

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

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In the matter of:

The Digital Performance
Right in Sound Recordings | Docket No.
and Ephemeral Recordings | 2005-1 CRB DTRA

(Webcasting Rate
Adjustment Proceeding)
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Volume 14

Room LM-414
Library of Congress
First and Independence Ave,, S.E.
Washington, D.C. 20540

Tuesday,
June 6, 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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1 Freundlich for Royalty Logic. We had, I
2 think, discussed - I think Mr. Watkins on
3 that phone call, that we were going to go
4 second. We have one witness, and it just
5 made, we thought, logistical sense to just
6 put our witness on, get all the cases on
7 that side in first, and then have the
8 broadcasters come after that. But I just
9 want to sort of clarify that, because I have
10 to make plans to go back to L.A., and then
11 to get back here with my one witness.

12 CHIEF JUDGE SLEDGE: You have no
13 response at this point, but we'll get you
14 one soon.

15 MR. FREUNDLICH: Thank you.

16 CHIEF JUDGE SLEDGE: Mr.
17 Perrelli.

18 MR. PERRELLI: Thank you, Your
19 Honor. Sound Exchange would call Barrie
20 Kessler.

21 CHIEF JUDGE SLEDGE: Thank you,
22 Ms. Kessler, for remaining standing. Would

1 you please raise your right hand.

2 WHEREUPON,

3 BARRIE KESSLER

4 was called as a witness and, after having
5 been first duly sworn, was examined and
6 testified as follows:

7 CHIEF JUDGE SLEDGE: Thank you.
8 Please be seated.

9 MR. PERRELLI: Your Honor, with
10 your permission, I'll hand out binders with
11 Ms. Kessler's testimony. Thank you, Your
12 Honor.

13 DIRECT EXAMINATION

14 BY MR. PERRELLI:

15 Q Ms. Kessler, can you give your
16 full name for the record?

17 A Barrie Kessler.

18 Q And can you tell the Board your
19 job title?

20 A Yes. I'm the Chief Operating
21 Officer of Sound Exchange.

22 Q And in that job, what are your

1 responsibilities?

2 A All the operational functions of
3 the organization report to me, including the
4 membership outreach function, all of the
5 distribution operations functions, the
6 accounting and royalty administration
7 functions, and the general legal and
8 compliance functions. In addition, the IS&T
9 function, the systems development and
10 extensions report to me.

11 Q And when you say IS&T, what does
12 that refer to?

13 A Information Systems & Technology.

14 Q And how long have you served in
15 that position?

16 A Since the summer of 2001.

17 Q And what was your position before
18 your current job?

19 A I was the Director of
20 Distribution Operations.

21 Q For Sound Exchange?

22 A For Sound Exchange, yes.

1 Q And how long did you serve in
2 that role?

3 A That was since November of `99 to
4 the summer of 2001.

5 Q And what were your job
6 responsibilities in that job?

7 A In that role, my responsibilities
8 were to ascertain the business and systems
9 requirement for the royalty distribution
10 system, to design, build, and implement that
11 system, and all of the data ingestion
12 requirements around that system, meaning the
13 performance logs, as well as the royalty
14 accounts.

15 Q So with respect to the royalty
16 collection and distribution systems now
17 operating in Sound Exchange, were you in
18 charge of developing those?

19 A Yes, I was the architect.

20 Q I want to start with an overview
21 and ask you just how you describe sort of
22 overall an overview of what it is that Sound

1 Exchange does.

2 A Sound Exchange is responsible for
3 the collection and the timely, and
4 efficient, and transparent distribution of
5 royalties under Sections 112 and 114 of the
6 Copyright Act.

7 Q Okay. From whom do you collect
8 royalties?

9 A We collect royalties from a
10 number of licensee types, including the pre-
11 existing services, the SDARS, business
12 establishment services, and the webcasters.

13 Q Do you also collect royalties
14 from foreign collecting societies?

15 A Yes, we have limited collections
16 from foreign collecting societies.

17 Q And how many -- can you identify
18 how many different services you collect
19 royalties from?

20 A With respect to each one of those
21 categories?

22 Q Sure.

1 A The PES, we currently have two;
2 the SDARS we currently have two; the
3 business establishment services two;
4 webcasters over 570, I believe.

5 Q Now when you talk about 570
6 webcasters, does that reflect the number of
7 webcasting channels that are available to
8 the public?

9 A No, in no way does that number
10 reflect the number of channels. That number
11 is substantially higher. You have your
12 large commercial webcasters who have many,
13 many, many channels of music. You also have
14 licensees who are reporting as part of a
15 broadcast group, so there's one reporting
16 by, for example, a Clear Channel, but that's
17 on behalf of many terrestrial stations that
18 are simulcasting over the internet.

19 Q Do you also have webcasters
20 reporting who are aggregators?

21 A Yes, we do. In the case of Live
22 365, they aggregate many, many individual

1 webcasters, many hundreds.

2 Q And to whom do you distribute
3 royalties?

4 A We distribute royalties to the
5 copyright owner of the sound recording
6 transmitted, as well as the featured
7 performer, and also the non-featured
8 performers through their union. That would
9 be AFTRA and AF of M.

10 Q And how do you decide how much to
11 give each of those groups?

12 A It's set by the statute. There's
13 a statutory split of 50 percent to the
14 copyright owner, 45 percent to the feature
15 performer, and 5 percent total to the non-
16 feature performers. And that's with respect
17 to the 114.

18 Q And with respect to Section 112?

19 A That is 100 percent of those
20 royalties are distributed to the copyright
21 owners.

22 Q Do you have to be a member of

1 Sound Exchange in order to receive royalty
2 distributions?

3 A No, you do not. Membership is
4 not required, and we make no distinction
5 between a member of a non-member with
6 respect to collections and distributions.

7 Q And can you give the Board a
8 rough sense of the number of performances of
9 sound recordings that Sound Exchange has --
10 on which Sound Exchange has received reports
11 to-date?

12 A Yes. We have currently processed
13 just about 700 million performances from
14 licensees who are reporting.

15 MR. PERRELLI: Okay. With the
16 Court's permission, I'm going to put up the
17 demonstrative exhibit. And for the record,
18 this is a blown-up versions. It's labeled
19 Sound Exchange Demonstrative 54, but it is a
20 blown-up version of Sound Exchange Exhibit
21 211DP. We're going to get into these issues
22 in a little bit more detail.

1 BY MR. PERRELLI:

2 Q Can you describe what this
3 demonstrative exhibit reflects?

4 A Yes. This demonstrative reflects
5 the basic functions of Sound Exchange from
6 the moment we collect the royalty to the
7 point where we distribute the royalties to
8 copyright owners, and artists, and some of
9 the post-distribution activities that ensue.

10 Q Okay. And what was your role in
11 developing these processes?

12 A I was the architect of these
13 business processes.

14 Q And how long did it take Sound
15 Exchange to develop the system?

16 A Sound Exchange spent a great
17 deal, a tremendous amount of time, energy,
18 and money developing both the business
19 processes and the systems that model those
20 processes to effect the distribution to
21 copyright owners and artists. And while
22 there was an initial investment in these

1 systems and services, we have since expended
2 additional resources refining, expanding,
3 and making more efficient the business
4 process, as well as the underlying computer
5 system.

6 Q Does that process continue to
7 this day?

8 A I expect it will always continue.

9 Q I want to go step-by-step through
10 the various steps of your collection and
11 distribution efforts. First of all, does
12 Sound Exchange bill webcasters for their
13 usage of sound recordings?

14 A No, we don't. We're not a kind
15 of typical business that has a product,
16 sells the product, invoices for the product,
17 receives payments, and then delivers the
18 product. We're in a situation of self-
19 invoicing by the licensees. All of the
20 information that Sound Exchange needs to
21 distribute the royalties are in the
22 possession of the webcasters, and that

1 includes the performances that they've
2 transmitted, as well as the number of
3 listeners to those performances. And in
4 addition, all the financial information is
5 in their possession.

6 Q And what kind of information does
7 Sound Exchange need from, in this instance,
8 webcasters in order to conduct its
9 collection and distribution operations?

10 A Ideally, we receive several
11 pieces of information. First is an election
12 of which license metric they're going to be
13 making their payments. We receive, ideally,
14 the payment itself, along with a statement
15 of account reflecting how the royalty
16 obligation was calculated. Concurrent with
17 the receipt of those three documents is the
18 performance log, which lists all of the
19 performances performed during a specific
20 period.

21 Q And just so we're clear, when you
22 talk about a performance, what are you

1 referring to?

2 A Performance is a transmission of
3 a sound recording that's listened to by an
4 end-user. It's a non-interactive digital
5 transmission.

6 Q You talked about several
7 different pieces of paper. Can you explain
8 what information that you receive on each,
9 for example, the statement of account?

10 A Yes. Depending if the webcaster
11 is paying on a percentage of revenue,
12 percentage of cost, per performance, or
13 aggregate tuning hour, it reflects that
14 metric, and the usage of the content times
15 the applicable rate resulting in the royalty
16 obligation. In addition to the extent a
17 minimum fee was paid, that royalty
18 obligation is reduced by the minimum fee,
19 and if the minimum fee is not exhausted,
20 then the balance is the current royalty
21 obligation.

22 Q And, again, on the reports of

1 use, what is the report of use, and what
2 information does it provide Sound Exchange?

3 A A report of use is a listing of
4 sound recordings transmitted, which includes
5 information, such as the title, the artist,
6 the album, the marketing label, in some
7 cases the catalogue number, in other cases
8 an ISRC, and it reflects transmissions
9 during a relevant period. It will also
10 reflect the number of performances or
11 aggregate tuning hours for that performance.

12 Q Now does Sound Exchange always
13 get those different pieces of paper, those
14 different pieces of information from
15 webcasters?

16 A No, we commonly don't get all of
17 the paperwork, payment, and logs at the same
18 time. We sometimes receive payments without
19 any statement of account. The alternative
20 is true, we get statements of account
21 without the attendant payment. We are
22 currently not receiving performance logs

1 from many, many, many of the webcasters, but
2 it is not uncommon for us not to receive all
3 the items necessary to log the receipt of
4 the payment, and ultimately distribute those
5 royalties.

6 Q Now without a statement of
7 account, are you able to actually distribute
8 royalties?

9 A No, we are not. The statement of
10 account reflects the period for the payment,
11 and in order to match the payment with the
12 log, we need to know what date the payment
13 is for, what period the payment is for. In
14 addition, certain services are paying on
15 behalf of a great many stations, or they are
16 paying multiple royalties in one check, and
17 so without the statement of account, we have
18 no idea how to attribute that money on a
19 station-by-station basis, or to which
20 service that licensee is paying for.

21 Q And without the reports of use,
22 are you able to distribute royalties?

1 A No, the reports of use are the
2 basis for the distribution. Without that,
3 we have no way of knowing which performer's
4 recordings have been transmitted, or
5 copyright owners, as well.

6 Q You mentioned that you don't get
7 reports of use from at least some
8 webcasters. Can you explain why?

9 A Currently there are no final
10 regulations with respect to the reports of
11 use for the webcasters to the extent of the
12 format of those reports, and the mechanism
13 that they are to deliver them to Sound
14 Exchange. There are regulations in place
15 with respect to the information they're
16 supposed to retain and ultimately report to
17 us, but without the format, the file format,
18 the manner in which they actually deliver it
19 to Sound Exchange, those regulations have
20 not been promulgated.

21 Q Why is the file format important
22 to Sound Exchange?

1 A Well, it's critical to the
2 efficient processing of the performances.
3 If webcasters can report in any old file
4 format with information in any order they
5 please, there's no way that we could build
6 an efficient system that would ensure the
7 prompt and efficient payment to the
8 copyright owners and artists that these
9 services are building their businesses on.

10 Q Let's go through the process.
11 Assuming you've gotten the statement of
12 account and the report of use, can you
13 explain the first step once Sound Exchange
14 receives payment from a licensee?

15 A When we receive the payment, of
16 course, we log that payment and deposit the
17 check. We review the statement of account
18 for completeness, and accuracy, and we
19 forward the logs to our distribution
20 operations department.

21 Q And what's the next step in your
22 processing of payment and in the logs?

1 A Well, in some cases in step one
2 there is some follow-up required, if
3 information is missing, or a payment is
4 received late, so there may be special
5 follow-up in step one. But presuming that
6 everything is received together and on time,
7 we're able then to move to step two, which
8 is the loading of the performance log into
9 our computer system for identification.

10 Q And can you explain that log
11 loading process and how it operates?

12 A Yes. First, we receive the log
13 and the system tries to recognize the log,
14 and verify that the log is structurally
15 loadable, meaning that the format is proper
16 and can be loaded. Upon successful loading
17 of the log, then each performance in the log
18 is examined to see if we have received that
19 performance in the past from this or another
20 webcaster, and to the extent that it has
21 been seen before, we match it to an existing
22 record in our database. If the performance

1 has not been matched, we move into step
2 three, and manual identification. The
3 system kind of learns as it goes along. We
4 retain all the performances from all the
5 webcasters, and all the licensees who have
6 ever reported. And we know that webcasters
7 and licensees don't always report everything
8 exactly correctly in the title, artist,
9 album, label, catalogue, copyright owner,
10 and so on in those fields, and so we expect
11 to see the same performance reported
12 incorrectly or improperly repeatedly from
13 the same service.

14 Q And how does your software
15 account for that or address that problem?

16 A We take all of those improperly
17 reported records and ascertain what the
18 proper text representation is for that sound
19 recording, and so we match all these
20 incorrect incoming - incorrect from a text
21 standpoint incoming sound recordings, and
22 match it to our standard actor processing

1 value, so it's kind of our master version of
2 all those variations of how a sound
3 recording can be reported.

4 Q You talked about matching it
5 against an existing database. Where did
6 Sound Exchange get that database?

7 A Sound Exchange built that
8 database from the reports of use from the
9 licensees themselves. It was not pre-loaded
10 by any other source. This has all be
11 discerned from the perfection of data
12 reported by the services.

13 Q Is there any requirement for
14 copyright owners to register their works
15 with Sound Exchange?

16 A No, unfortunately there is no
17 requirement for copyright owners to register
18 with Sound Exchange for the payment of their
19 royalties, and as a result, we only get the
20 information from the licensees themselves.

21 Q And when you're talking about
22 matching, how many records are you talking

1 about matching in any particular report of
2 use or log?

3 A Well, as I said, we processed
4 over or nearly 700 million individual
5 performances, and the amount of performances
6 from log to log varies depending on what
7 period we're loading, but it's in the tens
8 of millions of records. And our system is
9 able to identify in the exact matching step
10 number two, typically anywhere from around
11 70 percent to all the way up to 93 or 95
12 percent matching.

13 Q If you have the artist and the
14 name of the sound recording, is that enough
15 to tell Sound Exchange to whom to pay
16 royalties?

17 A No, it's not enough information
18 to ascertain that. Just having a title of a
19 song and an artist's name doesn't lead us to
20 the exact recording being reported.

21 Q Why not?

22 A Because artists record the same

1 songs, multiple versions of the same songs
2 throughout the life of their career, which
3 could span many decades. If the artist is a
4 group, the group members may be different on
5 one version of the sound recording to the
6 next, and the feature performer, the non-
7 featured performers, the background
8 vocalists and musicians will change from
9 version of the sound recording to the next,
10 even though it's the same song and the same
11 group.

12 Q Why can't Sound Exchange simply
13 pay Fleetwood Mac if it's a Fleetwood Mac
14 song?

15 A Well, Fleetwood Mac is a good
16 example of a featured artist who over their
17 30 or 35 year career has changed the
18 composition of their group frequently,
19 almost from album to album, and they've re-
20 released songs that they previously recorded
21 on a subsequent album, and so in their case
22 we pay the individual members of the group.

1 And unless we know what album the track has
2 been performed, we don't know which version
3 of the group it is. If we don't know which
4 version of the group it is, then we don't
5 know who the individual performers are who
6 are entitled to the royalties.

7 Q Is it sufficient for Sound
8 Exchange to pay out artists and copyright
9 owners to get a sample of data from an
10 individual webcaster showing a sample of the
11 performances?

12 A No. There's nothing that I'm
13 aware of that says some artists should be
14 paid and some shouldn't, or some copyright
15 owners should be paid and some shouldn't.
16 And by definition, a sample will exclude
17 copyright owners and artists from the
18 receipt of those royalties to the extent
19 they're not present in the log, simply by
20 virtue of it being a sample.

21 CHIEF JUDGE SLEDGE: Ms. Ablin.

22 MS. ABLIN: Your Honor, I would

1 object to this last question and answer and
2 move to strike it. Sample reporting is an
3 issue that's been dealt with in the separate
4 record keeping proceeding. It's not a part
5 of this proceeding. I think the statute is
6 clear that the terms to be set in this
7 proceeding are terms of royalty payments,
8 not record keeping terms. There's a
9 separation provision, I believe 114(f)(4)(A)
10 that talks about the record keeping
11 requirements. As Ms. Kessler testified,
12 there are already interim requirements in
13 place at the Copyright Office, and now it's
14 in the Board's hands, are dealing with
15 issues like sample versus census. It's been
16 considered in this separate proceeding.
17 However, Mr. Simson, when he testified
18 earlier in this proceeding, admitted that
19 this was not an issue, sample versus census
20 and record keeping is going to be determined
21 by the Board here. In the other proceeding,
22 there are lots of other parties that are not

1 privy to the testimony going on in here
2 which is an adjudicatory proceeding as
3 opposed to a promulgation of regulations
4 done by notice and comment, so I would move
5 to strike that, as well. That list of
6 exhibits which we can handle now or later
7 that Ms. Kessler is sponsoring and that deal
8 exclusively with the record keeping
9 proceeding.

10 CHIEF JUDGE SLEDGE: Ms. Ablin, I
11 appreciate your attention to relevance to
12 the matters before the Board, but
13 unfortunately at this point, if we had
14 applied that standard to the evidence we've
15 received, about 80 percent of what we've
16 heard would not have been heard. Your
17 motion is denied.

18 BY MR. PERRELLI:

19 Q Ms. Kessler, I want to take you
20 back and finish this topic. You talked
21 about Sound Exchange looking at sampling.
22 Has Sound Exchange looked at the impact of

1 sampling on the distribution of royalties to
2 copyright owners and performers?

3 A Yes, we have. Based on census
4 reporting supplied by a webcaster, we
5 conducted a sample on those performances
6 which reflect the two week sample per
7 quarter which has been indicated in the
8 interim regulations, and we found that over
9 40 percent of the artists performed in the
10 census were not picked up by the sample.
11 And those that were picked up by the
12 samples, some of those artists were over-
13 paid, and some of the artists, of course, we
14 under-paid.

15 Q On whom does that problem fall
16 most directly in the artist and copyright
17 owner community?

18 A It falls -- the displacement of
19 the royalty payments falls most heavily on
20 independent copyright owners, the small
21 copyright owners, and the feature artists.

22 Q We talked about Sound Exchange's

1 automated matching. Is the software that
2 Sound Exchange uses off-the-shelf software?

3 A No. It's completely custom
4 built.

5 Q Now if the software is unable to
6 match a particular sound recording with an
7 existing sound recording on Sound Exchange's
8 database, what's Sound Exchange's next step?

9 A The next step is the system will
10 present to a computer user a listing of all
11 of the sound recordings that have not been
12 matched; in other words, we have not yet
13 seen them reported or identified them
14 previously. In some cases, these sound
15 recordings are new releases, and we expect
16 around a 7 or 8 percent new release rate, so
17 we anticipate not matching everything. But
18 it also includes sound recordings that may
19 have a match in our database, but based on
20 the complex algorithm in the matching, the
21 automated matching, it was unable to a
22 degree of certainty match that sound

1 recording, and so one of our staff has to
2 look at the computer screen with the
3 unmatched recording, and then below that are
4 typically a list of six or so possible
5 matches that represent that same sound
6 recording.

7 Q Are there particular kinds of
8 sound recordings or works that raise more
9 difficult issues for matching purposes?

10 A Yes. Sound Exchange has a couple
11 of categories of problematic performances.
12 The first is the compilation album, where a
13 copyright owner is marketing the overall
14 album and licensing tracks from other
15 copyright owners. I can think of, like for
16 example, the Soprano soundtrack. I believe
17 it's a Sony compilation, but of course, they
18 license independent and other major label
19 content. Very often licensees will report
20 compilations not with the individual
21 copyright owners of each track, but the
22 overall marketing label for the sound

1 recording.

2 Further, they often won't
3 identify who the featured artist is, but
4 rather they'll report the featured artist as
5 various because it's a compilation and
6 different artists are on different tracks.
7 Kind of a running joke at Sound Exchange is
8 the first band that's named various is in
9 for quite a windfall because we've got a
10 number of recordings that are reported that
11 way. But Sound Exchange, of course, has to
12 undertake the tremendous research involved
13 in finding alternate sources of information
14 to truly identify who the copyright owner
15 is, and who the featured artist is, so
16 compilations are challenging.

17 Classical music is another big
18 challenge for us. I can't tell you how many
19 times a sound recording is reported, the
20 featured artist is really the composer, and
21 so it's -- we know who the composers are.
22 What we're trying to find out are who the

1 featured artist is, and so sometimes based
2 on other information on the record, for
3 example, the album, or the track title, we
4 can get a sense of who the featured artist
5 may be, which symphony recorded that
6 particular composition. But often, it
7 requires a tremendous amount of research to
8 make that determination.

9 Q Are there particular problems
10 caused, challenges posed by foreign works?

11 A Yes. Foreign works are another
12 challenge, in part because there's not a lot
13 of candidates for staff that have extensive
14 knowledge of all types of world music. But
15 remember, Sound Exchange is paying out sound
16 recordings that are transmitted by services
17 that are playing a vast array, a great
18 breadth and depth of music, and that
19 includes quite a lot of world music, so
20 we're not just paying U.S. artists, we're
21 paying artists who are all over the world,
22 and their content is being performed by

1 these services, and it makes it quite
2 difficult to identify with certainty what
3 the sound recording is.

4 Q And what kinds of additional
5 information is helpful to Sound Exchange
6 when it's engaged in this kind of research?

7 A We rely on additional sources of
8 sound recording information. We rely quite
9 a lot on All Music Guide with whom we have a
10 license to use their information. And their
11 information is far more extensive than the
12 title, artist, album, label type of
13 information. It has biographical
14 information, members of the groups, liner
15 notes, years an artist recorded, what other
16 bands or groups they may have participated
17 in and recorded with. And sometimes that
18 additional information, in conjunction with
19 the limited fields that are reported to us,
20 we're able to discern what the sound
21 recording really is.

22 With respect to our classical

1 music challenge, we provided AF of M, the
2 non-featured union, with a list of, I want
3 to say over 90,000 records to review. They
4 have quite a lot of -- they have staff who
5 are quite experienced with respect to
6 classical music, and so we rely on these
7 types of partners to help us through the
8 identification process.

9 Q And how large is Sound Exchange's
10 staff that works on this kind of research?

11 A Well, it will fluctuate depending
12 on that initial match rate that's
13 established, but anywhere from four to eight
14 staff members are working through the
15 unmatched performances.

16 Q Now what happens if you cannot
17 identify what sound recording a particular
18 performance, what sound recording artist a
19 particular performance is?

20 A If we can't identify the sound
21 recording, then we can't determine who's the
22 entitled party of the sound recording that's

1 entitled to the distribution of the
2 royalties.

3 Q Do Sound Exchange employees
4 continue to research unmatched performances?

5 A Oh, yes. I mean, we never stop
6 in our quest to identify what the sound
7 recording really is. And sound recordings
8 are placed in a separate account and noted
9 as unidentified, and we continually go back
10 and look, and refine, and perhaps down the
11 road another licensee will report something
12 like that track, and it will show up in one
13 of the potential matches for the sound
14 recording. And this is an ongoing process
15 that continually is occurring.

16 Q Once you have a match for the
17 sound recording, are you able then to pay
18 out the royalties owed for that sound
19 recording?

20 A No. A simple identification of
21 what sound recording this actually is, is
22 really just the start for being able to pay

1 out on that sound recording. Each
2 performance has a copyright owner
3 entitlement, a featured artist entitlement,
4 and a non-featured artist entitlement, and
5 so we have to identify who the copyright
6 owner is, how they want the royalties to be
7 paid to them. In other words, their 50
8 percent share, who to make the check out to,
9 where to send the check, where to deposit
10 the funds if it's a direct deposit or a
11 wire. And similarly, on the artist side, we
12 have to assign the appropriate account to
13 the artist side of the performance, because
14 as I mentioned, just because you know it's
15 Fleetwood Mac, doesn't mean it's a Fleetwood
16 Mac from the 80s is the same Fleetwood Mac
17 that reported in the 90s, so you have to
18 identify with certainty the sound recording,
19 and which account it should be assigned to
20 for purposes of that payment.

21 Q Now this account assignment
22 process, is it automated or manual?

1 A It's automated to the extent that
2 we have seen the performance before and it's
3 assigned to an account. It's not automated
4 if it's a new performance, or if it's one of
5 the performances that we're able to identify
6 who the sound recording is, but we never got
7 information from the copyright owner or
8 artist of how to pay out on that track, so
9 artists, we find artists, artists come to us
10 and then we register them as an account in
11 the system, and attach their performances to
12 that account. And then we establish how the
13 money is to be paid out on those particular
14 tracks.

15 Q How do you decide how to pay out
16 particular artists of a particular track?

17 A We will always take the direction
18 of the artist, and we will pay it out the
19 way the artist instructs us to. To the
20 extent that that artist is a group, the
21 whole group will tell us how to pay out
22 those tracks.

1 Q You talked about how the artist
2 might tell you to pay out a particular
3 track. What kinds of directions do you get
4 from artists in terms of different ways to
5 distribute royalties for particular tracks?

6 A Well, typically when the artist
7 is an individual, they may have a company
8 that they want us to send their royalties to
9 for business purposes. Some artists want us
10 to make the check out to them and send it to
11 someplace other their home. Some artists
12 want us to pay them the royalties and send
13 it to a particular address. Some artists
14 who are living abroad will have to have tax
15 withholding on their royalty distributions,
16 and so in the simple case of the individual
17 artists, it's typically 100 percent of the
18 royalties go to them or their company that
19 is handling the accounting for them.

20 With groups it can become more
21 difficult. Absent the direct instructions
22 from the group members, Sound Exchange has a

1 number of policies on how to split the
2 royalties among those artists.

3 Q And can you describe some of
4 those policies?

5 A Yes. I guess it's important to
6 note here that the objective is to be as
7 fair and transparent as possible with
8 respect to the distribution of royalties, so
9 in no case do we have -- the approach is to
10 value the members of the group fairly, and
11 so each member of the group will get their
12 pro rata share. So if there's four members
13 of the group, each will get 25 percent of
14 the performance for that sound recording.
15 And remember, that's of the 45 percent of
16 the performance's value, so they get 25
17 percent or 45 percent.

18 In the case where, by virtue of
19 the sound recording it's not so easy to
20 split it evenly among the group members, and
21 this is an example in classical music where
22 you have the orchestra, the soloist and the

1 conductor, and they've all contributed to
2 the creation of the sound recording - those
3 are the kinds of things that Sound Exchange
4 will not in a vacuum make a policy decision
5 about. We go out to the artist community in
6 the form of roundtables with artist
7 managers, artist attorneys, and the artists
8 themselves, present some of these examples
9 and complications to those groups. We try
10 to determine what current business practices
11 are with respect to the division of
12 royalties, with the whole objective to have
13 our stakeholders buy into the policy and
14 help Sound Exchange establish them.

15 Then the policies go to a Sound
16 Exchange committee called the Distribution
17 Policy Committee, which was created by
18 virtue of the bylaws. And the policies are
19 presented to that committee, with options or
20 recommendations that Sound Exchange has
21 gathered through these roundtables that
22 we've held. The Distribution Policy

1 Committee then will decide the best course
2 of action, and make a recommendation to the
3 full board for adoption.

4 Q And who makes up the Distribution
5 Policy Committee?

6 A It's evenly comprised of three
7 copyright owner members and three artist
8 members.

9 Q And who makes up Sound Exchange's
10 Board?

11 A That is also equally comprised of
12 artists and copyright owners, nine copyright
13 owners and nine artists.

14 Q When Sound Exchange distributes
15 its royalties to individuals, does it
16 identify for the artist, for example, how
17 the royalties may have been divided up among
18 other members of a group, for example?

19 A Yes. Sound Exchange produces a
20 very detailed and thorough statement to each
21 artist and copyright owner, for that matter,
22 who is paid a royalty. And without showing

1 confidential information, such as Tax Ids or
2 addresses, we do show each artist how that
3 group's royalties were split, so the 25
4 percent or whatever they're instructed us,
5 however they have instructed us to split the
6 royalties.

7 Q What happens if there are
8 disputes among a group, for example?

9 A We do have some disputes where
10 the members of the group can't decide how
11 the royalties, or can't agree on how the
12 royalties should be split. In those cases,
13 we immediately put the account on hold and
14 simply accrue the royalties earned by those
15 sound recordings for future distribution,
16 and we hold those royalties until the
17 dispute is resolved.

18 Q And what role does Sound Exchange
19 play in resolving that dispute?

20 A Sound Exchange would never make a
21 determination of how to split the royalties.
22 What we do try to do, however, is facilitate

1 the communication among the disputing
2 parties, remind them that the royalties
3 aren't going to get distributed if they
4 can't agree on how to allocate the payments
5 of those royalties. And we're more in kind
6 of a broker situation than anything else.

7 Q I don't mean to interrupt you.
8 Do you want to finish your answer?

9 A We haven't yet had a situation
10 where a dispute has gone on for a long
11 period of time where it had to be referred
12 to another one of Sound Exchange's
13 committees, which is the Dispute Resolution
14 Committee.

15 Q And has that committee ever
16 decided any dispute?

17 A Not to-date. I have no doubt
18 there will be an occasion when it will have
19 to, but so far, no.

20 Q One of the things we didn't talk
21 about was, are you distributing monies just
22 to artists, or also to their heirs, for

1 example?

2 A Sound Exchange has seen in its
3 performance log such a breadth of music
4 spanning many decades, and we have quite a
5 number of featured artists who have died,
6 and so rather than trying to pay the
7 featured artist, we're looking for their
8 heirs. And when you look at the breadth of
9 music being performed, and the vitality of
10 it, you see that in some cases we're
11 actually looking for heirs of heirs, so
12 we're always looking to find those entitled
13 to the royalties from a particular artist's
14 recordings.

15 Q Do performances by non-human
16 performers, Barney, for example, or the
17 Muppets, do those raise particular problems?

18 A Yes, that's another area that
19 Sound Exchange, I'm telling you, didn't
20 anticipate when we first launched, but we do
21 have the Muppet characters, and the
22 Chipmunks, and Barney, and on and on. And

1 again, webcasters do perform a lot of
2 children's music. It's a wonderful array of
3 children's music, and a lot of times these
4 are animated characters or non-human
5 characters, and Sound Exchange struggled
6 with this issue, and took it to our
7 roundtables and to our committee, and we
8 looked at the legislative history, and we
9 pondered our options around this. And it
10 was ultimately determined that we should try
11 to find the voices behind the animation, or
12 the voices in the costume. And that's
13 exactly what we're doing, so we are trying
14 to find outlets to determine who the actual
15 voice is that recorded that sound recording.

16 Q You've talked a number of times
17 about the breadth of music performed. What
18 do you expect to happen with respect to the
19 breadth of music on which you're going to
20 receive reports when all of the webcaster
21 data comes in eventually?

22 A Once all the webcasters are

1 reporting, and we do look forward to that
2 day, I expect that just the sheer volume
3 will increase by virtue of going from a
4 handful of licensees reporting, to the 570,
5 plus all of their individual stations, in
6 the Live 365 example, I expect that we're
7 going to see an absolute explosion in the
8 number of performances reported. I would
9 also not be surprised if we see sound
10 recordings that aren't new releases, but
11 have never been performed by the services
12 currently reporting, again, because there's
13 just this incredible breadth of music that's
14 being transmitted by the webcasters.

15 Q We've gotten to the account
16 assignment section of this chart. If you
17 can't figure out who the copyright owner or
18 performer is, what happens to that account?

19 A The performances for whom we
20 can't identify the artist, or we don't
21 receive them from the artists instructions
22 on how to pay them, they're assigned to an

1 account, an escrow account where we continue
2 to accumulate those royalties in the hope
3 that our various outreach mechanisms will --
4 that artist will eventually come forward or
5 the copyright owner will eventually come
6 forward and make a claim to those
7 performances.

8 If we've been able to identify
9 the copyright owner but not the artist, we
10 will pay the copyright owner 50 percent
11 share. If we're able to find the featured
12 performer but not the copyright owner, we'll
13 pay that, so we pay to the extent that we
14 can. But if on either side we're unable to
15 fulfill that payment obligation, we escrow
16 those funds and identify those performances
17 as undistributable.

18 Q And for those copyright owners
19 and performers you able to identify, do you
20 have any obligations with respect to income
21 tax, for example?

22 A Can you repeat that?

1 Q With respect to copyright owners
2 or performers you are able to identify, do
3 you have any obligations with respect to the
4 Internal Revenue Service?

5 A Yes. Unless we receive the
6 proper tax information from the featured
7 artist or copyright owner, we're required to
8 withhold a certain percentage of the
9 royalties and pay that to the IRS. And if
10 it's an artist who's resident in the United
11 States, it's a certain percentage, but if
12 it's an artist resident in another country,
13 which we have quite a number of artists
14 residing all over the world, then we have to
15 determine what the tax treaties are, what
16 the proper withholding is. And even if they
17 do provide us with tax information, there is
18 sometimes a tax withholding obligation, so
19 we have to be cognizant of any of the latest
20 changes in any of those tax treaties, and
21 constantly reviewing our processing of
22 foreign artists' royalty payments to make

1 sure the withholding is done properly.

2 Q Once you've identified the
3 copyright owner or performer, does that mean
4 you know how to locate the individual or the
5 company?

6 A Oh, no, I wish it were so. We
7 spend a tremendous effort on locating
8 artists, and you think if you're an
9 organization, that's primary function is to
10 cut checks and pay the deserving artists and
11 copyright owners, it would be an easy job.
12 But we have found that, once again, the
13 breadth of the content and the vast array,
14 and just the sheer numbers of artists who
15 are entitled to the royalties, it's quite a
16 daunting task to locate, find, and not only
17 that, but get the artist to tell us where to
18 send the check to. Sometimes filling out a
19 simple piece of paper, an artist isn't
20 always the easiest to get that information
21 from them. So, of course, we need to know
22 where to cut the check, or the bank routing

1 information where to make the deposit.

2 Q Once you've -- let's assume
3 you've got all that information and you're
4 ready to move to the next step, step five,
5 allocation and distribution of royalties,
6 what does Sound Exchange do there?

7 A Allocation and distribution is
8 kind of the culmination of this process
9 where we actually get to send royalties to
10 the deserving copyright owners and artists.
11 The allocations happen four times a year on
12 a quarterly basis. Distributions have been
13 done on a quarterly basis, but we're looking
14 at more frequent distributions in order to
15 get more money to more artists more
16 frequently, more timely.

17 The first step in that process
18 is, as I said, the allocation, and the
19 allocation is where we take the royalties
20 received by each licensee and allocate them
21 to the performances reported by that
22 licensee. In the case of just one

1 webcaster, if they paid us \$100 and there's
2 100 performances, each one of those
3 performances is valued at a dollar. In the
4 case of a broadcast group, for example,
5 Clear Channel that's reporting for many,
6 many, many, many different stations, and
7 this goes back to why we need the statement
8 of account, we take the money attributable
9 to each station and allocate that money
10 across those performances.

11 Q Why isn't the value of a
12 performance the same regardless of the
13 licensee?

14 A First, not all webcasters have
15 opted for the per-performance or the
16 aggregate tuning hour metric of payment, but
17 more importantly, because we're in a
18 situation where it's just sample reporting;
19 in other words, the two weeks per calendar
20 quarter of reporting, we don't have a full
21 accounting of each and every performance to
22 value at the per performance rate, so our

1 only option then is to allocate the
2 royalties received across those
3 performances.

4 Q Can you explain in a little bit
5 more detail how you actually allocate
6 particular performance with or particular
7 set of featured artists or copyright owners?

8 A Yes. As I said, the first step
9 is allocating the royalties received on a
10 station-by-station, channel-by-channel,
11 licensee-by-licensee basis. Once that has
12 been done for the entire group of licensees
13 to whom we're distributing, we then
14 consolidate those allocations on the
15 copyright owner and the artist level. So in
16 the example I gave before, if there's 100
17 performance, each performance is \$1.00, and
18 Madonna has one performance, and then on
19 another allocation there's \$1,000, the same
20 100 performances, and her performance is
21 worth \$10, that performance consolidated is
22 \$11. That \$11 is then split based upon the

1 statutory requirement of 50 percent to the
2 copyright owner. In the Madonna example, I
3 think it's Warner, and then 45 goes to
4 Madonna, and 5 percent goes to the non-
5 featured unions. So there's the allocation,
6 the application of the statutory split, and
7 the consolidation of all these allocations.

8 Once you've allocated, then you
9 have to figure out based on the account
10 assignment how to pay out the featured
11 artist portion, the 45 percent. So if you
12 take an artist, for example, Eric Clapton,
13 who's been a solo performer, a member of the
14 group Cream, Blind Faith, Derrick and the
15 Dominoes, and all the collaborations he's
16 done, he may have a different split on a
17 variety of performances, but we still send
18 him one check consolidating all those
19 individual allocations.

20 Q Do you report to him how each of
21 those allocations was made?

22 A Yes, we do.

1 Q At that point, are you ready to
2 cut a check?

3 A Not quite. Not quite. We make
4 sure that we've got the right tax
5 withholding applied to the distribution, and
6 then we create a banking file, which is an
7 electronic file that we transmit to our
8 banking partner, and then they process that,
9 and actually cut the checks, or effect the
10 direct deposit. While that's going on,
11 we're running our statements, which is a
12 detailed comprehensive listing of each and
13 every sound recording to whom the recipient
14 is being paid.

15 Q You've got another step that
16 comes after the allocation and distribution
17 step, which refers to adjustments. Can you
18 describe for the Board what that is?

19 A Yes. Typically, Sound Exchange
20 will see a spike in customer care calls
21 after a distribution. Each distribution
22 we're distributing to more artists, and more

1 copyright owners. Some cases, it's the
2 first payment received by a particular
3 artist or copyright owner. As they're
4 reviewing their statements, they may find
5 misallocations on their statements; in other
6 words, performances that we are paying them
7 for that aren't really their's, or we'll get
8 calls or emails from recipients that say,
9 you know, I know my recording was performed
10 on this service, and why isn't it on my
11 statement, and so the statement is our
12 product and our mechanism for communicating
13 with our artists and our copyright owners to
14 further refine the data that we've
15 distributed on. Remember that we're
16 distributing based on what the licensees
17 have reported, based on all the research and
18 perfection of the data that we can, but we
19 will inevitably get an allocation and a
20 distribution incorrect. We have this
21 sophisticated adjustment engine that permits
22 us to debit the improperly paid party, and

1 credit the party to whom we should have
2 originally made the payment.

3 And then in the next distribution
4 cycle, that adjustment is manifested or is
5 actually effected, so it's out of future
6 royalties from the improperly paid artist,
7 they pay back the credit that we've made to
8 the artist that we should have paid.

9 Q Do you sometimes hear from
10 artists saying that they shouldn't have been
11 paid?

12 A Yes. We have, on occasion, heard
13 from artists who will send a check back
14 along with a statement and say, you know,
15 I'm not that John Williams. I'm a different
16 John Williams, and by the way, I know how
17 you can reach him, and here's his contact
18 information, so that has happened by virtue
19 of, again, the incredible amount of music
20 being performed, the not common but not
21 particularly uncommon occurrence when we
22 incorrectly pay out a royalty.

1 Q At the end of this process, what
2 happens with royalties that can't be
3 distributed?

4 A Again, those royalties are held
5 in separate accounts and we continue to chip
6 away at the undistributed royalties in an
7 effort to maximize the amount of royalties
8 that we're paying through to the deserving
9 featured artists and copyright owners.

10 Q Now do the Copyright Office's
11 regulations provide for what's supposed to
12 happen to that money?

13 A Yes. The regulations say that
14 we, after three years from the time of
15 payment by the licensee, the undistributed
16 funds may be used to offset the cost of
17 administering the royalties.

18 Q And has Sound Exchange ever
19 applied that provision?

20 A No, we have not.

21 Q What has Sound Exchange decided
22 to do?

1 A We have our first three
2 distributions that under this three-year
3 rule would technically be eligible for this
4 type of release and offsetting of
5 administrative costs. Our board has twice
6 voted to delay and defer the release of
7 those funds to give Sound Exchange ample
8 time to implement its variety of artist and
9 copyright owner outreach activities to reach
10 as many as possible entitled parties to the
11 royalties. And most recently, the
12 Distribution Policy Committee has
13 recommended if a release of these funds is
14 going to occur, that we limit it to the
15 first distribution; in other words, not all
16 three distributions that otherwise would be
17 eligible will be released.

18 Q Does Sound Exchange have a goal
19 for what percentage of the royalties it
20 hopes to distribute?

21 A Yes, my staff doesn't like to
22 hear this, but 100 percent. We would like

1 to pay absolutely every penny out to every
2 artist and every copyright owner. That's an
3 ideal that I don't expect that we will ever
4 reach, but our goal by October of this year
5 is to be able to pay out 65 percent of the
6 artist royalties, and 85 percent of the
7 copyright owner royalties.

8 Q Now how does that compare to the
9 ability of other collecting societies of
10 which you're aware in terms of paying out
11 royalties?

12 A I think one good comparison is
13 SENA, which is the Dutch collecting society.
14 It took them approximately 10 years to get
15 to between a 90 and a 95 percent pay through
16 rate. Sound Exchange is in its fifth year,
17 and we expect to be at 65 percent, and are
18 quite proud of that achievement. But it's
19 important to kind of compare the two
20 organizations. I mean, SENA is paying Dutch
21 artists, and Sound Exchange is not just even
22 paying American artists, we're paying

1 artists worldwide, so the task before us is
2 far greater than that of the Dutch, but we
3 will strive to meet that mark.

4 Q I want to move on to some other
5 aspects of Sound Exchange's operations.

6 First of all, we've talked a number of times
7 about outreach. Can you talk a little bit
8 about Sound Exchange's efforts to find
9 copyright owners and performers?

10 A Yes. You know, this is a fairly
11 new entitlement, and Sound Exchange has some
12 general outreach activities that it year-in
13 and year-out undertakes, and those include
14 attendance at industry conferences and
15 events, participation on panels, speaking
16 engagements, attendance at music festivals,
17 participating in these roundtables with
18 artist groups, and then, of course, general
19 advertising, both print and we've gotten an
20 occasional story done on television about
21 us, and so we work those angles. And those
22 are kind of our general, here's what Sound

1 Exchange is. We exist. We might have money
2 for you.

3 We have some print ads that we
4 also place. For example, we had the back of
5 the ASCAP magazine for a few months that was
6 meant to reach out to those songwriters who
7 happen to be recording artists, as well, so
8 we have our general outreach. We also have
9 a number of specific outreach activities
10 that we undertake.

11 Q Can you describe the more
12 specific outreach opportunities?

13 A Yes. We have found that one of
14 the most efficient ways to find artists who
15 are entitled to these royalties is to work
16 in conjunction with other organizations
17 whose membership may overlap with our
18 artists that we are to-date unable to find
19 and pay. Those organizations include our
20 two unions, AFM and AFTRA. We've done
21 matching exercises with their membership and
22 our unpaid artists, and been able to get

1 contact information for a great many
2 featured performers by virtue of this
3 exercise. CD Baby sent out an email blast
4 to about 100,000 artists, many of whom own
5 their own copyright, so they're entitled to
6 both the featured artist portion and the
7 copyright owner portion of the sound
8 recording. Our phones rang off the hook or
9 two and a half weeks as a result of that
10 mailing, and we found many, many, many
11 artists and copyright owners through that
12 endeavor.

13 We work with the Grammy
14 organization, MARIS, and the Latin Grammys,
15 LARIS. We've done coordinated outreach
16 efforts with the Blues Foundation, the Folk
17 Alliance, all the individuals escape me at
18 this moment, but there must two dozen
19 different organizations that we've worked
20 with in our effort to find featured artists
21 and sound recording copyright owners, and
22 also let them know that we exist, this right

1 exists, and we may have royalties owed to
2 you.

3 Q Do you also work with foreign
4 collection societies on locating artists
5 overseas?

6 A Yes, we do. We have found that
7 entering into reciprocal arrangements with
8 foreign societies helps us find a great many
9 artists that are citizens of other
10 countries. For example, we have such
11 arrangements with PPL in the UK, SENA in the
12 Netherlands, Abramus in Brazil. We're
13 working with RAAP to pay through - that's
14 Ireland, we pay RAAP for Irish artists, and
15 we're working on -- we're in the process of
16 negotiating about a dozen more of these
17 reciprocals. It's our view that the local
18 society will have better reach to their
19 artists. They know who their artists are,
20 they keep up with changes of address and
21 that sort of thing, and so it's a very
22 efficient way for us to get these royalties

1 paid to those artists.

2 Q Why doesn't Sound Exchange have
3 agreements with a broader range of foreign
4 societies?

5 A Well, not all territories have
6 collecting societies. Some territories have
7 what we call emerging societies where the
8 right is relatively new, like in our
9 country, and are not yet established. And
10 we're a little circumspect with whom we
11 enter into these agreements because we
12 believe that these organizations need to be
13 similarly situated as Sound Exchange,
14 meaning the philosophy of paying through the
15 maximum amount of royalties as quickly and
16 efficiently as possible. We like the
17 organizations to have a similar status, the
18 non-profit status, or some sort of
19 government designation so that we know that
20 they are a credible organization, and we
21 have restrictions in our agreements that
22 require them to return money to us to the

1 extent that in three years they're unable to
2 pay it through to their artist.

3 Now I did kind of want to make
4 the distinction that even if we pay RAAP for
5 Irish artists, and Irish artists can
6 certainly come directly to us, and we will
7 always honor paying the artist directly.
8 This is just one more thing we can do to get
9 as much of the royalties out to the featured
10 artists and the copyright owners.

11 Q Talked a lot about Sound
12 Exchange's operations. How large is Sound
13 Exchange staff?

14 A We're 26 full-time employees, we
15 have two positions vacant at the moment, so
16 a total of 28. We also have the unpaid
17 interns that help Sound Exchange out.
18 Occasionally, we hire temporary help,
19 depending on the spikes in our workload.

20 Q What kind of skills do you look
21 for in employees at Sound Exchange to do
22 this kind of work?

1 A Well, a knowledge of music is the
2 most important skill with respect to being
3 able to do this matching research and
4 outreach. I think there's only four of us
5 on staff that aren't musicians or performing
6 artists. It's remarkable how little talent,
7 for example, I have, compared to my staff,
8 but many of them are aspiring performers.
9 You know, obviously, we have certain roles
10 that require certain skill sets, like our
11 general counsel services and so forth, but a
12 lot of this work, a lot of this process,
13 it's just never been done before in the
14 United States, and we're building it and
15 refining it as we go, and our staff is very
16 dedicated, with a deep understanding that
17 they're in the service business, that their
18 job is to get this money out as quickly,
19 efficiently, and as accurately as possible.

20 Q Does Sound Exchange calculate an
21 administrative rate?

22 A Yes, we do.

1 Q And can you describe for the
2 Board what that is?

3 A Sure. The administrative rate is
4 a percentage that reflects the cost Sound
5 Exchange has incurred compared to the amount
6 of royalties is has collected.

7 Q And what Sound Exchange's
8 administrative rate been over time?

9 A Well, in the early years it
10 hovered around the 20 percent figure. And,
11 again, that was when royalties were low, and
12 we have start-up costs. It has consistently
13 dropped each year. Last year our final
14 admin rate was a little over 7-1/2 percent,
15 and this first quarter I don't have
16 finalized financials for the first quarter,
17 but it looks like it will be south of that.

18 Q And does that figure include
19 repayment for prior proceedings to set
20 royalty rates?

21 A It includes current, but not the
22 original CARP that established the

1 webcasting rate. That proceeding is being
2 repaid through, we have a promissory note,
3 and the terms of that require us to pay the
4 difference between our actual admin rate and
5 20 percent, and that differential is used to
6 pay down that debt. At spinoff, when we
7 spun-off and became an independent
8 organization, we repaid \$3 million of an
9 original \$9 million debt, and based on this
10 differential, we've been able to pay down
11 the debt every year. And this year we have
12 a balance of just a little bit more than 2-
13 1/2 million dollars. And I suspect that
14 based on the royalties that we've collected
15 for the first quarter, and the containment
16 of our costs, that we will easily repay the
17 remainder of that debt based on the results
18 of 2006.

19 Q You talked about Sound Exchange's
20 admin rate. How does that compare to other
21 entities that are collecting monies for
22 public performances?

1 A It's far lower. Our 7-1/2 admin
2 rate compares to, I don't know, 14, 16
3 percent for ASCAP and BMI, so it's very low,
4 and getting lower.

5 MR. PERRELLI: Your Honor, I
6 still have a ways to go, but I actually am
7 at a breaking point. I don't know what the
8 schedule the Court intends for this
9 afternoon, if we're going to continue until
10 3:1, or if this would be a time for a break.

11 CHIEF JUDGE SLEDGE: Go ahead and
12 continue.

13 MR. PERRELLI: Okay. Thank you,
14 Your Honor.

15 BY MR. PERRELLI:

16 Q Ms. Kessler, I want to shift a
17 little, and we've covered a lot of ground
18 about collection and distribution. I want
19 to talk about how all of this might be
20 different if there are multiple designated
21 agents, all administering the same statutory
22 license. First of all, I want to ask you,

1 can you explain the distinction between a
2 statutory license and its rates and terms
3 set by the CRB, and a direct or voluntary
4 license?

5 A Yes. The statutory license is a
6 license that is one set of rights, one set
7 of terms, one set of rates that applies to
8 everybody evenly, and ultimately those rates
9 and terms will be set by this Board. And
10 compared to a direct license, which permits
11 a copyright owner to directly negotiate with
12 a service as to those rates and terms for
13 the use of their sound recordings. And this
14 could be the copyright owner themselves, or
15 through someone that they've designated to
16 negotiate that direct license.

17 Q So if a copyright owner doesn't
18 like the rates and terms that come out of
19 this proceeding, are they able to actually
20 license their content separate and apart
21 from this proceeding?

22 A Yes, the statutory license is

1 non-exclusive. We can't force anyone to
2 operate under the statutory license. Any
3 copyright owner is free to negotiate
4 directly and establish whatever rates and
5 terms are in their interest.

6 Q You talked in your written
7 testimony about a multi-tier designated
8 agent system. Can you explain what that is?

9 A The way I understand the multi-
10 tier system is there would be the concept of
11 a receiving agent, and then designated
12 agents, and so the first level would be the
13 receiving agent would receive all the
14 royalties, and the reports of use, and the
15 paperwork, and the statements of account and
16 all that sort of thing, and then they would
17 figure out how to distribute, or they would
18 administer the distribution to each of the
19 individual distributing agents for their
20 downstream distributions.

21 Q How is that different from a
22 multi-agent system?

1 A The way I understand the multi-
2 agent system to work is, anybody could be a
3 designated agent, and you could have two, or
4 ten, or a hundred of them, and you would
5 eliminate the receiving agent concept.

6 Q Now of the -- well, who would
7 decide how much to be paid to each
8 designated agent under the multi-agent
9 system?

10 A I can only presume the licensee
11 would have to figure out how to do the
12 splits in the payments to the individual
13 designated agents.

14 Q Why couldn't each designated
15 agent bill the webcasters?

16 A Well, the way it works now is we
17 don't have the information available. A
18 designated agent wouldn't have that
19 information available to them until the
20 licensee reported to them, so it's based on
21 the usage of the sound recordings. And the
22 sound recordings could be represented by the

1 same -- one sound recording could be
2 represented by multiple agents, so until you
3 get the performances, you wouldn't be able
4 to determine what the split is.

5 Q Now among the three options, the
6 single agent system, a multi-tier system, a
7 multi-agent system, which one is more
8 efficient?

9 A Oh, a single designated agent is,
10 by far, the most efficient way to administer
11 a single license, like a statutory license
12 with a single rate and a single set of
13 terms. In my view, the statutory license
14 should be administered with a single set of
15 rules, and one organization should be tasked
16 with the administration and implementation
17 of those rules.

18 Q What would the impact on overall
19 costs of distribution of royalties be from
20 having a multi-tier or a multi-agent system?

21 A They would increase tremendously.

22 Q What would the impact be on the

1 time, the promptness of distribution of
2 royalties for a multi-agent or a multi-tier
3 system?

4 A I have no doubt that in a multi-
5 agent system there will be disputes, and
6 those disputes among the agents will cause
7 delays, and some of those disputes, I don't
8 know how they would get resolved. And it
9 would ultimately impact the timely,
10 efficient, and fair distributions to all the
11 copyright owners, and all the artists who
12 are entitled to the royalty under the
13 statutory license.

14 Q Does the fact that we're talking
15 about the administration of a single
16 statutory license, rather than a set of
17 voluntary licenses, affect your thinking on
18 this?

19 A Yes. I mean, it seems common
20 sense to me that you've got one statutory
21 license, one set of terms, there's one price
22 set, there's one rate, and there should be

1 one set of rules on how that is
2 administered. In a direct license
3 situation, you could be licensing a whole
4 panoply of rights and different rates and
5 different terms for different business
6 purposes, but on behalf of that copyright
7 owner, so the alternative to the statutory
8 scheme is always direct licensing. But in a
9 statutory situation, there's no -- it seems
10 inefficient, and excessively and unnecessary
11 costly to have multiple agents.

12 Q Couldn't you have cost
13 competition among designated agents?

14 A Well, to me, cost competition is
15 really nothing more than an incentive to
16 free ride, and by that I mean, I could
17 foresee in a multi-agent system where one
18 designated agent undertakes all of these
19 costs, and all of this marketing and
20 outreach, and all of these efforts to pay
21 through royalties, and another designated
22 agent just free riding on all of the work

1 done by the other designated agent. And
2 that's with respect to whether it's the
3 costs associated with a rate setting
4 proceeding, or trying to draw down - reduce
5 the undistributed royalties, or what have
6 you.

7 Q What's the benefit of that kind
8 of free riding?

9 A Well, that the designated agent
10 who's free riding doesn't incur the costs.
11 They potentially have a lower admin rate.
12 We can't compete on price here, we can only
13 compete on costs. And in spite of all the
14 good work that the one designated agent is
15 doing, the other designated agent enjoys the
16 benefit of the cost reduction. And to the
17 extent that designated agent is a for-profit
18 company, they get to keep that.

19 Q What is the effect on the
20 incentive to do research, for example, on
21 unmatched performances in a system like
22 that?

1 A I think it creates a disincentive
2 to dedicate resources to those types of
3 activities, that it's to the benefit of the
4 free rider not to distribute royalties
5 rather than distribute them.

6 Q Going back up to the
7 demonstrative exhibit, can you explain to
8 the Board the kinds of additional costs and
9 inefficiencies that you would find in a
10 multi-agent system each step along the way?

11 A Yes. I believe that there are
12 complications, delays, and increased costs
13 throughout this series of steps that are
14 required to distribute royalties timely and
15 efficiently. I think in step one, the first
16 area of confusion will be with the licensees
17 themselves, who do they report to, who do
18 they pay, how much do they pay, how do they
19 figure out their split among the designated
20 agents. For them when they call, for
21 example, Sound Exchange, they get consistent
22 information about the statutory license,

1 about the rates and terms and what they have
2 to do to comply. Now do they have to call
3 all the designated agents to make sure that
4 they're operating under the same
5 understanding with respect to the license,
6 so I think it will be difficult for the
7 licensees, in the first instance.

8 The actual splitting of the
9 money, I'm not sure how that will occur,
10 because you would essentially have to go
11 through this entire process practically to
12 distribution, and then come back and say
13 okay, well, that results in so much money
14 going to this designated agent by virtue of
15 which artists and copyright owners are
16 represented by the individual designated
17 agents, so I'm not sure even how the
18 payments are made. And if there's some
19 approximation of how the payments are to be
20 allocated among the multiple, the two, the
21 ten, hundred designated agents, I would
22 fully expect there to be disputes about

1 shares of who gets what. I don't know how
2 those disputes get resolved, but I assure
3 you that those disputes will cause delays in
4 the distribution to copyright owners and
5 artists.

6 In addition, Sound Exchange
7 doesn't spend any significant amount of time
8 requiring compliance from its licensees so,
9 for example, someone doesn't pay on time and
10 we send them a late payment notice, if Sound
11 Exchange does that and receives a payment
12 for late fees, how is that split among the
13 designated agent? So audits and enforcement
14 is another area of how do you fairly spread
15 those costs among all the designated agents
16 to avoid this idea of free rider, where one
17 designated agent might engage in an audit on
18 the payment side of things, and resulting in
19 additional royalties to copyright owners and
20 artists, and yet the free rider agent
21 benefits from those additional royalties
22 without having done a single thing, so that

1 is with respect to payments and the logs,
2 those are some of the complications, delays
3 and additional costs that I see.

4 Q Do you see additional
5 inefficiencies and costs in the matching and
6 research aspects of the collection and
7 distribution operations?

8 A Sure I do. I mean, again, Sound
9 Exchange firmly believes that the proper
10 identification of what that sound recording
11 is, is essential to the accurate and prompt
12 payment of the royalty. We expend resources
13 both manual and automated, and we're
14 constantly refining our matching algorithm
15 and efficiency with the use of technology.
16 Another designated agent may decide you know
17 what, we're just not going to spend those
18 kinds of resources. We'd rather keep that
19 money for something else, and not process
20 the logs in the same level that Sound
21 Exchange or another designated agent might,
22 which will ultimately result in one

1 designated agent thinking the sounding
2 recording and the log is something, and
3 another designated agent saying it's
4 something else all together. And again,
5 this all leads to the improper distribution
6 of royalties, so I think just in these two
7 steps alone, there's a free rider issue, as
8 well as a different result among the
9 designated agents.

10 Q Moving to account assignment, do
11 you see additional inefficiencies and costs
12 from a multi-agent system, or a multi-tier
13 system?

14 A Yes. The account assignment, and
15 remember, that's identifying that it's
16 Fleetwood Mac, and then identifying all the
17 different versions of the group, and all the
18 different pay splits on the track. This is
19 where my head explodes. I don't know how
20 you are going to figure out account
21 assignment when you've got two or more
22 designated agents applying different policy

1 splits, or different valuations of the
2 performance. I mean, one designated agent
3 could say, you know what, drummers always
4 deserve 5 percent more than everybody else,
5 and Sound Exchange values every performer,
6 feature performer evenly, and you could end
7 up in a situation where the claim on the
8 sound recording is in excess of 100 percent.
9 And I just don't know how you work that with
10 multiple agents who are operating under a
11 single license, the point of which is to pay
12 all artists and all copyright owners fairly,
13 without respect to membership in an
14 organization, and then you get the situation
15 where rules are being established by
16 designated agents that are inconsistent with
17 one another. So I don't know how this
18 works.

19 Q Would you expect to see
20 competition among designated agents for
21 drummers or trombone players?

22 A Well, I mean, that's the extreme

1 of this. Of course, that could happen, but
2 I also see the designated agent spending
3 money just in general on marketing to
4 artists and copyright owners to have them
5 join their organization, an unnecessary
6 expense, in my view. We would much prefer
7 to spend those funds on finding actual
8 artist contact information to effect the
9 royalty, rather than competing for
10 performers to join our organization. And,
11 again, there's no differentiation between
12 members and non-members under the statutory
13 scheme.

14 Q Moving to the allocation and
15 distribution of royalties, do you see
16 additional inefficiencies and costs by a
17 multi-agent or a multi-tier system?

18 A Now that piece almost has to
19 happen first in order to make the initial
20 distribution among the designated agents, so
21 this whole thing gets out of order. But
22 let's presume we were even able to make the

1 original allocation of the royalties among
2 the agents, and now we're at the point where
3 there's an allocation and distribution. As
4 I said earlier, we do have the situation
5 where based on the reports of use from the
6 licensees, we've inadvertently paid an
7 artist or a copyright owner for something
8 that wasn't their's. Now we're in a
9 situation where you have two or, I don't
10 know, 50 or however many designated agents,
11 and we're seeing that we inadvertently paid,
12 or allocated this royalty to one of their
13 artists that they represented, versus one of
14 our's, and now you've got inter-agent
15 adjustments going on. How you ever
16 reconcile that, resolve disputes around
17 that, how the money gets reattributed
18 properly to the right designated agents, it
19 would require so much in terms of systems
20 development, accounting systems, and also,
21 some agreement among the agents, so I just
22 don't know how any of that would work.

1 Q In looking at these various
2 systems, the single agent, the multi-agent,
3 and the multi-tier system, did you look at,
4 or did you consider other models in other
5 countries or in the United States?

6 A We've looked at how other
7 countries handle the similar right to the
8 statutory license, and most countries have a
9 single entity charged with the
10 administration of the license. Even
11 countries where the copyright owner was
12 administered apart from the featured artist,
13 we're seeing mergers occur. For example, in
14 the UK, PBL which represents the copyright
15 owners, and Pamra and Aura, which represent
16 the artists, have now merged into a single
17 type line, and it's for the very reasons of
18 efficiency, to eliminate cost duplication,
19 and to better serve copyright owners and
20 artists collectively, that they have merged.
21 And another example in the UK is with the
22 Mechanical Rights Society and the Performer

1 Society, MCPS and PRS, they also merged,
2 again for efficiencies and economies of
3 scale. And when you look at countries that
4 have multiple agents, for example, Brazil,
5 which at one point had 14, it's highly
6 dysfunctional, with tremendous delays,
7 royalties never getting anywhere near the
8 entitled parties, and little by little we're
9 seeing a reduction from those 14 societies.
10 I think they're down to maybe eight now, so
11 elsewhere in the world the model when you're
12 comparing the statutory license with a
13 similar right elsewhere, it's a single
14 organization.

15 Q Did you consider ASCAP, BMI, and
16 SESAC, all of which administer public
17 performance rights for music publishing?

18 A You know, that's not an apples-
19 to-apples comparison. Sound Exchange is
20 operating under a statutory license, that's
21 what's at issue here, and its rates and
22 terms that will be decided in this

1 proceeding. ASCAP, BMI, and SESAC are more
2 akin to the direct licensing, where on
3 behalf of members, their members, and their
4 members only, negotiate in the marketplace
5 rates and terms for a variety of uses of
6 their copyrights. They engage in these
7 negotiations and rate settings independent
8 of one another, and only for their members.
9 In a statutory license, it's really
10 everybody, it's all the copyright owners,
11 it's all the artists, without distinction of
12 membership, and if a copyright owner wishes
13 to escape the statutory rates and terms,
14 they are welcome to do that through a direct
15 license. And so that this is in no way a
16 comparison and, therefore, was not a model
17 we considered.

18 Q Do your comments about the
19 additional costs and inefficiencies apply
20 whether there are two, or ten, or fifty
21 designated agents?

22 A Well, the moment a second

1 designated agent is introduced into the
2 statutory scheme, you're going to incur
3 costs in systems, revamping systems,
4 revamping business processes, retraining
5 staff, developing marketing campaigns, so
6 all the costs are introduced the minute a
7 second designated agent exists. And it only
8 increases exponentially with each and every
9 other designated agent that comes along.

10 Q Would you also envision delays in
11 the distribution of royalties?

12 A I have no doubt there will be
13 extensive delays in distributions.

14 Q Now has Sound Exchange looked at
15 the cost that would be required to modify
16 its systems for a multi-agent system?

17 A Yes, we have looked at the cost
18 of just modifying the systems, and I believe
19 it's between a quarter of a million and
20 \$350,000 simply to remodel this, and that's
21 just the start, I mean, that's just a drop
22 in the bucket of the way the costs will

1 increase. That's just technology, that's
2 just this piece of the technology.

3 Q So that \$250,000 does not include
4 personnel and other costs?

5 A It does not.

6 MR. PERRELLI: Your Honor, if
7 this is a time for a break, I imagine I have
8 20 minutes or so remaining.

9 CHIEF JUDGE SLEDGE: We'll recess
10 for 10 minutes.

11 MR. PERRELLI: Thank you.

12 (Whereupon, the proceedings went
13 off the record at 3:13 p.m. and went back on
14 the record at 3:28 p.m.)

15 CHIEF JUDGE SLEDGE: Thank you.
16 We'll come to order. Mr. Perrelli?

17 MR. PERRELLI: Thank you, Your
18 Honor.

19 BY MR. PERRELLI:

20 Q Ms. Kessler, just to finish up
21 the subjects that we were talking about
22 before the break, have you heard from

1 licenses about whether they would prefer to
2 pay and send reports of use to a single
3 licensee -- sorry, a single designated agent
4 or multiple designated agents?

5 A No, the licensees have repeatedly
6 stated that they want to submit payments,
7 paperwork, and reports of use to just one
8 agent.

9 Q Now, in SoundExchange's history,
10 have you experienced working in a multi-
11 agent system before?

12 A Yes. RLI was designated for the
13 '98 to '02 period, and we did have occasion
14 to attempt to work with them on one aspect
15 of the distribution services.

16 Q Can you explain that experience
17 of attempting to work with RLI?

18 A Yes. We were working under a
19 deadline where we had to post a statement of
20 account on our website and make that
21 available to licensees for the calculation
22 of their royalty obligation. And as we

1 understood, the designated agents were
2 required to work together to come up with,
3 you know, paperwork, the statements of
4 account that were jointly created.

5 And so in the first instance, it
6 was difficult to get the meeting with RLI's
7 principals to even begin the conversation.
8 And, again, we were working under a
9 deadline, so time was of the essence. We --
10 you know, finally after, you know, a couple
11 of tries we were able to get a meeting in
12 the form of a conference call with Ron Gertz
13 and Doug Brainin -- I think he's the CFO of
14 MRI or RLI or both of them.

15 And they clearly had not given
16 any thought to the statement of account.
17 They had little or no opinion about the
18 statement of account or how this would work.
19 They asked questions that I found irrelevant
20 to the purpose of that meeting, which was to
21 come up with a statement of account. And so
22 SoundExchange went ahead on its own and

1 designed the statement of account and posted
2 the statement of account for all licensees,
3 irrespective of, you know, how many
4 designated agents or who ultimately would be
5 administering the royalties.

6 So that experience led me to
7 believe that if on something as simple as a
8 statement of account there wasn't
9 cooperation, I couldn't imagine on the more
10 complicated issues that might arise that
11 they would be any more cooperative.

12 Q Now, in that 1998 to 2002
13 timeframe, did RLI distribute any royalties
14 under the statutory license?

15 A No, not to my knowledge. They
16 didn't come forward with -- as representing
17 any copyright owner or artist during that
18 time period.

19 Q Since that 2002 timeframe, can
20 you describe SoundExchange's experiences
21 with RLI?

22 A Yes. In the '03/'04 period where

1 the rates were ultimately pushed forward and
2 settled by the parties, RLI forced a CARP
3 based on the sole term of the designated
4 agent status. And, of course, SoundExchange
5 encountered costs in both money and time
6 preparing a case to argue our position on
7 the multi-agent scheme. And inexplicably,
8 before the proceeding commenced, RLI
9 withdrew, and, you know, SoundExchange had
10 already incurred not insignificant
11 expenditures preparing that case.

12 Q Again, since that 2002/2003
13 timeframe, have you -- what efforts have you
14 seen RLI undertake on behalf of copyright
15 owners and performers?

16 A They have done absolutely
17 nothing. In fact, they have worked contrary
18 to the interests of copyright owners and
19 artists, supporting the rates of the music
20 users, not trying to maximize the benefit to
21 copyright owners and artists. They have not
22 advocated for census reporting, which would

1 ensure the accurate and fair distribution of
2 royalties to copyright owners and artists.

3 I have seen no indication of them
4 working for copyright owners' and artists'
5 interests. And, in fact, you know, their
6 sister company, MRI, as I understand it, the
7 objective is to get the lowest possible
8 price for -- that music users have to pay
9 for copyrights.

10 MR. STEINTHAL: Your Honor, I
11 rise to object on foundation grounds to the
12 last comment, which is also unresponsive to
13 the question itself.

14 MR. FREUNDLICH: I raise the same
15 exact objection. There was no foundation.
16 She is speculating about what MRI does or
17 doesn't do.

18 MR. PERRELLI: I'm happy to ask
19 her questions about what MRI does or doesn't
20 do, and to lay the foundation for that
21 question.

22 CHIEF JUDGE SLEDGE: You don't

1 resist their motion.

2 MR. PERRELLI: I'm not going to
3 resist their motion. I'm happy to ask a
4 couple of questions.

5 CHIEF JUDGE SLEDGE: Objection
6 sustained.

7 BY MR. PERRELLI:

8 Q Ms. Kessler, are you aware of
9 what MRI's business is?

10 A To an extent, yes.

11 Q Okay. What is the extent of your
12 knowledge?

13 A They represent music users with
14 respect to musical works, and the objective
15 is to get the lowest possible price that
16 they have to --

17 MR. STEINTHAL: You Honor, I
18 again move to strike. There's no foundation
19 for her testimony as to what MRI's objective
20 is.

21 MR. FREUNDLICH: Same objection.
22 She is completely speculating.

1 CHIEF JUDGE SLEDGE: So the
2 objection is that "their objective is" as
3 opposed to "I observed that they."

4 MR. STEINTHAL: Right. I don't
5 believe she has established a foundation for
6 commenting on what MRI's business is or what
7 its objective is.

8 CHIEF JUDGE SLEDGE: Sustained.

9 MR. PERRELLI: I'm just going to
10 move on, Your Honor.

11 CHIEF JUDGE SLEDGE: All right.

12 BY MR. PERRELLI:

13 Q Ms. Kessler, at the end of your
14 written testimony there are a number of
15 terms -- issues discussed, specific areas,
16 specific terms issues. Why is SoundExchange
17 proposing changes to a number of terms in
18 the statutory license?

19 A We have found that, through our
20 experience in administering the license,
21 that there are some things that we propose
22 be changed, in some cases tweaks or in some

1 cases terms that we would like changed or --
2 in order for us to fulfill our mission of
3 the prompt and efficient distribution of
4 royalties.

5 I believe that, you know, a lot
6 of these were established before there was
7 an agent in the role of administering the
8 royalty and the license, and so there are
9 just some things that we believe should be
10 adjusted in order, you know, to facilitate
11 the prompt distribution of royalties.

12 Q Among the recommendations that
13 you make are some changes to issues related
14 to late payment. Can you describe those for
15 the Board?

16 A Sure. Right now there's -- when
17 a licensee pays late, there is a nominal
18 late fee that is required on the amount of
19 royalties paid. And, you know, it's a low
20 amount and we would hope for something that
21 would give us more teeth and more -- and
22 incentivize licensees to pay their royalties

1 on time.

2 You know, the prompt payment of
3 royalties is the first step in a prompt
4 distribution. And so, you know, at the low
5 amount of interest that they're paying on
6 their late fee, in conjunction with the only
7 other remedy available to us, which would
8 likely be a copyright infringement suit, we
9 had hoped that there would be something in
10 between where penalty and interest could be
11 applied to the late payment of royalties.

12 Q And has SoundExchange indeed had
13 problems with late payments?

14 A Yes, we've had problems with both
15 non-payment and late payment that have gone
16 on for weeks, months, years. And so
17 particularly where there are licensees who
18 are paying just minimum fees or small
19 amounts, it's not likely going to be the
20 economic decision of the copyright owners to
21 bring an infringement action, yet those
22 licensees continue to enjoy the use of the

1 sound recordings on their services.

2 Q Have you also had problems with
3 late or failure to submit statements of
4 account and reports of use?

5 A Yes. This is a problem for
6 SoundExchange. There's no penalty, there's
7 no late fee assigned to the non-compliance
8 of submitting paperwork. And so, again, but
9 for a copyright infringement action, I don't
10 know of any way that we can, you know,
11 encourage or incentivize licensees to submit
12 their paperwork timely and as required by
13 the regs.

14 Q Has SoundExchange had problems
15 under the current confidentiality
16 regulations that govern the statutory
17 license?

18 A Yes. There are a couple of
19 specific areas where the confidentiality
20 clause causes SoundExchange some difficulty
21 and frustration. You know, the first is
22 with respect to the audit provision. You

1 know, our Board is comprised of copyright
2 owners and artists, and we're unable, under
3 the current terms, to share the results of
4 an audit with copyright owners.

5 And so unless we get permission
6 from the licensee that we've audited, we're
7 unable to share information from the audit
8 report that would allow them to make the
9 appropriate next step business decisions of
10 how to proceed, you know, based on the
11 royalties at stake as determined by the
12 audit process.

13 We're also unable to share
14 payment history of a particular licensee
15 with our copyright owners. Remember that
16 our copyright owners are sitting on our
17 Board. Our Board approves, you know,
18 financial and programmatic, you know,
19 activities of SoundExchange, and so we're
20 only permitted to share with them in the
21 aggregate our receipts, but not with respect
22 to any particular licensee.

1 This is particularly problematic
2 with respect to copyright owners trying to
3 determine if there are other things that
4 they want to engage in with respect to, you
5 know, a potential infringement or non-
6 compliance by the licensee. Without being
7 able to share that information, they are
8 unable to make those business decisions.

9 Q What information can you share
10 with copyright owners about a particular
11 licensee that's, say, delinquent in payment?

12 A What we can say -- you know, that
13 they have a history of paying on time or not
14 paying on time, but not the amount of money
15 at risk.

16 Q Why do the copyright owners want
17 that information?

18 A Because one of the factors in
19 determining what next actions to take is,
20 you know, the cost of, you know, engaging in
21 copyright infringement action makes sense
22 against the amount of royalties that may be

1 collected.

2 Q You also make some proposals
3 about audit provisions. Can you explain the
4 audits that SoundExchange currently
5 conducts?

6 A Yes. We have conducted two
7 audits of the pre-existing services, and we
8 have noticed about a dozen audits that we
9 intend to conduct this year.

10 Q And without going into specific
11 details about what you found in any
12 particular audit, can you explain generally
13 what you find in these audits?

14 A Well, what we find primarily is
15 that it's very -- it's impossible to share
16 the results of the audit with our Board or
17 with our appropriate committees because of
18 the confidentiality issues. And so it makes
19 it difficult for us to go to the next step
20 in resolving issues identified in the audit.

21 MR. PERRELLI: I believe, Your
22 Honor, I think we will -- I will conclude

1 the examination of Ms. Kessler and leave the
2 rest of the specific details to her written
3 testimony. Thank you, Your Honor.

4 CHIEF JUDGE SLEDGE: Thank you.
5 You're not next, Mr. Freundlich.

6 MR. FREUNDLICH: Okay, Your
7 Honor. Can I just ask a quick question? I
8 didn't catch the last words that he -- that
9 you said. Leave the rest of the details --
10 I just didn't hear what you said.

11 CHIEF JUDGE SLEDGE: For her
12 written -- for her written statement.

13 MR. FREUNDLICH: Oh, okay. I'd
14 like to ask to go next, but if it's Your
15 Honor's preference that I don't, then I'll
16 stand back.

17 CHIEF JUDGE SLEDGE: Based on our
18 rotation that has been established, you're
19 pretty near the end of the line.

20 MR. FREUNDLICH: All right.

21 CHIEF JUDGE SLEDGE: Mr.
22 Steintal?

1 MS. ABLIN: Your Honor?

2 CHIEF JUDGE SLEDGE: Yes, ma'am.

3 MS. ABLIN: If I may, before we
4 move into the cross examinations, I'd just
5 like to ask for some clarification on one
6 thing. I understood Your Honor's ruling
7 earlier today about Ms. Kessler talking
8 about census versus sample that sample --
9 I'm sorry. I understood Your Honor's ruling
10 earlier today about Ms. Kessler talking
11 about -- testifying about census versus
12 sample reporting -- I just wanted to clarify
13 whether the denial of that motion also
14 applied to the exhibits, which I don't
15 believe I squarely raised, but I would like
16 to do so now just to, again, receive further
17 clarification.

18 Exhibits 414 through 418 were a
19 set of pleadings that had been filed in
20 various recordkeeping proceedings that
21 lawyers, I believe, from the Recording
22 Industry Association of America, and then

1 SoundExchange had filed, signed by their
2 counsel, that dealt with various
3 recordkeeping issues that they have proposed
4 to admit through Ms. Kessler's testimony.

5 I just would, again, squarely
6 move to -- or, you know, seek clarification
7 whether you have also denied moving to
8 strike those and just point out that if
9 those stay in evidence -- and perhaps this
10 is just going to be the unfortunate result
11 -- certainly the parties on this side would
12 feel compelled, if there's record evidence
13 on recordkeeping issues handled elsewhere
14 that's admitted into the record, you know,
15 in the upcoming rebuttal phase, we're going
16 to feel compelled to put those same
17 submissions in if, you know, Exhibits 414
18 through 418 stay.

19 So if you could just clarify,
20 Your Honor, if those -- if my motion to
21 strike those exhibits was denied, and, you
22 know, we can act accordingly in the next

1 phase.

2 CHIEF JUDGE SLEDGE: Ms. Ablin,
3 that's not a proper form to address that
4 issue, in an oral motion in the middle of
5 the testimony, so you'll present that in
6 writing or in more -- consistent with the
7 regulations on dealing with the provisions
8 of a written statement.

9 MS. ABLIN: Okay. We will do
10 that, Your Honor, in the written submission.

11 CHIEF JUDGE SLEDGE: Thank you.

12 MS. ABLIN: Thank you.

13 CROSS EXAMINATION

14 BY MR. STEINTHAL:

15 Q Good afternoon, Ms. Kessler.

16 A Good afternoon.

17 Q You mentioned at the beginning of
18 your testimony that there were some 570
19 webcasters I think that you said that were
20 making payments, is that right?

21 A That's correct.

22 Q Is it correct that more than 90

1 percent of the webcasting royalties come
2 from less than 10 of those webcasters?

3 A I don't know if it's -- it's 10.
4 You know, it could be as many as 15 or 20,
5 but it's not 10.

6 Q Okay. The 570 webcasters that
7 are making payments, do they include the
8 simulcasters or radio signals?

9 A Yes, they do.

10 Q Do you know roughly how many of
11 those 570 are engaged in simulcasting as
12 opposed to non-simulcast webcasting?

13 A Well, it's difficult to ascertain
14 from that number, because, again, the
15 broadcast simulcasters would be counted once
16 as a broadcast group, but they would
17 represent quite a large number of stations.
18 So I don't have that figure for you.

19 Q But in terms of that 570, roughly
20 how many are entities that are engaged in
21 simulcasting?

22 A I don't know the answer to that.

1 Q Is it over half?

2 A I wouldn't expect so, no.

3 Q And you mentioned that there were
4 difficulties in reporting or that there was
5 bad reporting from your perspective. Can
6 you draw any conclusions as to what
7 categories of companies have been the
8 greatest violators in your view, compared to
9 others?

10 A No, I can't. I never quantified
11 the data in that regard. We load logs and
12 for efficiencies consolidate those
13 performances irrespective of licensee for
14 the purposes of the identification and the
15 account assignment. So there was never any
16 operational reason to examine the data in
17 that regard.

18 I will tell you that it has not
19 been my experience that one licensee is a
20 particularly bad actor or a bad data
21 reporter over another. I think that, you
22 know, each log has its issues, and, you

1 know, each log is dealt with by staff in the
2 manner that I described earlier.

3 Q Are there specific objections you
4 have with the reporting made by the DiMA
5 companies?

6 A I'm not sure --

7 Q I'll be more specific, so that --
8 in particular, Microsoft and AOL and Yahoo
9 and Live365 that are testifying in this case
10 for DiMA?

11 A I don't understand the question.
12 That they've objected about the reporting or
13 --

14 Q No, no.

15 A -- that I have objections or
16 SoundExchange has objections --

17 Q Right. That SoundExchange --

18 A -- to the way they're reporting?

19 Q -- had specific objections with
20 the manner of reporting by those four
21 companies.

22 A Well, remember that there aren't

1 any regulations in place with respect to the
2 format and delivery of those reports of use.
3 As a result, those webcasters who
4 voluntarily report, the reports are coming
5 in inconsistently. But I would expect that
6 once the regulations are promulgated that
7 SoundExchange would work with their
8 licensees -- your DiMA companies -- to work
9 through those issues.

10 Q And when you talk about the
11 regulations being promulgated, through what
12 process does that happen? It's a process
13 different than this proceeding, correct?

14 A Well, prior to CARP reform, the
15 process was through a notice in
16 recordkeeping proceedings.

17 Q Right. And is it your
18 understanding that the notice in
19 recordkeeping proceeding process still goes
20 on with respect to matters that have been
21 subject to those kinds of proceedings
22 before?

1 A I understand that terms are under
2 the auspices of this Board, and I don't know
3 the -- where the notice in recordkeeping
4 will be determined.

5 Q Okay. And by that, you mean
6 where -- the issues relating to
7 recordkeeping and reporting?

8 A Correct.

9 Q I just want to ask you some
10 questions about the terms portion of your
11 testimony, which start at page 24, and as to
12 which Mr. Perrelli just asked you a few
13 questions towards the end of your
14 examination.

15 A Thank you. I'm sorry. You said
16 page?

17 Q It starts at page 24. Section 3
18 of your written testimony is modifications
19 needed to license terms. And you only spent
20 a little bit of time on your oral testimony
21 on that subject, and there are certain
22 questions I wanted to ask about that.

1 First of all, the importance of
2 census reporting, which starts at page --
3 starts on page 25 of your written testimony,
4 and you did testify a bit about that this
5 afternoon. Is it your testimony, Ms.
6 Kessler, that no sample can be accurate for
7 purposes of providing SoundExchange with
8 ample information to distribute royalties
9 collected?

10 A No. My testimony is that I have
11 never seen any evidence by any of the
12 licensees that prove that a sample results
13 in the proper allocation and distribution of
14 royalties. That wouldn't disenfranchise
15 certain artists or copyright owners.

16 Q Well, you're familiar with the
17 fact that internationally it's common, is it
18 not, in particular for radio, for
19 collections by collecting societies to be
20 distributed on a sample basis, correct?

21 A I'm not aware if that's common.
22 I do know that over the years other

1 organizations that distribute royalties are
2 moving to census reporting that is conducted
3 through technology, you know, monitoring
4 services of each and every performance.

5 Q But are you familiar with the
6 fact that, for example, in broadcast radio
7 the general practice of collecting societies
8 has been to distribute based on a sample and
9 not a census?

10 A Well, no, I understand that ASCAP
11 and BMI have been monitoring radio stations
12 for quite some time now through their joint
13 ventures with technology services companies
14 like Media Guide to -- and those are census
15 collection. I mean, they collect all the
16 data. And one of the purposes for that is
17 to distribute royalties.

18 Q Is it your testimony that they
19 actually distribute for broadcast radio
20 based on a census rather than a sample at
21 this point?

22 A I don't know if they are or

1 they're not. I know that the -- one of the
2 chief purposes of investing in this joint
3 venture was to collect the broadcast
4 performance information.

5 Q And while I would certainly agree
6 with you that a census is better than a
7 sample in terms of getting more information,
8 is it correct that samples can be created
9 that are generally accurate barometers of
10 the greater use being made of a given media?

11 A Well, since all that information
12 is in the possession of your clients and the
13 broadcasters, I would like to see that
14 analysis done on that census reporting
15 applying various samples to see if there is
16 a mathematical and scientific and
17 statistical way. I have never seen any
18 evidence, and to the contrary
19 SoundExchange's own analysis reveals, you
20 know, that based on information reported by
21 certain webcasters to SoundExchange's sample
22 does not remotely result in the fair

1 distribution of royalties to artists and
2 copyright owners.

3 Q Other than that one snapshot that
4 you looked at, are you aware of any other
5 tests of samples that have been done of
6 webcaster performances under the statutory
7 license to see how accurate a sample could
8 be?

9 A I'm unaware, and I'm unaware of
10 any evidence put in by your clients in any
11 notice and recordkeeping proceeding that
12 would prove your supposition that sample is
13 appropriate.

14 Q I'm not supposing anything. I'm
15 just asking you some questions, okay?

16 A Well --

17 Q Now, in Section B, starting on
18 page 25 of your testimony, it deals with
19 your request that the terms state that the
20 failure to pay royalties when required,
21 followed by payment of a late fee, does not
22 preclude a copyright infringement claim. So

1 is it your testimony, then, that you want
2 the regs or the law to explicitly state that
3 non-payment of a statutory fee could result
4 in copyright infringement penalties to the
5 entity that didn't pay on time?

6 A Penalties?

7 Q Copyright infringement penalties.

8 A Is your question about my written
9 testimony?

10 Q Yes.

11 A Can I take a moment and --

12 Q Sure.

13 (Pause.)

14 A Can you repeat your question,
15 please?

16 Q I first want to find out what the
17 proposal is. Is the proposal that if a
18 statutory licensee doesn't pay on time that
19 you want the statute to read, or the regs to
20 read, that a statutory licensee can be
21 liable for copyright infringement for having
22 failed to pay its statutory royalties?

1 A The objective of this request to
2 change to the term is so that a persistently
3 delinquent licensee who doesn't pay on time
4 and, in fact, could go months and, you know,
5 in one case years of not paying their
6 statutory obligation had simply, by paying
7 those royalties and getting those up to date
8 and paying the attendant late fee, does not
9 absolve them from a potential copyright
10 infringement action.

11 Q So you -- well, let me ask it
12 this way. Do you have any basis that you're
13 aware of for legislating that the failure to
14 pay a licensee fee during a time period when
15 someone is operating under a statutory
16 license could render that entity liable for
17 copyright infringement during that time
18 period?

19 A I'm not an attorney, but my
20 understanding is that failure to comply to
21 the rates, the payment of the royalty
22 obligation and the terms, would expose a

1 licensee to a potential copyright
2 infringement action.

3 Q Did you have any basis for
4 proposing what is set forth in Section B of
5 your testimony in terms of support from any
6 other medium or any other statutory license
7 regime?

8 A Well, again, you know, this
9 requested change in the term is just to
10 clarify that simply by making the payment
11 and paying the late fees does not absolve
12 you or -- or inhibit a copyright owner from
13 bringing an infringement case, simply
14 because you ultimately, after many months or
15 however long of non-payment, you know,
16 finally paid your royalties and late fees.
17 That's all this is saying.

18 Q I understand what you're saying
19 it's saying. My question was: did you have
20 any basis, in other statutory licenses or
21 any other support, for the request to change
22 the terms being made in this aspect of your

1 testimony?

2 A You know, I think this is clear
3 in -- I don't remember -- maybe the -- with
4 respect to the PES. I'm not sure. But it's
5 not done in a vacuum. This is not a new
6 term.

7 Q But you don't cite PES, meaning
8 the pre-existing services, statutory
9 license?

10 A Well, it's not cited in the
11 testimony, no.

12 Q And are you familiar with the
13 fact that copyright infringement penalties
14 are pretty draconian, up to \$150,000 per
15 infringement, if it's wilful? Are you
16 familiar with that?

17 A Well, I wouldn't agree that they
18 are draconian. I would agree that they are
19 not insubstantial.

20 Q Well, hypothetically, if a
21 licensee owed \$150 for a given license
22 period, and it could be rendered liable for

1 just one infringement at \$150,000, wouldn't
2 you believe that to be fairly draconian
3 relative to the amount of royalties due?

4 A No, I do not believe that.

5 CHIEF JUDGE SLEDGE: It would be
6 a big incentive.

7 MR. STEINTHAL: Excuse me?

8 CHIEF JUDGE SLEDGE: It would be
9 a big incentive.

10 (Laughter.)

11 MR. STEINTHAL: That's for sure.

12 BY MR. STEINTHAL:

13 Q Now, aren't there other less
14 draconian ways to arrive at the same result
15 that you'd like to get, meaning
16 incentivizing people to pay on time?

17 A I think that there are a
18 combination of changes that could be made
19 that would incentivize licensees to pay on
20 time. I do not, however, believe that if a
21 licensee doesn't pay on time, and doesn't
22 pay their late fees or otherwise comply with

1 the various aspects of the statutory
2 license, that a copyright owner -- again,
3 this isn't my decision, it would be the
4 copyright owners' decision -- if they chose
5 to pursue a copyright infringement action,
6 that's completely up to them.

7 Q Well, let me ask you this. Did
8 you consider, for example, whether to solve
9 the very problem you're talking about, which
10 is having to sue people for not making
11 payments on time -- did you consider, for
12 example, whether if the regulations were
13 amended to provide that in any action
14 brought by SoundExchange to collect for non-
15 payment SoundExchange would be entitled to
16 the attorney's fees incurred as part of any
17 such effort, might be another way of making
18 sure that SoundExchange is not out of pocket
19 for having to pursue late payers?

20 A I don't disagree that there are
21 ways in which SoundExchange could -- or the
22 regulations or the terms could be written to

1 incentivize folks to pay on time and to
2 submit the appropriate paperwork, and I've
3 made a number of suggestions in my testimony
4 of how that would happen. But it's not
5 SoundExchange's copyright. You know, we're
6 administering the license, and if a
7 copyright owner feels that non-compliance
8 with the terms of the license, you know,
9 warrants a copyright infringement action
10 they should absolutely be entitled to do so.
11 And one doesn't impact the other.

12 Q Then, why do you need to change
13 the rest? If your position is that a
14 copyright owner has the right anyway, why do
15 we have to saddle the regs with explicit
16 language of the nature that you're seeking?

17 A To make it clear.

18 Q So apparently it's not that
19 clear, is it?

20 A I wouldn't be requesting a change
21 in my testimony if it were crystal clear.

22 Q Okay. So it's not clear that an

1 entity that doesn't pay a statutory license
2 fee is liable for infringement simply for
3 failing to pay, correct?

4 A Again, failure to comply with the
5 statutory license -- it's my understanding,
6 as a non-lawyer, that a copyright owner does
7 have the avenue of bringing a copyright
8 infringement action.

9 Q But that was the very thing that
10 you just said was unclear, which is why you
11 wanted to clarify it, right?

12 A No. I wanted to make clear that
13 by simply finally making your payments
14 didn't absolve you of the -- or protect you
15 from a potential copyright infringement
16 action is what I said.

17 Q I guess that just puzzles me,
18 then, as to why you need the change in the
19 regulation.

20 Let me have you turn to page 27
21 where you talk about the interest penalty.
22 And is it true -- I mean, I'm just reading

1 from your testimony here on pages 27 to 29
2 -- that you seek a change in the regs to
3 increase the late payment fee from .75
4 percent to 2-1/2 percent per month, right?

5 A That's correct.

6 Q So if I get that right, that's 30
7 percent per annum?

8 A I trust your calculation.

9 Q Do you know of any other
10 collecting society that has late payment
11 fees as high as 30 percent per annum?

12 A Well, I think the point here is
13 that, you know, we want to disincentivize a
14 licensee from waiting and waiting and just
15 paying this nominal amount. And if they're
16 similar to the IRS that charges penalties
17 and interest when taxes aren't received,
18 that that would incentivize licensees to pay
19 on time.

20 Q Do you view SoundExchange as
21 operating essentially like the IRS?

22 A I do not, nor would I want to

1 undertake that massive undertaking. But I'm
2 using that as an example of, you know, the
3 concept of some sort of graduated or
4 escalating penalty for lengthy and repeated
5 non-payment of royalties that inhibit
6 SoundExchange's ability from making the
7 timely distributions that it is charged to
8 make.

9 Q Well, wouldn't a better analogy
10 be to whatever the late payment fees are
11 that are prevalent with collecting societies
12 in the United States and elsewhere?

13 A I don't know what those late fees
14 are, and I haven't really given thought to
15 whether those would be, you know, applicable
16 or not.

17 Q So where did --

18 A I was trying to --

19 Q I'm sorry. Where did the 2-1/2
20 percent come from, then?

21 A In my testimony I'm trying to
22 solve an administrative problem that we have

1 seen where licensees for months and months
2 aren't paying their royalties, or repeatedly
3 they do not pay their royalties on time.

4 And I can only surmise that having a rate of
5 .75 percent isn't a very big problem for
6 them if they continue to pay late.

7 And this is a suggestion of what
8 may give some teeth to the requirement --
9 and, I mean, it's the requirement in the
10 first instance -- to pay on time.

11 Q I understand that. I'm not here
12 to defend deadbeats. I'm here to try to
13 make sure that whatever the regs are that
14 are ultimately rendered are fair. Okay? Do
15 you know of any collecting society that
16 comes near a 30 percent annual rate for late
17 payments?

18 A I don't know if it would be near
19 or not, because I don't know what their late
20 fee percentages are.

21 Q Is it the fact that the number
22 just came out of SoundExchange's desire to

1 make sure that people pay on time, so let's
2 pick a high number, that they don't want to
3 have to pay as a late fee, without any
4 consideration of comparable late fees
5 existing in other collecting society
6 arrangements?

7 A Can you repeat the question?

8 Q Let me rephrase it this way. Is
9 it true that the number that was taken here
10 was taken without consideration of any other
11 comparable collecting society late fee
12 arrangements, the 2-1/2 percent per month?

13 A You know, I -- the number was
14 reflective of what credit card companies
15 charge when you don't pay on time, and it
16 was something that we felt was a substantial
17 enough late fee to disincentivize licensees
18 from paying late. That's where it came
19 from.

20 Q And when you talked before about
21 a graduated late fee for people that are
22 recalcitrant, this proposal isn't a

1 graduated late fee, is it? It's just a --
2 basically changing the late fee to 2-1/2
3 percent per month or 30 percent per annum,
4 is that right?

5 A Let me take a second to look at
6 this, please.

7 (Pause.)

8 Well, when I talked about the
9 graduated late fee, I was really referring
10 to the second paragraph on page 28, with
11 respect to the grace period, and then late
12 fees would be doubled.

13 Q Doubled on top of --

14 A Yes.

15 Q -- the 2-1/2 percent --

16 A So that's the --

17 Q -- per month or --

18 A -- graduated.

19 Q Right. Let's turn to page 29, if
20 you will. When you talk about penalties
21 should also apply for services that fail to
22 submit completed statements of account and

1 reports of use. Let me ask you this: did
2 you consider how one would resolve
3 situations where entities might not have
4 every bit of information on a SoundExchange
5 reporting form and what the implications
6 would be if they were subject to late
7 payment fees for failure to provide
8 information that doesn't exist?

9 A Well, my job is to consider how
10 SoundExchange distributes royalties timely,
11 efficiently, transparently, and accurately.
12 And so in order to get the royalties out on
13 time, we absolutely need a completed and
14 accurate statement of account. That's the
15 first step in this entire process and will
16 result in delays in distributions otherwise.

17 So what I considered was what
18 might be an approach to solve the problem of
19 missing statement of accounts or -- or
20 incomplete statements of account. And, you
21 know, there's a 45-day window after the end
22 of the month where the statements of account

1 can be prepared, and that seems ample time
2 to collect the information on the statement
3 of account -- a statement of account, by the
4 way, which the licensee opted to take.

5 So if they were unable to report
6 and comply with that, then perhaps the
7 statutory license wasn't the way for them to
8 go.

9 Q Well, we don't even have, as you
10 said at the beginning, final reporting and
11 recordkeeping regulations, right?

12 A That's on the reports of use, not
13 on the statement of account information.

14 Q But on the reports of use -- your
15 proposal here applies to both statements of
16 account and reports of use, right?

17 A Yes.

18 Q So you're proposing that there be
19 late payment penalties for incomplete
20 reporting for reports that we don't even
21 know what they're going to be, and whether,
22 for example, a given reporting obligation

1 would be applicable to every individual
2 licensee, right?

3 A So that was a multi-part
4 question, and I -- I'll try to address --
5 address it. You know, there is an
6 obligation for a licensee to report the use
7 of the sound recording to the copyright
8 owner. That is their obligation. The
9 mechanism for doing that is through the
10 reports of use. Reports of use have been in
11 operation with the pre-existing services for
12 a long period of time, and, you know, so the
13 -- you know, the idea that reports of use
14 are something brand new and unknown just
15 really isn't the case.

16 The piece of the notice in
17 recordkeeping that's outstanding is not what
18 data elements should be reported, and it's
19 what format should the file be in, and how
20 do you physically deliver that file or
21 electronically deliver that file to
22 SoundExchange. So maybe I'm not answering

1 your question.

2 Q Well, for example -- let me ask
3 it this way. I'll do it in little bits and
4 pieces.

5 A Thank you.

6 Q If we go to what an ISRC code is
7 -- would you tell the Panel what an ISRC
8 code is?

9 A Yes, I know what an ISRC code is.

10 Q What is it?

11 A It's the International Sound
12 Recording Code, which uniquely identifies a
13 sound recording.

14 Q And doesn't SoundExchange want
15 licensees to report the ISRC code with
16 respect to all of their transmissions?

17 A Yes, we do.

18 Q And isn't it true that it doesn't
19 exist with respect to all of the sound
20 recordings?

21 A Isn't it true that it doesn't
22 exist with all the sound recordings.

1 Q There isn't an ISRC available to
2 every webcaster for each sound recording
3 that it transmits, is there?

4 A Well, I know that at least for
5 the last 16 or so years ISRCs have been
6 assigned to new releases. I mean, that's
7 quite a bit of catalog. But we're not
8 asking for ISRC to the exclusion of other
9 information. If you read the reporting
10 requirements, you know, licensees have the
11 option of reporting the ISRC or the
12 marketing label on the album or some other
13 combination of fields.

14 So it's not -- it's not a
15 requirement. It's an either/or situation.
16 To the extent that you have it, it's a great
17 bit of information for us to have. If you
18 don't, then go ahead and report these other
19 elements.

20 Q But in a situation where you're
21 proposing that a report that's not
22 "complete" when so many fields of

1 information are being requested, could
2 render a licensee liable for late payment
3 penalties when they've done their best
4 efforts to comply, isn't that a bit penal
5 when the issue of what is complete or not
6 complete may depend on the eyes of the
7 beholder?

8 A I don't believe completion of the
9 file is remotely unknown. I think the
10 regulations are quite clear that if you're
11 going to report the ISRC you need not report
12 other fields. If you report the other
13 fields, you need not report the ISRC. A
14 computer program can examine that file and
15 ascertain, to the extent on a record-by-
16 record basis, what is complete and what
17 isn't, what has adhered to the reporting
18 requirements and what has not.

19 And, no, I do not think that it's
20 unreasonable to expect a licensee to comply
21 with, you know, the terms of the statutory
22 license when they get the tremendous benefit

1 of using copyright owner and artist sound
2 recordings. So I think they should report
3 and report timely and completely in order
4 for us to get through this entire process
5 and distribute the royalties.

6 Q And I'm not suggesting otherwise.
7 However, when a licensee is reporting, as
8 you said, hundreds of thousands of
9 performances of sound recordings during a
10 given reporting period, have you or have you
11 not seen situations where the licensee feels
12 that it has reported completely, and
13 SoundExchange feels that there are a couple
14 of things missing?

15 A Well, first, you know, the
16 regulations aren't final. So, you know,
17 currently while webcasters are required to
18 retain the information, they aren't yet
19 required to deliver those reports of use to
20 SoundExchange.

21 Secondly, you know, I'm not
22 really understanding your characterization

1 of reporting. I mean, first of all, you
2 know, I believe I have all the fields right,
3 but it's title of the sound recording, it's
4 the artist, it's the marketing label and
5 album, or the ISRC, and then the number of
6 performances in your transmission category
7 and some other elements about the licensee.

8 But with respect to identifying a
9 sound recording, it's a handful -- truly a
10 handful of fields. That is not unreasonable
11 when the sound recording and the information
12 about the sound recording and the act of
13 transmitting that sound recording is in the
14 possession of the licensee.

15 Q Isn't it true, Ms. Kessler, that
16 the basis of the information that the
17 licensee has is directly from the record
18 companies that provide it with the sound
19 recordings for purposes of airing?

20 A I'm not sure how webcasters
21 obtain the product from which they stream.
22 I don't know if they're getting it directly

1 from the record company or through a third
2 party, like a Loudeye. I don't know where
3 your clients are getting either the sound
4 recordings or the information.

5 Q So do you have any basis for
6 testifying that every one of those fields is
7 information that the webcasters have for
8 every one of the sound recordings that they
9 stream?

10 A You know, at the risk of
11 repeating myself, it's not that all five
12 fields are required. It's some combination
13 of them that are required. And the purpose
14 of it is to identify the sound recordings,
15 so we can pay it out. And if you don't
16 provide it to us, where will SoundExchange
17 -- SoundExchange won't know --

18 Q The suggestion is not --

19 A -- the information --

20 Q -- that you not get these
21 reports, ma'am. The suggestion is not that
22 at all. The question is whether, when you

1 have a proposal, that because a report in
2 your judgment is not complete, even though a
3 licensee has endeavored to provide
4 information in response to a reporting
5 obligation, that if there is this dispute
6 between SoundExchange and a licensee over
7 the completeness of their report, they
8 should be rendered liable for late payments
9 when they have endeavored to comply but
10 there is a dispute as to the completeness of
11 it.

12 A Well --

13 Q Is it your position that there
14 should be a late payment fee in that
15 circumstance?

16 A I firmly believe that a late
17 payment should be in place when a service
18 simply doesn't send us any report of use.
19 You know, SoundExchange's experience has
20 been -- as I've explained in this process,
21 we get misreported information, poorly
22 reported information, all the time. And we

1 expend a lot of resources to clean up those
2 -- those records of use in order to get our
3 job done and distribute the royalties.

4 If after all of this we still
5 don't know what the sound recording is
6 because one of your clients is reporting
7 Bach as the featured artist and -- or
8 various as the featured artist or something
9 like that -- we have no remedy to require
10 you, or we have no resource of funds to go
11 out and do something else, apart from
12 depleting the statutory royalties that are
13 going to copyright owners and artists.

14 The intent of this is to
15 disincentivize sloppy recording and the
16 untimely delivery of reports of use.

17 Q Is it your position that a good
18 faith effort to report, that nonetheless
19 yields not as much information as
20 SoundExchange would like, should render a
21 licensee liable for late payment fees?

22 A Well, let me answer it this way.

1 SoundExchange has demonstrated its
2 willingness to work with licensees on the
3 reporting issues. We have, and we will, and
4 we do. But to the extent that there is
5 repeated behavior of not making any attempt
6 to rectify issues identified in trying to
7 process those reports of use, I think, yes,
8 there should be a penalty of -- you know,
9 short of a copyright infringement action for
10 that repeated type of behavior.

11 But in the first instance, not
12 reporting -- you know, not even sending a
13 log in at all should definitely -- there
14 should definitely be a penalty for that. It
15 delays our entire process when we don't
16 receive logs on time.

17 Q You didn't answer my question.
18 In the instance where there is a good faith
19 effort to report -- I didn't say a recurring
20 problem, which is what you answered -- in
21 the instance of a good faith effort to
22 comply with the reporting obligations, and a

1 disagreement or dispute between
2 SoundExchange and the licensee as to whether
3 the information provided is complete, is it
4 your position that SoundExchange in that
5 situation should get a late payment fee?

6 A I think that SoundExchange -- and
7 I did answer this, and I said that to the
8 extent SoundExchange works with the
9 licensee, and when you see improvement in
10 the reporting, and we work together to try
11 to rectify the problems, then there is no
12 problem.

13 But to the extent that there is,
14 you know, no effort being made to report the
15 very basic five fields, not even -- some
16 combination of that information, in order
17 for us to definitively know what sound
18 recording was transmitted, yes, I think that
19 a penalty should be applied.

20 Q So when you said in your answer
21 that you didn't think there was a problem
22 when there's a good faith effort to comply

1 and an exchange of information between
2 SoundExchange and the licensee, I gather
3 when you said there was no problem that your
4 position is there's no need for a late fee
5 for that particular circumstance.

6 A I would say that when we work
7 with licensees and they demonstrate a
8 willingness and an improvement that
9 SoundExchange -- this is on a case-by-case
10 basis, and I don't have the particulars in
11 front of me, but it -- you know, it should
12 be our -- you know, we would have the option
13 of waiving those late fees. But not to have
14 them in the first instance would give us
15 absolutely no ability to require accurate
16 and timely reporting.

17 Q Well, isn't another way of
18 dealing with it to make clear that good
19 faith efforts to comply on a non-recurring
20 basis don't yield a payment -- a late
21 payment obligation as distinguished from
22 your request to have it across the board,

1 and the ability of SoundExchange and its
2 discretion to waive?

3 A I think that's an alternative,
4 but I prefer my recommendation.

5 Q Well, I'm sure you would.

6 CHIEF JUDGE SLEDGE: I'm somewhat
7 puzzled by your questions focusing more on a
8 fault issue. Isn't the issue who is in the
9 best position to provide information in
10 order to have an efficient system as opposed
11 to fault?

12 MR. STEINTHAL: Well, Your Honor,
13 I think that there is a -- this whole issue
14 of the terms is one that is full of data
15 issues and the like.

16 CHIEF JUDGE SLEDGE: Right.

17 MR. STEINTHAL: It's not just a
18 question of fault. In other words, our
19 objections here -- and we didn't have notice
20 of these proposed terms until SoundExchange
21 filed its case. And to the extent we have
22 any concerns about these terms, we will deal

1 with them in our rebuttal case. What I
2 wanted to do in this cross is just simply,
3 on certain of the issues that I know our
4 clients have some concerns about, ask
5 questions as to what the bases are and what
6 the limits are of the proposals.

7 So, for example, in this
8 instance, Your Honor, it's simply a question
9 of I don't dispute the notion that repeat
10 offenders that either don't pay or don't
11 report in a good faith, accurate manner
12 should be subject to some term provisions,
13 whatever they may ultimately be.

14 But one of the things that I have
15 trouble with in reading these terms is its
16 over-precautionary in favor of SoundExchange
17 approach. So, for example, there is a lot
18 of data here. The witness is talking about
19 the fields. We're talking about hundreds of
20 thousands of sound recordings. It is not
21 uniform.

22 The data that the webcasters get,

1 as you'll hear, is not uniform. Some of
2 them are old sound recordings where there is
3 no ISRC number. The data we get is -- you
4 know, we rely on the sound recording
5 providers that give it to us or what's in
6 the actual album or the CD that we, you
7 know, digitize to put on the server to get
8 that information.

9 So the universe of information
10 isn't perfect. And I'm simply trying to ask
11 questions, so that we can ultimately get to
12 a world in which good faith efforts to
13 report, which may not be exactly what the
14 licensors wanted to have, don't render
15 somebody responsible for financial
16 penalties. I'm not here to argue in favor
17 of deadbeats, as I said before.

18 CHIEF JUDGE SLEDGE: Right. But
19 my -- my question deals with -- because I
20 would think that the focus is on who is in
21 the best position to provide the
22 information, and perhaps some incentives are

1 required on one part or the other as part of
2 the terms in order to encourage people to do
3 that. But --

4 MR. STEINTHAL: But we're only in
5 the position --

6 CHIEF JUDGE SLEDGE: I hear you
7 all talking about who is at fault, and that
8 just doesn't seem very important.

9 MR. STEINTHAL: Well, this seems
10 to be -- their proposal seems to be a no-
11 fault situation, where if the data isn't
12 complete you get penalized. And if we don't
13 have the data, and we have no way of getting
14 better data than what we have, then that, in
15 our view, is an unfair system.

16 CHIEF JUDGE SLEDGE: But if
17 you're determined to be the one in the best
18 position to provide the data, then the fact
19 that you don't have the data is no excuse.

20 MR. STEINTHAL: Well, again, Your
21 Honor, the question is: do you require of a
22 licensee -- a statutory licensee to report

1 data that may not exist?

2 CHIEF JUDGE SLEDGE: Which
3 wouldn't be a very good regulation.

4 MR. STEINTHAL: No, it wouldn't
5 be.

6 CHIEF JUDGE SLEDGE: Yes.

7 MR. STEINTHAL: And that's our
8 concern.

9 CHIEF JUDGE SLEDGE: Right.

10 MR. STEINTHAL: And to have a no-
11 fault situation where completeness is
12 required, otherwise you have a late payment
13 fee, and if we don't have the information in
14 the first place -- and that's the nature of
15 the question. We will deal with these in
16 more detail.

17 CHIEF JUDGE SLEDGE: If the
18 system requires data that doesn't exist,
19 then the system needs changing.

20 MR. STEINTHAL: Exactly.

21 CHIEF JUDGE SLEDGE: Okay. Thank
22 you.

1 BY MR. STEINTHAL:

2 Q Now, there's a provision in your
3 proposed terms regarding audits. And am I
4 correct that the proposal is that
5 SoundExchange be permitted to audit
6 licensees with its own staff rather than
7 requiring independent outside auditors doing
8 the auditing of the licensees?

9 A If you don't mind, if you could
10 give me a page reference, so that I --

11 Q I believe it's in Section F
12 starting on page 35.

13 A Thank you. And I'm afraid I'm
14 going to have to ask you to repeat the
15 question.

16 Q Well, my question is whether the
17 SoundExchange position is that SoundExchange
18 ought to be able to conduct the audit with
19 its own staff rather than use an outside
20 independent auditor to do the auditing
21 function.

22 A Well, let me answer your question

1 this way. SoundExchange is confronted with
2 a situation where audits rather than being
3 financial in nature are data and analytic or
4 technical in nature. And so we are
5 wondering if there should not be a
6 clarification as to what an independent
7 auditor is.

8 And to the extent that
9 SoundExchange has the technical capability
10 of doing the data analytics, you know, our
11 -- the question is: what makes an auditor
12 independent or not? I believe that's what
13 we're getting at here.

14 Q Well, isn't the -- in the past,
15 under statutory licenses, hasn't
16 SoundExchange or its predecessor been
17 required when conducting audits to do
18 independent audits with outside auditors?

19 A Isn't SoundExchange required --

20 Q Or its predecessor, RIAA, when it
21 was doing --

22 A To engage an outside auditor.

1 The way I understand the regulation that's
2 in place right now is that an independent
3 auditor is to conduct the examination.

4 Q And in suggesting that
5 SoundExchange be able to do that itself
6 without requiring an independent auditor,
7 what's the basis for seeking to change a
8 system that requires outside independent
9 auditors to one where SoundExchange can
10 conduct the audits with their in-house
11 people? Or is that just something that
12 SoundExchange would like and it has put it
13 in the regs as something it would like?

14 A I'm just reading again.

15 (Pause.)

16 Where is this language that
17 you're referring to?

18 Q It -- I'm not sure where this
19 specific language is, but it's the subject
20 of what you're testifying to.

21 A I just want to make sure I
22 respond.

1 JUDGE WISNIEWSKI: You might try
2 point 5 on pages 38 and 39.

3 THE WITNESS: Thank you, Your
4 Honor.

5 MR. STEINTHAL: I thank you as
6 well.

7 THE WITNESS: You know, this
8 discussion is really about what does
9 independence mean. I mean, that's -- we've
10 come cross auditors who own copyrights, and
11 the question is, you know, does that
12 disqualify them under the independence
13 factor, because they own copyrights, as
14 opposed to independence from the licensor.

15 BY MR. STEINTHAL:

16 Q Well, then, is it your testimony
17 that SoundExchange is not seeking to be able
18 to conduct the audits, whether they be
19 technical or financial, through their own
20 in-house people?

21 A Well, I think to the extent that
22 SoundExchange develops technology that can

1 examine the server logs in a cost effective
2 manner that we should -- we would like to be
3 able to conduct those types of technical
4 data analytic audits.

5 Q And are you familiar with any
6 precedent and other statutory license
7 schemes that permits the licensor to conduct
8 audits through their own in-house staff
9 rather than through independent outside
10 auditors?

11 A Well, remember, you know --

12 Q Just yes or no would be fine.

13 A Well, I can't -- I can't just
14 answer yes or no. I can say that, you know,
15 SoundExchange doesn't own any copyrights.
16 We're administering a license. It's
17 copyright owners who own -- own -- and
18 they're not exactly licensing their content.
19 A statutory license is being taken by virtue
20 of it being established by the government.
21 So, you know, no, to answer your question,
22 I'm not aware of what you're referring to,

1 but I just wanted to make clear that we're
2 not the licensor. We're administrating the
3 statutory license.

4 Q And my question is simply whether
5 you are familiar with any other statutory
6 license scheme where the licensor or its
7 administrator is permitted to conduct the
8 audits through their own in-house staff as
9 distinguished from relying on outside
10 independent auditors?

11 A I'm not familiar with how other
12 statutory licensees conduct their audits.

13 Q And to be clear, is it
14 SoundExchange's proposal that just the
15 technical audits be able to be conducted by
16 their in-house staff or technical and
17 financial as well?

18 A Just the examination of the
19 server logs, the technical audits where
20 we're looking at the numbers of performances
21 reported on the statements of account.

22 Q So you're not seeking to have a

1 system in which the financial audits, to the
2 extent they're conducted, of a licensee be
3 conducted by anyone other than an outside
4 independent auditor?

5 A I had not contemplated that, no.

6 Q And there are outside independent
7 technical auditors, are there not, including
8 Mr. Bernstein's company, which is currently
9 under contract by SoundExchange to conduct
10 audits of the very licensees in this
11 proceeding?

12 A Royalty Review Council is one
13 auditor that we identified who may have the
14 capability of doing these types of audits.
15 We've identified him in our notices of
16 intent to audit.

17 Q And to be clear, that's in
18 relation to notices that were sent by
19 SoundExchange to, among others, AOL and
20 Yahoo and Microsoft and Live365, in
21 connection with a prior license period?

22 A That's correct.

1 Q Okay. Now, there's another
2 provision that you propose in relation to
3 the audits, which is on pages 39 to 40,
4 where you propose a change in the -- what
5 I'll call the error threshold for which
6 penalties are imposed where you basically
7 propose that the current 10 percent leeway
8 be changed to 5 percent, is that right?

9 A Yes.

10 Q And just to be clear, currently
11 under the regs, if an audit reveals a
12 differential of less than 10 percent, then
13 SoundExchange pays for the cost of the
14 audit. But if the differential is greater
15 than -- is 10 percent or greater, then the
16 licensee has to pay for the cost of the
17 audit. Is that what your --

18 A That's my understanding, yes.

19 Q And you propose to change that 10
20 percent to 5 percent, correct?

21 A That's correct.

22 Q Do you have any basis in other

1 statutory licenses for changing that 10
2 percent to 5 percent?

3 A No. The basis for this change is
4 that this could essentially result in a 10
5 percent discount to the licensee. It's that
6 for, you know, the audit period they could
7 underreport, you know, and not hit this 10
8 percent threshold and never have -- be
9 required to reimburse SoundExchange for the
10 cost of the audit. And it just seems like
11 an incentive to underreport, and it should
12 be tightened.

13 Q Do you have any evidence --

14 A It's a practical solution to a
15 problem that we have identified.

16 Q Do you have any evidence under
17 the current statutory license of licensees
18 deliberately underreporting by 9 percent?

19 A Do you mean with respect to
20 webcasters?

21 Q Yes.

22 A We haven't conducted the audits

1 yet.

2 Q So when you talk in paragraph 7
3 about -- at the bottom of page 39 you say,
4 "At a 10 percent threshold, services could
5 have an incentive to underpay by 9 percent,
6 knowing that the only likely consequence is
7 an obligation to pay the underpayment,
8 excluding for the moment the possibility of
9 an infringement action," that's just a
10 hypothetical assumption on your part,
11 because you've got no evidence that under
12 the current system people are actually
13 deliberately underreporting at 9 percent,
14 right?

15 A We have not conducted the audit,
16 so I have no results to examine.

17 Q And have you undertaken before in
18 making this proposal to look at other
19 collecting society arrangements to see what
20 the prevalent practice, if any, is with
21 respect to where there is a cost shift for
22 the cost of an audit in terms of

1 underreporting?

2 A No, I did not.

3 Q Did you look at any other
4 benchmarks to justify the change from 10 to
5 5 percent?

6 A No, I did not.

7 Q Take a look on page 42 and
8 Section I, the section on transmissions of
9 recordings of comedic performances. What's
10 the basis for this change?

11 A Again, it's a clarification that
12 a sound recording consisting of spoken word
13 is also compensable under the statutory
14 license as opposed to musical content.

15 Q Is it SoundExchange's position
16 that under the prior license comedic
17 performances are not required to be paid
18 for, and this is a change to -- to elaborate
19 upon the existing performances, subject to
20 license?

21 A SoundExchange believes comedic
22 performances are compensable, but we wanted

1 to make it absolutely clear in the event
2 that there might be some confusion with
3 respect to what licensees were required to
4 pay.

5 Q Have there been any disputes
6 between licensees and SoundExchange over the
7 issue of comedic performances?

8 A I wouldn't characterize it as a
9 dispute. I would characterize it as a
10 reporting issue that they were unaware that
11 they might have to report performances on
12 their spoken word channels, and that, in
13 fact, yes, they should and they are
14 compensable.

15 MR. STEINTHAL: No further
16 questions, Your Honor.

17 CHIEF JUDGE SLEDGE: Let me just
18 follow up on that last question. Is there
19 any difference between comedic reporting --
20 recordings versus any spoken word
21 recordings, or is that just --

22 THE WITNESS: This was one

1 specific clarification that we requested.

2 And to the extent that, you know, spoken
3 word booked as a sound recording -- it seems
4 to me it should be compensable as well.

5 CHIEF JUDGE SLEDGE: Thank you.

6 Okay.

7 CROSS EXAMINATION

8 BY MS. ABLIN:

9 Q Good afternoon, Ms. Kessler.

10 A Good afternoon.

11 Q It's good to see you again. I'd
12 like to start by asking you about a
13 statement or -- that you made on page 2 of
14 your testimony. Actually, let's go straight
15 to page 16, shorten this a little bit. Go
16 to page 16. That's the more direct
17 statement.

18 A Yes.

19 Q And I believe that back in
20 October 31st or thereabouts when direct
21 cases were due, you testified that
22 SoundExchange had allocated more than 55

1 million in royalties.

2 A Yes.

3 Q And just so we have all the
4 figures down, what is that number today?

5 A As of the distribution we're
6 conducting right now, that's nearly 70
7 million.

8 Q And that's out of how much in
9 royalties that's been collected?

10 A This distribution represents two
11 quarters of -- am I permitted to say this?

12 MR. PERRELLI: I'm not sure I
13 know the answer to -- to the extent the
14 witness is going to get into restricted
15 testimony about a particular licensee or
16 licensee payments, it may require us to go
17 into closed session.

18 CHIEF JUDGE SLEDGE: What
19 restricted testimony?

20 MR. PERRELLI: Well, I don't
21 believe she has any restricted testimony in
22 her direct testimony, but it's -- as I

1 understand from the witness' hesitance, she
2 may feel that the question requires her to
3 reveal some restricted information.

4 CHIEF JUDGE SLEDGE: Well, you'll
5 have to be more specific before you're
6 persuasive.

7 MR. PERRELLI: I'm not sure I can
8 be more specific, since I don't -- to the
9 extent that the question is seeking
10 information about specific payments by
11 specific licensees, that is information that
12 is -- has been treated as restricted under
13 the protective order, and this is
14 specifically confidential under the
15 regulations.

16 So to the extent that the
17 question seeks that information, and Ms.
18 Kessler was about to provide that
19 information, that information should be
20 restricted, and I think pursuant to the
21 regulations needs to be treated as
22 restricted.

1 CHIEF JUDGE SLEDGE: What
2 regulation?

3 MR. PERRELLI: It's 261 -- or --
4 sir, I believe it's the PES. If it relates
5 to the PES, it's 262 -- 261. And if we're
6 talking about --

7 CHIEF JUDGE SLEDGE: I'm sorry.
8 I didn't understand -- with your
9 interchange, I didn't understand your
10 answer.

11 MR. PERRELLI: If it relates to
12 the pre-existing subscription service, it's
13 36 CFR 261. If it relates to the satellite
14 digital audio radio services, that relates
15 to the prior -- a private agreement, which
16 is subject to the confidentiality provisions
17 within that agreement and has been treated
18 as restricted in this proceeding.

19 It may make sense for Ms. Ablin
20 to ascertain from the witness what types of
21 information she is seeking to elicit, so
22 that we can identify most appropriately the

1 basis for the restriction.

2 CHIEF JUDGE SLEDGE: You're
3 saying that under the regs 361 --

4 MR. PERRELLI: 261. I'm sorry,
5 Your Honor.

6 CHIEF JUDGE SLEDGE: -- 261 for
7 pre-existing.

8 MR. PERRELLI: Yes, sir.

9 CHIEF JUDGE SLEDGE: And 262 for
10 satellite?

11 MR. PERRELLI: For satellite,
12 that is the subject of a private agreement
13 --

14 CHIEF JUDGE SLEDGE: Private
15 agreement --

16 MR. PERRELLI: Which has
17 confidentiality provisions in it that
18 restrict that information.

19 CHIEF JUDGE SLEDGE: That's not
20 the question nor the answer that has been
21 given, so please proceed, Ms. Ablin.

22 MS. ABLIN: Thank you, Your

1 Honor.

2 BY MS. ABLIN:

3 Q And how much of -- I believe my
4 question right before the little break was
5 how much -- you had said that nearly 70
6 million in royalties had been allocated.
7 How much had been collected? That's
8 70 million that has been allocated out of
9 what bigger number?

10 A Oh, the total collected to date?
11 I don't know what that number is. What I
12 can say is that the distributions have taken
13 us through collections on the PES and the
14 SDARS through the end of 2005. Remember,
15 the webcasters haven't been required to
16 report because of the outstanding
17 regulations on format delivery and -- file
18 format and delivery specifications. So
19 without the logs we can't distribute those
20 royalties, and I just don't have that figure
21 off the top of my head.

22 Q Okay. So for the --

1 A So we've distributed royalties
2 collected through Q1 of 2004 for the
3 webcasters, and through the end of 2005 for
4 the PES and the SDARS.

5 Q Okay. Well, let's start with the
6 webcasters, the money that you have
7 distributed through Q1 2004. How much total
8 webcaster money, through that quarter, has
9 been collected? Putting aside what happened
10 after Q1 2004.

11 A I have innumerable reports that
12 say all this. Off the top of my head
13 sitting here in this moment, I can't recall
14 what the exact number of -- of what we've
15 distributed. I know that for the '98 to '02
16 period it was in excess of \$10 million, but
17 I'd have to refer to my distribution reports
18 to be able to answer your question with
19 accuracy.

20 Q I guess what I'm trying to get at
21 is, out of the money, approximately -- out
22 of the money that has been collected through

1 Q1 2004 where you do have a basis for paying
2 it out, what percent of that money has been
3 distributed versus the percent that is
4 sitting in an account because you haven't
5 been able to find, for example, the
6 copyright owner that it needs to go to?

7 CHIEF JUDGE SLEDGE: I couldn't
8 hear your question.

9 MS. ABLIN: I'm sorry. I can try
10 to repeat all of that again.

11 BY MS. ABLIN:

12 Q I'm trying to get at how much --
13 of the total money that has come in, how
14 much of the -- for webcasters, through Q1
15 2004, how much of that money has been
16 distributed versus the money that has not
17 been distributed, for whatever reason, it
18 has either not been allocated or it is
19 sitting in an escrow account, because you
20 don't know how to allocate it?

21 A So with respect to the copyright
22 owners' share of the royalty, 85 percent of

1 the money has been paid through to the
2 copyright owner, and 15 percent is
3 unidentifiable, either because of our issue
4 with the sound recording or our issue of
5 locating the copyright owner that we should
6 pay.

7 Q For copyright owners, what about
8 the artist money?

9 A On the artist side, we're at
10 about a 60 percent pay-through rate to
11 featured artists, and we expect to hit the
12 65 percent pay-through rate by October.

13 Q October of this year.

14 A Yes.

15 Q And can you -- I know you can't
16 give a number with precision without looking
17 at reports, but can you just give a ballpark
18 of how much money we're talking about that
19 has come in, just to your best recollection?

20 A Well, if we take the 70 million
21 that we've allocated and approximate, you
22 know, between the artists and the copyright

1 owners, whatever that blended percentage is
2 paid through, that would result in what we
3 have been able to not only allocate but pay
4 through. So I think that blended rate must
5 be what is -- 35 and 15, it's, you know, 60
6 percent or whatever it happens to be.

7 Q Let me just make sure I'm on the
8 same page with you.

9 A Yes.

10 Q The 70 million -- because I don't
11 know that I am -- the 70 million that has
12 been allocated, has that amount also been
13 distributed, or has it just --

14 A Yes.

15 Q -- been allocated?

16 A Yes. No, we allocate and
17 distribute --

18 Q Okay.

19 A -- at the same time.

20 Q So when you testify that a
21 certain amount of money has been allocated,
22 it has also been distributed?

1 A No. The distinction is that the
2 allocation has occurred, and the
3 distribution from the sound recording to the
4 accounts has occurred but may not have
5 resulted in an actual payment due to the
6 lack of address information or identify of
7 the artist or copyright owner to pay. So we
8 distributed the funds to the sound recording
9 level. It just hasn't necessarily resulted
10 in a check to a recipient.

11 And those percentages that I was
12 describing to you, the 65 percent pay-
13 through or the 85 percent pay-through is
14 what we have been able to successfully
15 allocate and distribute in the form of a
16 payment. The remaining percentage is what
17 is in our unidentified escrowed accounts
18 waiting identification.

19 Q Okay. I'll leave that. Not
20 quite sure, but I'll have to -- I'll go
21 back.

22 A And if you're asking, you know,

1 what is collected versus what is allocated,
2 we're -- we've allocated through 2005 for
3 two of -- the PES and the SDARS. But due to
4 this lack of reporting on the webcasters, we
5 have only been able to distribute through Q1
6 of 2004.

7 Q And then, how does the amount of
8 money sitting in what I think -- I believe
9 you testified was called a suspense account,
10 how does that amount of money relate to what
11 is allocated?

12 A That is what has been allocated
13 but not paid out, so --

14 Q Okay. And about what percentage
15 of the total royalties collected for
16 webcasters is sitting in an expense account
17 -- a suspense account, rather?

18 A It's that similar percentage --

19 Q Okay.

20 A -- and spread across all our
21 royalty streams. Thirty-five percent of the
22 artist entitlement and 15 percent of the

1 copyright owners has yet to be distributed
2 in the form of a payment to those entitled
3 parties.

4 Q Okay. If you could -- I guess
5 you are on page 16 of your testimony still,
6 correct? And you said there that you
7 projected that SoundExchange's
8 administrative costs, exclusive of expenses
9 incurred in participating in proceedings
10 such as this one, at the time you projected
11 a figure of 12-1/2 percent as of October
12 2005.

13 A Yes.

14 Q Now, I thought I heard you say a
15 couple of hours ago that the actual number
16 was 7-1/2 percent?

17 A A little bit more than 7-1/2
18 percent for 2005. That's correct.

19 Q And did you ever provide -- did
20 you provide documents to your counsel that
21 showed the basis for this number? Because I
22 don't see -- obviously, it's a recent

1 number. It didn't appear in your written
2 direct statement.

3 A We will provide documents -- I
4 mean, I have documents, obviously, that
5 calculate the administrative rate and the
6 factors that go into it, and that I provided
7 to counsel -- I mean, I'm assuming I
8 provided that report to counsel, but -- I
9 think that I did.

10 Q Okay.

11 A But not the 7-1/2 percent,
12 because we just closed our books for '05.
13 So the 12-1/2 was based on a budget
14 projection, and in actuality the admin rate
15 was a little north of 7-1/2 percent after we
16 closed our books for 2005.

17 Q And the books closed on what
18 date?

19 A Recently. We just had our
20 accountants take a look at them and certify
21 them, and we're about to be audited for that
22 2005 period.

1 Q Now, in the 7-1/2 percent rate,
2 were legal fees -- I think you said legal
3 fees, for example, for this proceeding are
4 included in -- for the current proceedings,
5 I'm not talking about the past CARP
6 proceedings, are --

7 A Well, any legal fees, whether it
8 was this proceeding or some other licensing
9 activity, your general legal is included in
10 the 7-1/2 percent, except the CARP
11 repayment. The CARP repayment that we're
12 making is based on the differential between
13 our actual admin rate last year of a little
14 more than 7-1/2 percent and a 20 percent
15 cap.

16 Q So your 2006 projections, then,
17 do they take account of -- for example, if
18 current legal proceedings are now going to
19 be included in the administrative rate on a
20 going-forward basis, did the 2006 estimate
21 account for, for example, the legal fees
22 getting incurred right now in this room, in

1 this proceeding?

2 A We estimated just some amount for
3 the purposes of coming up with the admin
4 rate. And remember that the cost of the
5 proceeding is for a five-year license
6 period. So under accounting procedures you
7 would capitalize those costs over the term
8 of the license.

9 So with respect to the expression
10 of the admin rate, we're taking one-fifth of
11 our estimated cost for each year of the
12 license.

13 Q But you are, in fact, including
14 the one-fifth in there.

15 A It is in there, yes.

16 Q Okay. I'd like to hand you a
17 document in a minute here, which is going to
18 be marked as Services Exhibit 134.

19 (Whereupon, the above-
20 referred to document was
21 marked as Services
22 Exhibit No. 134 for

1 identification.)

2 Actually, before I do this, I'll
3 just direct you to your witness statement
4 again where you say on page 16, for
5 comparison purposes when you're, again,
6 discussing your admin rate, that you believe
7 the administrative costs for ASCAP and BMI
8 are typically around 16 percent of total
9 revenue.

10 A Yes.

11 Q I just wanted to -- we're going
12 to explore that statement a little bit. And
13 I'm going to hand you a document that we
14 received in discovery from your counsel.
15 It's Bates numbered SX74113 to 114. It's a
16 -- actually, why don't you describe this
17 press release for us, Ms. Kessler. Are you
18 familiar with this? Have you seen this
19 press release?

20 A No. I'll have to -- may I first
21 read it?

22 Q Certainly.

1 (Pause.)

2 Have you finished reading --

3 A I have.

4 Q -- the press release? I will
5 represent to you that this was produced by
6 your counsel as a document that supported
7 the statement that you made in your witness
8 statement concerning the administrative
9 expenses. Have you ever seen this document
10 before today?

11 A I believe I have read this
12 before.

13 Q You have read this document.
14 Okay. And could you describe the document?

15 A It's a description of BMI and its
16 reporting for the '04/'05 fiscal period.
17 It's collections, it's costs, and it's
18 describing the year that it had.

19 Q And just for the record, the
20 document is dated September 12, 2005?

21 A Yes, it is.

22 Q It's covering the fiscal year

1 spanning the 2004/2005 timeframe?

2 A I'm not sure what BMI's fiscal
3 year is.

4 Q Well, at least the document says
5 that on the -- in the first sentence it's
6 covering whatever they call "fiscal
7 '04/'05." It's reporting a rate over a
8 period of -- let's back up. The document is
9 reporting revenues over a period of time
10 that they are describing as fiscal
11 2004/2005.

12 A Yes. But, again, I don't know if
13 --

14 Q Sure.

15 A -- fiscal year 2005 ends in
16 January of '05 or September of '05.

17 Q Well, that's fine.

18 A I don't know what 12-month period
19 they are describing here.

20 Q But in any event, the revenues
21 that BMI posted for the period of time were
22 728 million?

1 A Yes, according to this press
2 release.

3 Q And they also state that BMI's
4 royalty distribution out of those -- that
5 revenue pool to BMI affiliated songwriters,
6 composers, and publishers was over 623
7 million for the time period?

8 A That's what this document says.

9 Q And it states that BMI's
10 operational expenses as a percentage of
11 revenues were 14.2 percent?

12 A That's correct. That's what this
13 says.

14 Q So in other words, the amount
15 that BMI did not distribute, I take it,
16 would be the difference between the revenues
17 that they received and the money that was
18 actually paid out, right?

19 A You'll have to ask them. I don't
20 know what their undistributed royalties
21 consist of.

22 Q Okay. Well, at a minimum, the

1 press release says that their operating
2 costs were 14.2 percent of their revenues,
3 correct?

4 A That's what this press release
5 says, yes.

6 Q Okay. And if you just simply
7 perform the calculation of taking the money
8 that they -- that BMI reports in here as
9 having been collected, and you divide into
10 that the money that they actually paid out
11 -- and, actually, I'd like you to do that
12 for us. I brought a calculator.

13 A I'll accept your characterization
14 that the difference between the 700 million
15 and the 623 million is what they incurred in
16 their admin cost. Is that what -- how you
17 --

18 Q Okay. Which is -- I was just
19 trying -- right, and that number comes out
20 to be approximately what they report as 14
21 --

22 A Fourteen percent. Okay. I

1 accept that.

2 Q Okay. Fair enough. Now, BMI,
3 just like SoundExchange, that performance
4 rights organization engages in license
5 negotiations on behalf of its affiliated
6 songwriters and publishers, and what-not?

7 A BMI, on behalf of its members,
8 and their members only, negotiates the
9 rates. That's right.

10 Q And BMI also participates in
11 rate-setting proceedings -- well, let me
12 back up. BMI operates pursuant to a consent
13 decree, correct?

14 A I understand that BMI operates
15 under a consent decree, yes.

16 Q And there is a rate court that
17 has been established to litigate fee
18 disputes when BMI is not able to reach
19 agreement with potential licensees over
20 funds?

21 A When BMI is unsuccessful in its
22 negotiations, which I don't even know the

1 last time that happened, then they would be
2 subject to a rate-setting procedure.

3 Q You're not aware of the BMI/Music
4 Choice, for example, rate court proceedings?

5 A I don't -- no, I'm not.

6 Q In any event, BMI, when they
7 don't reach agreement, they do participate
8 in these rate court proceedings. And the
9 purpose of those is to set a rate.

10 A My understanding is that, absent
11 a negotiated deal, they are subject to a
12 rate-setting procedure, yes.

13 Q And BMI also, on behalf of its
14 members, or perhaps with the participation
15 of its members, also engages in direct
16 enforcement actions or copyright
17 infringement actions on behalf of its
18 members, correct?

19 A I would assume that BMI enforces
20 its license and engages in compliance
21 activity, although I certainly can't speak
22 to what, if anything, they do. I would

1 assume that BMI does those things.

2 Q You know, if BMI engages in --
3 and all of those activities are activities
4 that SoundExchange engages in, correct? Or
5 let's back up.

6 A Go ahead and ask the question.

7 Q SoundExchange, like BMI, engages
8 in license negotiations.

9 A No, no. SoundExchange is nothing
10 like BMI. We are not a membership
11 organization. We have to pay -- we pay
12 copyright owners and artists, whether they
13 are members or not of SoundExchange. So
14 we're not a membership organization. We're
15 not remotely like BMI in that respect.

16 You know, BMI, in my view, is
17 engaged in more of a direct licensing type
18 of a situation, where SoundExchange is
19 operating under a statutory license. I
20 think those things are completely different,
21 and so I wouldn't agree with you that
22 SoundExchange and BMI operate the same way.

1 Q Well, no, that's actually not
2 what my question was. I simply asked
3 whether SoundExchange, like BMI, engaged in
4 the activity of license negotiations. BMI,
5 in fact, negotiates licenses and
6 SoundExchange negotiates licenses.

7 A If you oversimplify it, that's
8 the case. But, again, the license that
9 we're involved with, which is a statutory
10 license and the license that BMI is
11 negotiating, which is akin to a direct
12 license, are just different. But licensing
13 occurs, if that's what you're asking.

14 Q Yes, that is, and --

15 A Licensing occurs.

16 Q And so BMI -- all I'm trying to
17 get at is BMI incurs costs in negotiating
18 licenses.

19 A I assume that they do, yes.

20 Q Okay. Just like SoundExchange
21 incurs costs in negotiating licenses.

22 A Oh, we incur costs with respect

1 to licensing, yes.

2 Q Now, I believe you testified that
3 for 2005, although your stated
4 administrative rate was a little over 7-1/2
5 percent, the actual deduction was 20
6 percent, because there's still this
7 outstanding CARP repayment figure that has
8 not been repaid. And so the monies that are
9 actually being deducted for administrative
10 expenses by SoundExchange total 20 percent
11 of collections for 2005?

12 A That's correct. But remember
13 that the 7-1/2 percent is the cost of
14 actually operating SoundExchange. And that
15 pursuant to a promissory note for the
16 repayment of some startup costs with respect
17 to the rate-setting for Webcaster I are
18 being repaid over time through these
19 royalties.

20 Q Right. But for the year 2005,
21 the activities that we're talking about that
22 are included in the CARP repayment rate are

1 the same types of activities -- namely,
2 participating in a rate-setting proceeding
3 -- that BMI engages in as part of its
4 operations.

5 A Well, the way in which the rate
6 was established for Webcasting I is not, as
7 I understand it, the way BMI's rates are
8 set. But if what you're saying is that the
9 differential between actual operating costs
10 and the 20 percent is what we are required
11 to pay down the promissory note for the
12 startup arbitration cost, that's correct.
13 But that was from a prior period. That's
14 not the current -- a current cost to
15 SoundExchange.

16 Q But it's --

17 A This is repayment of startup
18 costs.

19 Q Just looking at the year 2005,
20 though, in fact, SoundExchange took a 20
21 percent deduction.

22 A SoundExchange took a little more

1 than 7-1/2 percent to cover operations, and
2 the differential between the 20 percent and
3 the 7-1/2 percent was used to repay the
4 debt. That's the way I characterize it.

5 Q So the total deduction from both
6 of those sources was 20 percent.

7 A Twenty percent.

8 Q For 2005.

9 A For 2005.

10 Q And according to this press
11 release, BMI's deduction was 14.2 percent,
12 correct?

13 A According to this press release,
14 yes, their admin rate is 14.2 percent.

15 Q So actually, for 2005, BMI
16 deducted a lesser percentage from its
17 revenues received as SoundExchange -- than
18 SoundExchange did, correct?

19 A See, I think that you're
20 incorrect in how you're characterizing this
21 admin rate. When we talk about the 20
22 percent, it's on certain royalty streams.

1 Other royalty streams are -- the 7-1/2
2 percent are applied. So blended across our
3 various royalties, the admin rate is not 20
4 percent.

5 I believe that this number that
6 BMI is reporting is, if you broke it down
7 into various licenses that they administer
8 and enforce, that sort of thing, some would
9 be in excess of the 14 percent, and some
10 would be below, you know, would be around
11 this 14.2 percent.

12 But this number is not well
13 described to the extent of, what is it
14 really costing them to enforce in their
15 clubs, and this number may be artificially
16 reduced from -- you know, from royalties
17 that we're receiving. And so that's why I
18 want to be very clear in how we describe
19 SoundExchange's admin rate. That on certain
20 royalty streams, the way you're describing
21 it the admin rate is 20 percent simply
22 because of the repayment of this debt.

1 But the actual cost of operation,
2 which is what I think this percentage
3 reflects, or is the comparable to
4 SoundExchange's number, is 7-1/2 percent.

5 Q Let's talk about the webcasting
6 stream, though. I take it that the
7 webcasting CARP royalties -- or CARP
8 expenses, rather, have not yet been repaid.

9 A From the CARP I, Webcast I --

10 Q Yes.

11 A -- CARP proceeding, we owe a
12 balance of \$2-1/2 million for those costs.

13 Q So the deduction in
14 administrative expenses to the webcasting --
15 in the webcasting stream of royalties was,
16 in fact, 20 percent.

17 A That was 20 percent, but our
18 blended admin rate is not 20 percent, which
19 is what -- I think this admin rate that
20 they're reporting is a blended admin rate
21 across licenses. Do you understand what I'm
22 trying -- you know, I'm trying to, you know,

1 understand what this number is across all
2 their royalties, which is what I think they
3 are reporting and what SoundExchange reports
4 across all of its royalties.

5 Q When you refer to -- when you say
6 "blended admin rate," though, the 7-1/2
7 percent number, as I understood your
8 testimony, was not a blended rate. That was
9 your actual operating cost? It did not
10 include the CARP repayment?

11 A That's right.

12 Q So what would --

13 A That's right.

14 Q Do you know what the blended rate
15 is?

16 A I actually don't have that report
17 in front of me, so, no, but it's not 20
18 percent.

19 Q But the webcaster deduction was,
20 in fact, 20 percent.

21 A The webcaster deduction for that
22 license is 20 percent, and the difference

1 between actual cost and the 20 percent is
2 used to repay the bank.

3 CHIEF JUDGE SLEDGE: Ms. Ablin,
4 could I clarify confusion that I have from
5 that last answer? Do I understand correctly
6 that they have been no distributions on
7 webcasting since first quarter 2004?

8 THE WITNESS: Yes.

9 CHIEF JUDGE SLEDGE: So how can
10 there be a deduction of 20 percent in
11 distributions in 2005 if you've made no
12 distributions?

13 THE WITNESS: Well, that's an
14 excellent question. So we don't take our
15 admin rate at the moment; the money goes
16 through this entire cycle. We're permitted
17 to deduct the cost of operating
18 SoundExchange from the royalties received.

19 So at the moment of distribution,
20 we know that costs for any particular period
21 -- in this example 7-1/2 percent -- that's
22 what we -- that's when we book the admin

1 rate for accounting purposes. But in order
2 to operate SoundExchange, we need the admin
3 rate, you know, on a cash basis to pay for
4 the costs of operating SoundExchange.

5 So, and I know this is a little
6 complicated, it confuses our auditors all
7 the time, but the booking of the admin rate
8 and the taking of the admin rate aren't the
9 same thing.

10 CHIEF JUDGE SLEDGE: Thank you.

11 THE WITNESS: You're welcome.

12 MS. ABLIN: Your Honor, I note
13 the time, and I'm about to move into another
14 area. Perhaps it might be --

15 CHIEF JUDGE SLEDGE: That's a
16 good suggestion. Thank you. We'll recess
17 -- Mr. Handzo, did you have --

18 MR. HANDZO: No, I'm sorry. I
19 just wanted to alert the Board that what
20 we're going to do is pick up with Mr.
21 Kenswill tomorrow, because of scheduling
22 issues. So we'll bring Ms. Kessler back

1 after that.

2 CHIEF JUDGE SLEDGE: That's
3 understood.

4 MS. ABLIN: And if I might
5 clarify, because it obviously involves me,
6 will Ms. Kessler -- is she scheduled to
7 appear at the end of Mr. Kenswill's
8 testimony or --

9 CHIEF JUDGE SLEDGE: That's what
10 he went over this morning.

11 MS. ABLIN: I'm sorry. I must
12 not have been here.

13 MR. HANDZO: Yes, she is. I
14 mean, I think our assumptions have been that
15 Mr. Kenswill is likely to go all day, but --

16 CHIEF JUDGE SLEDGE: We don't
17 need this on the record. You all can have
18 that conversation. All right. We'll recess
19 until 9:30 in the morning.

20 (Whereupon, at 5:11 p.m., the
21 proceedings were adjourned, to reconvene at
22 9:30 a.m., the following day.)