  
6 you can do it.

7 So from the buyer's perspective,  
8 the phrase I used in my report, is these two  
9 rights are inextricably intertwined in terms  
10 of the creation of value to the buyer. Each  
11 right is literally valueless without the other  
12 and once the buyer has both of them, they  
13 jointly create the legal right to make the  
14 broadcast the webcaster wants to make. So  
15 from the buyer's perspective, they are  
16 inextricably intertwined. There is no reason  
17 why the buyer would have a reason to aim more  
18 for one or the other or less for one than for  
19 the other. So that's the buyer's side.

20 Now from the seller's side, we  
21 have a somewhat different situation because  
22 they are different sellers. In the one case,

1 we have the sellers of a sound recording  
2 performance right and the other case we have  
3 the sellers of a musical works performance  
4 right.

5 Q But the buyers are the same as --  
6 The buyers of performing rights and the buyers  
7 of musical work rights are the same.

8 A Are the same and view them  
9 economically as being equivalent in their  
10 creation of value for the user.

11 Q The seller.

12 A So the seller we have different  
13 sellers, but I believe that the economics  
14 underlying how the sellers would approach the  
15 hypothetical sale of this right in a  
16 competitive market are in fact identical as  
17 between the sellers of the musical works right  
18 and the sound recording right and the reason  
19 for this is that in both cases what we have is  
20 a situation in which the cost of creating the  
21 underlying intellectual property is sunk which  
22 by an economist what we mean is that

1 investment has already been made and this  
2 decision, do I license it to these webcasters  
3 or do I not, has no consequences for my costs  
4 and no consequences of any significance for my  
5 continued investment in the creation of this  
6 property because by any stretch of the  
7 imagination the revenues that are at issue in  
8 this particular context, the licensing to  
9 webcasters, are of very small magnitude  
10 relative to the overall revenues in both cases  
11 whether you're talking about the owners of the  
12 musical work right or you're talking about the  
13 owners of the sound recordings. They recover  
14 their costs on an ongoing basis whatever you  
15 think of those costs as being whether they are  
16 out-of-pocket costs or the time and creative  
17 energy of a composer or a singer. They  
18 recover those costs in other venues, primarily  
19 the sale of reproductions usually CDs but  
20 increasingly digital downloads or other media  
21 in which hundreds of millions or billions of  
22 dollars are paid for these works. So in both

1 cases, we have two different sellers and they  
2 are selling two different things, but they  
3 come to the decision whether or not to sell  
4 and what price with exactly the same economic  
5 framework to which is say in effect any money  
6 they can get out of this sale is incremental  
7 revenue to them with no corresponding  
8 incremental cost.

9 Now that doesn't mean they're  
10 going to give it away. I've never suggested  
11 that the fact that there's no incremental cost  
12 means that the sellers of this kind of  
13 property would just give it away. They're  
14 not. They're going to try to get as much for  
15 it as they possibly can. But as they approach  
16 that task, that goal, of getting as much as  
17 they can for this right, they're both  
18 approaching it from the same economic  
19 position.

20 So what economics tells us about  
21 that kind of situation we have on the one hand  
22 the potential buyer, the webcaster, who can't



1 engage in a business that they would like to  
2 engage in without getting this right. On the  
3 other hand, we have a seller who has no cost  
4 or close to no cost in delivering this right.  
5 So from an economic perspective, any outcome  
6 in that hypothetical, think of it as a  
7 hypothetical negotiation between these two  
8 parties, any division of the surplus, the  
9 profits, that can be made in this business  
10 between those two parties is actually a  
11 possible outcome of that negotiation. If  
12 somehow it turned out that the webcasters paid  
13 in effect one percent of their profits to  
14 either the sound recording owners or the  
15 musical works owners, that would be in a sense  
16 a good deal for them because they can go off  
17 and do their business and in a sense it would  
18 be a good deal for the sound recording owners  
19 because even though it's a small percentage,  
20 it's gravity. It's money that otherwise  
21 wouldn't have gotten and incur no costs to get  
22 it.

1                   Conversely, if the outcome of that  
2 negotiation were that 99 percent of the  
3 profits went to those two entities together,  
4 that's in some sense a reasonable outcome  
5 because from the webcaster's perspective if  
6 the choice is give away 99 percent of my  
7 profits or not do this business at all in some  
8 sense a little sliver of profit is better than  
9 none at all and from the sellers' perspective,  
10 obviously they'd be happy to get 99 percent.  
11 Now we don't really expect that to be the  
12 outcome, but economic theory as a mode of  
13 analysis actually cannot resolve that  
14 uncertainty, cannot tell us where in that  
15 range of possible deals that would be  
16 beneficial for both sides such a negotiation  
17 would come out.

18                   But we have a way of resolving  
19 that unknown which is we have data to look at  
20 with respect to the musical works. That has  
21 happened. It has happened in the form of a  
22 Rate Court sitting in the background ready to

1 step in if the result is not judged to be  
2 competitive and it has produced a certain  
3 result. A certain royalty rate was set in  
4 various different ways for four different  
5 webcasters.

6 So from an economist's perspective  
7 what I would say is using only economic  
8 theory, I'd be in big trouble because an  
9 economist would have a hard time saying how  
10 this sort of pie of economic benefit that is  
11 being created by webcasting would ultimately  
12 be divided in a competitive market between  
13 these parties. Theory doesn't allow me to  
14 answer that question. But fortunately one of  
15 the two and they are identically situated has  
16 done it and has done it in a competitive  
17 framework and I can look at that answer and I  
18 can say "Okay. Based on theory, it could have  
19 been anywhere in that range, but data tells me  
20 here's where it falls. Here's where with a  
21 competitive Rate Court in the background the  
22 parties agree to price one of these two

1 essential components and therefore from an  
2 economic perspective, I can infer that the  
3 competitive price for the other component is  
4 the same."

5 Q In your analysis, did you rely on  
6 any evidence from any other markets?

7 A Well, I did look -- Again, I'm sort  
8 of an empirical guy. I like to look at data  
9 and I think I've made a strong theoretical  
10 argument as to why the musical work right and  
11 the sound recording right are likely to be  
12 priced at the same level, but I did ask myself  
13 "Is there any evidence that that's actually  
14 true?" That's a theoretical proposition. Is  
15 there any way to test it

16 And it turns out there is another  
17 circumstance that is in a way analogous to  
18 this one where that proposition and just that  
19 proposition, the likely equality in the value  
20 of the two rights can be tested and that  
21 involves a situation in which a producer of an  
22 audio-visual system like a TV show or a movie

1 wants to incorporate into that program a  
2 previously created sound recording. So I'm  
3 going to make a movie about the `60s and I  
4 want to have the Beatles singing "I Want To  
5 Hold Your Hand" in the background as the  
6 people walk down the street.

7 As the movie producer in order to  
8 do that, I need to secure the right to  
9 reproduce. This is not a performance right  
10 that I'm looking at. It's actually the right  
11 to reproduce in the creation of the movie  
12 itself that sound recording, the Beatles  
13 singing that song, and the underlying  
14 composition which in that case happens to be  
15 written by one of the performers, but for a  
16 legal perspective it's two different rights.  
17 I need the right to incorporate the sound  
18 recording into the movie and I need the right  
19 to incorporate the composition into the movie.  
20 In the jargon of the business, the right to  
21 incorporate the sound recording is called a  
22 master use right and the right to incorporate

1 the musical work is called a synchronization  
2 or synch.

3 Now I'm not really very interested  
4 in the level of how high or low the prices are  
5 that people pay when they put music in movies,  
6 but I am interested in the relative valuation  
7 of the sound recording and the musical work  
8 because it just turns out that that  
9 circumstance is economically very similar to  
10 the one I care out here. The sound recording  
11 has already been created. The incremental  
12 cost of allowing it to be used in the movie or  
13 allowing the composition to be used in the  
14 movie is zero. So the argument that I made  
15 about the symmetry of the position of the two  
16 sellers is the same and just as with the  
17 webcast the guy making the movie needs both  
18 rights. So from the buyer's side, it's a  
19 situation that is analogous that I described  
20 for the webcasting. So I went out and got a  
21 bunch of data on what people actually pay for  
22 the master use right and the sync right in

1 several dozen movies and in several dozen  
2 television shows.

3 Now one thing that is different  
4 about that situation than what we're talking  
5 about here is there you're talking about  
6 buying a single sound recording not the right  
7 to broadcast a whole repertoire of sound  
8 recordings. So for any particular recording,  
9 it may well be that the sound recording really  
10 is worth more than the composition or vice  
11 versa. If I'm making a movie about Frank  
12 Sinatra, it's probably pretty important to me  
13 that I get Frank Sinatra singing the songs at  
14 least at some point in the movie.  
15 Substituting some other sound recording won't  
16 really work, but I may not care which songs  
17 are in he's singing.

18 On the other hand, if I'm making a  
19 movie in which there's a birthday party, it  
20 might be really important to me to use "Happy  
21 Birthday" which is actually a copyrighted  
22 composition. I may not care at all whose

1 rendition of "Happy Birthday" I'm using. So  
2 that would be a case where I would put a  
3 higher value on the musical work than on the  
4 sound recording for a single performance. But  
5 what I argue is that on average if we look at  
6 multiple performances, those things should  
7 average out and I would expect that there  
8 would be no significant tendency to pay more  
9 for the sound recording or more for the  
10 musical work and that's in fact what I found.  
11 It's summarized in my report in Table 1 that  
12 both for movies and for television if you look  
13 over all. Actually, in the data I had, the  
14 sound recording were on average three percent,  
15 were three percent less than the musical  
16 works, but that is not a statistically  
17 significant difference. So what I would  
18 conclude is that on average this evidence  
19 supports the proposition that in this kind of  
20 negotiation where both sellers are coming to  
21 this incrementally and the buyer needs both  
22 rights, it's market evidence that the two tend



1 to be valued on average at the same level  
2 supporting my theoretical contention that that  
3 should in fact be the case.

4 Q In your last answer, you used the  
5 term "incremental cost." Is that the same as  
6 "marginal cost"?

7 A Yes, in this context.

8 Q All right. Now would you now  
9 explain the model, the fee model, that you  
10 came up with and I believe it's Figure 2, the  
11 last page in your report booklet.

12 A Figure 2 summarizes the results.  
13 Let me explain a little bit about how I got  
14 there. So as I indicated earlier, MSN, AOL,  
15 Yahoo and Live365 have all to varying degrees  
16 reached agreements with they're called the  
17 PROs, performing rights organizations, who  
18 license the right to make public performances  
19 of the musical works. There are three such  
20 organizations. ASCAP and BMI each control  
21 slightly less than half of in some sense the  
22 overall repertoire of musical works that are

1 out there. An organization called SESAC  
2 controls something less than 10 percent.

3 We looked at the year 2004 and we  
4 looked at what agreements those four  
5 webcasters had in place with ASCAP and BMI and  
6 to some extent SESAC, the goal being to  
7 reconstruct based on those agreements what the  
8 webcasters paid in that year for the right to  
9 publicly perform the musical works with  
10 respect to the set of performances that are at  
11 issue in this case and it turns out that's  
12 kind of important because, for example, Yahoo  
13 has agreements with these PROs that cover not  
14 just DMCA compliant webcasting, but also  
15 covers music videos and so I had to figure out  
16 how to allocate what Yahoo paid to the musical  
17 works owners in order to identify that portion  
18 that deals just with the DMCA compliant  
19 webcast.

20 And that did require some  
21 judgments about which numbers to use and how  
22 to do some of these allocations. What I did

1 was in every case if there was any ambiguity  
2 about how to do that calculation so there are  
3 two different ways you can do this. I always  
4 chose the manner of calculation that would  
5 give me the highest number. So in the jargon  
6 of economic analysis, I did a conservative  
7 analysis. Every time I had to make a choice,  
8 I chose the approach that gives the higher  
9 number. So the numbers that I have I would  
10 argue are in some sense an upper bound. The  
11 real numbers could be lower, but they're not  
12 likely to be higher.

13 Now if you look at Figure 2, the  
14 column labeled musical work fee shows there  
15 are three rows. There's a calculation of a  
16 cost per performance that a performance being  
17 one song that is played one time per aggregate  
18 tuning hour and then as a percentage of  
19 revenue. The first two are calculated by  
20 taking actual dollar amounts that were paid by  
21 these four companies to the PROs and then  
22 dividing that by, for example, the total

1 number of aggregate tuning hours or the total  
2 number of aggregate tuning hours used in  
3 constructing estimate of performances.

4           There's a range of the numbers.  
5 You can see for example in the first entry.  
6 Under "Per Performance Musical Work Fee," the  
7 range is from 0.00008 to 0.00040 and the  
8 reason for that range is a couple of things.  
9 You know these four entities didn't all  
10 negotiate the exact same deals and they don't  
11 have exactly the same profile in terms of  
12 performances they make the relative  
13 significance, for example, of webcasting  
14 versus music videos and other things. So  
15 there is a range. And similarly, on the basis  
16 of aggregate tuning hour there's a range of  
17 0.0012 and that's in dollars. So that's  
18 basically 0.12 cents on the lower end to on  
19 the upper end of about 7/10ths of a cent and  
20 as I said those were calculated numerically,  
21 arithmetically, from actual dollar figures as  
22 they were available.

1                   The percentage of revenue is  
2                   calculated in a somewhat different way. ASCAP  
3                   and BMI both offer as sort of a standard form  
4                   license that webcasters can license themselves  
5                   on a percent of revenue basis and the  
6                   percentage that you would pay depends on  
7                   whether you select a very broad notion of  
8                   revenue or a somewhat more defined notion of  
9                   revenue. But for the higher percentage which  
10                  corresponds to something that I believe seems  
11                  to come closest to a webcasting model when you  
12                  add together the BMI offer and the SESAC  
13                  offer, sorry, the BMI offer and the ASCAP  
14                  offer, you get to a number which is just over  
15                  five percent and then I added in an additional  
16                  increment for SESAC based on a combination of  
17                  an offer that they have in fact made and an  
18                  estimate of their relative market share to get  
19                  to this 5.5 percent upper limit.

20                  The lower limit of the 3.8 percent  
21                  corresponds to the other alternative model  
22                  which ASCAP and BMI make available in terms of

1 the form license. So the difference between  
2 the first two rows and the last two rows is  
3 the first two rows are actually arithmetically  
4 calculated based on actual dollar figures  
5 relative to estimates of performance and ATH.  
6 The last one is directly taken from what BMI  
7 and ASCAP offer. And then just to complete  
8 the table, although you didn't directly  
9 address in your question, the right-hand  
10 column is the corresponding numbers actually  
11 paid by these entities, these four entities,  
12 for the sound recording rights in this same  
13 time period of 2004 and what you can see is  
14 that even if you take the upper limit of this  
15 range, it's considerably below the lower limit  
16 of the range of what was paid for sound  
17 recordings.

18 JUDGE WISNIEWSKI: Can you clarify  
19 something here, Dr. Jaffe, two things  
20 actually? The first one is simply the average  
21 that you have here. Is that just a straight  
22 arithmetic average?

1 THE WITNESS: That's a good  
2 question. I don't remember. It might have  
3 been. For the aggregate tuning hours, for  
4 example, it might have been an average over  
5 all the aggregate tuning hours rather than  
6 just an average over the four numbers for the  
7 four companies. I'd have to go back and check  
8 that. I actually don't know.

9 JUDGE WISNIEWSKI: I would  
10 appreciate it if you could clarify that at  
11 some point.

12 THE WITNESS: I will do that.

13 JUDGE WISNIEWSKI: The other  
14 question that I have for you has to do with  
15 the source listed here for this particular  
16 figure. As I understood your testimony, you  
17 had looked at these various agreements and  
18 that's where you came up with these number.  
19 But the source indicates testimony of various  
20 witnesses that we previously heard here.  
21 Could you explain why that is?

22 THE WITNESS: So this was an

1 attempt to try to make it I guess clean for  
2 the record of the case. I was provided with  
3 written materials from a number of these  
4 companies which I worked from, but my  
5 understanding is that these witnesses in  
6 effect sponsored those materials and put into  
7 the record through their written testimony the  
8 numbers. I mean I didn't in my mind actually  
9 get them in the first instance from their  
10 written testimony because these things were  
11 being created in parallel. I actually got  
12 them from certain documents. But my  
13 understanding is that these witnesses  
14 sponsored those same materials and so in some  
15 sense you as the fact finder can connect my  
16 report to their testimony and find those  
17 sources.

18 JUDGE WISNIEWSKI: Okay. Thank  
19 you.

20 MR. SUGARMAN: So your proposal to  
21 this panel is that the rates ought to be the  
22 rates that you set forth in the first column



1 of your --

2 THE WITNESS: Yes, the way I would  
3 word it is --

4 CHIEF JUDGE SLEDGE: Wouldn't that  
5 question require an opinion by an expert?

6 MR. SUGARMAN: No, I'm just asking  
7 what this expert is proposing to Your Honors  
8 as to what he believes to be the appropriate  
9 fee.

10 CHIEF JUDGE SLEDGE: I'll restate  
11 my question. Wouldn't that answer require an  
12 opinion by an expert?

13 MR. SUGARMAN: Well okay. I  
14 apologize for neglecting to -- Thank you for  
15 reminding me in that way to tender Professor  
16 Jaffe as an expert in the areas that he's  
17 discussed.

18 CHIEF JUDGE SLEDGE: Is there any  
19 objection to Professor Jaffe being accepted as  
20 an expert?

21 MR. HANDZO: No Your Honor.

22 CHIEF JUDGE SLEDGE: Professor

1 Jaffe, am I correct in applying to your resume  
2 my observations that when you became Dean of  
3 the School of Arts and Sciences you no longer  
4 performed as an active member of the faculty?

5 THE WITNESS: When I became Dean,  
6 I have not been teaching since I became Dean.  
7 I have continued to engage in scholarship and  
8 publishing as an economist and I'm considered  
9 by Brandeis to be a member of the faculty and  
10 a member of their Commerce Department.

11 CHIEF JUDGE SLEDGE: But you had  
12 no teaching responsibilities since that time.

13 THE WITNESS: That is correct.

14 CHIEF JUDGE SLEDGE: Any other  
15 questions?

16 MR. HANDZO: No Your Honor.

17 CHIEF JUDGE SLEDGE: Without  
18 objection, Prof. Jaffe is accepted as an  
19 expert.

20 MR. SUGARMAN: Thank you.

21 BY MR. SUGARMAN:

22 Q Now would you --

1 A Yes.

2 Q -- tell the panel what your  
3 recommendation is.

4 A So my view is that it's not  
5 possible to come in here and give you a  
6 precise number which is the reasonable rate or  
7 the willing buyer/willing seller rate.  
8 Economics is a somewhat imprecise science and  
9 the data in this area are somewhat limited.  
10 I believe that the calculations shown under  
11 the music works fee column in Figure 2  
12 represent an appropriate estimate of the range  
13 that a reasonable fee should fall in and so to  
14 state my conclusion in the other way, I  
15 believe that rates outside of the ranges  
16 indicated here are not from an economic  
17 perspective consistent with the willing  
18 buyer/willing seller standard as I've  
19 articulated it.

20 Q One more question about the way  
21 you came about, did your analysis. You said  
22 that you analyzed the dollars paid by the four

1 webcasters to the performing rights  
2 organizations. Is that in any way different  
3 from the analysis that you did when you  
4 testified in the first CARP?

5 A It's completely different.

6 Q And would you explain how?

7 A So in the first CARP in a way  
8 conceptually I approached the matter the same  
9 way trying to use the notion of competitively-  
10 determined musical work royalties as a  
11 benchmark. The problem we had back then was  
12 that the experience with the licensing of  
13 musical works on the internet was extremely  
14 limited both in time and in extent and I  
15 didn't feel comfortable at that time given how  
16 new that was and how limited the experience  
17 had been using that information. So what I  
18 tried to do was to take the analogy a very  
19 large additional step which was to look at  
20 what was paid for musical works in the context  
21 of conventional, over-the-air radio which  
22 meant that I was looking both in a context

1 where the buyers were not the same and where  
2 the structure of the market is quite different  
3 and that required some assumptions about how  
4 to bridge that gap.

5 In this case because it's five  
6 years later and we now have considerably more  
7 experience with the performance of musical  
8 works on the internet by these same  
9 webcasters, this was a much simpler and much  
10 more straightforward set of calculations  
11 requiring many fewer judgments for assumptions  
12 or modeling efforts because I was looking at  
13 the very same set of performances valued in  
14 the very same context. And so all I needed to  
15 do was to estimate what was in fact paid for  
16 then for the musical work right.

17 Q Professor Jaffe, in the last part  
18 of your report, it starts on page 39, you  
19 listed other factors to consider in setting a  
20 reasonable fee. Could you just briefly  
21 describe those factors for the panel?

22 A Yes, I think from my perspective

1 as an economist these are -- I've combined  
2 together here some factors which are  
3 specifically enumerated in the statute as  
4 considerations with other factors and the way  
5 I would think about this would be I've  
6 expressed my opinion as to the reasonable  
7 range, but I think these factors taken in  
8 their entirety would argue that that range as  
9 a range is in some sense -- I'm not  
10 indifferent about the range. I would argue  
11 that the reasonable royalty probably should be  
12 in the lower end of the range because these  
13 factors which I wasn't able to quantify argue  
14 that the methods I've used may have  
15 overestimated the competitive rate.

16 So the first factor is the fact  
17 that the PROs that license the musical works  
18 themselves have market power. Now I've made  
19 reference to the fact that there's a Rate  
20 Court sitting in the background. I actually  
21 think the likelihood of the parties going to  
22 the Rate Court if they're satisfied with the

1 negotiated outcome is not really quite  
2 symmetric between the PROs and the licensees.

3 Because if I think about just take  
4 one for example, I'll pick one at random,  
5 Yahoo, for Yahoo to go the Rate Court to get  
6 a reduction in its fee to ASCAP would be an  
7 expensive proposition in the terms of the  
8 litigation costs for a relatively small return  
9 because the costs of the musical work royalty  
10 are a relatively small part of Yahoo's overall  
11 economic picture, whereas the ASCAP, ASCAP has  
12 to worry that every one of these agreements in  
13 some sense, in some diffuse sense, is a  
14 precedent that the Rate Court might look at  
15 later. And so even if Yahoo is insisting on  
16 a rate that's a little too low and there's  
17 very much money at stake with Yahoo, ASCAP has  
18 to worry that if it signs that deal with Yahoo  
19 at a rate that really is below the competitive  
20 rate when it's in the Rate Court with somebody  
21 else, the Rate Court is going to point to that  
22 and say, "Well, you signed that deal with

1 Yahoo. We take that as evidence of the  
2 competitive rate."

3 So I think that while the Rate  
4 Court is in the background, it has a bigger  
5 impact in terms of ASCAP than in terms of, or  
6 BMI, than the users. So to an unquantifiable  
7 extent, the negotiated deals we see are more  
8 likely to be on the high side of competitive  
9 than they are to be on the low side. So  
10 that's the first factor.

11 The second thing which I discussed  
12 in my report which we haven't yet talked about  
13 is the issue of the promotional value of these  
14 performances being made on the internet. So  
15 from an economic perspective, if I think about  
16 sort of the competitive price for the transfer  
17 of this right, what would happen would be if  
18 there's value that is transferred really in  
19 either direction by the two parties in  
20 association with the transaction, it is  
21 separate from the royalty and what I would  
22 accept would be that the royalty would adjust



1 so that the sum of the actual royalty payment  
2 and any other consideration that's flowing  
3 between the two parties, the sum of those two  
4 things would be equal to a competitive rate  
5 and to the extent that the sound recording  
6 owners are getting value from the performance  
7 of their sound recordings on the internet  
8 because of that performance inducing the  
9 purchase of CDs, people hear a song they've  
10 never heard before. They get excited. They  
11 can go out to the store and buy a CD or in  
12 some of these services, they can hit a button  
13 right on the internet to buy the CD there.  
14 The extent of that phenomenon is difficult to  
15 quantify. It's clearly significant in over-  
16 the-air radio. There is some evidence in this  
17 proceeding from some of the webcasters about  
18 activities that they engage in and that the  
19 record companies engage in that suggest that  
20 there is also promotional value on the  
21 internet.

22 I haven't been able to quantify

1 it. So I didn't factor it into my  
2 calculation. If I were able to quantify the  
3 extent to promotional value, then that would  
4 imply that the actual royalties should be  
5 lower so that the sum of the two is equal to  
6 the competitive rate. And the reason for that  
7 is because the promotional value is of much  
8 more importance to the sound recording owners  
9 than to the musical work owners. So if I  
10 owned the right to a musical work, I do  
11 benefit if someone goes out and buys that CD  
12 or digitally downloads that recording but not  
13 nearly as much as the record companies. The  
14 division of the profits on reproductions  
15 reflects frankly the much greater cost that  
16 the record companies engage in in creating the  
17 sound recording.

18 So on the margin when we sell one  
19 more CD, that benefits the record companies  
20 much more than it benefits the composers and  
21 publishers. That means that any activity that  
22 promotes the sale of CDs is more valuable to

1 the record companies than it is the composers.  
2 So if it were possible to quantify the  
3 promotional value of webcasting, in principle  
4 that would suggest a downward adjustment of  
5 the musical works royalty rate in order to get  
6 a competitive sound recording royalty rate.  
7 Since I haven't been able to quantify it, I  
8 have not included. But I do think it's  
9 relevant in terms of thinking about where  
10 reasonable I think it to be.

11 The next sort of set of things  
12 that I talk about in the report relate to both  
13 factors that might influence a hypothetical  
14 negotiation between these parties but which  
15 are also specifically identified by the  
16 statute are the technological contribution and  
17 the capital investment, the risks that are  
18 being faced by the two parties and the costs  
19 that are being born by the two parties and  
20 with respect to all of these factors what's  
21 relevant is that the sound recordings have  
22 already been made. They are not going to go

1 away one way or another whether or not we have  
2 a webcasting, whether we have webcasting,  
3 whether we have an agreement to license  
4 webcasting.

5 So relative to this transaction to  
6 this market, the owners of the sound  
7 recordings, all they're contributing is the  
8 right itself. They are not investing in it.  
9 They are not taking risks in it. They are --  
10 And they're bearing costs in it. Whereas the  
11 webcasters are. I mean they're the ones who  
12 have to hire the DJs and purchase the  
13 bandwidth and they're incurring the costs and  
14 taking the risks to create this market. So  
15 again, to the extent that those factors have  
16 some qualitative role, I would argue they  
17 suggest that the numbers that I've, the range  
18 that I have proposed we would look at the  
19 lower end.

20 And then finally the legal right  
21 that is actually conveyed for the DMCA  
22 compliance webcasting is restrictive in a way

1 that the right to perform the musical works is  
2 not and again I can't quantify the  
3 significance of that, but in general, if you  
4 get a restrictive legal right that would be  
5 potentially worth less than an unrestrictive  
6 legal right. So that might be a factor that  
7 would also suggest all else equal going  
8 towards lower rates.

9 Q So the sum of these factors would  
10 suggest to you that the rate for sound  
11 recording should be lower than the rate for  
12 musical works. Is that what you're saying?

13 A Yes, all else equal.

14 MR. SUGARMAN: Right. No further  
15 questions.

16 CHIEF JUDGE SLEDGE: Mr. Joseph,  
17 any questions by the Broadcasters?

18 MR. JOSEPH: No questions, Your  
19 Honor.

20 CHIEF JUDGE SLEDGE: Ms. Brown?

21 MS. BROWN: No questions, Your  
22 Honor.

1 CHIEF JUDGE SLEDGE: Mr. Handzo?

2 MR. HANDZO: I have some  
3 questions, Your Honor.

4 CROSS EXAMINATION

5 BY MR. HANDZO:

6 Q Good Morning, Dr. Jaffe.

7 A Good morning.

8 Q Dr. Jaffe, in the 2001-2002 CARP  
9 proceedings, you testified for certain of the  
10 webcasters. Correct?

11 A That is correct.

12 Q And in 2001, you did some research  
13 into what the movie and TV industries pay for  
14 sound recordings and for musical works.  
15 Right?

16 A For the reproduction rights, yes.

17 Q Okay, and the empirical data that  
18 you talked about today with respect to what  
19 gets paid in the movie and TV business is the  
20 same data that you used in 2001. Correct?

21 A That is correct.

22 Q With respect to the calculation of

1 the relative values of sound recordings and  
2 musical works in the movie and TV business  
3 you've done no new work for this proceeding.  
4 Is that right?

5 A That is correct.

6 Q You've just recounted the analysis  
7 four or five years ago. Right?

8 A Yes.

9 Q And with respect to the  
10 theoretical framework of your analysis as to  
11 why you think sound recordings and musical  
12 works should be valued the same, the same  
13 theoretical framework was part of your  
14 testimony last time as well. Correct?

15 A Basically yes.

16 Q And in fact, parts of your written  
17 testimony in this case are taken word for word  
18 from your testimony last time. Right?

19 A That is true.

20 Q Now when you were engaged for this  
21 case, in 2005, the only documents that you  
22 reviewed were your statements from the 2002

1 CARP and the decisions from the 2002 CARP.  
2 Correct?

3 A When you mean -- I'm not sure what  
4 you mean by "when I was engaged." Do you mean  
5 the course of all of my work or at the time I  
6 was engaged?

7 Q There came a point in time when  
8 you were engaged to be a witness in this case.  
9 Correct?

10 A Yes.

11 Q And that happened some time in  
12 2005.

13 A Yes.

14 Q And in connection with that  
15 engagement, the documents that you reviewed  
16 were your testimony from the 2002 CARP and the  
17 decisions from the 2002 CARP. Right?

18 A I don't mean to quibble with you.  
19 I'm just -- Subsequent to my engagement in  
20 preparing my report, I also, for example,  
21 looked at material from the clients about  
22 their PRO agreements. Are you delimiting it



1 in time so that we don't get to that?

2 Q When you first, let's start when  
3 you first started off. When you first started  
4 off, that's what you looked at, right, your  
5 testimony from the prior CARP and the prior  
6 CARP decision?

7 A I think that's right. Yes.

8 Q Okay.

9 A And the Librarian's decision.

10 Q And the Librarian's decision. And  
11 as I understand your testimony, you  
12 subsequently got some documentation from your  
13 clients with respect to what they paid the  
14 PROs. Right?

15 A That is correct.

16 Q Okay, and that's the documentation  
17 that you've reviewed here. Right?

18 A I think that's right. Yes.

19 Q When you were engaged in this  
20 case, you also had some conversations with  
21 your clients, right, some conference calls?

22 A Yes.

1 Q And you discussed with them their  
2 business models and how they calculate the  
3 musical works and sound recordings fees.

4 A Generally yes.

5 Q You did not investigate in  
6 connection with your engagement for this case  
7 how the costs and revenues of the webcasting  
8 business have changed since 2002. Is that  
9 right?

10 A Not in any detail. No.

11 Q You haven't looked at it at all,  
12 have you?

13 A I mean I think in our  
14 conversations there may have been some general  
15 discussion about it, but I've done no  
16 systematic analysis of it.

17 Q Other than some general discussion  
18 with your clients, you haven't looked at that  
19 issue, have you?

20 A That's correct.

21 Q You didn't investigate in  
22 connection with your retention here how the

1 webcasting business has grown in terms of the  
2 number of listeners or listener hours, have  
3 you?

4 A Well, it's implicit in my  
5 analysis. I have the numbers and I had the  
6 numbers last time. So --

7 Q That's not something that you  
8 investigated though, did you?

9 A I'm not sure I know what it would  
10 mean to investigate. For these clients, I  
11 know the magnitude of their ATH in 2004 and  
12 for some of these clients and similar clients,  
13 I knew those numbers back in 2001. So I know  
14 what the difference is, but I'm not -- So  
15 that's the extent of my investigation.

16 Q So you know those numbers have  
17 grown substantially. Right?

18 A Yes.

19 Q Okay, but that formed no part of  
20 your analysis here. Is that right?

21 A I don't know what you mean when  
22 you say it's "formed no part." I have a model

1 which is predicated on aggregate tuning hours  
2 precisely because it's important to track that  
3 growth.

4 Q Well, you tracked it only to the  
5 extent that it affected the royalties paid for  
6 to performing rights organizations and sound  
7 recordings. Correct?

8 A Well, I guess what I'm saying is I  
9 think it also implicitly underpins my model.  
10 It's not an accident that I've chosen a model  
11 that results in higher royalties when an  
12 industry grows because I know that that's an  
13 important thing to do. So I have a model and  
14 this was discussed in my previous testimony  
15 and it is discussed I think in here too that  
16 one of the reasons I chose a model based on  
17 aggregate tuning hours is because it has the  
18 feature that it causes royalties to increase  
19 when the scale of performances grows. So it  
20 is implicit in my model that the model is  
21 robust to the growth of the industry.

22 Q When you say it's "implicit in

1 your model" what I understand and correct me  
2 if I'm wrong is that your proposal to this  
3 Board as to how the fees should be structured  
4 includes an ATH component.

5 A That's correct.

6 Q Okay. So that's what you mean  
7 when you've taken ATH into account in your  
8 model. Correct?

9 A Yes.

10 Q But the growth in the business of  
11 webcasting has no part in your analysis of  
12 whether sound recording rights should be  
13 valued the same as musical works. Right?

14 A The trouble I have is that the  
15 first part of your question contradicts the  
16 second part. So maybe I'll answer it in this  
17 way by saying other than constructing a model  
18 which is designed to produce higher royalties  
19 when an industry grows, other than that, the  
20 fact that the industry has grown does not  
21 factor into my analysis.

22 Q Now you did not in the course of

1 your engagement here investigate how the  
2 owners of sound recording rights are  
3 compensated in other digital markets, have  
4 you?

5 A No.

6 Q In your initial discussions with  
7 your clients when you were engaged in this  
8 case, you concluded from the beginning that  
9 the easiest approach would be to work with the  
10 musical works rate that you used in the prior  
11 CARP. Right?

12 A Yes.

13 Q And that was easiest for you to do  
14 because you'd done it before. Right?

15 A Well and because as I described to  
16 the Panel, it's predicated on a competitive  
17 benchmark and so it allows you to get a  
18 competitive result without having to solve  
19 the very difficult problem of how you would  
20 take a benchmark that is not competitive and  
21 somehow correct for the market power.

22 Q And so from the very beginning of

1 your engagement that benchmark, musical works  
2 rate, was what you were focused on. Right?

3 A Yes.

4 Q Now in 2001, Dr. Jaffe, when you  
5 presented your theory that the musical works  
6 rate should be the same as the sound recording  
7 rate, the CARP rejected that theory, didn't  
8 it?

9 A I don't think so.

10 MR. HANDZO: Dr. Jaffe, let me  
11 show you what we're marking as SoundExchange  
12 Trial Exhibit 74 which I represent to you is  
13 the CARP decision.

14 (Whereupon, the above-  
15 referred to document was  
16 marked as Sound Exchange  
17 Exhibit No. 74 for  
18 identification.)

19 BY MR. HANDZO:

20 Q Let me ask you to turn if you  
21 would to page 41 of that decision. Do you  
22 have that?

1 A Yes.

2 Q Okay, and do you see there the  
3 paragraph where it says "The Panel agrees with  
4 RIAA that the market for the performance of  
5 musical works is distinct from the market of  
6 the performance of sound recordings. Musical  
7 works and sound recordings do not compete in  
8 the same market and they have different cost  
9 and demand characteristics." I'll skip the  
10 cite. "Moreover, the Panel rejects Dr.  
11 Jaffe's premise that the value of performance  
12 rights in sound recordings are necessarily no  
13 greater than in musical works because the  
14 costs are sunk. This view assumes erroneously  
15 in our view that sound recording owners have  
16 a static perspective and do not consider the  
17 cost of developing new sound recordings when  
18 negotiating fees." Do you see that?

19 A Yes.

20 Q Okay. And so that section of the  
21 decision the CARP certainly disagreed with  
22 your theory. Correct?



1           A       They disagree with an aspect of my  
2 theory. Yes.

3           Q       Okay. And I take it you disagree  
4 with those statements by the CARP.

5           A       I think most economists would  
6 disagree with those statements.

7           Q       And my question is do you  
8 disagree.

9           A       I do disagree. Yes.

10          Q       Okay. And you are asking this  
11 Board to disagree with that aspect of the CARP  
12 decision as well. Correct?

13          A       I haven't analyzed the extent to  
14 which -- I mean this focuses on an aspect of  
15 my argument and frankly I haven't analyzed the  
16 extent to which one could reconcile my  
17 ultimate conclusion with this particular  
18 point. A lot of people can decide that on  
19 their own.

20          Q       Well, for example, the CARP here  
21 says that they reject your premise that the  
22 value of performance rights and sound

1 recordings are necessarily no greater than  
2 musical works because the costs are sunk.  
3 They specifically rejected that sunk cost  
4 theory. Right?

5 A That is correct.

6 Q And that is part of your theory  
7 today. Right?

8 A It is, yes.

9 Q And so you're asking this Board to  
10 disagree with the CARP on that point, sir.  
11 Right?

12 CHIEF JUDGE SLEDGE: Mr. Handzo,  
13 I'm puzzled by your question. It seems to  
14 infer that a fact decision made by some prior  
15 adjudicatory process would have any relevance  
16 to a fact decision in this adjudicatory  
17 process.

18 MR. HANDZO: I think it would,  
19 Your Honor, if the facts were the same and --

20 CHIEF JUDGE SLEDGE: Is there any  
21 argument that the facts are the same?

22 MR. HANDZO: I think with respect

1 to his theory the answer is yes they are.  
2 He's relying on his data from 2001. He hasn't  
3 changed it.

4 CHIEF JUDGE SLEDGE: I suggest  
5 that we'll make our decision based on the  
6 facts presented to us in this case and not  
7 make our decision based on facts presented to  
8 some other body in some other case.

9 MR. HANDZO: I certainly recognize  
10 that that's the case, Your Honor. I think  
11 what I'm suggesting through my questions to  
12 Dr. Jaffe is that to the extent that the facts  
13 were the same in that case certainly the  
14 Panel's decision should be a significant  
15 factor for this court.

16 CHIEF JUDGE SLEDGE: Go ahead.

17 BY MR. HANDZO:

18 Q Dr. Jaffe, the current statutory  
19 rate for the performance of sound recordings  
20 is more than twice the current musical works  
21 rate in the webcasting market. Correct?

22 A That is correct.

1 Q Okay. As I understand your theory  
2 in a competitive market, willing buyers and  
3 willing sellers would have agreed to a sound  
4 recording rate equivalent to the musical works  
5 rate. Is that right?

6 A Approximately, yes.

7 Q So if your theory is right, the  
8 CARP and the Librarian had to be wrong when  
9 they determined that a willing buyer and a  
10 willing seller would agree to a performance  
11 rate for sound recordings that was twice the  
12 musical works rate.

13 A Well, this gets back to what I  
14 think from an economist's perspective is in  
15 terms of economic jargon ambiguity in the  
16 phrase "willing buyer/willing seller." I  
17 believe that what the CARP and Librarian did  
18 last time based on the limited information  
19 that was available at that time was set a rate  
20 that was above the competitive rate and  
21 therefore not consistent with what I am  
22 arguing is the appropriate public policy and

1 economic interpretation of the willing  
2 buyer/willing seller framework.

3 Q Which is another way of saying you  
4 disagree with the rate that the CARP set last  
5 time. Is that right?

6 A Yes.

7 Q But you would agree with me that  
8 if the CARP was right last time in the rate  
9 that it set your theory must be wrong because  
10 the CARP set a rate that was substantially  
11 higher than the musical works rate.

12 A Well, I guess it depends on what  
13 you mean by "if the CARP was right." The CARP  
14 and then the Librarian in reviewing the CARP's  
15 decision made I think it's fair to say the  
16 best estimate they could based on the data  
17 that was available and the concept that they  
18 were trying to implement.

19 We know more now than we knew then  
20 and so I think that one interpretation would  
21 be that the CARP and the Panel were right in  
22 the sense that given the information that was

1 available at the time they did the best they  
2 could to come up with a competitive rate.  
3 With what we know now, we know that the rate  
4 that they chose was too high for 2004.

5 Q It still is the case, is it not,  
6 that if the CARP got the rate right, then your  
7 theory is wrong?

8 CHIEF JUDGE SLEDGE: Mr. Handzo,  
9 I'm sorry. You're asking him to give an  
10 opinion as to an ultimate decision to be made  
11 this Board. That's an improper question.

12 MR. HANDZO: I'll move on, Your  
13 Honor.

14 CHIEF JUDGE SLEDGE: Please move  
15 on.

16 BY MR. HANDZO:

17 Q Now, Dr. Jaffe, I think when you  
18 testified about your theoretical framework  
19 here you sort of examined it both from the  
20 buyer's side and then from the seller's side.  
21 Right?

22 A Yes.

1 Q Now I want to start with the  
2 buyer's side of the negotiations. One of the  
3 things you said I believe is that the buyer  
4 needs both the musical work and the sound  
5 recording rights to be a webcaster. Right?

6 A Effectively yes.

7 Q Now in theory you would agree,  
8 wouldn't you, that just because a manufacturer  
9 let's say needs two different patents in order  
10 to make a widget. It doesn't mean that the  
11 manufacturer is necessarily going to pay the  
12 same thing for those two pieces of  
13 intellectual property. Is that fair?

14 A So your hypothetical is that both  
15 patents are needed. They are both required.  
16 And your question is about the ultimate  
17 outcome of what they will pay, not what the  
18 value is to the manufacturer.

19 Q Let me refine the hypothetical a  
20 little.

21 A Okay.

22 Q Let's say you need two patents to

1 make this widget, but let's say the  
2 manufacturer has some other patents that it  
3 could substitute for one of those patents. It  
4 doesn't have a good substitute for the other  
5 patent.

6 A Okay.

7 Q Under those circumstances, you're  
8 not going to pay the same for the two pieces  
9 of intellectual property. Right?

10 A The difficulty I'm having with  
11 your question is your predicate was you said  
12 we're going to focus on the buyer, but then  
13 your question has been not about what is the  
14 buyer's valuation. It's been about what is  
15 actually paid as a result of a market  
16 transaction which of course involves both the  
17 buyer and the seller. So if what you're  
18 getting at which is not exactly what you asked  
19 is that the buyer's valuation of those  
20 different patents one of which there's a  
21 substitute for would be different, I would say  
22 yes, the buyer's valuation would be different.



1 Q The buyer would value at a lower  
2 level the patent for which it has substitutes  
3 compared to the patent for which it doesn't  
4 have a good substitute.

5 A Yes.

6 Q Okay. Now with respect to music,  
7 the same thing is true if you're only buying  
8 one song. Right?

9 A That is correct.

10 Q If you really want a particular  
11 musical work and you don't care who performs  
12 it, the musical work is likely to be more  
13 valuable to the buyer.

14 A The right to the musical work will  
15 be more valuable than the right to a  
16 particular sound recording of that musical  
17 work.

18 Q And if you really like a  
19 particular performer and don't care which  
20 musical work she performs, the sound recording  
21 may be more valuable to the buyer. Right?

22 A Yes, that is correct.

1 Q So in effect, going back to my  
2 first example of a buyer who really likes a  
3 particular musical work and doesn't care who  
4 performs it, the musical work becomes  
5 relatively more valuable because there are  
6 substitutes for the performer or the sound  
7 recording.

8 A That's correct.

9 Q Now as I understand your theory,  
10 you argue that this ability to substitute one  
11 sound recording for another or one musical  
12 work for another doesn't really exist when  
13 what you're doing is purchasing a blanket  
14 license. Is that correct?

15 A Yes.

16 Q So as a matter of theory, it's the  
17 fact that the buyer in the webcasting  
18 situation is purchasing a blanket license that  
19 in your view makes the two rights equivalent.

20 A Well, I would say it's a little  
21 more general than that. I think what makes  
22 them equivalent is that the business that the

1 webcaster wants to engage in is the public  
2 performance of a relatively large and diverse  
3 set of musical works and sound recordings so  
4 that in the aggregate one way or another, and  
5 it wouldn't in theory have to be a blanket  
6 license, one way or another in the aggregate  
7 they have to have access to a large number of  
8 sound recordings and to a large number of  
9 musical works and so whatever differences  
10 there might be in individual titles are likely  
11 to be averaged out in the same way they were  
12 in the music and TV data resulting in  
13 valuations of the two rights from the buyer's  
14 perspective that are the same.

15 Q Let me examine that a little bit.  
16 I mean you would agree with me, wouldn't you,  
17 that when you're buying an individual song,  
18 musical work might be more valuable, sound  
19 recording might be more valuable. Right?

20 A Yes.

21 Q And there's no necessary economic  
22 reason why if you just happened to be buying

1 a lot of them that's necessarily going to  
2 average out to be the same. Right?

3 A I think there is because in the  
4 aggregate there's no way -- I guess one way to  
5 say it is this. If we're talking about a very  
6 large number of titles, in some sense there  
7 can't be big variations in the availability of  
8 substitutes because if I need thousands of  
9 titles, there isn't going to be a substitute  
10 for thousands of titles that's going to vary  
11 greatly in the availability of that as between  
12 the sound recordings and the music works.  
13 It's a fundamentally different proposition  
14 particularly since when I'm setting up to  
15 webcast at that moment I don't even know  
16 necessarily which titles either from the terms  
17 of a sound recording or composition I'm  
18 particularly looking for and so it's the  
19 essence of the situation that you have the  
20 same need for the sound recording and the  
21 musical works licenses.

22 Q It certainly is theoretically

1 possible, isn't it, that if I'm buying a  
2 significant number of songs the sound  
3 recordings might be relatively scarcer than  
4 the musical works. Theoretically, that's  
5 possible.

6 A I guess if you pose a completely  
7 abstract theoretical with no other context I  
8 can't reject that that might be possible. It  
9 doesn't -- I can't think of a circumstances in  
10 which it would apply and it doesn't seem very  
11 sensible to me. But you made the hypothetical  
12 so general and so abstract I guess I can't  
13 rule out that that, theoretically that could  
14 happen.

15 Q Okay, and so what I come back to I  
16 think is that it is important for your theory  
17 with respect to webcasting that webcasters are  
18 buying a blanket license. Right?

19 A No, it is not.

20 Q As I understand what you're saying  
21 at least, it's a blanket license or it's a  
22 large volume of sound recordings. I'm sorry.

1 A large volume of songs.

2 A It's a large number of songs.  
3 It's the business model of webcasting where  
4 what you're doing is by definition creating  
5 the ability to deliver a large number and  
6 variety of both musical works and sound  
7 recordings.

8 Q Now your empirical test of your  
9 theory --

10 JUDGE WISNIEWSKI: Just --

11 MR. HANDZO: Sorry.

12 JUDGE WISNIEWSKI: All right.  
13 Just a point of clarification, are you  
14 suggesting that all webcasters are homogenous?

15 THE WITNESS: No, but for example  
16 you know I'm thinking about other kinds of  
17 internet services including, for example,  
18 certain kinds of interactive services or on-  
19 demand services. I haven't really thought  
20 about their needs in terms of licensing  
21 because it's not a market that I've analyzed.  
22 But I think webcasters, what they are doing,

1 is it's by definition. It's not interactive.  
2 They can't in fact play the same songs over  
3 and over again. They're actually legally  
4 restricted from doing that. So they have to  
5 have a reasonably wide diversity of titles  
6 available to them. I'm not ruling out that  
7 there might be a webcaster that just like in  
8 radio that's going to sort of specialize in  
9 country and western and some other webcaster  
10 might specialize, you know, in acid rock. But  
11 the economics of the situation are still  
12 generically that they need a large number and  
13 variety of titles.

14 JUDGE WISNIEWSKI: I was just  
15 trying to figure out if you were equating the  
16 Yahoos that are part of this proceeding with  
17 the religious broadcasters that are also part  
18 of this proceeding.

19 THE WITNESS: I haven't thought  
20 about the religious broadcasters.

21 JUDGE WISNIEWSKI: Thank you.

22 MR. HANDZO: Looking at the clock,

1 Your Honor, we're at our normal break time.  
2 I don't know if this is a good time for you to  
3 break --

4 CHIEF JUDGE SLEDGE: All right.  
5 We'll recess ten minutes. Off the record.

6 (Whereupon, the foregoing matter  
7 went off the record at 11:04 a.m. and went  
8 back on the record at 11:20 a.m.)

9 CHIEF JUDGE SLEDGE: On the  
10 record. We'll come to order.

11 MR. HANDZO: Thank you.

12 BY MR. HANDZO:

13 Q Dr. Jaffe, just to try and finish  
14 up the issue we were talking about before the  
15 break, do I correctly understand your  
16 testimony that in your view if you look at a  
17 large enough volume of songs the buyer's  
18 ability to substitute one sound recording for  
19 another and the buyer's ability to substitute  
20 one musical work for another on average is  
21 going to come out about the same.

22 A I am not just saying that. I'm



1 saying that if you're looking at a large  
2 number of songs it's going to be the case by  
3 construction that you can't, you're not going  
4 to find variations in the extent to which you  
5 can find substitutes for that large body  
6 because that's what you'd need. Your ability  
7 to substitute for a single song is irrelevant.

8 The question is could you find a  
9 substitute for the large body of sound  
10 recordings and could you find a substitute for  
11 the large body of musical works and is there  
12 going to be a difference in that ease of  
13 substitutability and it's the nature of the  
14 fact that it's a large group that I think it's  
15 extremely unlikely there would be any  
16 variation in the availability of substitutes.

17 Q Okay. I think I'm now  
18 understanding, but let me summarize it to make  
19 sure. Your theory as to why the musical works  
20 rights and the sound recording rights are  
21 going to be equivalent is that the buyer is  
22 either purchasing a blanket license or a large

1 volume of songs.

2 A A large volume and variety, yes.

3 Q Okay. Now it was the movie  
4 business and the TV business that you looked  
5 to to try and find some empirical confirmation  
6 for that theory. Right?

7 A Yes.

8 Q Now in the movie and TV business,  
9 the buyers are not buying either a blanket  
10 license or a large volume of songs.

11 A That is correct.

12 Q So the movie and TV business  
13 didn't really test your theory. Isn't that  
14 right?

15 A I don't think that's right.

16 Q Well, your theory as I understand  
17 it turns at least in part on the buyers buying  
18 a blanket license or a purchase of a lot of  
19 songs. Right?

20 A No, I don't think you're looking  
21 at it right as an empirical test. What I  
22 would say is if one had found in the movie and

1 TV arena that there was a difference which we  
2 didn't find I suppose you could think about  
3 whether the reason for that difference is the  
4 fact that they're actually looking at  
5 individual songs and in the aggregate the  
6 differences didn't average out. But given  
7 that I found no difference, the fact that it  
8 was done song by song in a way the test I  
9 propose for my own theory was stacked against  
10 my own theory. But since it passed the test,  
11 it still passes even though the circumstance  
12 is different in that regard.

13 Q Is it fair to say that your  
14 conclusion that sound recordings and musical  
15 works wind up being valued the same in the  
16 movie business is based on the empirical  
17 evidence and not on an economic theory that it  
18 had to come out that way in that business?

19 A Again, I would say it differently.  
20 I would say I have a theory which I believe is  
21 right. I believe it's right for performance  
22 rights for webcasts. I believe it's right for

1 reproduction rights for movies, but a theory  
2 is always something that you would like to  
3 test if you can. So I tested it in the movie  
4 area and the data supported it.

5 Q Okay. I don't want to beat a dead  
6 horse, but your theory involved buyers who  
7 were buying a blanket license or a large  
8 volume of songs and your empirical test was in  
9 a market where the buyers were buying single  
10 songs. Right?

11 A And that difference might explain  
12 away --

13 Q Dr. Jaffe, before you explain your  
14 answer, can you just give me a yes or no?

15 A Yes, that difference exists.

16 Q Okay. Thank you.

17 A And you don't want me to explain.

18 Q I have a feeling you're going to  
19 get your chance.

20 A Okay.

21 Q You would agree with me, wouldn't  
22 you, that in the movie and TV business the

1 buyers are different from the buyers in the  
2 internet radio business?

3 A Yes.

4 Q And in the movie business the  
5 buyers are buying music for a different  
6 purpose. Right?

7 A Yes.

8 Q They're buying it to incorporate  
9 it into a movie or a TV show. Right?

10 A Yes.

11 Q And in that context for movies or  
12 TV, the music may be a relatively minor  
13 artistic component of the overall work.

14 A Yes.

15 Q And for internet radio or  
16 webcasting, music is a critical component.  
17 Right?

18 A Yes.

19 Q Now another difference between the  
20 movie and TV market on the one hand and the  
21 internet radio business on the other is that  
22 the buyers that are in the movie and TV

1 business are actually buying reproduction  
2 rights rather than performance rights.  
3 Correct?

4 A That is correct.

5 Q Would you also agree with, Dr.  
6 Jaffe, that another difference between the  
7 movie and TV business on the one hand and the  
8 internet business on the other is that buyers  
9 in the movie and TV business can use what's  
10 called a cover band?

11 A I don't actually know about that.

12 Q You know what a cover band is.  
13 Right?

14 A I don't. Sorry.

15 Q Are you familiar with the concept  
16 of having a band that sounds a lot like a  
17 popular band but it isn't that band?

18 A Sure.

19 Q Okay, and let's just agree that  
20 I'm going to call that a cover band.

21 A Okay.

22 Q So just to take the example a

1 little further, you could have a band that  
2 sounds a lot like the Beatles, but they're not  
3 the Beatles.

4 A Okay.

5 Q And we're going to call that a  
6 cover band and you would agree with me,  
7 wouldn't you, that in the movie business if I  
8 wanted to make a movie to use your example  
9 that used a Beatles' song, I forget the one  
10 you picked.

11 A I don't remember either.

12 Q I don't remember. Let's call it  
13 "A Hard Day's Night."

14 A Fine.

15 Q I want to make a movie that uses  
16 "A Hard Day's Night" and I can't get the sound  
17 recording rights at a price that I want to  
18 pay. I could hire a cover band which would  
19 perform "A Hard Day's Night." Correct?

20 A I assume so.

21 Q And if I'm in the movie business I  
22 could just have that cover band perform that

1 song and I could incorporate it into the  
2 movie.

3 A You could.

4 Q And under those circumstances, I  
5 wouldn't have to pay the sound recording  
6 rights for the Beatles' version of that song.

7 A That's correct.

8 Q But in the hypothetical that I'm  
9 giving you I would still have to pay for the  
10 musical work rights for "A Hard Day's Night."

11 A That is correct.

12 Q Now let me turn it around. Let's  
13 say in my movie I want to use the song "A Hard  
14 Day's Night" because the lyrics really happen  
15 to fit with what I'm trying to do in the  
16 movie. I don't have the option of going out  
17 and hiring a songwriter to write a song that  
18 really sounds exactly like "A Hard Day's  
19 Night." Right?

20 A That's correct and you'll recall  
21 that in my analysis I excluded every song in  
22 which there was a new recording made for the



1 movie. I didn't include those. So the  
2 analysis is based only on those cases where in  
3 fact it was a preexisting recording and a  
4 preexisting composition.

5 Q Isn't it the case though, Dr.  
6 Jaffe, that when people in the movie business  
7 or in the TV business are negotiating to buy  
8 those sound recording rights they have the  
9 ability to at least threaten that they'll just  
10 rerecord with a cover band if the sound  
11 recordings aren't sold at the price they want?

12 A In some cases, they may have that  
13 ability. Yes.

14 Q Now you would agree with me that  
15 webcasters can't recreate a big portfolio of  
16 music by hiring a bunch of cover bands to go  
17 out and rerecord it. Right?

18 A That is correct.

19 Q So the option to use a cover band  
20 exists in the movie and TV business, but  
21 doesn't exist in the internet radio business.

22 A That is correct.

1 Q And whatever leverage the ability  
2 to use the cover band might give buyers of  
3 sound recordings in the movie and TV business  
4 doesn't exist in the internet business.  
5 Right?

6 A Whatever that may be and however  
7 it may be greater than the ability to  
8 substitute a different composition does not  
9 exist.

10 Q I'm sorry. I didn't hear the end  
11 of your answer.

12 A Well, I mean you gave me the  
13 hypothetical if I want to have "A Hard Day's  
14 Night" I can't get someone else to write "A  
15 Hard Day's Night" for me, but we don't know to  
16 what extent in typically movies the movie  
17 producer cares about the exact song or could  
18 substitute a different song, a completely  
19 different song, even one that they got written  
20 just for the movie. So your hypothetical  
21 posits that there is a greater ability to  
22 substitute a cover band than there is an

1 ability to substitute a different song and  
2 that may be true or it may be not. I have no  
3 idea.

4 Q Okay. That's not something that  
5 you'd studied.

6 A No.

7 Q Now let's talk about the seller's  
8 side of the negotiations. As I understand  
9 your theory, you suggest at least in part that  
10 sellers of musical works and sellers of sound  
11 recordings would settle for the same amount in  
12 a negotiation because the cost of producing  
13 the copyrighted material are sunk for both of  
14 them.

15 A That's correct.

16 Q And by "sunk" just so I understand  
17 it, you mean that the cost of producing that  
18 intellectual property have already been  
19 expended.

20 A Yes.

21 Q And so in your view, neither the  
22 seller of the musical works nor the seller of

1 the sound recording is coming to the  
2 negotiating table thinking that they have to  
3 cover some future costs of production.

4 A From this particular transaction,  
5 that's correct.

6 Q Okay, and in the case of the movie  
7 and TV market that you looked at you made sure  
8 actually that you only looked at transactions  
9 involving a musical work or sound recording  
10 that already existed.

11 A That's correct.

12 Q Now in the webcasting market, you  
13 understand, don't you, that we are setting a  
14 rate here that will be in place until 2010?

15 A That's correct.

16 Q And you understand that the record  
17 companies and the artists are going to be  
18 creating new music between now and 2010.

19 A I hope so.

20 Q So do we. And as to that new  
21 music, the recording industry's costs are not  
22 sunk, are they?

1           A       That is correct.

2           Q       You would agree with me, wouldn't  
3 you, that if a seller is making sort of  
4 ongoing investments or incurring ongoing costs  
5 it's not going to keep doing that if it's not  
6 earning a fair return on its investment?

7           A       I agree.

8           Q       I think you've also suggested that  
9 again with respect to the sellers that one of  
10 the reasons that the sellers of musical works  
11 and the sellers of sound recordings might be  
12 similarly situated is that both recover their  
13 costs principally in other markets. Is that  
14 fair?

15          A       Yes.

16          Q       So is what you're saying that a  
17 seller who has, let's say, five different  
18 revenue streams will just look to one or two  
19 of those revenues streams for cost recovery  
20 and won't worry about the other three or four?

21          A       That's not what I'm saying. No.

22          Q       What are you saying?

1           A       What I'm saying is, for example  
2       the record companies, if they are making  
3       rational business planning decisions about  
4       this period from now to 2010 I think it is  
5       incredible to suggest that the extent to which  
6       they will invest in the creation of new sound  
7       recordings over the period now to 2010 is  
8       going to change one iota on the basis of  
9       whether in this proceeding they're awarded the  
10      royalty at the level that I've suggested or  
11      the level say that your clients have suggested  
12      because the difference would be in the fifth  
13      or sixth decimal place in terms of their  
14      return on investment. And so it would not  
15      rationally affect their investment decisions.

16           Q       Don't you believe, Dr. Jaffe, that  
17      a rational seller when making investment  
18      decision is going to look to all of the  
19      potential sources of revenue to recover the  
20      costs of making that investment?

21           A       Yes, but there's still an  
22      empirical question as to whether when they

1 look at one of them the impact it has is  
2 something that is big enough to have any  
3 effect or worry about or where it will affect  
4 the decision and a rational sound recording  
5 creator is going to look at the revenue screen  
6 from webcasting and say "Well, I'd like to get  
7 as much as I can because more money is always  
8 better than less money." But the magnitude is  
9 so small that when I'm making my investment  
10 decisions about do I hire that band or do I  
11 have that band another record or do I have  
12 that band do another record with a really good  
13 producer and really good equipment or with  
14 crummy equipment and a not-so-great producer  
15 whether or not the revenue stream includes  
16 this tiny fraction is not going to affect the  
17 decisions and from an economic perspective,  
18 that means that in effect that is irrelevant,  
19 that those costs are not relevant and those  
20 revenues are not relevant to the licensing  
21 decision.

22 Q You're not suggesting, are you,

1 that in this market we should consider the  
2 record companies to be not willing sellers but  
3 indifferent sellers?

4 A I'm certainly not suggesting that.

5 Q Okay. The sellers certainly want  
6 to get as much as they can from every possible  
7 revenue stream. Right?

8 A Absolutely. That's what I've  
9 testified.

10 Q Now in your written rebuttal  
11 testimony in 2001, you included a footnote  
12 which read in part "It is possible that at  
13 some future date it will cease to be the case  
14 that the cost of making sound recording is  
15 covered by CD sales and that digital  
16 performance royalties are no longer  
17 incremental." Do you recall that?

18 A Generally, yes.

19 Q That footnote was not included in  
20 your current testimony, was it?

21 A There is an equivalent footnote in  
22 my current testimony, not the same words, but



1 the same point is in the testimony.

2 Q You're aware, are you not, that  
3 the record companies believe they need to look  
4 much more to digital distribution to earn  
5 revenues and much less to CD sales?

6 A Yes, but that digital distribution  
7 includes a lot of things besides webcasting  
8 performance royalties and my argument would be  
9 exactly the same if the record companies were  
10 earning the revenues that pay the costs  
11 entirely from digital downloads. That  
12 wouldn't change my argument at all. It would  
13 still be the case that the revenue stream from  
14 webcasting would be too small to make a  
15 difference and what I've said in that footnote  
16 is theoretically one could imagine the world  
17 will change so much in the future that it's  
18 not CDs, it's not digital downloads, it's not  
19 any reproducible copy that the user owns that  
20 the way the business model for making sound  
21 recordings is that all of the return comes  
22 from radio in some form, digital or analog.

1 That's a theoretical possibility that I don't  
2 think, I've not seen any business analysts  
3 suggest is realistic because there is a  
4 difference between owning a copy of the thing  
5 be it a digital download or a CD and hearing  
6 an uncontrollable mixture either over the  
7 airwaves or over the internet of a bunch of  
8 different songs.

9 Q As the distribution of music moves  
10 from physical to digital, do you have any  
11 reason to think that the record companies are  
12 going to look to other distributions, other  
13 digital distribution channels, rather than  
14 internet radio as a way to recover their  
15 costs?

16 A Yes, because there is as I just  
17 said from the user's perspective I think just  
18 thinking about the economics of it and by here  
19 I mean when I say "user" not the webcasters  
20 but you and me, the people who listen to  
21 music, there is a big difference between  
22 having in some form a copy of a song that I

1 like from a band I like or an orchestra I like  
2 so I can play it whenever I want. That's a  
3 very different thing from the ability to turn  
4 on the radio and hear a mixture of all kinds  
5 of different songs which by construction under  
6 the statute cannot in fact repeat particular  
7 bands and which I as the user cannot control  
8 what I hear. I think there is a reason based  
9 on economics to think that it's extremely  
10 unlikely theoretically and there is  
11 absolutely no empirical evidence that somehow  
12 we're going to reach a point where a primary  
13 mechanism by which you recover the cost of  
14 making sound recording is simply to have  
15 various kinds of radio stations pay them. I  
16 don't think any economic analysis of what  
17 users are getting makes that plausible.

18 CHIEF JUDGE SLEDGE: Mr. Handzo, I  
19 suspect that there's a lack of clarity in your  
20 question that may have affected the answer.  
21 When you used the word "internet radio," that  
22 may mean a awful lot of different things and

1 I think the witness interpreted that to mean  
2 DMCA compliant radio.

3 THE WITNESS: I did.

4 CHIEF JUDGE SLEDGE: And I'm not  
5 at all sure that that's what your question is.

6 MR. HANDZO: Actually, that was my  
7 question. So I agree that was an imprecise  
8 term, but just for the sake of being clear,  
9 I'll refer to DMCA compliant webcasting in the  
10 future so that we're clear on it. But my  
11 question may have been imprecise in another  
12 way as well.

13 THE WITNESS: Okay.

14 BY MR. HANDZO:

15 Q Because what you said in your  
16 answer was that record companies wouldn't look  
17 to DMCA compliant webcasting as the primary  
18 way to recover their costs. Isn't it  
19 reasonable to expect that whether it's a  
20 primary way or not record companies are going  
21 to look to all of their revenue streams  
22 particularly those that are growing compared

1 to CDs as the way to recover their costs?

2 A Well, when you say "look to" that  
3 is not an economically precise term. I would  
4 agree with you that record companies are going  
5 to try to get revenue everywhere they can.  
6 The economically important question is whether  
7 in the 2006 to 2010 time period that's at  
8 issue here, it is remotely conceivable that  
9 the revenue from webcasting will be  
10 sufficiently large that the level of that  
11 revenue, if we take the range of possible  
12 answers to what that revenue will be as on the  
13 lower end of what I said it should be and on  
14 the upper end what you've said it should be,  
15 I don't think it is remotely conceivable that  
16 in the period 2006 to 2010 which is all I need  
17 to think about now, that variation could have  
18 a big enough effect on the profitability of  
19 making sound recordings to have any observable  
20 or measurable impact on record companies'  
21 costs or the level of their investment in the  
22 creation of sound recordings.

1 Q And so you just view costs are  
2 utterly irrelevant to the record companies'  
3 decisions with respect to rates that are being  
4 set for sound recordings that are going to be  
5 made in the future. Is that fair?

6 A I guess I wouldn't say utterly  
7 irrelevant. I would say economically  
8 irrelevant.

9 Q Dr. Jaffe, going back to the movie  
10 and TV market that you looked at for your  
11 empirical analysis, you would agree, wouldn't  
12 you, that having a sound recording in a movie  
13 could stimulate or promote CD sales or sales  
14 of downloads for that music?

15 A It might, yes.

16 Q And I believe you also think that  
17 there's some promotional effect of having  
18 sound recordings paid on DMCA compliant  
19 webcasting services.

20 A Yes.

21 Q Isn't it possible that the  
22 promotional value of playing a sound recording

1 in a movie or on TV is going to be different  
2 from whatever promotional value there might be  
3 in playing it on a DMCA compliant webcasting  
4 service?

5 A It is possible, yes.

6 Q And you would agree, would you  
7 not, that having a sound recording in a movie  
8 or TV is not going to substitute for or  
9 display CD sales?

10 A I don't think it would, no.

11 Q With respect to DMCA compliant  
12 webcasting, you would agree that it's at least  
13 plausible that for some consumers the digital  
14 distribution of sound recordings may  
15 substitute for CD sales.

16 A It's conceivable, yes.

17 Q So the net promotional or  
18 substitutional impact of playing a sound  
19 recording in a movie may be different from the  
20 net promotional, substitutional or  
21 promotional, impact of having it on DMCA  
22 compliant webcasting. Is that fair?

1           A     It might be, yes.

2           Q     Okay.           And     whether     the  
3     reproduction of a sound recording or on DMCA  
4     compliant webcasting promotes or substitutes  
5     could have affect on the royalty rate charged  
6     for that sound recording.   Right?

7           A     Theoretically yes.

8           Q     If     there     is     some     difference  
9     between the movie and TV business and the DMCA  
10    compliant webcasting business with respect to  
11    promotion or substitution, that could very  
12    well have a differential impact on the rates  
13    in those two markets.   Right?

14          A     If     there     is     a     difference     that's  
15    big enough to be noticeable in the range of  
16    imprecision of all of these analyses, then it  
17    could make a difference.

18          Q     Okay.   That's not something that  
19    you've investigated.   Is that fair?

20          A     I don't think that's quite fair.  
21    I guess what I would say would be I have  
22    thought about the displacement question in the



1 webcasting market and I think the way I would  
2 think about it would be if I were convinced or  
3 some other fact finder were convinced that  
4 there is going to be significant displacement  
5 of CD sales or of other sales such as digital  
6 downloads as a result of webcasting that that  
7 ought to result in an increase in the  
8 royalties above what I have recommended, that  
9 I have recommended the royalties that I have  
10 because I've looked at the evidence and I  
11 really don't see compelling evidence that  
12 displacement will be significant. If that's  
13 wrong, then my rates should be adjusted for  
14 that.

15 Q But just so I'm clear, with  
16 respect to any differences that might exist  
17 between the movie and TV business and DMCA  
18 compliant webcasting, you haven't attempted to  
19 quantify any difference that might exist.  
20 Correct?

21 A That's correct.

22 Q You haven't looked at any

1 empirical evidence for either movie and TV or  
2 DMCA compliant webcasting with respect to this  
3 issue, have you?

4 A I think I have looked at the  
5 evidence that I can in the webcasting context  
6 and I really haven't seen compelling empirical  
7 evidence of significant displacement. If  
8 there isn't significant displacement in the  
9 webcasting for my comparison, it doesn't  
10 matter whether there's displacement in the  
11 movie context because you can't have less than  
12 none or less than a trivial amount. So --

13 Q Just so I'm clear, you haven't  
14 looked at any evidence with respect to the  
15 movie and TV business.

16 A That is correct.

17 Q Okay, and with respect to DMCA  
18 compliant webcasting what you looked at were  
19 the witness statements of Mr. Roback, Mr.  
20 Frank and Mr. Isquith. Correct?

21 A Yes.

22 Q That's all you looked at. Right?

1           A       So far, yes.

2           Q       Okay, and so your opinions with  
3       respect to promotion and substitution in DMCA  
4       compliant webcasting are based on those three  
5       witness statements. Right?

6           A       So far, yes.

7           Q       Now I take it, Dr. Jaffe, that  
8       it's your opinion that there are enough  
9       similarities between the movie and TV business  
10      on the one hand and DMCA compliant webcasting  
11      on the other to allow an inference that the  
12      relative values of musical works and sound  
13      recordings should be the same in both  
14      industries. Right?

15          A       I wouldn't really say that. What  
16      I would say is that I presented an economic  
17      analysis as to why in a competitive market I  
18      would expect the rates for these two different  
19      rights to be similar. If I hadn't found the  
20      movies and the TV to be candid, I would have  
21      offered the same opinion because I think it  
22      stands on its economic foundation. It's

1 always nice to have more than just an economic  
2 model, to have some empirical evidence that  
3 confirms your model and I do believe that the  
4 similarities between these two markets are  
5 sufficient that it does provide a measure of  
6 confirmatory empirical evidence for the  
7 economic model that I put forward.

8 Q But you're not suggesting, are  
9 you, that the actual rates charged for sound  
10 recordings in the movie business or the TV  
11 business could be a benchmark for the rates  
12 being set in this proceeding?

13 A I am not. That's correct.

14 Q And that's because the markets are  
15 too different to be used for that purpose.  
16 Correct?

17 A That's correct.

18 MR. HANDZO: Dr. Jaffe, I'm going  
19 to show you what we've marked as SoundExchange  
20 Trial Exhibit 75.

21 (Whereupon, the above-  
22 referred to document was

1 marked as SoundExchange  
2 Exhibit No. 75 for  
3 identification.)

4 BY MR. HANDZO:

5 Q Dr. Jaffe, do you recognize this  
6 document?

7 A Yes.

8 Q And this is part of the data that  
9 you analyzed with respect to the payments for  
10 sound recordings and musical works in the  
11 movie industry from 2001.

12 A That's correct.

13 Q Now correct me if I'm wrong, but  
14 as I understand it, looking, let's say, at the  
15 second page of this document when you  
16 determined that on average movie studios paid  
17 the same for musical works and sound  
18 recordings what you did was compare the synch  
19 quote column on this page with the master  
20 quote column in this page. Is that right?

21 A I think that's correct, yes.

22 Q Now some movies also produce

1 soundtrack albums. Right?

2 A That's correct.

3 Q And you'll see there's a column a  
4 little further over that appears to say "Sound  
5 Track Advance and Royalty."

6 A Yes.

7 Q And that indicates that in those  
8 cases the record company was getting an  
9 additional payment for a sound track album.  
10 Right?

11 A It does indicate that, yes.

12 Q And the additional payment would  
13 be some amount of dollars in an advance plus  
14 some percentage of the sales.

15 A Yes.

16 Q When you did your analysis of what  
17 gets paid for sound recording and musical  
18 works in the movie business, you didn't take  
19 account of those sound track revenues, did  
20 you?

21 A I'm sure we didn't take account of  
22 them. I don't remember whether we looked at

1 the question of whether you get a different  
2 answer if you simply exclude those occurrences  
3 where that's part of the story.

4 Q Okay, but as you sit here today  
5 what you do remember is that you didn't take  
6 account of those.

7 A We did not use that data in any  
8 way.

9 Q Now there's a column on the far  
10 right that says "Trailer Quote." Do you see  
11 that?

12 A Yes.

13 Q Do you know what a trailer quote  
14 is?

15 A Not as I sit here, no.

16 Q Do you see there's some additional  
17 amounts of revenue being paid to the record  
18 company for the trailer quotes?

19 A I don't know who they are paid to.

20 Q Would it appear to you that this  
21 side of the chart relates to the payments to  
22 the record company?

1 A I don't know.

2 Q Okay. So as you sit here today,  
3 you don't know whether these payments were  
4 taken into account when you did your analysis.

5 A I'm quite sure they were not taken  
6 into account. I don't know what they are.

7 Q Okay. Dr. Jaffe, in your written  
8 testimony I believe you said that it wasn't  
9 possible to test your economic theory in an  
10 actual competitive market for the performance  
11 of sound recordings. Do you recall that?

12 A Not precisely.

13 Q Well, let me -- You have your  
14 statement there. Right?

15 A Yes.

16 Q Let's take a look at page 28.

17 A Twenty-eight?

18 MR. HANDZO: I'm sorry, Your  
19 Honor. Before I move on, I would offer  
20 SoundExchange Exhibit 75 into evidence.

21 CHIEF JUDGE SLEDGE: Any objection  
22 to the admission of Exhibit 75?



1 MR. SUGARMAN: No Your Honor.

2 CHIEF JUDGE SLEDGE: Without  
3 objection, the exhibit is admitted.

4 (The document referred  
5 to having been  
6 previously marked for  
7 identification as  
8 SoundExchange Exhibit  
9 No. 75, was received in  
10 evidence.)

11 MR. SUGARMAN: With the caveat  
12 that it should be restricted, Your Honor.

13 CHIEF JUDGE SLEDGE: We have  
14 admitted it. Now if you have a motion.

15 MR. SUGARMAN: Yes. We would move  
16 that it would be accepted as restrictive as  
17 opposed to generally admitted. It is  
18 restricted in this document.

19 CHIEF JUDGE SLEDGE: As you should  
20 have been briefed, that requires extensive  
21 showing of evidence on your behalf of why that  
22 motion should be granted.

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1 MR. SUGARMAN: Your Honor, as I  
2 understand it, it is information received,  
3 confidential information from the source  
4 received on the understanding that it would be  
5 treated confidentially.

6 JUDGE ROBERTS: This is data from  
7 more than five years ago.

8 MR. SUGARMAN: That is correct,  
9 but I don't know that that has any bearing on  
10 the level of confidentiality.

11 JUDGE ROBERTS: Why wouldn't it?

12 MR. SUGARMAN: It might, but since  
13 it was received confidentially, I don't think  
14 we can say with certainty that it's not and  
15 therefore to err on the side of caution, we  
16 would ask that it be received as restrictive  
17 not knowing that there might be factors that  
18 make it unrestrictive. I think the assumption  
19 should be that if it was given to us as  
20 restrictive that it should remain so.

21 CHIEF JUDGE SLEDGE: If there is  
22 nothing further, the motion is denied.

1 JUDGE WISNIEWSKI: Before you move  
2 on, Mr. Handzo, I notice you seem to have  
3 extra copies of this exhibit. Could I trade  
4 you mine which has a large clip on it for one  
5 that's stapled? I'm afraid I might lose parts  
6 of it.

7 (Discussion off microphone.)

8 BY MR. HANDZO:

9 Q All right. Dr. Jaffe, getting  
10 back to your written testimony, do you see on  
11 page 28 where you say "So it's not possible to  
12 make a direct comparison of musical work and  
13 sound recording performance royalties in a  
14 competitive market"?

15 A Page 28?

16 Q Yes.

17 A Yes, I do see that.

18 Q You have that? Okay. Now you're  
19 aware, aren't you, that the recording industry  
20 sells sound recording rights for use of  
21 ringtones?

22 A I've actually wondered about that.

1 Q So you aren't aware of that I take  
2 it.

3 A I've not thought about it.

4 Q Okay. Are you aware that the  
5 buyers of those sound recording rights for  
6 ringtones have separately acquired the rights  
7 to the musical works?

8 A As I said, I've wondered about  
9 that because of my knowledge of the general  
10 statutory framework, but it's not something  
11 that I've studied. So I really don't know.

12 Q I take it then that you're not  
13 aware that with respect to those ringtones --  
14 Well, I'm sorry. Let me skip that and go on  
15 to something else. Are you aware that the  
16 recording industry sells sound recording  
17 rights for use in on-demand or interactive  
18 services?

19 A Yes.

20 Q And you're aware that in that  
21 market the buyers of the sound recording  
22 rights have to separately acquire the rights

1 to the musical works that are embedded in  
2 those sound recordings.

3 A Yes.

4 Q Are you aware that the recording  
5 industry sells rights to perform musical  
6 videos?

7 A In general terms, yes.

8 Q And are you aware that the buyers  
9 of those rights must separately acquire the  
10 rights to the musical works embedded in those  
11 music videos?

12 A I would assume that to be the  
13 case.

14 Q Okay. That's not something you've  
15 looked at.

16 A That's correct.

17 Q Do you know what clip samples are?

18 A Clip samples?

19 Q Yes.

20 A No, I'm afraid I don't.

21 Q So you're not aware that the  
22 recording industry sells sound recordings in

1 the form of clip samples.

2 A I am not, no.

3 Q And you're not aware that the  
4 buyers have to buy the musical work  
5 separately.

6 A I don't know anything about it.

7 Q Okay. I take it then that you're  
8 not aware that in all of those markets the  
9 sellers of sound recordings get more than the  
10 sellers of the musical works.

11 A I am aware that in some of those  
12 markets -- I mean I am aware of some of those  
13 markets and no, that in the ones that I am  
14 aware of the sound recording owners get more  
15 than the owners of the musical works which of  
16 course then begs the question of are they  
17 competitive markets which is a different  
18 question.

19 Q Okay. Just to be clear, the  
20 market that you're aware of where you know  
21 that there's more paid for the sound recording  
22 than the musical work is the on-demand or

1 interactive market.

2 A That's correct.

3 Q And you weren't familiar with the  
4 other markets.

5 A That's correct.

6 Q Do I correctly understand your  
7 answer to one of my questions then to be that  
8 you don't consider the market for the sale of  
9 sound recordings for on-demand services to be  
10 competitive?

11 A Well, so there are actually two  
12 issues in terms of its use for this purpose.  
13 One is the question of whether the market is  
14 competitive and the other is the question of  
15 whether it mirrors the situation with  
16 webcasting with respect to the whole long  
17 discussion we had about the cost being sunk.

18 So I think with respect to both of those  
19 concerns, there is at least a significant  
20 question whether the on-demand and interactive  
21 markets qualify, which is to say I don't think  
22 they're competitive and I think since those

1 things are now closer to what a user gets when  
2 they get a digital download or a CD. One  
3 would have to look carefully at the question  
4 of whether my conclusion in the other market  
5 that these were incremental revenue unrelated  
6 to investment would hold in that market.

7 Q You have not undertaken that  
8 inquiry, have you?

9 A I have not so far, no.

10 Q Okay. Now with respect to whether  
11 the market for on-demand or interactive  
12 services is competitive, you haven't taken any  
13 analysis of that issue either, have you?

14 A Not to date, no.

15 Q And actually just to pick up on  
16 something you talked about in your direct  
17 examination, let me ask you the same question  
18 with respect to the market for DMCA compliant  
19 webcasting. You have not analyzed, have you,  
20 whether the four major record companies and  
21 the independent record companies are operating  
22 in a competitive market in that market? Is



1 that right?

2 A I think a fair answer would be  
3 I've thought about it, but I have not really  
4 systematically figured out what I would need  
5 to do to reach an opinion about it.

6 Q Okay. So the answer at this point  
7 is you haven't reach an opinion about it.

8 A That's correct.

9 Q In your direct written testimony,  
10 Dr. Jaffe, you propose a fee model. Right?

11 A Yes.

12 Q And under your proposal, a  
13 webcaster could elect whether they were going  
14 to pay based on a percentage of revenue or a  
15 per-performance basis or a per-ATH basis. Do  
16 I have that right?

17 A Yes.

18 Q And in your view, that proposal  
19 would apply to for-profit webcasters both  
20 large and small. Right?

21 A Yes.

22 Q And you're not aware, are you, of

1 any reason to have different level of fees or  
2 a different structure for subscription  
3 webcasting services as compared to ad-  
4 supported services?

5 A You may need to implement, for  
6 example, a percent of revenue formula in a  
7 different way in order to correctly tract the  
8 appropriate revenue, but I'm not aware of  
9 reasons why the basic economic structure  
10 should be different.

11 Q Okay. Now under your proposal,  
12 you would agree, wouldn't you, that a  
13 webcaster is always going to choose the least  
14 expensive option for the webcaster?

15 A Yes.

16 Q Let me pose a hypothetical to you.  
17 If a webcaster doesn't attempt to make money  
18 on DMCA compliant webcasting and instead uses  
19 it as an effect a lost leader to bring people  
20 to its portal so it can sell other things to  
21 them, you would agree with me, wouldn't you,  
22 that a webcaster under those circumstances

1 might choose the percentage of revenue fee and  
2 just claim that they have no revenue from DMCA  
3 compliant webcasting?

4 A Well, what I would say although I  
5 leave the details of this to Mr. Fancher who  
6 has looked at it, but conceptually as an  
7 economist, the revenue, if you're going to  
8 choose a percent of revenue model, you as a  
9 licensee have an obligation to come up with a  
10 way of measuring revenue that captures the  
11 economic value that you are getting from that  
12 site. And so what I would say is if a  
13 webcaster in your hypothetical was getting  
14 economic benefit from its webcasting somewhere  
15 else, then one of two things has to happen,  
16 either that economic benefit would have to be  
17 included in what's called "revenue" for the  
18 model or that webcaster would have to say "I'm  
19 not using a revenue model. I don't have  
20 access to that option. I would have only the  
21 ATH or the performance option" because it  
22 would not be economically appropriate to in

1 effect allow them to use an option which keyed  
2 off of the economic benefit you get and then  
3 not report that economic benefit.

4 Q Okay. Just so I understand, it's  
5 your view that if the webcaster has the option  
6 to choose a percentage of revenue, they have  
7 to fairly attempt all of the economic benefit  
8 they're getting from the use of the music.

9 A Yes.

10 Q Dr. Jaffe, going back to your  
11 written testimony, towards the end of your  
12 written testimony, I think you talk about a  
13 number of factors why you think your analysis  
14 may be conservative. Is that right?

15 A Yes.

16 Q And one of the things you mention  
17 at page 46 I believe is that the number of  
18 webcasters decreased or declined after the  
19 2002 CARP.

20 A Yes.

21 Q And in connection with that in  
22 Footnote 48, you cite to a BRS Media Press

1 Release.

2 A That's correct.

3 Q And that's a press release dated  
4 September 12, 2002.

5 A That's correct.

6 Q When you cited to that press  
7 release, did you go on the BRS website?

8 A I don't recall.

9 MR. HANDZO: I'm going to show you  
10 what we've marked as SoundExchange Trial  
11 Exhibit 76 I'm going to represent to you is  
12 from the BRS website.

13 (Whereupon, the above-  
14 referred to document was  
15 marked as SoundExchange  
16 Exhibit No. 76 for  
17 identification.)

18 BY MR. HANDZO:

19 Q Does that refresh your  
20 recollection as to whether you went on that  
21 website when you cited that press release?

22 A No.

1           Q     Okay. But this in fact shows that  
2           the number of webcasters started increasing  
3           again.

4           A     Oh, I thought you meant when I --  
5           I see. You're saying did I go on the website  
6           recently. I don't remember seeing this, no.

7           Q     I guess my question to be clear  
8           was did you go on the website at the point  
9           where you prepared your written testimony and  
10          inserted that --

11          A     I don't remember where we got the  
12          press -- The press release is dated back from  
13          September of 2002. I don't honestly remember  
14          whether it's something we had in the files  
15          that had been acquired back in 2002 or whether  
16          it was found recently. I really don't  
17          remember.

18          Q     You don't know what's happened to  
19          the number of webcasters in this industry  
20          since 2002. Right?

21          A     I have no data on that.

22          Q     You would agree with me, wouldn't

1 you, that the willing buyer/willing seller  
2 standard doesn't require that this court set  
3 a rate that everyone can afford. Right?

4 A That's correct.

5 Q If a competitive rate is set under  
6 this willing buyer/willing seller standard, it  
7 doesn't matter how many webcasters can or  
8 can't afford it. Right?

9 A Correct.

10 MR. HANDZO: Your Honor, I wonder  
11 if I could take a few minutes. I'm done or  
12 close to done.

13 (Pause.)

14 MR. HANDZO: Thank you. That's  
15 all I have.

16 THE WITNESS: Thank you.

17 MR. SUGARMAN: Your Honor, could  
18 we take a ten minute break and hopefully  
19 finish before lunch?

20 CHIEF JUDGE SLEDGE: All right.  
21 So you want a ten minute recess and then you  
22 feel like you'll finish in ten minutes after

1 that?

2 MR. SUGARMAN: I'm not sure it  
3 will be ten, but it might be only 20. I'll  
4 know better after the ten.

5 CHIEF JUDGE SLEDGE: Are you  
6 taking into account Mr. Handzo's recross?

7 MR. SUGARMAN: Oh, the recross.

8 MR. HANDZO: I would venture to  
9 guess that if we just plow ahead right now, we  
10 have a whole lot better chance of finishing  
11 before lunch.

12 CHIEF JUDGE SLEDGE: It seems  
13 curious to take ten minutes now when we  
14 normally recess in 25 minutes.

15 MR. STEINTHAL: Your Honor, I  
16 think it's just an effort to finish before  
17 lunch and I think we're confident we'll finish  
18 by 1:00 p.m. including a recross if we take a  
19 ten minute break now and then we don't have to  
20 take an hour and a half break and then come  
21 back to what might be just 15 minutes. That  
22 was the theory.



1 CHIEF JUDGE SLEDGE: That's the  
2 theory.

3 MR. STEINTHAL: No, I think in  
4 execution that is our expectation.

5 CHIEF JUDGE SLEDGE: We'd feel a  
6 lot more comfortable if somebody other than  
7 you was saying that.

8 MR. STEINTHAL: I'm not asking the  
9 questions so -- In my own defense, I got much  
10 better after the experts. I mean on the fact  
11 witnesses I was pretty on target as to what  
12 the cross would be.

13 CHIEF JUDGE SLEDGE: We'll recess  
14 then.

15 MR. STEINTHAL: Thank you.

16 CHIEF JUDGE SLEDGE: Off the  
17 record.

18 (Whereupon, the foregoing matter  
19 went off the record at 12:08 p.m. and went  
20 back on the record at 12:20 p.m.)

21 CHIEF JUDGE SLEDGE: On the  
22 record. Thank you. We'll come to order.

1 (Discussion off microphone.)

2 MR. SUGARMAN: Thank you, Your  
3 Honor. I'd like to mark as --

4 MR. HANDZO: This is the next  
5 Services exhibit.

6 MR. SUGARMAN: -- Services Exhibit  
7 173 a four page document which is Bate-  
8 stamped CRBJAF001313 through 1316.

9 (Whereupon, the above-  
10 referred to document was  
11 marked as Services  
12 Exhibit No. 173 for  
13 identification.)

14 REDIRECT EXAMINATION

15 BY MR. SUGARMAN:

16 Q Dr. Jaffe, can you identify what  
17 has been marked as Services Exhibit 173?

18 A Yes, this is one of the papers  
19 that I produced that underlie the calculations  
20 in Figure 2 of the musical award fees for  
21 webcasters.

22 Q Does this allow you to answer the

1 question the Judge raised before about  
2 weighted average or average?

3 A I believe that it does. I'm doing  
4 this on the fly. So if you look at the page,  
5 it's the third page of the document, where it  
6 says "Payments to ASCAP, BMI, SESAC and Total  
7 Aggregate Tuning Hours in 2004," you'll see  
8 for example at the bottom of the column where  
9 it says "Dollar Per ATH" is a figure of 0.0038  
10 or about .4 cents which I report elsewhere in  
11 the report as the average and the question I  
12 was asked was is that a simple average of the  
13 numbers for the four companies, the four  
14 numbers above, or is it some kind of weighted  
15 average and using my handy-dandy calculator  
16 here what I can confirm is that it's not the  
17 simple average of those four numbers. Rather,  
18 it's the aggregate ratio. It's \$2,696,000 and  
19 change divided by the total number of hours of  
20 706 or equivalently it's the weighted average  
21 of the four companies weighted by the number  
22 of aggregate tuning hours.

1 Q Referring to the testimony with  
2 respect to the one-to-one --

3 CHIEF JUDGE SLEDGE: Mr. Sugarman,  
4 what exhibit is this referring back to?

5 MR. SUGARMAN: I'm sorry, Your  
6 Honor.

7 CHIEF JUDGE SLEDGE: He was  
8 answering a question that was related to  
9 exhibit what?

10 MR. SUGARMAN: It was Exhibit,  
11 Figure 2 to his report.

12 CHIEF JUDGE SLEDGE: Figure 2 to  
13 his report. Thank you.

14 BY MR. SUGARMAN:

15 Q Professor Jaffe, coming back to  
16 the relationship between the master use  
17 license and the synch license, are you aware  
18 of any testimony in this case that the one-to-  
19 one relationship, synch and master use  
20 licenses, remains the same today as it was in  
21 2001?

22 A Yes, I believe that Ms. Uhlman

1 from MRI testified to that effect.

2 Q Karen Uhlman?

3 A Yes.

4 Q Now Mr. Handzo read you a portion  
5 of the CARP decision, SX Trial Exhibit 74, and  
6 I'd like to read you a sentence that he didn't  
7 read which is in the next paragraph which  
8 says, "As to the ..."

9 CHIEF JUDGE SLEDGE: What page?

10 MR. SUGARMAN: I'm sorry. Page  
11 41. It's the first sentence of the third  
12 paragraph.

13 BY MR. SUGARMAN:

14 Q It says "As to the precise  
15 relative value of performing rights in  
16 sounding recordings vis á vis musical works we  
17 rendered no opinion." Is that as well  
18 relevant to the question that he asked you?

19 A Yes, I mean basically I read that  
20 to say that the panel wasn't reaching a  
21 conclusion about the relative value of those  
22 two rights.

1           Q     And then lower, there's some  
2     testimony or there's reference to Mr.  
3     Mandelbrodt's testimony from Yahoo and let me  
4     just -- Assuming Yahoo perceived at the time  
5     it did its RIAA deal that it was at about the  
6     same rate as its PROs fees, then the adoption  
7     of the Yahoo rate by the CARP is not  
8     necessarily inconsistent with the proposition  
9     that musical work and sound recording have  
10    roughly equivalent.     Is that a correct  
11    statement?

12                   MR. HANDZO:    I'm going to just  
13    object to the question.  It's hypothetical on  
14    many levels, hypothetical as to what Mr.  
15    Mandelbrodt was testifying about, speculating  
16    as to what the CARP meant when it said  
17    something.  I'm not sure we can get any kind  
18    of useful answer out of that.

19                   CHIEF JUDGE SLEDGE:  Mr. Sugarman.

20                   MR. SUGARMAN:  Your Honor, I think  
21    there's only one hypothetical which is that  
22    Yahoo perceived at the time that it did its

1 RIAA deal that was about the same. Then the  
2 next question which is not hypothetical is  
3 whether the adoption of the Yahoo rate isn't  
4 necessarily inconsistent. I mean that's not  
5 a hypothetical. That's just a question that  
6 he can answer as an expert.

7 CHIEF JUDGE SLEDGE: Not  
8 necessarily inconsistent with what?

9 MR. SUGARMAN: With the  
10 proposition that the musical work and the  
11 sound recording have roughly equal value.  
12 That's his conclusion based on this one  
13 assumption is the CARP's decision necessarily  
14 inconsistent with his view. That I don't  
15 think is hypothetical. That's just a question  
16 he can answer.

17 CHIEF JUDGE SLEDGE: It may not  
18 have any relevance but the objection is  
19 overruled.

20 MR. SUGARMAN: Thank you.

21 BY MR. SUGARMAN:

22 Q Do you have the question in mind?

1 A Yes.

2 Q All right.

3 A So I think just to say as I  
4 understand it if in fact it's the case that  
5 Mr. Mandelbrodt testified that they believed  
6 that they were paying about the same for the  
7 musical works and what they paid for the sound  
8 recordings and the panel was actually citing  
9 to that here in this paragraph in the context,  
10 I think one can infer from that that the rate  
11 that they chose which they understood from  
12 Yahoo's testimony under your hypothetical to  
13 be equivalent to the musical works rate, their  
14 decision was therefore not inconsistent with  
15 my view that those two should be approximately  
16 the same.

17 Q Now in your testimony, you talked  
18 about a 99 percent/1 percent webcaster take or  
19 record company take. Were you talking about  
20 those numbers after a reasonable return on  
21 investment?

22 A Yes, an economist always includes



1 as part of the cost of any business earning  
2 and return on your investment. That's a cost  
3 just like the cost of janitors and the cost of  
4 anything else. So when I was talking about  
5 this hypothetical dividing up of the surplus  
6 between the two parties, that would be a  
7 surplus over and above a reasonable return on  
8 investment and that's why I was prepared to  
9 say a webcaster, they might not be ecstatic  
10 about it, but if they had no option but to get  
11 just one percent of the surplus over and above  
12 a reasonable return, they would agree to do  
13 that because they would be getting something  
14 they couldn't otherwise get.

15 Q Mr. Handzo cut you off confident  
16 that you would be asked the question to  
17 explain why the difference associated with  
18 master use and synch evidence in webcasting  
19 are not meaningful to your analysis. Would  
20 you now explain that?

21 A I think the point is that I didn't  
22 use the music and TV data in any direct way in

1 my calculations. I used them as empirical  
2 evidence in support of a theory and the theory  
3 is that when a buyer needs two rights and the  
4 sellers might be different but come to that  
5 with the same position, namely that their  
6 costs are sunk, you would expect as a result  
7 that these things would be valued similarly  
8 and none of the differences that were referred  
9 to earlier changed the fact that the movie and  
10 TV data are appropriate in that sense. They  
11 test the theory because they correspond to the  
12 assumptions of the theory.

13 Q Mr. Handzo also asked you some  
14 questions about new music that's going to be  
15 recorded in the period now, 2006 to 2010, and  
16 you agreed that the costs have yet to be  
17 created in music are not yet sunk. Is that  
18 right?

19 A Yes.

20 Q By the time the music gets to the  
21 webcasting industry, however, will those costs  
22 have been sunk?

1 A Yes, they will.

2 Q In asking you about the press  
3 release that you referred to in your testimony  
4 with respect to the lesser number of  
5 webcasters after the CARP decision, Mr. Handzo  
6 showed you SX Trial Exhibit 76. Do you have  
7 that in front of you?

8 A I do.

9 Q It's the graph. First question is  
10 is this is the press release that you referred  
11 to.

12 A No, this is a different document.

13 Q And is there any way that you can  
14 tell whether the data that are reflected here  
15 refers just to webcasters as opposed to  
16 webcasters and radio simulcasters?

17 A Well, it says radio stations which  
18 would suggest, although it's not my data so I  
19 don't really know, that it's both.

20 Q And is there -- I mean it says  
21 number of radio stations worldwide  
22 broadcasting. So is there any way to tell

1 what piece of this is U.S. as opposed to  
2 worldwide?

3 A Not from this document.

4 Q Mr. Handzo also showed you SX  
5 Trial Exhibit 75, the Disney movies document.  
6 Do you have that?

7 A Yes.

8 Q And pointed you to the last column  
9 of the document and let's look at page 1056 as  
10 one and the last column is headed "Trailer  
11 Quote" and then there's an entry S 20,000, M  
12 20,000. Do you have reason to believe that  
13 that means sync 20,000 and master use 20,000?

14 A Well, I haven't looked at these  
15 data for a long time, but in the context of  
16 what was being done here and the fact that if  
17 you're going to use music in a trailer, you  
18 would need both of these rights. It seems to  
19 me reasonable to assume that that's what it  
20 means.

21 Q And on this particular page in  
22 both instances the same amount of money is

1 being paid for the synch rights and the master  
2 use rights.

3 A That's correct.

4 Q Mr. Handzo also asked you some  
5 questions, referred to that already, about the  
6 CARP view. The Librarian as well talked about  
7 his view of the model that you suggested. Is  
8 that right?

9 A Yes.

10 Q And is it correct and this is from  
11 the *Federal Register*, the Librarian's decision  
12 at page 45247. It's first referring to an  
13 earlier order. The Librarian said, "The  
14 musical work fees benchmark identified in a  
15 previous rate adjustment proceeding as the  
16 upper limit on the value of the performance of  
17 a sound recording may or may not be adopted as  
18 the outer boundary of the zone of  
19 reasonableness in this proceeding. This is  
20 factual determination to be made by the CARP  
21 based upon its analysis of the record evidence  
22 in this proceeding." Is that an accurate

1 reading of one of the things the Librarian  
2 said?

3 A I have a recollection of something  
4 to that general effect, yes.

5 Q And then in the middle column and  
6 I have a question after I'm going to read  
7 this, the Librarian said, "Nevertheless, the  
8 *Register* agrees with the services on a number  
9 of theoretical points. Certainly, the Panel  
10 could have utilized Dr. Jaffe's model in  
11 making its decision either alone or in  
12 conjunction with the voluntary agreements  
13 provided that it considered the model's  
14 deficiencies and made appropriate adjustments  
15 for the fact that the model required reliance  
16 on a string of assumptions to perform the  
17 conversion of a rate for the public  
18 performance of musical work in an analog  
19 environment into a comparable rate for the  
20 public performance of a sound recording in a  
21 digital format." Now my question after that is  
22 in your analysis in this proceeding, did you

1 do anything to address the considerations that  
2 the Librarian was setting forth in his  
3 opinion.

4 A Well, I was able because of the  
5 passage of time and the accumulation of more  
6 data to eliminate that string of assumptions  
7 that's referred there that was necessary last  
8 time in order to move from the analog  
9 environment to the digital environment.

10 Q And so certainly the Panel could  
11 have utilized it had you been able to  
12 eliminate the assumptions five years ago.

13 A I think so.

14 MR. SUGARMAN: Nothing further,  
15 Your Honor.

16 CHIEF JUDGE SLEDGE: Mr. Joseph,  
17 any questions?

18 MR. JOSEPH: No questions, Your  
19 Honor.

20 CHIEF JUDGE SLEDGE: Mr. Handzo,  
21 any further questions?

22 MR. HANDZO: No further questions,

1 Your Honor.

2 CHIEF JUDGE SLEDGE: Any questions  
3 from the bench?

4 JUDGE WISNIEWSKI: Dr. Jaffe, two  
5 questions for you. One is a hypothetical.  
6 Let me start with that one. If the PROs no  
7 longer received a royalty for terrestrial  
8 radial air, would that likely impact the  
9 royalty rates they might seek in the internet  
10 market?

11 THE WITNESS: I have not thought  
12 about that. I suppose it might.

13 JUDGE WISNIEWSKI: Let me ask you  
14 a different question. If we had, and again  
15 this is in the vein of a hypothetical, if we  
16 had relative equality of market power between  
17 the buyers and the sellers in this market,  
18 would that be good evidence of a competitive  
19 market?

20 THE WITNESS: So just to be clear  
21 that I understand your hypothetical, you're  
22 talking not about the market power of the



1 webcasters in the webcasting market. You're  
2 talking about the market power that they may  
3 have as buyers in the performing rights  
4 market.

5 JUDGE WISNIEWSKI: That's correct.

6 THE WITNESS: I think that when  
7 you have a -- The limiting case of that is  
8 what economists refer to as a "bilateral  
9 monopoly" situation and the problem with a  
10 bilateral monopoly situation is it fits in the  
11 description I gave a little while ago about  
12 the negotiation hypothetically between these  
13 parties which is that economic theory does not  
14 really give you a prediction as to what the  
15 outcome of that will be. So it's hard to say  
16 whether a situation of bilateral monopoly or  
17 bilateral significant market power would or  
18 would not reproduce an approximate competitive  
19 outcome. It's just very difficult to say.

20 JUDGE WISNIEWSKI: Wouldn't that  
21 be true also in the case of a market where you  
22 didn't have strict monopolies on each side,

1 but in fact you had equivalent oligopolies on  
2 each side?

3 THE WITNESS: Yes, I think that's  
4 right.

5 JUDGE WISNIEWSKI: Thank you.

6 CHIEF JUDGE SLEDGE: Judge  
7 Roberts?

8 JUDGE ROBERTS: I have a couple  
9 questions as well. Throughout your testimony,  
10 you have told us that the data that you had  
11 back in 2001 was not very well developed and  
12 since then there's been a considerable volume  
13 of data and experience with webcasters that  
14 you can make more accurate predictions now.  
15 Is that what you've been saying? That's what  
16 I've been hearing.

17 THE WITNESS: Yeah, I mean  
18 considerable is in the mind of the beholder.  
19 In 2001, there was both limited data and also  
20 the fact that what data there was related to  
21 an economic experience which was relatively  
22 new and so there was some question of whether

1       you could sort of rely on it being kind of in  
2       equilibrium. I think what's changed since  
3       then is we have more information. Whether  
4       it's considerable or not, people could argue  
5       about. But we have more information and five  
6       years have gone by. So I'm more comfortable  
7       relying on it as reflecting some kind of real  
8       economic situation as opposed to the parties  
9       just kind of feeling each other out in a new  
10      environment.

11                    JUDGE ROBERTS: In looking now as  
12      your model does at what is paid for the  
13      musical works right to the performing rights  
14      societies, wasn't it not the case back in 2001  
15      that webcasters also had to pay the PROs for  
16      the musical works right at that point in time  
17      as well?

18                    THE WITNESS: They did and ASCAP  
19      and BMI had put forward their form license.  
20      But as I recall, first of all, as I say it was  
21      new and so it was hard to know whether what  
22      was going on at the moment really represented

1 some kind of economic equilibrium and as I  
2 recall, very few webcasters had actually  
3 reached agreement with ASCAP and BMI in a  
4 bilateral way as opposed to just ASCAP and BMI  
5 saying we're putting out this form license.  
6 You have it if you want it. Very few  
7 webcasters had actually made deals with ASCAP  
8 and BMI as of that time.

9 JUDGE ROBERTS: So the agreements  
10 that you're looking at now for the current  
11 proceeding are in fact the results of deals  
12 that the webcasters had made with the  
13 performing rights societies to contrast that  
14 from the circumstance of 2001.

15 THE WITNESS: It's a bit of a  
16 mixture because I had to put together what I  
17 could get for the different webcasters, but  
18 most of the data is in fact specific deals  
19 that have been reached between webcasters on  
20 the one hand and primarily ASCAP and BMI on  
21 the other hand, actual contracts that they  
22 have voluntarily negotiated with each other.

1 JUDGE ROBERTS: And we would just  
2 need to look at the source data to your Table  
3 2 to find those.

4 THE WITNESS: Right, and the  
5 witnesses from the webcasters who explained  
6 the origin of that information.

7 JUDGE ROBERTS: The other matter I  
8 wish to raise with you, could you turn to page  
9 13 of your testimony please?

10 THE WITNESS: Hm-hm (yes).

11 JUDGE ROBERTS: And this is where  
12 you're discussing the decision in Webcaster 1  
13 in saying that toward the top portion of the  
14 page that "the decision is not an appropriate  
15 starting point for the following reasons."  
16 And then your first point here is it's because  
17 "it's not an appropriate starting point  
18 because it's a contract for a single user with  
19 special circumstances" and you discuss there  
20 and going over to page 14 about Yahoo  
21 "calculating the cost of litigation to achieve  
22 a competitive royalty would be greater than

1 the saving from paying a reasonable rate and  
2 having to spent litigation fees to get it."

3 You also make essentially the same  
4 point on page 15 that the cost of litigation  
5 is large and that affects why that's not a  
6 competitive rate. When is litigation costs  
7 not in play?

8 THE WITNESS: Well, I think that's  
9 a good question because in this arena  
10 typically in one way or another litigation is  
11 part of the story. I think I would contrast  
12 for example the Yahoo situation where you have  
13 a completely new arena and Yahoo quite  
14 explicitly is looking at do I cut a deal or do  
15 I play this particular game. With the data  
16 that I used in this case for the webcasters,  
17 all of whom in principle could have litigated  
18 rather than agreeing to ASCAP and BMI's  
19 royalties, but we have, first of all, many  
20 deals you know made over a period of time so  
21 that it's just a more generic picture of the  
22 situation.

1 I think that my sense for example  
2 from Mr. Mandelbrodt's testimony is that the  
3 Yahoo situation was, there was an unusually  
4 sharp, what's the word I want, coming together  
5 of their thinking about this as a litigation  
6 decision versus a business decision. I agree  
7 with you. It's always there to some extent,  
8 but it seemed particularly sharp in that case.

9 JUDGE ROBERTS: And you said that  
10 if you had more players involved you kind of  
11 spread out the effect.

12 THE WITNESS: Right, and you're  
13 seeing the same result multiple times. They  
14 may all to some extent be thinking about  
15 litigation, but as an inferential matter it  
16 seems that the effect that that's having is  
17 having less effect if you're seeing multiple  
18 players over a period of time making these  
19 decisions in an ongoing market.

20 JUDGE ROBERTS: Could you contrast  
21 that to the situation with the PROs? There is  
22 litigation there because there is the Rate

1 Court.

2 THE WITNESS: Right.

3 JUDGE ROBERTS: And you only have  
4 in that instance two sellers, BMI and ASCAP,  
5 that are subject to the consent decree. How  
6 is that situation different than say for  
7 instance the --

8 THE WITNESS: Well, I think the  
9 difference is that in the PRO situation you  
10 have a symmetric or at least somewhat  
11 symmetric, both parties are in some sense if  
12 there's a potential deal on the table, are  
13 deciding whether or not they're going to take  
14 that deal and maybe they think it's not a good  
15 deal. Or if they don't think it's a good deal  
16 whether they're going to have recourse to Rate  
17 Court to get a better deal which is going to  
18 be costly and that affects both parties.

19 With Yahoo and the RIAA in this  
20 particular case, it was clear there was going  
21 to be a proceeding and RIAA was going to have  
22 to bear the cost of going through that



1 proceeding. So RIAA was not in a position  
2 where they would save litigation costs by  
3 making a deal with Yahoo. They were going to  
4 have to litigate anyway and I don't think  
5 there's reason to think that the cost of them  
6 litigating was going to be significantly  
7 different if Yahoo was in or Yahoo was out.

8 But Yahoo had the opportunity in  
9 effect to leave it to the other guys to  
10 litigate RIAA, cut a deal for themselves,  
11 avoid the cost of participating and frankly in  
12 the long run if the outcome in the proceeding  
13 had been a rate lower than what they  
14 negotiated with RIAA at some point when that  
15 original agreement lapsed, they could have  
16 gotten the benefit of it. So they were in an  
17 asymmetric position where they could save a  
18 lot of costs by doing a deal with RIAA and I  
19 don't think that is typically the case in, for  
20 example, the PRO setting.

21 JUDGE ROBERTS: But knowing that  
22 there was going to be a proceeding, Yahoo

1       could have just sat out and watched the others  
2       litigate and taken that rate. Correct? And  
3       if they didn't like it, then maybe they could  
4       attempt to negotiate something else.

5                   THE WITNESS:     Yes, now you're  
6       straining my memory. I don't recall what  
7       Yahoo's perception was of whether they could  
8       in fact, you know, whether that was a feasible  
9       outcome. I really don't remember.

10                   CHIEF JUDGE SLEDGE:   Any other  
11       questions as a result of the questions from  
12       the Bench?

13                   MR. SUGARMAN:   Two, Your Honor.

14                   CHIEF JUDGE SLEDGE:   All right.

15                   REDIRECT EXAMINATION

16                   BY MR. SUGARMAN:

17                   Q     Just as a follow-up with respect  
18       to the data you used in the CARP and the data  
19       you're using today, in the last CARP, you used  
20       terrestrial radio data for the analog. Right?

21                   A     That's correct.

22                   Q     And in this proceeding, it's

1 webcaster agreements with ASCAP and BMI for  
2 what they paid to the PROs.

3 A That's correct.

4 Q Now as far as litigation costs, in  
5 a hypothetical market where there are multiple  
6 sellers offering substitutable products, is  
7 litigation cost an issue associated with the  
8 failure to reach agreement with any one of  
9 those sellers?

10 A I don't think so.

11 Q And that's because they always  
12 have another person to go to.

13 A Right.

14 MR. SUGARMAN: Thank you, Your  
15 Honor.

16 CHIEF JUDGE SLEDGE: I don't  
17 assume that raises any other questions. That  
18 completes your testimony. Thank you.

19 THE WITNESS: Thank you.

20 (Witness excused.)

21 CHIEF JUDGE SLEDGE: Mr.  
22 Steinthal.

1                   MR. STEINTHAL:    We have -- We  
2                   didn't anticipate finishing so early today  
3                   based on everyone's estimates.  We have Ms.  
4                   Uhlman tomorrow who will be extremely brief.  
5                   I don't know whether Mr. Parks has been lined  
6                   up.

7                   MR. PARKS:        I actually inquired  
8                   specifically    about   tomorrow   and   the  
9                   possibility that we could --

10                  MR. STEINTHAL:  So I think we have  
11                  a really short day tomorrow because we will  
12                  close our case.  As we talked earlier in the  
13                  week, SoundExchange wasn't in a position to go  
14                  shift to any of the small webcasters right  
15                  away.  So we'll be out of here by the morning  
16                  break tomorrow morning.

17                  CHIEF JUDGE SLEDGE:  Thank you.  
18                  We'll recess to 9:30 a.m.  Off the record.

19                  (Whereupon,    the   above-entitled  
20                  matter was concluded at 12:52 p.m.)

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