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Copyright Royalty Board
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BEFORE THE COPYRIGHT ROYALTY JUDGES

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Washington, D.C.

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| In the Matter of: | ) | Docket No. |
| | ) | 2006-3-CRB DPRA |
| MECHANICAL AND DIGITAL | ) | Volume 25 |
| PHONORECORD DELIVERY RATE | ) | A.M. and P.M. |
| ADJUSTMENT PROCEEDING. | ) | Pgs 6971-7254 |

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Washington, D.C.

Monday, May 19, 2008

The following pages constitute the proceedings held in the above-captioned matter, held at the Library of Congress, Madison Building, 101 Independence Avenue, Southeast, Washington, D.C., before Deborah Larson Hommer, of Capital Reporting Company, a Notary Public in and for the District of Columbia, beginning at 9:31 a.m. Present on behalf of the respective parties:

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1 A P P E A R A N C E S

2 Copyright Royalty Tribunal:

3 CHIEF JUDGE JAMES SLEDGE

4 JUDGE WILLIAM ROBERTS

5 JUDGE STANLEY C. WISNIEWSKI

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1 C O N T E N T S

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3 WITNESS: KEVIN MURPHY PAGE

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18 E X H I B I T S

19 EXHIBIT NO. RECEIVED

20 Copyright Owners' 394 7031

21 RIAA 94 7100

22 Copyright Owners' 406 7206

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

2 CHIEF JUDGE SLEDGE: Good morning.

3 We will come to order.

4 Mr. Handzo?

5 MR. HANDZO: Thank you, Your Honor.

6 Before we begin with Professor Murphy, there

7 are a couple of housekeeping matters. The

8 first was with respect to the time. We were

9 advised at the end of Thursday that we had

10 seven-and-three-quarter hours left. That was

11 a little at odds with what we thought, and so

12 I had a question to raise there.

13 And the question was, there was an

14 agreement that Mr. Kirk's direct, up to an

15 hour, would be allocated to the copyright

16 owners, not to our side, and I just wondered

17 whether the court's calculations took that

18 into account.

19 JUDGE ROBERTS: No. So I didn't, I

20 guess, fully appreciate exactly what your

21 understanding with Mr. Kirk was. I thought

22 you were just talking about the slotting


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1 rather than the actual time. You had an
2 agreement to cede an hour's worth of time --
3 that would knock you down from 22 hours, 15
4 minutes to 21 hours, 15 minutes, and raise the
5 copyright owners to 21 hours.
6 MR. HANDZO: Yes. And just to be
7 precise, I think the agreement was that it was
8 Mr. Kirk's direct up to an hour. I wasn't
9 here. I don't know that it actually took an
10 hour. Perhaps others who were here would have
11 a recollection.
12 JUDGE ROBERTS: Well, I would have
13 to go back to look to verify what the time
14 was, again, because I thought that you were
15 just talking about the slotting rather than
16 actual ceding of time. So I will do that.
17 MR. HANDZO: Thank you.
18 JUDGE ROBERTS: Just so you know,
19 that's back at my office. It won't be
20 probably until tomorrow. Is that going to
21 affect --
22 MR. HANDZO: I don't think that's


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1 going to affect anything.
2 MR. COHEN: Your Honor, I do have
3 courtesy copies for the court of the
4 opposition to the motion to exclude portions
5 of Professor Landes' testimony. May I hand it
6 up?
7 MR. HANDZO: Thank you.
8 Whereupon,
9 KEVIN MURPHY,
10 called for examination by counsel, and having
11 been previously sworn by the Chief Judge, was
12 examined and testified as follows:
13 CHIEF JUDGE SLEDGE: Welcome back.
14 THE WITNESS: Thank you.
15 CROSS-EXAMINATION (RESUMED)
16 BY MR. HANDZO:
17 Q. Good morning, Professor Murphy.
18 A. Good morning.
19 Q. Professor Murphy, when we broke
20 Thursday I think we were discussing the
21 incentives for songwriters to create songs.
22 And continuing along that subject, I wanted to


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1 ask you some questions about the extent to
2 which the mechanical royalty itself is the
3 incentive here. You would agree, wouldn't
4 you, that with respect to the incentive of
5 obtaining a mechanical for a songwriter, it's
6 not the rate per copy that's an incentive;
7 it's also the number of copies or the number
8 of units that a songwriter expects to sell
9 that's part of the incentive, right?
10 A. Yes. I think it would be the
11 income they could derive that would be the
12 incentive.
13 Q. Which is a function of both the
14 units sold and the price per copy, right?
15 A. Yes, it is.
16 Q. Now, whether or how many copies a
17 song sells is partly a function of which
18 artist performs the song, isn't it?
19 A. That in general would be the case,
20 yes.
21 Q. And how many copies a song sells is
22 partly a function of who produces the song and


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1 how it's produced, right?
2 A. I would imagine, yes.
3 Q. How many copies a song sells is
4 also, at least in part, a function of the
5 marketing resources that are put into selling
6 that song?
7 A. That would be true as well.
8 Q. And sometimes the number of copies
9 a song sells are just the result of things
10 that nobody could possibly predict, right?
11 A. Yes. I mean, usually we don't know
12 everything that goes on. It doesn't mean that
13 it's not a function of something that
14 fundamentally we couldn't figure out, but
15 usually we don't have all the information, so
16 yes, there would be things that, in any given
17 circumstance, we wouldn't understand.
18 Q. So when a songwriter writes a song,
19 it's to some degree unpredictable how many
20 copies that song is going to sell?
21 A. I would say that's certainly true.
22 It doesn't mean that there aren't things they


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1 can do to influence the number of copies that
2 will be sold, so there is some uncertainty,
3 but there's also some deterministic components
4 that the more effort and work you put into it,
5 presumably you do so with regard to the idea
6 that you will probably sell more.
7 Q. Okay. But at the end of the day,
8 it's just not knowable how many copies a song
9 is going to sell, is it?
10 A. You couldn't predict exactly how
11 many, no.
12 Q. Now, to the extent that mechanicals
13 form a part of the incentive for a songwriter
14 to write a song, that incentive depends on
15 whether the record company uses the song to
16 make a sound recording in the first place,
17 doesn't it?
18 A. Well, it doesn't necessarily depend
19 on whether a particular record company does
20 that. Somebody is going to have to make a
21 recording of it and sell copies of that
22 recording in order for them to use


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1 mechanicals. But it wouldn't be, quote, the
2 record company; it would have to be somebody.
3 Q. Right. Somebody has to make that
4 song into a sound recording in order to earn
5 mechanicals, right?
6 A. That would be correct by
7 definition.
8 Q. And you can't earn mechanicals if
9 nobody records the song, right?
10 A. That, again, would be true by
11 definition.
12 Q. So the more likely it is that a
13 record company is going to use the song to
14 make a sound recording, the greater the
15 incentive to write the song, right?
16 A. It depends on what changed to make
17 it more likely. If you lowered the rate in
18 order to make it more likely, that may or may
19 not be true.
20 Q. Let me ask it this way. All other
21 things equal, the more likely it is that a
22 record company will use a song to make a sound

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1 recording, the greater the incentive to write
2 the song?
3 A. In general.
4 Q. And all else equal, if the per unit
5 cost of the mechanical goes up, the cost to
6 the record company of making a sound recording
7 goes up, doesn't it?
8 A. The cost of selling copies of it
9 would rise in that case. The cost of making
10 the recording itself presumably wouldn't --
11 Q. But overall --
12 A. Those would not be in the first
13 copy cost, but they would be in the other
14 costs.
15 Q. But overall, the cost to the record
16 company goes up if the mechanical rate goes
17 up, doesn't it?
18 A. Subject to one question, which is
19 obviously as you raise the mechanical -- as
20 you raise the mechanical rate, there is going
21 to be more incentive to provide better songs.
22 So if they provide better songs and more songs


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1 to choose from, the cost to the record company
2 wouldn't necessarily go up. Right?
3 In general, in a marketplace, and
4 this has been well known in economics for a
5 long time, that if you set the price -- the
6 thing about a competitive market, in general
7 the competitive price actually maximizes
8 output. If you set the price too high, then
9 there will be too few buyers and the price
10 will be high and you will sell fewer units.
11 If you set the price too low, there will be
12 too little supply and you will also get less
13 sales.
14 The same is true here. If you were
15 to set the mechanical rate too low, that would
16 reduce the number of songs being supplied;
17 you're reducing the choice of songs, reducing
18 the quality of songs that would be supplied --
19 that actually could raise the record company's
20 costs per unit of, really, true quality of
21 songs and actually reduce output.
22 Q. Well, let me leave the quality of


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1 the song out of this for the moment -- and I
2 will come back to that. But leaving quality
3 of the song aside, do you agree that raising
4 the mechanical rate raises the record
5 company's costs?
6 A. Well, also if it reduced the number
7 of songs that would get written, that would
8 also happen. Right? Because even if you have
9 a fixed distribution of qualities, if you
10 produce fewer songs there are fewer good
11 songs. And in order to get the same number of
12 songs, you're going to have to go further down
13 in a given distribution.
14 So you have the same problem there,
15 which is the way you -- you don't help a
16 downstream market by suppressing the price of
17 the input below what a market would determine
18 because when you suppress the price, you
19 actually reduce the incentive to supply that
20 input which, at an industry level, actually
21 makes it more costly, not less.
22 This is known all the time. This


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1 is like what happens if you suppress the
2 wholesale price of gasoline; you get less
3 gasoline supplied. Even if you don't control
4 the retail price with less supply, that
5 actually worsens things at the retail level.
6 The same thing happens here if you were to put
7 the royalty price too low.
8 So you have to be careful about
9 thinking that that's always good for the
10 downstream business.
11 Q. What I am talking about now,
12 Professor Murphy, is actually raising the
13 mechanical rate. Right? So if you raise the
14 mechanical rate, the cost to the record
15 company goes up, doesn't it?
16 A. Well, not if it's starting from a
17 place where it's too low, because if it's too
18 low and you raise the mechanical rate, you
19 will do more to increase the supply, which
20 will increase the number of songs the record
21 company has to choose from. As I mentioned
22 before -- you wanted me to hold constant, but


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1 it would also be true in reality that would
2 also make for a better distribution of songs,
3 both of which are going to contribute to an
4 expansion of a downstream business.
5 So it's just faulty economics to
6 say that raising the price is going to reduce
7 or -- sorry -- raise the true cost to the
8 record companies. It actually could go the
9 other way.
10 And the point is that's why you
11 want to set the rate at the right level. If
12 you set it too high, then I would agree. If
13 it's too high, that's going to make the
14 product cost too much on the demand side, so
15 the demanders -- in this case, the record
16 companies -- would demand less. If you set
17 the price too low, then the suppliers won't
18 supply enough and you squeeze the market from
19 the other side.
20 You know -- if I had a blackboard,
21 I would show you, but there is a demand curve
22 and a supply curve and a competitive output


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1 maximizes -- competitive price maximizes
2 output. If you go above there, you move up
3 the demand curve and it pushes quantity back.
4 If you move down there from price, you move
5 back down the supply curve and reduce
6 quantity. Competitive output is the output
7 that really provides the most resources to the
8 downstream business.
9 Q. Well, the output that I am talking
10 here about at the moment is a sound recording.
11 Okay? So if you increase the cost of a sound
12 recording to the record company, doesn't that
13 decrease the record company's incentive to
14 make a sound recording?
15 A. No. Let's say you had a zero
16 royalty for sound recordings. Okay? So
17 nobody produced any sound recordings. It's
18 true they would be free if they existed, but
19 there wouldn't be anything to record. That's
20 not going to make the record companies produce
21 more sound recordings.
22 That's the whole point of getting


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1 the royalty right, is that you balance the two
2 sides. If you go too high, you get too little
3 usage. If you go too low, you get too little
4 production.
5 The ideal point is the point you
6 find in the middle that provides sufficient
7 incentives to create and sufficient incentives
8 to use. And I think that's what this whole
9 idea is about.
10 And my point is if you're too low,
11 you're actually not helping the downstream
12 business by keeping the price down. You would
13 actually be helping downstream business and
14 the ultimate consumers by allowing the price
15 to rise.
16 Q. And are you saying that if the
17 mechanical rate is too low, you will simply
18 run out of songs and we won't have enough
19 songs to record?
20 A. It's not a matter of running out.
21 That would be true in my hypothetical, putting
22 it down to zero. That's just to sort of


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1 illustrate the basic process. It still
2 involved -- if the royalty is down, that's
3 going to suppress the supply of, in this case,
4 the creative input of songs, which is an input
5 to the downstream industry.
6 And I think that that's -- you
7 know, when we think about what this proceeding
8 is about, it's about setting the correct rate
9 that allows for sufficient supply without
10 pricing out demand. So the question of
11 whether you should raise or lower the rate in
12 order to increase output in a downstream
13 market is a question of whether you're
14 starting from where it's too low, in which
15 case you should raise the rate, or if you're
16 starting from where it's too high, in which
17 case you should lower the rate.
18 There is an appropriate rate, not
19 lower rates are always better and not higher
20 rates are always better.
21 Q. Would you agree with me that, all
22 else equal, if the record companies have to


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1 charge a higher price for a sound recording,
2 the demand for sound recordings is going to
3 drop?
4 A. Well, in layman's terms, yes. As
5 an economist, what you would say is the
6 quantity demanded would fall. You would move
7 along the demand curve as opposed to shift the
8 demand curve, so...
9 Q. Okay. Fair enough. So if the
10 price of sound recordings increases, the
11 consumers' demand for a certain quantity is
12 going to drop?
13 A. That's assuming that the record
14 companies are passing that along to consumers.
15 So under your presumption, you're assuming
16 that the record companies will pass the higher
17 royalty on to consumers?
18 Q. Yes.
19 A. Okay. If they did pass some of it
20 on, then subject, again, to the quality issue
21 and the other things -- because, again, if the
22 quality was up even though the price was


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1 higher, you could sell more recordings.
2 Correct?
3 So it's the same provision we just
4 talked about. But if, for some
5 hypothetical -- you said, well, for some
6 reason, I'm not going to allow quality to
7 adjust as prices rise -- then consumers would
8 demand less. That would presume, in some
9 sense, that we're above, again, the optimal
10 royalty. If we're below the optimal royalty,
11 it all works the same way again. The increase
12 in quantity supplied and the increase in the
13 quality is sufficient to more than compensate
14 for the rise in royalties.
15 Q. But, again, holding quality steady,
16 if I increase the price to consumers, the
17 number of units the consumers buy is going to
18 drop, right?
19 A. Holding not just the quality
20 distribution but also the number of songs
21 created. If you said, I have the same mix of
22 songs to choose from and I raise the royalty,


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1 consumers -- and that royalty is passed on,
2 which has not been, as I understand it, what
3 has been talked about by the record industry
4 in this case -- but if they are passed on to
5 consumers, then they would buy less.
6 Q. Okay. And if an increase in the
7 mechanical rate is not passed on to consumers
8 by the record companies and the record
9 companies absorb that cost, the record
10 companies' incentive to create sound
11 recordings is diminished, isn't it?
12 A. But, again, if you were holding
13 quality constant, as in your prior example,
14 consumers would buy the same number, right,
15 because they're paying the same price and they
16 have the same quality of recordings. They
17 would buy the same number.
18 Q. But the record company's incentive
19 to invest has diminished if the record company
20 is absorbing that cost, right?
21 A. Well, that's the reason why the
22 record companies, in the end, would pass some


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1 of it on, because we would be out of
2 equilibrium by definition. Right? Consumers
3 would want to buy just as many, according to
4 what you're saying; record companies would
5 want to sell less; that would create an
6 imbalance in the end-user market which would
7 require some pass-through.
8 So, I mean, I think what we're
9 saying here is we're going to end up getting
10 some pass-through to consumers in any case.
11 Q. All right. But we've already
12 talked about what happens if there's a
13 pass-through. I am giving you a hypothetical
14 which is assuming there is no pass-through.
15 That's going to decrease the record companies'
16 incentive to create sound recordings, isn't
17 it?
18 A. Right. But since consumers
19 wouldn't buy less, we can't -- that can't
20 possibly be the end state, right? That's all
21 I'm pointing out. So the record companies
22 might want to supply less, consumers demand


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1 the same amount. We're out of equilibrium in
2 the final product market at that point.
3 Q. And in that circumstance, you
4 believe the record companies would pass some
5 of the increase on?
6 A. Well, it's not up to them. I mean,
7 the marketplace would kind of push the
8 equilibrium in that direction.
9 Q. Now, if I understand you correctly,
10 if the mechanical rate is increased, some of
11 that is passed on to consumers and consumers'
12 demand for number of units falls. Is it your
13 testimony that there would be offsetting
14 effect by increasing the quality of songs?
15 A. The point is it depends on where --
16 if you're going to pay people more to supply
17 them, okay, if people are getting paid more
18 than they were before to produce a song, then
19 what we would get would be more incentive to
20 produce songs. You would get more songs.
21 You would also have an incentive to
22 improve your quality of your songs. So the


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1 distribution of quality of songs produced
2 would shift up and, with more songs produced,
3 you would have more to choose from. So even
4 for a fixed distribution, you would be able to
5 pick a better distribution of songs.
6 So the average quality of the song
7 recorded would rise and, of course, from the
8 point of view of consumer demand, it's the
9 quality of the songs recorded, not the quality
10 of songs produced that really matters.
11 Q. So is it your testimony that
12 songwriters don't currently produce their best
13 songs?
14 A. I think what they do is try to
15 produce a total output of songs that is as
16 good as possible, which means they don't spend
17 forever working on one song. They recognize
18 that, you know, they can put their inputs into
19 producing -- working more on a given song or
20 move on to a new song.
21 It's just like me when I do my
22 research. I don't simply focus and try to do

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1 everything on one paper. I write a number of
2 papers. And I put what I think is effort into
3 a given paper to the point where the return to
4 additional effort in that paper gets to the
5 point where it's just exactly equal to the
6 return I can get from writing another paper.
7 And then I say, well, I could work
8 more on this one, but I can get more out of
9 putting efforts on the next paper, and I move
10 on to the next paper. Otherwise, I would
11 presumably keep working on one paper basically
12 forever.
13 Q. Professor Murphy, no songwriter has
14 ever said to you that they don't write very
15 good songs because they're not trying hard
16 enough at this point, have they?
17 A. Nobody is saying that they don't
18 try hard enough. Everybody -- you know, there
19 is an optimal amount of effort to put into
20 anything. That is, you decide how much effort
21 I am going to put in, and you get to the point
22 where you say, look, everybody is trying to do


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1 a good job.

2 I don't deliberately write a paper

3 that's not good. But as -- the more and more

4 time I put in, they run into what we call, in

5 economics, diminishing returns. I can add

6 quality by adding additional time, but it

7 falls to the point where my time is better

8 used producing the next song.

9 And so what they try to maximize is

10 the total value of all the songs they produce,

11 not each one individually.

12 Q. And right now the songwriters --

13 let me start again.

14 The more copies of a song or a

15 sound recording a songwriter sells, the more

16 money they make, right?

17 A. Under the royalty structure, yes.

18 Q. Okay. So a songwriter already has

19 an incentive to write the best song he or she

20 can, right, because the better it is, the more

21 copies it would sell?

22 A. Holding constant the inputs they


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1 put in, definitely they want to produce the
2 best song they can. That is, for a given
3 amount of time, they want to write as good a
4 song as they can. That doesn't mean that
5 they're going to go to the point where
6 additional time has zero value producing a
7 song. That wouldn't be what we want them to
8 do. That's not what they would want to do.
9 Nobody spends, you know, as much
10 time as they possibly could preparing for
11 anything. You know, presumably people engage
12 in multiple activities. They write multiple
13 songs. Because they work on a song to the
14 point where they say, you know, I have gotten
15 it to the point where the costs to me, in
16 terms of my opportunity cost of writing
17 another song or doing another activity, exceed
18 what I can get with further work on this song.
19 And that determines the optimal amount of
20 effort put into a song.
21 And there is nothing wrong with
22 that. That's how people do all activities in


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1 life.

2 Q. Professor Murphy, if, in fact, an

3 increase in the mechanical rate would produce

4 better quality songs which would sell more

5 sound recordings, wouldn't the record

6 companies, as rational economic actors,

7 already have offered more to songwriters?

8 A. No, that's not true. That's just

9 why anybody, acting collectively as a

10 purchaser, has an incentive to deviate from

11 the competitive price. That's the whole

12 theory of monopoly. That's the whole theory

13 of monopsony. All of those cases are all

14 about once we act collectively, we're no

15 longer interested in maximizing the total

16 value. We're interested in squeezing the

17 supplier.

18 So, collectively, they would have

19 an interest in squeezing the supplier. Even

20 if it meant somewhat a cost to them on that

21 margin, their savings from paying a lower

22 royalty would more than offset it.


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1 It's just like a monopolist. When
2 a monopolist raises the price of the product,
3 it's not that they don't sell less than they
4 would have if they hadn't raised the price --
5 in fact, that's the hallmark of monopoly. You
6 raise the price, you sell less. But they're
7 willing to tolerate the reduction in sales
8 because it allows them to get more out of the
9 consumer, squeeze them a little more.
10 The same is true if you're in the
11 record industry and you're bargaining with
12 songwriters. You're going to go below the
13 competitive price not because it is going to
14 expand output at the downstream industry; in
15 fact, it's going to restrict output in the
16 downstream industry. But you gain more by
17 pushing down the royalty and squeezing the
18 supplier.
19 It's the basic theory of monopoly.
20 Monopoly does not maximize output. As a
21 group, they are going to act like a monopoly
22 and want to restrict output and push the price


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1 to the suppliers down. So it's patently not
2 true.
3 Q. Professor Murphy, you understand,
4 don't you, that record companies negotiate
5 individually with singer/songwriters, right?
6 A. Oh, but that's a very different
7 story because when they go out and negotiate
8 with individual songwriters, they're taking
9 the songs that have been produced out there as
10 given. To them -- to pay songwriters more to
11 get them to produce more would be a benefit to
12 all the other record companies out there who
13 presumably they are not benevolent toward.
14 That is, if I went out and said, I
15 am going to be a good guy and I am going to
16 pay songwriters more to get them to write
17 better songs, well, I don't have the property
18 rights over those better songs. They're going
19 to be shared with all the other record
20 companies. They don't have an individual
21 incentive to do that.
22 Q. I'm talking now about


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1 singer/songwriters. Okay? You understand
2 that a singer/songwriter may be under contract
3 to a particular record company, right?
4 A. Yes.
5 Q. Okay. And that record company will
6 negotiate individually with that
7 singer/songwriter, correct?
8 A. They would negotiate a record deal
9 with that singer/songwriter, correct.
10 Q. Right. And that's an individual
11 record company negotiating with an individual
12 singer/songwriter, not the entire industry
13 negotiating rate?
14 A. No. But -- wait. First of all,
15 when I made my speech -- when I made my
16 discussion, you didn't talk about
17 singer/songwriters. You talked about
18 songwriters generically. So now we go to
19 singer/songwriters. It's true they are going
20 to internalize some of that with
21 singer/songwriters. They are going to try --
22 they have an interest in getting them to


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1 produce better songs.
2 Of course, they don't have
3 perpetual rights in that singer/songwriter, so
4 they're not going to get all of the benefits
5 of getting them to write better songs, nor do
6 they have perpetual rights in those songs.
7 Other people can record those songs in the
8 future, not just them. Right?
9 So, for example, I negotiate with,
10 you know, Cat Stevens to write "The First Cut
11 is the Deepest," or whatever, and then that
12 song is then subsequently recorded by a bunch
13 of other people. So the benefits of making
14 that song a little better didn't go to that
15 record company because they might have got it
16 on the copy sold on Cat Stevens. But when it
17 was remade by Rod Stewart, and then
18 subsequently later, they're not going to get
19 that benefit.
20 So, no, they wouldn't internalize
21 that.
22 Q. So you don't think that when a


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1 record company negotiates with a
2 singer/songwriter, if it thought it could get
3 better songs and sell more copies, they
4 wouldn't pay more money for that; is that your
5 testimony?
6 A. No. That's certainly not what I
7 said. What I said is if they can get a better
8 song, if they get some of the benefit, then
9 they are going to have some of the incentive
10 to get that song produced. They don't have
11 the full incentive if some of that benefit
12 goes to other people. So, you know, it would
13 be a mixed bag in that case.
14 In the case of the independent
15 songwriter, they have almost no incentive. In
16 the case of the singer/songwriter, because
17 they're signing a deal with the singer, they
18 internalize, what we call in economics, some
19 of that incentive, but not all of it.
20 Q. And yet we don't see record
21 companies agreeing to pay higher mechanical
22 royalties to singer/songwriters in order to


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1 get better songs, do we?
2 A. No, but why would they do it in the
3 form of mechanical royalties? They have a
4 multi-part deal with the artist. They can get
5 them to write better songs by getting them
6 to -- giving a higher artist royalty, right,
7 because they care about how many -- in fact,
8 the artist royalty is better because that
9 gives them the incentive to produce songs that
10 will sell a lot for them, not ones that will
11 sell a lot for somebody else who is going to
12 record it in the future. Because the record
13 company wants more song sales from that singer
14 on that contract.
15 So, in fact, economics would
16 predict you wouldn't do that with a mechanical
17 royalty; you would do it with the artist
18 royalty because, again, if you sell more
19 copies, they get more artist royalties. It's
20 a more effective instrument.
21 So according to your theory that
22 you're trying to get the singer/songwriter to


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1 write better songs, that incentive is going to
2 be best implemented through the artist
3 royalty, not through the mechanical royalty.
4 In fact, you might want to cut the mechanical
5 royalty and raise the artist royalty, because
6 that's going to focus him on writing songs
7 that are going to sell under his writings, not
8 necessarily songs that are going to sell from
9 other people singing them, because if I --
10 Q. I'm sorry. I didn't mean to cut
11 you off.
12 A. But that's what I am saying. So I
13 would expect that not to show up as higher
14 mechanicals.
15 Q. Professor Murphy, I want to shift
16 just a minute to some of the numbers that you
17 have on page 9 of your written rebuttal
18 testimony -- starting on page 9, I should say.
19 The numbers that you give us cover
20 the period from 1991 to 2005, right?
21 A. That's correct.
22 Q. And there was no magic to choosing


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1991 as the starting point, was there?

A. No. Those were the data I had available.

Q. You agree, don't you, that from 1991 through 1999, or so, wholesale prices were rising?

A. In -- certainly in nominal terms.

Q. And you agree that from 1991 through 1999 unit sales were increasing, weren't they?

A. Yes, they were.

Q. And unit sales and wholesale prices have been falling since that time, haven't they?

A. Certainly. I don't know if '99 is the right turning point. It depends on whose data you look at.

Q. Right.

A. But maybe '99 or 2000 is the turning point.

MR. HANDZO: If I may have just one moment, Your Honor.


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1 CHIEF JUDGE SLEDGE: Yes, sir.
2 MR. HANDZO: Thank you. That's all
3 I have.
4 JUDGE WISNIEWSKI: If I may
5 follow up on that last question. During the
6 period of your analysis, we have both a period
7 when wholesale prices and unit sales were
8 rising, as you just said, and you have a
9 period when they're falling, as you just said.
10 What was happening to the mechanical
11 throughout the period?
12 THE WITNESS: Well, as a -- it was
13 basically constant in real terms over the
14 period as a whole.
15 JUDGE WISNIEWSKI: And how does
16 that fit in with your theory?
17 THE WITNESS: I think it -- it
18 works pretty well. There has been a shift in
19 supply of distribution actually even in the
20 earlier period. In that case, it wasn't so
21 much driven by the emergence of, say, digital
22 distribution but, for example, manufacturing


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1 costs fell dramatically.

2 If you look at what happened to

3 manufacturing costs, they fell very sharply in

4 the pre-'99 period. So like when we talk

5 about a shift in the supply of distribution,

6 that need not come from something new, like

7 digital. It could be something more mundane,

8 like manufacturing costs as a fraction going

9 down in that earlier period.

10 That will tend to make royalties

11 drift up as well because any supply increase

12 in distribution is going to tend to favor

13 those fixed cost inputs.

14 JUDGE WISNIEWSKI: So from your

15 point of view in terms of your theory as you

16 look at the data covering the period, it

17 doesn't matter whether prices were rising or

18 falling; the mechanicals should have been

19 rising?

20 THE WITNESS: Well, no. I mean, we

21 have different forces in the two different

22 directions. I think the mechanicals have more


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1 forces going toward making them rise per unit
2 in the later period. Remember, in the early
3 period, you have both sales expanding and --
4 JUDGE WISNIEWSKI: But I thought
5 you just said that they had risen fairly
6 constantly throughout both periods.
7 THE WITNESS: No, I said they had
8 risen during both periods. I didn't say
9 constantly. If you go back and look at
10 Figure 2, for example --
11 JUDGE WISNIEWSKI: I am looking at
12 it now.
13 THE WITNESS: Okay. We get a
14 bigger rise in the later period, for example,
15 for total -- if you look at the top line,
16 which is total intellectual property, that's
17 rising more in the second part of the period
18 than it was in the early part of the period.
19 JUDGE WISNIEWSKI: Well, but
20 Figure 2 is as a percentage. This is an
21 absolute level of mechanicals.
22 THE WITNESS: But the theory is all


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1 about percentages; it's about relative prices.
2 That's what pops out of the theory.
3 Now, the mechanicals -- it's
4 actually probably better to look at the artist
5 components as opposed to the mechanical,
6 right, because the mechanical isn't telling us
7 about what the market would do, because the
8 mechanical is set as a statutory matter. So
9 probably the best thing to look at is the
10 artist -- or the total of the pool is probably
11 a better economic concept.
12 JUDGE WISNIEWSKI: You said that,
13 actually, earlier on your direct testimony,
14 and I had asked you a little bit about that,
15 but I'm not quite sure I got a full answer --
16 THE WITNESS: Okay.
17 JUDGE WISNIEWSKI: -- as to what
18 you think makes up the artist royalties.
19 THE WITNESS: Okay. What the
20 artist -- well, the artist royalty is a
21 compensation for the inputs being provided to
22 by the artist.


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1 JUDGE WISNIEWSKI: Yes, but where
2 does it come from? What are the sources of
3 that compensation?
4 THE WITNESS: Okay. The sources --
5 well, do you mean in terms of mechanically how
6 is it paid? It's going to be paid as a
7 fraction of revenues --
8 JUDGE WISNIEWSKI: For what is it
9 paid?
10 THE WITNESS: For what is it --
11 it's paid for the inputs they provide to the
12 products sold by the record company. So, for
13 example, they're helping the record company
14 sell CDs. In the early years, that's
15 primarily what they're doing is they're saying
16 the artist is going to be paid compensation
17 based on how much value they add to the CD
18 business of the record company. In the later
19 period, it's going to be the CDs together with
20 digital distribution. Of course, we have
21 licensing, which is sort of indirect sales of
22 the same two products, because they're either


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1 sold through record clubs or through foreign
2 sales.
3 They're not going to be compensated
4 here --
5 JUDGE WISNIEWSKI: Well, let's look
6 at the digital for a second. What are the
7 sources of artist royalties on the digital
8 side?
9 THE WITNESS: Well, they're getting
10 paid a percentage of revenues in general from
11 wherever those revenues are coming from. So
12 that could be from digital or from --
13 JUDGE WISNIEWSKI: But that's my
14 question. Where did you think they come from?
15 THE WITNESS: I'm a little
16 confused. I'm sorry.
17 JUDGE WISNIEWSKI: Well, let me ask
18 you this question. Do artists share in any
19 royalties from such digital distribution media
20 as satellite radio or webcasting?
21 THE WITNESS: Well, if the record
22 companies get revenues from those -- so


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1 anything the record companies get revenue from
2 that's derivative from the songs that they get
3 the artist to produce, the market is going to
4 cause that to be paid out to the artist.
5 Right? That's how compensation -- record --
6 the way I see it is this --
7 JUDGE WISNIEWSKI: Aren't royalties
8 for satellite and for webcasting, in fact,
9 determined through proceedings just like this?
10 THE WITNESS: To the record
11 companies. So the artists are going to be
12 compensated for whatever the record
13 companies -- the record companies are going to
14 pay the artist for whatever value they add to
15 the record companies' operations because there
16 is competition among the record companies to
17 get the artists. So --
18 JUDGE WISNIEWSKI: And that's your
19 view as to how that works?
20 THE WITNESS: Well, yes, because
21 there is competition between the record
22 companies.


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1 JUDGE WISNIEWSKI: Thank you, sir.
2 MR. BRECKINRIDGE: Thank you, Your
3 Honor.
4 CROSS-EXAMINATION
5 BY MR. BRECKINRIDGE:
6 Q. Good morning, Dr. Murphy. My name
7 is Chad Breckinridge. I represent the Digital
8 Media Association in this proceeding. I have
9 a few questions for you this morning.
10 If I could start by asking you to
11 turn to paragraph 13 in your statement. It
12 starts on page 5. I am actually going to read
13 a sentence -- the final sentence of that,
14 which is over on page 6. In the last sentence
15 here you say, "A benchmark based on a fixed
16 ratio between the price paid to an input
17 (songwriters) and the price of the output
18 (recorded music), as proposed by Professor
19 Teece is not an appropriate indicator of
20 market values under such conditions."
21 Now, when you refer to a fixed
22 ratio here, you're commenting on a percentage


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1 rate structure; is that right?
2 A. That would be the intent here, to
3 think about what happens if you have a percent
4 of revenue type rate structure.
5 Q. Okay. And in this paragraph, in
6 paragraph 13, what you're opining on here is
7 that a percentage rate structure is flawed
8 because it does not account for changes in the
9 relative market values of the creation step
10 and the distribution step over time; is that
11 right?
12 A. Essentially.
13 Q. Dr. Murphy, a penny rate doesn't
14 account for market values that change relative
15 to each other over time either, does it?
16 A. No, but at least it wouldn't move
17 it in the wrong direction.
18 Q. Now, during your examination by
19 Mr. Synnott on Thursday, you used an analogy
20 to explain your theory, and that was selling
21 African orchids in New York. Do you remember
22 that?


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1 A. Yes, I do.
2 Q. And you described the market impact
3 of a distribution innovation that would make
4 it cheaper to bring the orchids to New York,
5 correct?
6 A. That's correct.
7 Q. And you noted that cheaper
8 distribution would encourage people to ship
9 more African orchids and a greater supply
10 would push the price of orchids down at the
11 point of sale in New York.
12 A. That's correct.
13 Q. At the same time, the demand for
14 those orchids grown in Africa would go up,
15 which would increase the price for that input,
16 correct?
17 A. That's correct.
18 Q. Now, let me expand your analogy
19 just a bit to -- I'll throw another assumption
20 on top. Assume that the uptake in supply in
21 New York actually comes from illegal orchid
22 distributors that are giving them out for


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1 free, and assume that they don't buy their
2 orchids from the growers in Africa. So
3 they're not buying anything from the African
4 suppliers, but they're saturating the New York
5 market with free orchids.
6 Now, the increased supply in New
7 York would reduce the price for orchids at the
8 point of sale, right?
9 A. That's correct.
10 Q. And you would expect at least some
11 orchid consumers in New York to stop paying
12 for original orchids grown in Africa and to
13 take an identical pirated one instead, right?
14 A. Some of them would switch,
15 presumably.
16 Q. Okay. So demand for orchids from
17 the growers in Africa would go down because or
18 of the pirate activity, right?
19 A. Assuming that -- yes, we're under
20 the assumption that they don't buy their
21 orchids from the guys in Africa.
22 Q. Right.


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1 A. Yes. Under that case, yes.
2 Q. So if there's less demand for
3 orchids in Africa, the price paid for orchids
4 in Africa would go down as well; is that
5 right?
6 A. Under those conditions, yes.
7 Q. Okay. Now, let me add another
8 assumption to the analysis here. Assume that
9 there was a new distribution system, a system
10 that, through technological innovation and
11 investment, gives consumers more selection; it
12 gives them information about the varieties of
13 orchids they can receive, comprehensive
14 information about every plant they might want
15 to buy, data about what other people are
16 buying, that kind of thing.
17 And assume that these new features
18 compel some people to switch back from the
19 pirated orchids to legitimate orchids sourced
20 in Africa, and assume that the features also
21 compel some people to buy orchids for the very
22 first time.


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1 Now, wouldn't that innovative
2 distribution system that's bringing people
3 back to the legitimate market constitute the
4 higher value input?
5 A. It would be higher value than the
6 pirated one, presumably, although it would
7 still push down prices in New York but raise
8 demand in Africa. So we would get more demand
9 for the orchids coming out of Africa, which
10 would push up the African orchid price, but
11 would push down the distribution price in the
12 U.S.
13 Q. Let's explore that just a little
14 bit. So if people wanted just an orchid, with
15 nothing more, they can still get the same
16 flower from the pirates or from the legitimate
17 suppliers, so it's not the orchid that's
18 bringing them back to the legitimate market,
19 right?
20 A. No, but in this case, if we have a
21 cheaper way to get the orchids to people, then
22 the price of orchids would go down.


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1 Q. But it's something about the new
2 innovative distribution system that's bringing
3 people back from the pirate market to the
4 legitimate market.
5 A. Yes, but they still have to compete
6 with the old distribution methods, and that's
7 going to push the price down for the old
8 distribution methods. Correct?
9 MR. BRECKINRIDGE: No further
10 questions from me.
11 CHIEF JUDGE SLEDGE: Redirect?
12 MR. SYNNOTT: No, Your Honor.
13 CHIEF JUDGE SLEDGE: Questions from
14 the bench?
15 JUDGE WISNIEWSKI: One or two.
16 Professor Murphy, let's get back to Figure 2
17 again.
18 THE WITNESS: Okay.
19 JUDGE WISNIEWSKI: If I catch the
20 drift of what you're trying to tell us here
21 with respect to Figure 2, you're saying that
22 artist royalties are determined in the


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1 market -- let's leave aside whether that's an
2 accurate assumption or not. Let's assume it
3 is an accurate assumption. If they are
4 determined in the market, they seem to show
5 here that mechanical royalties fairly well
6 track those artist royalties. And I think
7 that's part of your -- what you're trying to
8 tell us; is that correct?
9 THE WITNESS: Yes. When I say
10 artist royalties here, I mean the total
11 royalties that are being paid by the record
12 companies to -- not under any particular rule.
13 And what I -- and this is, I think, what we
14 were saying before. What matters is sort of
15 the total compensation deal of artists, which
16 is what we're looking at here, be determined
17 in the market, even if components of that are
18 not.
19 JUDGE WISNIEWSKI: Okay. Well, two
20 questions for you.
21 THE WITNESS: Sure.
22 JUDGE WISNIEWSKI: If the


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1 mechanical payments had been fairly stable in
2 tracking these artist royalties over time, why
3 should we do anything in this proceeding to
4 change the rates?
5 THE WITNESS: I think if you look
6 at that evidence alone -- and it's probably
7 better represented, actually, in Figure 3
8 where we give mechanicals relative to artists,
9 so it's a direct hit -- horse race in that
10 figure -- and it's roughly been constant,
11 maybe slightly going down if you compare just
12 to artist royalties. That would tell you that
13 there is not a rationale for cutting the rate.
14 And that's really my opinion.
15 I was asked whether -- to address
16 whether the data suggests, because sales and
17 prices have gone down; therefore, we need to
18 cut the rate. And the answer -- I think the
19 conclusion here is one that says there is no
20 evidence here to say you should cut the rate.
21 Now, is there evidence here that
22 says the rate should go up? Not from this


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1 particular piece of information. It says it's
2 roughly been keeping track with where a
3 market-determined rate -- namely, the artist
4 rate -- is. So I think we're on the same page
5 there with what you get out of Figures 2 and
6 3.
7 JUDGE WISNIEWSKI: Well, that's how
8 I took your testimony to be only with respect
9 to having the rebuttal effect to the original
10 testimony that talked about a decrease in
11 rates.
12 THE WITNESS: Yes. I think that in
13 terms of what we get out of Figure 3 --
14 there's a couple of other places that give you
15 some other ideas that maybe go a little
16 slightly the other way.
17 JUDGE WISNIEWSKI: Let's come back
18 to Figure 2 again, though. You were talking
19 about making the comparison between
20 mechanicals and the total compensation of
21 artists. Is there some reason why we
22 shouldn't take into account the total


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1 compensation of songwriters; that is,
2 royalties that they get from other sources
3 than simply the mechanicals?
4 THE WITNESS: But when I am taking
5 total compensation of artists, I am only
6 taking total compensation from the record
7 companies. If the artists are earning money
8 elsewhere, selling tickets and stuff like that
9 that's not included in the total artist --
10 JUDGE WISNIEWSKI: Well, I
11 understand that.
12 THE WITNESS: Just like I'm not
13 taking account of the fact --
14 JUDGE WISNIEWSKI: So if I could
15 shortcut this a little bit, is the thrust of
16 the answer you're about to give me that,
17 therefore, we shouldn't take into account any
18 performance royalties that the songwriters
19 obtain that the artists don't obtain?
20 THE WITNESS: Yes. If we're --
21 JUDGE WISNIEWSKI: For the same
22 reason.


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1 THE WITNESS: -- thinking about
2 this as the production process for these -- I
3 am kind of thinking as we go here, so I just
4 want to make sure I get this right.
5 We're thinking about this as the
6 market-determined compensation for the input
7 supplied to this production process. And that
8 would include what the artists provide to
9 record companies -- if they're selling tickets
10 to fans, that's separate. Similarly, with the
11 songwriters, if they're getting other forms of
12 compensation, that's also on the other side.
13 This is about this production process.
14 JUDGE WISNIEWSKI: That's all the
15 questions I have.
16 CHIEF JUDGE SLEDGE: Thank you,
17 sir.
18 THE WITNESS: Thank you.
19 (Witness excused.)
20 CHIEF JUDGE SLEDGE: Mr. Cohen?
21 MR. COHEN: The copyright owners
22 call Alfred Pedecine.


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1 May Mr. Pedecine have one minute to
2 go to the men's room?
3 CHIEF JUDGE SLEDGE: Yes, sir.
4 (Pause.)
5 MR. COHEN: Mr. Pedecine, on the
6 other side.
7 MR. PEDECINE: Sorry.
8 CHIEF JUDGE SLEDGE: Please raise
9 your right hand, sir.
10 Whereupon,
11 ALFRED PEDECINE,
12 called for examination by counsel, and having
13 been first sworn by the Chief Judge, was
14 examined and testified as follows:
15 CHIEF JUDGE SLEDGE: Thank you.
16 Please be seated.
17 DIRECT EXAMINATION
18 BY MR. COHEN:
19 Q. Good morning, Mr. Pedecine. If you
20 would face me, I think that would be better.
21 Could you state your full name for
22 the record, please.


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1 A. My name is Alfred C. Pedecine.
2 Q. By whom are you employed, sir?
3 A. The Harry Fox Agency.
4 Q. What is your title at the Harry Fox
5 Agency?
6 A. I serve as senior vice president
7 and chief financial officer.
8 Q. And can you tell us briefly what
9 your responsibilities are as the senior vice
10 president and chief financial officer at Harry
11 Fox?
12 A. I am responsible for general
13 financial areas, including financial
14 reporting, planning, cash management, as well
15 as the areas of collections and royalty
16 compliance.
17 Q. And can you tell us a little bit --
18 first of all, when did you join Harry Fox, the
19 Harry Fox Agency?
20 A. In 1999.
21 Q. And what was your first position
22 there?


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1 A. Senior vice president of
2 distributions and collections.
3 Q. And when did you become the chief
4 financial officer?
5 A. In 2001.
6 Q. Can you briefly tell us a little
7 bit about what your career was like before you
8 joined the Harry Fox Agency?
9 A. Certainly. After college, I
10 started in public accounting with
11 Pricewaterhouse and Company. After that, I
12 spent most of my career in the music industry
13 with roles at Arista Records, PolyGram
14 Records, PolyGram Group Distribution, EMI
15 Records and Def Jam Music Group.
16 Q. What was your job immediately
17 before joining Harry Fox?
18 A. Vice president of finance and
19 administration at Def Jam.
20 MR. COHEN: May I approach, Your
21 Honor?
22 CHIEF JUDGE SLEDGE: Yes, sir.


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1 BY MR. COHEN:
2 Q. Mr. Pedecine, I am going to show
3 you a binder that we have marked as Copyright
4 Owners' Trial Exhibit 394 for identification.
5 A. Thank you.
6 Q. Sir, do you recognize Exhibit 394?
7 A. Yes, I do.
8 Q. And do you see that there is an
9 errata sheet at the end of that exhibit?
10 A. Yes.
11 Q. And can you explain to us what the
12 errata is that you corrected in your written
13 testimony?
14 A. Yes. On page 11, paragraph 25, the
15 budget for 2008, outside examiners, needed to
16 be corrected to read 2-1/2 million in lieu of
17 $3 million. And then the percentage change
18 versus the prior year would follow and
19 decrease from 73 percent to 44-1/2 percent.
20 Q. And, sir, would you look at the
21 page following page 16. Is that your
22 signature, sir?


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1 A. Yes, it is.
2 Q. And with the one correction that
3 you have made to your testimony, is your
4 testimony true?
5 A. Yes, it is.
6 MR. COHEN: Your Honor, I offer
7 Exhibit 394 into evidence.
8 CHIEF JUDGE SLEDGE: Any objection
9 to 394?
10 MR. HANDZO: No objection.
11 MR. LAGUARDA: No objection, Your
12 Honor.
13 CHIEF JUDGE SLEDGE: Without
14 objection, it's admitted.
15 (Copyright Owners' Trial Exhibit
16 No. 394 was received into evidence.)
17 BY MR. COHEN:
18 Q. Now, sir, I believe you testified
19 that one of your responsibilities at Harry Fox
20 includes collections.
21 A. Yes.
22 Q. Is that correct?


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1 A. Yes, it is.
2 Q. And could you describe for the
3 court a little bit about what the collections
4 process is at Harry Fox and what Harry Fox
5 does to ensure payment by its licensees?
6 A. Sure. The main royalty cycles
7 during the year occur quarterly. And so in
8 anticipation or advance of those due dates,
9 which are 45 days end of quarter, collections
10 personnel will reach out to licensees, either
11 by e-mail, telephone, to remind them of the
12 upcoming deadline, so to speak.
13 And then once that date passes,
14 they will start to note any nonpayments and
15 begin to follow up on those, again, using the
16 same methodology -- phone calls, e-mails. To
17 the extent that's not successful and items
18 still remain open, you know, if there are open
19 recordings for a given licensee, there will be
20 a series of letters, which tend to escalate up
21 to a warning of potential results involving
22 things such as termination and whatnot.


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1 So that's the four-part --
2 Q. What are the terms that Harry Fox
3 issues with respect to payments for mechanical
4 licensees? When is the payment due -- and
5 maybe you could give us an example to make it
6 concrete?
7 A. Sure. Royalties are payable on a
8 quarterly basis. So, for example, if we were
9 talking about the quarter of October through
10 December, payments are due no later than the
11 45th day following the end of that quarter or,
12 in that example, February 15.
13 Q. So payments for the quarter October
14 to December would be due on February 15?
15 A. Correct.
16 Q. And do all of Harry Fox's
17 mechanical licensees pay in a timely fashion?
18 A. Not all, no.
19 Q. And in the course of your work,
20 what have you learned about timeliness at
21 Harry Fox generally?
22 A. Well, in general, we note there is


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1 a fair amount of late payments, varying
2 amounts and amounts of delay. So we noticed
3 that, but we decided to do a study in which we
4 looked at all of our cash receipts for a
5 period from the beginning of 2000 to I think
6 September 5, 2007.
7 Q. Mr. Pedecine, would you turn,
8 please, to paragraph 10 of Exhibit 394. And
9 does that paragraph set out the results of the
10 study that you just referenced?
11 A. Yes, it does.
12 Q. Okay. Can you tell us what you did
13 to look at timeliness of payments at Harry Fox
14 and what the results were that you found?
15 A. Right. An analysis was performed
16 on all the receipts during the period I
17 described, from January 1, 2000, to 2007, to
18 assess whether they were late or not late.
19 And we found that 41 -- more than 41,000 of
20 the receipts in this entire data set, which
21 consists in large, large part of record
22 companies and licensees and that sort,


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1 totaling more than $2.1 billion were received
2 late, which was roughly -- a little bit more
3 than 70 percent of the total dollars in the
4 data files.
5 And we found that the average of
6 those cash receipts, the lateness of all those
7 cash receipts worked out to 80 days, you know,
8 regardless of the amount involved.
9 Q. So the average late time was
10 80 days?
11 A. Yes. The average for all those
12 cash receipts was 80 days.
13 Q. Now, in paragraph 10 you --
14 A. The ones that were found to be
15 late. I'm sorry. Yes.
16 Q. In paragraph 10 you do some kind of
17 interest calculation. Can you explain to the
18 court what you were illustrating here?
19 A. Yes. We looked to see what kind of
20 interest would result if we applied the
21 1-1/2 percent per month, or 18 percent
22 per annum, rate to the late payments, and the


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1 result was approximately $16 million.
2 Q. Assuming a 1-1/2 percent per month
3 late fee?
4 A. Yes.
5 Q. Mr. Pedecine, you also testified, I
6 believe, at the beginning of your testimony
7 that you have responsibility for something
8 called the royalty compliance examination
9 process --
10 A. That's correct.
11 Q. -- the RCE process at Harry Fox,
12 correct?
13 A. Yes, it is.
14 Q. Could you tell the court what the
15 RCE process is at Harry Fox?
16 A. Royalty compliance process, or also
17 referred to as the audit process, is where we
18 undertake to examine books and records of a
19 given licensee to determine if they have been
20 reporting in full and in compliance with the
21 licenses that we have issued.
22 Q. And how often does the Harry Fox


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1 Agency audit its licensees?
2 A. There's basically kind of two
3 tracks or tranches of audits of licensees.
4 For larger licensees, in terms of their
5 size -- and this would include the majors, but
6 other fairly large non-major companies --
7 Q. I'm sorry. When you say the majors
8 here, do you mean the major record companies?
9 A. Yes, sir. We look to do those on a
10 regular basis. We currently endeavor to try
11 to do them on three to four-year type audit
12 periods, so once we have completed one of
13 those, and resolved it, we would then
14 somewhere subsequently schedule another one,
15 so constantly bringing it up to date.
16 For other licensees, it's done on a
17 more judgmental basis, usually triggered by
18 some criteria, such as whether a given
19 licensee has had a history of noncompliance
20 with licenses. Some empirical indicator may
21 tell us that it might be worth looking at
22 them, given -- say the number of licenses we


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1 have issued to them doesn't seem to kind of
2 correlate with the sort of royalty accounting
3 we have been getting.
4 And then, finally, we may also use
5 SoundScan information to identify apparent
6 shortfalls in recording.
7 Q. If you can just explain that last
8 part. What do you mean you use SoundScan
9 information to look for shortfalls?
10 A. Oh, sorry. SoundScan is a company
11 that monitors retail sales of music and, I
12 guess, video. And a lot of the music
13 companies use it -- subscribe it to its
14 information for various purposes. And it's
15 also the statistical information that drives a
16 lot of the Billboard -- one of the key
17 industry publications -- charts.
18 Q. And when Harry Fox conducts these
19 audits or royalty compliance exams in the
20 ordinary course, what do you typically find?
21 A. Typically find deficiencies in
22 royalty reporting which results in some


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1 significant claims.
2 Q. And could you tell us what kinds of
3 deficiencies comprise the major categories
4 that you find on audit?
5 A. Okay. The types of things we may
6 find in the course of an examination could
7 include, but aren't necessarily limited to,
8 unlicensed usage of some of the compositions,
9 underreporting either in terms of units and/or
10 incorrect rates for licensed titles, units
11 that are given away for promotional purposes
12 for which no royalties are voluntarily paid.
13 Sometimes we will find sales aside
14 from the normal channels that also royalties
15 are not paid on in the ordinary course, such
16 as cutout sales and sort of -- they're called
17 courtesy sales in some cases. We also find
18 excessive reserves for returns,
19 unaccounted-for inventory production, things
20 of that nature.
21 Q. And does Harry Fox issue reports at
22 the end of this audit process?


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1 A. Yes. At the completion of the
2 process, either the outside accounting firms
3 that we utilize or, if the exam is being
4 conducted by our own staff, a report is put
5 together. It's sort of the initial claims
6 report with a lot of detail supporting it.
7 And once that has been given to the
8 licensee, there is an opportunity to, I guess,
9 either accept or endeavor to refute some of
10 those claims. It's often referred to as sort
11 of the rebuttal phase of the process.
12 During this period, oftentimes the
13 licensees will provide additional
14 documentation and/or explanation that didn't
15 come up in the course of the fieldwork that
16 was being performed, and so that gets -- that
17 additional documentation gets assessed and, to
18 the extent deemed appropriate, claims are
19 adjusted downwards, typically, as a result of
20 what they have given us, to get to adjusted
21 claims.
22 Q. And what happens then? Do the


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1 licensees typically just pay the adjusted
2 claims?
3 A. That would not be typical, no.
4 Q. What is the typical process?
5 A. Well, at that point, usually
6 there's three options. One would be
7 termination of licenses. One would be for us
8 to underwrite litigation on behalf of the
9 copyright owners and/or to seek to compromise
10 and settle the amounts involved.
11 Q. And how do these audits typically
12 end?
13 A. Typically, they end through
14 compromise and settlement. The first two
15 options are used not very often. You know,
16 termination is a pretty severe process. It
17 can be detrimental, damaging to the
18 relationships. It puts a hiatus on commerce
19 for a while as it relates to that specific
20 licensee. Litigation is something that we try
21 to avoid because it's expensive, it's very
22 time-consuming. It can last for quite the


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1 duration.
2 So other than really -- real tough
3 situations where we just can't do anything
4 better, we typically work out a compromising
5 settlement with the licensees.
6 Q. Now, do you set out in your
7 statement the magnitude of recoveries that
8 Harry Fox has achieved through this audit or
9 royalty compliance process since the time that
10 you became chief financial officer in 2001?
11 A. Yes. There is a table in my
12 statement, if I could just turn to it.
13 Q. Is that table 1 on page 7?
14 A. Yes, it is.
15 Q. And could you explain to us what
16 information is set out in table 1?
17 A. Okay. Table 1 shows the
18 collections from the royalty compliance
19 process by year for 2001 to 2007. While there
20 is not a total shown, I believe it adds up to
21 approximately $193 million.
22 Q. 193 million in additional


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1 collections that occurred '01 to '07?
2 A. Yes.
3 Q. Now, do you also set out in your
4 statement somewhere the collections that Harry
5 Fox has achieved through this auditing process
6 over a longer period of time?
7 A. Yes.
8 Q. Where is that, sir?
9 A. It's located at Exhibit A.
10 Q. Exhibit A to your report?
11 A. Yes. That's -- I will give people
12 a chance to get there.
13 That's a schedule of collections of
14 all types for the period 1990 through 2007.
15 Q. And can you show us where you would
16 find the amounts that are attributable to the
17 auditing process in Exhibit A?
18 A. In Exhibit A there's two columns.
19 The fifth column in from the left, mechanical
20 RCE. And then the third column from the
21 right, import RCE. Much smaller amount, of
22 course.


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1 Q. And what does Exhibit A show us as
2 the sum total that Harry Fox has collected
3 through audits of late -- of audits since
4 1990?
5 A. Well, if we take the sum of those
6 two columns that I just cited, it would be
7 over $430 million. I guess, rounded, it would
8 be closer to 431.
9 Q. Now, does Harry Fox expend money in
10 connection with these audits?
11 A. Yes, we do.
12 Q. And have you set out for us in your
13 report the costs of the audit process, at
14 least since you have been the chief financial
15 officer?
16 A. Yes, they appear on page 11 in
17 paragraph 25.
18 Q. And what does that show? Is that
19 table 2?
20 A. Table 2, yes. Well, it shows the
21 costs of outside examiners and the accounting
22 firms that we have paid in those years, the


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1 costs of the in-house department that I
2 referred to earlier in my areas of
3 responsibility, and the sum of the two which,
4 for these years 2001 through 2007 was $18.8
5 million, or an average of about $2.7 million a
6 year.
7 Q. Is that close to what you're
8 budgeting for the coming year, based on your
9 correction?
10 A. Yes. Based on the correction,
11 we're showing $2-1/2 million for the outside
12 auditors, so that's that a 44-1/2 percent
13 increase over the million-7 shown for 2007 for
14 the outside examiners' costs.
15 Q. What is your expectation about the
16 continuing need to audit over the coming
17 years?
18 A. I think the need is going to
19 increase and the cost is going to increase.
20 Q. And can you explain why?
21 A. Yes. Well, two things immediately
22 come to mind. Digital distribution is --


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1 every indication is it's continuing to grow,
2 and that adds something new to the --
3 relatively new to the process in terms of
4 layers of complexity. Complexity oftentimes
5 translates into cost.
6 And then the other thing is
7 following the proceedings, assuming there is a
8 rate set for the subscription services that we
9 have licensed to date but we haven't performed
10 any exams of subscription services because, up
11 until now, there have been no royalties paid.
12 So once that comes on-line, that
13 will add to the potential field or universe of
14 licensees to examine.
15 Q. Is there something more complex
16 about auditing digital licensees?
17 A. Yes, there is. In the case of a
18 digital licensee, in addition to some of the
19 usual things we need to do, there is an area
20 involving assessing technology --
21 technological-type issues: Computer
22 environments, integrity of the servers. And


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1 so we have to bring, we would envision -- and
2 we have done it once so far -- bringing a
3 computer expert, if you will, into the mix to
4 augment what the auditors do. So that adds
5 another layer to it because there we have to
6 look at that environment, assess that all the
7 units are being accounted for properly and
8 whatnot.
9 Also, in the digital type of things
10 where it's not a direct relationship with that
11 distributor -- say, we're dealing with a
12 label -- there, in addition to looking at the
13 usual inventory systems and royalty accounting
14 systems that we would look at to assess the
15 situation with respect to the physical
16 goods-based transactions, to look at the
17 digital, which to date is really DPD -- full
18 permanent DPDs -- we have to look at reporting
19 they have received from the distributors, from
20 the Apples of the world and whatnot.
21 Q. Sir, are you aware that the
22 copyright owners are seeking a late fee in


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1 this proceeding?
2 A. Yes, I'm well aware of that.
3 Q. And do you support the adoption of
4 a late fee?
5 A. Yes, I do.
6 Q. Can you tell us why?
7 A. Well, hopefully by establishing a
8 formal late fee at an adequate enough rate,
9 it's going to encourage licensees to be much
10 more diligent in their reporting on a regular
11 basis in terms of timeliness and completeness
12 of the reporting. To the extent it doesn't
13 meet with that desired behavior, at least it
14 would provide, you know, fair compensation to
15 the copyright owners for the lost time value
16 of the money, for the delays.
17 Q. And what need is there for a late
18 fee if the right to terminate already exists?
19 A. Well, as I said earlier, we
20 don't -- oftentimes do not use termination,
21 unless it's a pretty -- really extreme case
22 for the reasons I mentioned. But the other


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1 thing is part of the process involving
2 termination is there is a giving of notice --
3 and my recollection is there is a 30-day
4 period in which the licensee can cure.
5 So as a result, you know, someone
6 can get pretty close to the edge -- one can
7 initiate the termination process through that
8 notice and whatnot, and if they cure it within
9 the 30 days, you know, cut the check, so to
10 speak, then there is no provision for interest
11 in the rules and whatnot.
12 Q. And what impact does that have?
13 A. Well, it's just -- in some
14 respects, it means they don't get compensated
15 for the lost time value of the money. And it
16 just adds -- you know, also, going through the
17 termination process, as I mentioned earlier,
18 can create a good deal of friction, certainly,
19 and possibly, you know, sort of hiatus for the
20 commerce.
21 Q. Now, sir, are you also aware that
22 the copyright owners are seeking a 3 percent


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1 assessment on pass-through arrangements?
2 A. Yes, I am aware.
3 Q. And could you just explain your
4 understanding of what a pass-through
5 arrangement is in the context of licensing?
6 A. Okay. Well, the term, as it's
7 used, refers to those situations in which a
8 licensee authorizes someone else, another
9 entity, to distribute on their behalf. So
10 earlier I alluded to full downloads. There, a
11 label can take the license for the DPD, full
12 DPD configuration, but authorize a service,
13 whether it's Apple or Napster or someone else,
14 to actually do the making and transmission or
15 distribution of the downloads.
16 Q. And what impact does that have on
17 how Harry Fox gets paid in the ordinary
18 course?
19 A. Well, we have come to learn that it
20 has an impact in the form of a delay through a
21 couple of the royalty compliance exams that we
22 have done -- essentially, a delay of one


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1 month's royalties being delayed for three
2 months.
3 Q. And could you explain why a
4 pass-through license results in a one-month
5 delay, resulting in a three-month delay in
6 payment?
7 A. Yes. The practice we have
8 encountered is that our licensee, the
9 labels -- at least the ones we have found
10 about so far -- make a practice of
11 accounting -- of treating the units as being
12 distributed in the month in which it's
13 reported to them by the service as opposed to
14 the month that the transmissions actually take
15 place, the way CFR requires the reporting, as
16 does our license.
17 So just by way of example, if we
18 use that same December quarter that I
19 mentioned earlier, if the DPDs transmitted in
20 December -- if we had a direct license with
21 the service, Apple iTunes, whomever, we would
22 expect payment, under the terms of our


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1 licenses, to come in for the entire quarter,
2 including that third month, on February 15.
3 But by --
4 Q. Is that the 45 days?
5 A. That's the 45 days end of that
6 December quarter. But by using the so-called
7 pass-through approach and the practice of how
8 they're treating those third months, they
9 would be picked up as part of the subsequent
10 quarter because they would get a report from
11 the service -- from Apple, whomever -- in
12 January, which would become part of the March
13 quarter, and that isn't payable until May 15,
14 which is -- you know, payable on or about
15 May 15, which is 90 days later than
16 February 15.
17 Q. And just to have a clear record,
18 when you said "they" in that sentence, who are
19 the "they" you're referring to?
20 A. Our licensees. The label in this
21 case.
22 Q. And that's the reason for the


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1 delay?
2 A. For the delay, yes.
3 Q. Is there any other reason why you
4 support an assessment on pass-through
5 licensing?
6 A. Yes. It has to do with the audit
7 side. When the -- under -- in the so-called
8 pass-through arrangement, we don't have direct
9 access to the distributor's books, records,
10 server logs, because it's digital
11 distribution. We're essentially limited to
12 dealing with our licensee -- the label in the
13 example we gave -- and only being able to see
14 the reports they receive from the service.
15 So, therefore, we're not able to get access to
16 those underlying source documents, if you
17 will.
18 And, you know, when I think of --
19 when we looked at Exhibit A and I see the
20 relationship of the royalty compliance
21 collections to the general collections we have
22 gotten, which I think is over 6 percent if


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1 it's just against the relevant ones as opposed
2 to the grand total -- it's probably upper 6s,
3 a little under 7 percent, as I recall -- sort
4 of the exception rate.
5 And so our experience has been that
6 there is usually a significant amount of money
7 left to be found, if you will, through the
8 audit process, you know, identified and
9 collected. I have no reason to believe that
10 that wouldn't be true in dealing with the
11 services, but we can't go that extra yard.
12 You know, one example -- the only
13 instance where we have audited directly a
14 digital service where it was somewhat
15 unusual -- but they did license directly --
16 there was audit findings. So for that reason,
17 certainly I think the 3 percent would be
18 intended to address both that one month that's
19 the 90 days late, as well as kind of what it's
20 costing the publishers by not being able to
21 audit directly in most instance -- well, in
22 any instance where it's a pass-through.


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1 Q. Now, the late fee and the
2 pass-through assessment, do you understand
3 that those are terms that the copyright owners
4 are proposing for the statutory license?
5 A. Yes.
6 Q. And where are those changes
7 necessary for Harry Fox in the statutory
8 license?
9 A. Okay. The licenses that we issue
10 for the most part incorporate -- reflect the
11 terms of the statutory license other than to
12 the extent that ours are a little more
13 flexible, you know, such as the quarterly
14 reporting versus monthly reporting, the due
15 date for the quarterly reporting being 45 days
16 after the end of the period. I believe the
17 statutory is 20 days after the end of the
18 month. That sort of thing. So there is not
19 much resistance to those terms that are
20 different, that are more flexible, if you
21 will.
22 On the other hand, based on my


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1 experience and being involved in some
2 settlements and whatnot, if the late fee is
3 not incorporated in the statutory -- the
4 compulsory license, it would be far more
5 difficult to put it into our license and make
6 it fully enforceable. If it is approved and
7 put in, then certainly I would expect we would
8 update our standard form of license to
9 incorporate such a late fee provision.
10 JUDGE ROBERTS: Could you explain
11 your answer a little bit greater,
12 Mr. Pedecine, as to why it would be far more
13 difficult and unenforceable if you put a late
14 fee payment into your agreement with your
15 licensees?
16 THE WITNESS: I will try to do
17 that, Your Honor. In the course of
18 collections over the years that I have either
19 been involved in directly or through people I
20 supervise, as well as royalty compliance
21 exams, when we have sought interest which, in
22 the royalty compliance exams we certainly


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1 always seek interest on the claims that have
2 been identified -- there is usually a fair
3 amount of resistance, either in general to
4 interest -- sometimes licensees will say there
5 is no provision for it under 115.
6 Secondly, they will sometimes
7 question the rate and that sort of thing.
8 JUDGE ROBERTS: When the licensees
9 say there is no provision of that under 115,
10 do you remind them that they're not getting a
11 115 license; they're getting a license from
12 you, the Harry Fox Agency?
13 THE WITNESS: I may remind them of
14 that, but I think, Your Honor, at least based
15 on my experience, practice in the business --
16 it's viewed that our license is -- if you want
17 to call it the equivalent or kind of
18 substitute for it in the music industry.
19 So you can remind them of that, but
20 it doesn't necessarily cause the arguments to
21 stop. And this is part of where we end up in
22 that compromising settlement phase that I


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1 referred to before, in describing the audit
2 process.
3 JUDGE ROBERTS: But obviously,
4 based on what you've said, they're quite happy
5 to have different reporting requirements that
6 are in contrast to those under 115; there is
7 no disagreement about that.
8 THE WITNESS: I have never
9 encountered anyone who said we would rather
10 report monthly rather than quarterly; we would
11 rather have a tighter due date. No, sir -- I
12 mean, no, Your Honor.
13 JUDGE ROBERTS: Thank you.
14 CHIEF JUDGE SLEDGE: What if they
15 say, we don't want to pay it because there is
16 a full moon?
17 THE WITNESS: We keep the
18 conversation going, and if they were to
19 continue, Your Honor, in that fashion, that
20 could be one of those cases where ultimately
21 litigation could be involved, or termination
22 would take place. It's not to say we never


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1 terminate licenses. It's just something we
2 try to avoid doing.
3 CHIEF JUDGE SLEDGE: That makes as
4 much sense to me as you saying that they don't
5 want to pay it because it's not in a license
6 that's not applicable to the agreement they're
7 entering.
8 THE WITNESS: Well, I'm not
9 necessarily saying they're correct, Your
10 Honor. I am just telling you what we
11 encounter and the resistance we face and the
12 friction, if you will, in the system.
13 CHIEF JUDGE SLEDGE: Should we
14 write regulations that deal with illogical
15 actions?
16 THE WITNESS: No, but I would
17 submit, Your Honor, that regulations that do
18 make sense, that should encourage good
19 behavior and provide for adequate penalty, for
20 lack of a better term, if bad behavior
21 persists I think would be in order.
22 CHIEF JUDGE SLEDGE: I don't


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1 understand why resisting a term that you're
2 seeking in an agreement is bad behavior. They
3 just don't want to pay it.
4 THE WITNESS: Well, not wanting to
5 pay one's obligation to me is a form of bad
6 behavior.
7 CHIEF JUDGE SLEDGE: It's not an
8 obligation if you don't put it in the
9 agreement.
10 THE WITNESS: Oh, I'm sorry. I
11 misunderstood, Your Honor. I thought you
12 meant paying royalties at all in the case of
13 the claims on -- RCEs and whatnot, or not
14 paying in accordance with terms of the license
15 in terms of the timing and so forth.
16 CHIEF JUDGE SLEDGE: That's
17 different than what I am asking you about.
18 THE WITNESS: I see. Yes.
19 CHIEF JUDGE SLEDGE: So how is it
20 bad behavior if they're complying with their
21 agreement with you and the fact that they're
22 not paying a late payment is simply because


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1 you don't get that in the agreement?
2 THE WITNESS: Well, the bad
3 behavior I was alluding to was the paying late
4 or not paying at all in the ordinary course of
5 business. To me, that's the bad behavior.
6 CHIEF JUDGE SLEDGE: I see. All
7 right. Thank you.
8 THE WITNESS: I am looking to
9 discourage that.
10 BY MR. COHEN:
11 Q. Is the Harry Fox license sometimes
12 referred to as a variant of the 115 license?
13 A. I have heard that term used, yes.
14 Q. Do you have an understanding of
15 what that means?
16 A. To sort of restate some of the
17 things I've said, I believe, one, it's viewed
18 as kind of an equivalent in practice, or a
19 substitute in practice in our industry.
20 And in terms of the terms that it
21 incorporates, many of them are reflected. We
22 try to stay very close to reflecting the terms


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1 of 115 other than some of the variations, such
2 as the ones I mentioned about the timing of
3 the reporting, the period of reporting, not
4 requiring some of the certifications and
5 whatnot every time statements are rendered,
6 that sort of thing. Again, more flexible.
7 MR. COHEN: I have no further
8 questions for the witness.
9 CHIEF JUDGE SLEDGE:
10 Cross-examination.
11 MR. HANDZO: Yes, Your Honor. I am
12 happy to start. I don't know if this is when
13 the court would want to take its mid-morning
14 break.
15 CHIEF JUDGE SLEDGE: Thank you. We
16 will recess. Ten minutes.
17 (Recess.)
18 CHIEF JUDGE SLEDGE: We will come
19 to order.
20 MR. HANDZO: Thank you.
21 CROSS-EXAMINATION
22 BY MR. HANDZO:


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1 Q. Good morning, Mr. Pedecine. I am
2 Dave Handzo representing the RIAA.
3 Mr. Pedecine, starting I think
4 around page 5 of your written testimony you
5 discuss your analysis of the HFA database; is
6 that right?
7 A. Yes. There's a cash receipts in
8 the database.
9 Q. And in that database you have a due
10 date for the payment and a date received,
11 right?
12 A. Yes.
13 Q. And obviously the difference
14 between those two is the number of days late
15 that you say the payment was late, right?
16 A. Yes.
17 Q. Now, when a record company makes a
18 license request, in that request they specify
19 the release date for the sound recording,
20 don't they?
21 A. I believe so, yes.
22 Q. And HFA uses that release date as


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1 the basis to calculate the due date for the
2 payment, right?
3 A. No.
4 Q. Tell me how the due date for the
5 payment is calculated.
6 A. In the context of this analysis,
7 the way the due date is determined was we
8 looked at the -- there should be a column in
9 the document or in the file that says period,
10 or period code, royalty period. So, for
11 example, if it says 03-12/05, that's saying
12 it's the three months ended December 2005. So
13 that example, we would look to the analysis
14 that was programmed to calculate the due
15 date -- it was the following February 15; it
16 was payable on or before the 15th.
17 Q. But how do you know what the start
18 date is?
19 A. In this case, we're only dealing
20 with the quarter's worth of -- the quarter's
21 accounting, or the period, whatever it may
22 happen to be, that we encountered. So if


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1 something had been hypothetically released
2 three years before and, for whatever reason,
3 the licensee hadn't processed it through and
4 so forth until that particular quarter that's
5 on one of those cash receipts, we're treating
6 it as part of that quarter.
7 So to that extent, the lateness is
8 probably understated to your point, because
9 we're only looking at that quarterly activity,
10 or that periodic activity.
11 Q. Okay. Now, the record companies,
12 the major record companies, pay advances to
13 Harry Fox, do they not?
14 A. Some do, yes.
15 Q. Which record companies pay
16 advances?
17 A. Some of the ones that immediately
18 come to mind -- this may not be
19 all-inclusive -- Sony, BMG, because they came
20 in separately before the merger. There's --
21 Universal Music Group has some advances.
22 Warner Bros. Records. I think very recently


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1 Atlantic/Elektra. I believe we hold an
2 advance from Columbia House, the club. There
3 was a Zomba piece, from the merger of BMG and
4 whatnot. I don't recall one from EMI.
5 Those are the typical players.
6 Q. And those advances are paid under
7 circumstances where the record companies
8 expect that they might otherwise be late,
9 correct?
10 A. Yes, they were -- these pending
11 advances, if you will, were I guess in all
12 cases brought about through negotiation as
13 part of an audit settlement.
14 Q. But, again, those advances that
15 they pay are monies that HFA holds onto
16 because the record company might have a late
17 payment, right, in the future?
18 A. Specifically to -- yes. With
19 respect to that unlicensed product, yes.
20 Q. Okay. And in your testimony here
21 you're not taking those advances into account,
22 are you?


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1 A. I'm not sure how I didn't take them
2 into account.
3 Q. Well, you're not showing those
4 advances as an offset to the monies that you
5 say are due, are you?
6 A. I wouldn't because, in this
7 analysis, we have only -- as I described, it
8 was to address the monies that were paid in
9 respect to those quarters and whatnot, in the
10 late payment analysis. So the advance
11 wouldn't come into play. We're only saying if
12 they reported $3 million in respect of the
13 quarter ended December '05, if that was paid
14 on -- if that parcel of money, if you will,
15 was paid on or before February 15, we didn't
16 count it as late. It would be in another
17 worksheet within the overall workbook that we
18 provided.
19 If it was paid on March 1, then we
20 would have considered it approximately two
21 weeks late. But that wouldn't -- we're not
22 picking up into that principal, if you will,


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1 upon which we have calculated estimated late
2 fees something that wasn't recorded, something
3 that either was advanced as pending or not
4 advanced and not paid.
5 So, no -- it's excluded
6 intentionally in order not to overstate the
7 late situation.
8 Q. At any given time, isn't it correct
9 that HFA is holding onto tens of millions of
10 dollars of advances from the record companies?
11 A. Yes, that's correct.
12 Q. In fact, do you know what the total
13 amount of advances that you're holding onto at
14 this point are?
15 A. I don't know the exact number
16 today, but I would certainly expect it to be
17 probably in excess of $50 million.
18 Q. Does HFA earn interest on that
19 money?
20 A. Yes, we do.
21 Q. Does HFA pay that over to its
22 songwriters?


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1 A. You mean to our publishers?
2 Q. Yes.
3 A. Not directly. They benefit through
4 the fact that it helps underwrite the cost of
5 the company which is -- our commission is
6 driven in large part by our costs.
7 Q. So the interest that you earn on
8 the record company payments doesn't get paid
9 to the songwriters either directly or through
10 the publishers, does it?
11 A. No. They benefit, though,
12 indirectly because the commission that we
13 charge does ultimately affect publishers --
14 and I would think, under most arrangements,
15 the underlying writers.
16 So to the extent we can hold down
17 the commission through the benefit of that
18 interest, then publishers and, indirectly, the
19 songwriters do benefit.
20 Q. And if there were a late fee paid
21 in this case, you likewise don't intend to pay
22 that to the songwriters, do you?


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1 A. The late fee?
2 Q. Yes.
3 A. No. Our intent -- my understanding
4 is we would pay it to the publishers. It
5 would be similar to the incremental royalties.
6 Q. Even though you don't pay the
7 interest on advances to the publishers?
8 A. Correct.
9 CHIEF JUDGE SLEDGE: Are you
10 finished with that topic?
11 MR. HANDZO: Yes.
12 CHIEF JUDGE SLEDGE: I don't
13 understand your answer on why advances are
14 held as a settlement from audits that include
15 late fees, and yet they're not shown as any
16 offset for late payments. How are the
17 advances used?
18 THE WITNESS: Your Honor, if you
19 think of findings on an audit -- and I
20 mentioned one of the large -- one of the claim
21 areas would be unlicensed -- you know,
22 royalties associated with product sales for


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1 which there haven't been licenses, and so
2 royalties aren't paid. What has evolved over
3 time is rather than just settling out those
4 unpaid royalties on a lump sum basis without,
5 you know, title detail and so forth, what we
6 have worked out mutually with the record
7 companies is they would -- there is a
8 methodology to calculating -- they pay in
9 advance against that. In other words, while
10 it's unlicensed, they're holding the money
11 absent the advance.
12 The advance was to put the money
13 over to our side in order to indirectly
14 benefit the publishers, as we discussed. So
15 that's how the advance works in general. So
16 it's an advance against unlicensed.
17 The late fee --
18 CHIEF JUDGE SLEDGE: And define
19 unlicensed.
20 THE WITNESS: Product for which a
21 license has not been obtained and, pending the
22 issuance of such a license, the record company


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1 isn't paying royalties on it yet, or
2 accounting for royalties on it yet.
3 So that advance, to the extent it's
4 being held, represents, in effect -- not
5 escrow, but payment on account towards that
6 which hasn't been paid. The late fees that
7 were the subject of the study in the case of
8 the interim royalties only related to money
9 that is flowing in the ordinary course of
10 business, primarily quarterly accounting,
11 sometimes a collection of a specific issue
12 that came to light on an off-cycle basis, and
13 only computing the late fee as it related to
14 that voluntary reporting -- well, that
15 reporting for that particular time frame,
16 typically a quarter.
17 So the advance doesn't go against
18 that because the advance is for the
19 unlicensed. What they're paying on would be
20 for the licensed product, presumably.
21 Does that help clarify, Your Honor?
22 CHIEF JUDGE SLEDGE: Yes, sir. I


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1 was confused by some of your answers, but the
2 advances deal only with unlicensed usage and
3 have no application to timeliness of payments?
4 THE WITNESS: No, because once --
5 yes, Your Honor, because once the product
6 would get licensed and come out of the
7 pending, it then becoming available in
8 production system of the record company to be
9 paid in the next quarterly cycle. And if it
10 flushes out in the next quarterly cycle and
11 that quarterly reporting takes place on or
12 before that 15th following the end of the
13 quarter, there would be no late fee applied.
14 CHIEF JUDGE SLEDGE: Thank you.
15 THE WITNESS: Yes, Your Honor.
16 JUDGE ROBERTS: Do you know that to
17 be the viewpoint, Mr. Pedecine, of the record
18 companies? Are the record companies of the
19 view that we will make these advances to you
20 and it will cover situations where we haven't
21 obtained a license yet, and it will recover
22 those times -- or cover those times where we


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1 make a late payment?

2 THE WITNESS: I'm sorry, Your

3 Honor. I don't quite follow.

4 JUDGE ROBERTS: Well, I am trying

5 to get an understanding if you have knowledge

6 as to whether the record companies view these

7 advances the same way that you do, which is

8 these are restricted -- the advances are

9 solely for the purpose of licenses not yet

10 obtained from the Harry Fox Agency?

11 THE WITNESS: I believe so. Just

12 as a point of clarification, we refer to

13 sometimes the advances as pending and

14 unmatched. So essentially deals with

15 unlicensed, but could also deal with -- it's a

16 term used in the business of unmatched where,

17 I guess, potentially something could have been

18 licensed historically, but there is a

19 disconnect in the licensee's royalty system

20 and they really can't identify what it is and

21 process it through.

22 So there could be some things


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1 technically licensed but not in payable state
2 at the record company at that point in time.
3 It was treated in the same manner.
4 But as to their knowledge, I'm not
5 sure how the other side -- I say the other
6 side -- the licensee would view the
7 application as it relates to these proposed
8 late fees, but this is my understanding of how
9 they would do it.
10 JUDGE ROBERTS: I asked you this
11 question because this industry, the record
12 companies and Harry Fox, operate so much under
13 an understanding with respect to licensing,
14 and I just wanted to get an understanding as
15 to what your perception was as to what role
16 advances serve. And you're saying the role
17 that advances serve is to pay for licenses not
18 yet obtained?
19 THE WITNESS: By and large, yes.
20 Yes, other than that unmatched business.
21 JUDGE ROBERTS: You say by and
22 large. Is that --


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1 THE WITNESS: I mean, it's
2 primarily for pending, as the term is used,
3 pending the license. But in some instances in
4 some of the agreements we see reference to the
5 unmatched files of a particular licensee,
6 which could be more unlicensed or, to some
7 extent, potentially there could be some
8 licensed in there that's hung up in their
9 system.
10 JUDGE ROBERTS: But not works that
11 are actually licensed for which late
12 payment --
13 THE WITNESS: That's not what it's
14 for.
15 JUDGE ROBERTS: I understand.
16 Thank you.
17 THE WITNESS: You're welcome.
18 BY MR. HANDZO:
19 Q. To be clear, Mr. Pedecine,
20 basically those advances cover any payments
21 that the record companies feel like they're
22 not in a position to pay yet, for whatever


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1 reasons -- that's in their unmatched fund, for
2 example?
3 A. Typically, the attendant agreements
4 are fairly specific. Sometimes they will even
5 use a term other than pending. They might say
6 in order to sort of customize it to that
7 particular record company's terms of art for
8 the situations -- but I believe they
9 understand it's strictly for the estimated
10 dollar value for those units that are hung up
11 in their pending or unmatched files.
12 Q. And unmatched files can be files
13 where a license agreement was already
14 submitted, right?
15 A. I think that's probably within the
16 realm of possibility, yes. As long as it has
17 been advanced, it shouldn't cause any extra
18 late fee.
19 Q. And, in fact, these advances were
20 negotiated in the context of RCE settlements,
21 right?
22 A. Yes.


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1 Q. So they're negotiated in the
2 context of an audit process where you're
3 auditing for late fees, right?
4 A. We're auditing for unpaid royalties
5 and whatnot and, in the course of doing that,
6 typically unlicensed claims would exist. In
7 situations where the parties agree to
8 establish this advance arrangement, you don't
9 settle that unlicensed; the advance comes
10 about and is carried forward and maintained in
11 a manner as prescribed in specific
12 settlements.
13 Q. But those advances are negotiated
14 in the context of an RCE process where you're
15 dealing with all of your claims against the
16 record companies, correct?
17 A. They were, yes, initially
18 established in the context of an RCE
19 settlement.
20 Q. Now, Mr. Pedecine with respect
21 to --
22 JUDGE ROBERTS: When Mr. Handzo


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1 just mentioned to you -- asked you the
2 question with respect to unmatched, does that
3 mean that a license was sought from Harry Fox
4 Agency and then was essentially never paid?
5 Is that what unmatched means?
6 THE WITNESS: Not necessarily. I
7 mean, I have experienced years back with one
8 of the majors where they ran into a problem
9 when they converted their royalty systems
10 whereafter items that had been licensed and
11 been paid in the ordinary course of business,
12 so to speak, became unmatched in their system,
13 no longer aligned with their royalty system
14 database and master files. And so the units
15 were no longer flowing through the production
16 system. So in that case, it was a disruption.
17 In that specific instance, they had received
18 licenses historically, but found they couldn't
19 process them through their regular system on a
20 quarterly basis until they resolved their
21 problems.
22 So in that case, unmatched was -- a


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1 license had been issued previously, and they
2 might have even paid on some of those titles
3 previously.
4 JUDGE ROBERTS: And let me ask you
5 this. The -- I can understand where a payment
6 is being made on a particular license and
7 then, in a given quarter, the payment is late.
8 That's certainly a late payment.
9 How would you categorize the
10 situation, however, where a license is sought,
11 but the very first payment when it becomes due
12 is not paid timely? Is that a late payment or
13 is that simply a license yet to be taken?
14 THE WITNESS: If I understand the
15 question correctly, I believe that would be a
16 license yet to be taken and, in the context of
17 the way things would work at our company, once
18 it has been licensed and the licensee begins
19 to report -- the first quarter it's in is
20 going to be the first time that money would be
21 eligible for a late fee. And if they pay that
22 quarter on time, there wouldn't be a late fee.


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1 Moreover, typical reporting -- the
2 quarterly data would not necessarily -- in and
3 of itself, would not necessarily tell us if
4 some of that is cumulative history that's
5 being presented as if it was just activity
6 within the quarter.
7 JUDGE ROBERTS: So the data that
8 you're reporting to us about late payments
9 then, in your testimony, is situations where
10 the payment had begun, but then became tardy
11 at some point?
12 THE WITNESS: Well, there are
13 specific periodic accountings that are
14 contained in that file, much of them
15 quarterly, if you will. Once in a while, it
16 will indicate it's a longer -- it might say
17 it's a period ended, which is kind of
18 open-ended; someone did a cumulative catch-up.
19 For purposes of measuring this --
20 and I would expect something similar to an
21 application fee should be put in place -- it's
22 only dealing with that period and just the


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1 comparison of when it would be payable based
2 on the period code and the actual date of
3 receipt. And that's how we calculated the
4 amounts involved, and applied the concept.
5 JUDGE ROBERTS: So that would
6 include first situations where the license
7 is -- the application is filed, the first due
8 date comes up, payment is not made timely.
9 Then your data would include that as a late
10 payment?
11 THE WITNESS: Right, but in some of
12 these --
13 JUDGE ROBERTS: Not as a license
14 not taken?
15 THE WITNESS: Your Honor, maybe I'm
16 confused, but maybe if -- perhaps if we take
17 an example, in the interest of clarification.
18 JUDGE ROBERTS: Sure.
19 THE WITNESS: If a use is licensed
20 in -- let's say it's first used -- the product
21 has been flowing for the better part for a
22 year. Let's say for a year. For whatever


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1 reason, the license gets taken in January the
2 following year. So there's 12 months prior to
3 that license being taken. So during that
4 period, that was a license not taken, up
5 through December.
6 In January of year 2, in this
7 example, the license is taken. The licensee
8 now is in a position to throttle the right
9 switches in royalty systems and so forth and
10 include in their reporting for that quarter
11 ended March of the second year not only the
12 activity for that quarter for that selection,
13 but as well as the cumulative reporting for
14 the 12 months prior. There's 15 months worth
15 of activity, if you will, presented as part of
16 that quarter.
17 In that instance, as long as that
18 quarter in this example that would end March
19 is paid on or before May 15, there would be no
20 late fee.
21 Does that help, Your Honor?
22 JUDGE ROBERTS: I think it does,


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1 yes. All right.
2 BY MR. HANDZO:
3 Q. If I can just follow up on that,
4 Mr. Pedecine, let's take that example one step
5 further --
6 JUDGE ROBERTS: Apparently it
7 hasn't helped.
8 MR. HANDZO: Well, I'm slow, Judge.
9 BY MR. HANDZO:
10 Q. If you have the license taken in
11 the second year --
12 A. Yes.
13 Q. -- and now you have 15 months of
14 activity to report, as you were explaining to
15 us, and then that fee is not paid on time, are
16 you going to show that whole 15 months as
17 late?
18 A. The amount -- in that example, I
19 would foresee that the amount that equals the
20 15 months worth of activity -- you're saying
21 is part of a quarterly that's paid after
22 May 15, right?


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1 Q. Right?
2 A. Would be deemed late, but the
3 interest calculation on that 15 months worth
4 of royalties would only be to the extent of
5 the difference between -- following May 15 and
6 say, for example, the first week of June, so
7 it's half a month's worth of interest. So
8 we're not calculating it for 15 months, no.
9 Q. Well, I am not asking you about
10 your late fee calculation.
11 A. Oh, I'm sorry.
12 Q. I'm asking you about how your
13 database works. In your database --
14 A. Yes.
15 Q. -- when you're giving us the
16 numbers of dollars associated with late fee
17 payments, you would show that whole 15 months
18 as late, right?
19 A. Of course, because we're treating
20 it just as if it was a quarter as well.
21 Q. And, in fact, though, you're
22 holding onto advances covering some part of


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1 that period, correct?
2 A. Right. But the way most of the --
3 not necessarily all, but most of the
4 arrangements work with the record companies in
5 such an instance, the -- they're entitled to
6 apply part of the advance to the extent that
7 items that were underlying the advance that
8 supported their determination of the advance
9 number clear.
10 So in that example, if there had
11 been money at the end of December of that
12 first year, or the 12 months it accumulated,
13 that, along with any such items, the record
14 company said, well, our advance balance needs
15 to be $22 million at the end of December.
16 And come February 15, there is an
17 adjustment made up or down, depending on how
18 that compares to what advance balance was on
19 hand. But when they would then get to doing
20 the same thing again at the end of March, in
21 concert with their May 15 accounting,
22 everything else being equal, that 15 months


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1 worth of royalties that had built up -- you
2 know, the 12 months pre-license and the three
3 months, let's say, post-license, 15 months --
4 they could apply the advance towards that.
5 They could recoup.
6 So if nothing else changed, they
7 would reduce their quarterly payment, you
8 know, by an offset to the advance in respect
9 to those items.
10 Q. I understand that that's how the
11 record companies might do it, but if they
12 didn't actually make the payment, then you're
13 going to be showing that whole 15 months as
14 late when, in fact, you got an advance for a
15 lot of it, right?
16 A. I don't understand -- I'm sorry.
17 When you say we have the advance for it -- but
18 once they have put it into that royalty
19 statement period, you're saying they're taking
20 it out -- they're going to apply it to the
21 advance, and now it becomes payable on a
22 real-time basis. So it can't be in both


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1 places.
2 So that now that they're going to
3 use the advance when they account on May 15,
4 to the extent they use it, that reduces their
5 cash obligation against the rest of the
6 royalties for that quarter, and it's that net
7 number that would be late. Does that follow?
8 Q. But I thought you told us earlier
9 that in your database --
10 A. Yes.
11 Q. -- you're not showing that net
12 number; you're showing the whole 15 months if
13 they don't make any payment on the due date.
14 A. There is no way to align the
15 advance to that because, in those numbers,
16 there is no assurance any advances would have
17 cleared or pertained to the company because
18 many of those line items are for record
19 companies with no advances. Probably the
20 lion's share.
21 Q. Okay. But I take it, then, the
22 answer to my question is yes. In a situation


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1 where the record company doesn't make that
2 first payment, you're going to be showing the
3 whole 15 months as late even though this may
4 be a record company that actually has an
5 advance covering a portion of it?
6 A. Right. But if that payment that's
7 in the database is net of their application of
8 recoupment, then they got the benefit of the
9 advance, if it's in a situation where an
10 advance exists.
11 Q. I am just talking about the numbers
12 that show up in your database.
13 A. But the number in that database,
14 the cash receipts -- when a record company
15 tells us they owe a number, a million dollars,
16 well, if that's net of $300,000 of recoupment,
17 the database has the net cash receipts, so it
18 wouldn't be a million-3 and then separately,
19 outside that database, is the $300,000 of
20 recoupment in this example. It's the net
21 number. So, in effect, they would have gotten
22 the benefit to the extent they recouped


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1 against an advance.
2 Q. Right. That's if they actually
3 submit the payment and take the recoupment,
4 right?
5 A. That's how they utilize their
6 advances. So I wouldn't understand why they
7 wouldn't take the benefit for the recoupment.
8 Q. Just switching subjects a little
9 bit, Mr. Pedecine, HFA has standard form
10 license agreements, does it not?
11 A. Yes.
12 Q. One for physical product, right?
13 A. Yes.
14 Q. Another one for digital products?
15 A. I believe so, yes.
16 Q. And in neither of those standard
17 form agreements do you obtain late fees from
18 your licensees, correct?
19 A. Our standard form does not provide
20 for late fees. The only way a late fee would
21 be in there is if at a publisher's specific
22 request -- or instruction, I should say.


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1 Q. Let me ask you a few questions
2 about your proposed 3 percent fee for
3 pass-through licensing.
4 A. Yes, sir.
5 Q. One of the issues that I believe
6 you raised on direct is this idea that because
7 there might be a 30-day lag in reporting
8 those, if it's reported in the third month of
9 a quarter, you're going to lose a quarter of
10 payment; is that right?
11 A. It would be delayed by 90 days,
12 yes.
13 Q. So -- but that's not going to be
14 the effect if it's -- if the license is taken
15 in the first or second month of a quarter,
16 right?
17 A. You mean if -- sales from the first
18 or the second month of the quarter?
19 Q. Sure.
20 A. No, because presumably they would
21 still be picked up in the quarter. It's just
22 always the third month that's being rolled


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1 forward into the next quarter.
2 Q. Okay. So the issue that you're
3 raising only applies to the third month of the
4 quarter, right?
5 A. Yes. I'm sorry if I wasn't clear
6 about that.
7 Q. But the fee that you're proposing
8 would apply regardless of when the activity
9 occurs, right?
10 A. It would be applied, in the case of
11 Harry Fox with the quarterly reporting,
12 against the entire quarter.
13 Q. Right. So, for example, if the
14 record company reports in the first month of
15 the quarter, that's not going to raise the
16 issue that you're talking about here, right?
17 A. I don't understand. If they report
18 in the first month of the quarter?
19 Q. Sure.
20 A. Pardon?
21 Q. If they report in the first month
22 of the quarter -- so even if they're, you


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1 know, 30 days late, it's not going to affect
2 the payment that quarter, right?
3 A. I'm sorry if I am --
4 Q. It may be my question.
5 A. I'm just trying to understand the
6 question.
7 Q. Let me ask it this --
8 A. There is quarter's worth of
9 royalties.
10 Q. Let me ask it this way.
11 A. Yes.
12 Q. This proposed 3 percent fee for
13 pass-through --
14 A. Yes.
15 Q. -- is going to apply, in your view,
16 whether or not the payment is late, right?
17 A. It would be applied to the entire
18 quarter. We would not be looking at exactly
19 the content of the reporting, because we
20 normally can't tell what month anything is.
21 That's why we have to discover this through
22 RCEs.


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1 Q. So with respect to this 3 percent
2 payment --
3 A. Yes.
4 Q. -- your proposal would be to apply
5 it to every pass-through license, even if the
6 payments are completely on time; isn't that
7 right?
8 A. If there is no deferral of a month?
9 Q. Yes.
10 A. That's my understanding.
11 Q. Okay. Just applies across the
12 board, late or not?
13 A. Right, in order to address the
14 lateness and the audit issue.
15 CHIEF JUDGE SLEDGE: Well, late or
16 not I think confuses the question. Let me
17 restate what I think you were intending to ask
18 and see if this gets the same answer.
19 The problem you have with
20 pass-throughs arises for those royalties that
21 result from usage in the last month of a
22 quarter.


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1 THE WITNESS: Yes, Your Honor.
2 CHIEF JUDGE SLEDGE: The proposal
3 for pass-throughs applies to all usage that is
4 a result of a pass-through agreement.
5 THE WITNESS: For that quarter.
6 CHIEF JUDGE SLEDGE: Right. And is
7 not limited to only the royalties that arise
8 from usage in the last month.
9 THE WITNESS: No. I don't know any
10 ready way to apply that, but it's intended to
11 address that fact for that third month, yes.
12 CHIEF JUDGE SLEDGE: Well, you're
13 applying three months to address the fact for
14 one month.
15 THE WITNESS: In practice, I would
16 think yes.
17 CHIEF JUDGE SLEDGE: All right.
18 Thank you.
19 BY MR. HANDZO:
20 Q. Mr. Pedecine, I just have a few
21 more questions about the actual numbers that
22 came out of your database analysis. And with

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1 some apologies the court for the volume of
2 paper -- Mr. Pedecine, I am showing you what
3 we have marked as RIAA Trial Exhibit 94.
4 A. Uh-huh.
5 Q. Have you seen this before?
6 A. Just one moment. It's very similar
7 to something I have seen before, not
8 necessarily sorted in the same order in which
9 I saw it.
10 Q. Okay. This appears to be a
11 printout from your database, correct?
12 A. The information content totals --
13 yes, it does, just not in the same order.
14 Q. Okay. And as you say, it's not in
15 the same order; it's actually sorted by the
16 number of days late, right?
17 A. I see.
18 Q. Is that right?
19 A. It appears to be in ascending
20 order, yes.
21 Q. Right. So the payments that are
22 just one day late are on the first pages,


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1 right?
2 A. It appears that way, yes.
3 Q. And the payments that are latest
4 are at the end, right?
5 A. Yes.
6 Q. Now, you've testified that the
7 total late payments from this period are, I
8 believe, something on the order of $2.1
9 billion; is that correct?
10 A. Total of this report, total late --
11 yes, almost 2.2 billion. Yes.
12 Q. Now, looking at the first five
13 pages or so, which are the payments that are
14 one day late --
15 A. Uh-huh.
16 Q. -- it appears, does it not, that
17 some of those one-day-late payments are really
18 quite substantial, millions of dollars, right?
19 A. Sure.
20 Q. And looking at the ones that are,
21 oh, 5,000 days late at the end, most of those
22 are quite small numbers, right?


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1 A. At the very end, yes.
2 Q. Now, isn't it correct that a very
3 substantial percentage of the 2.1 billion you
4 say is late was, in fact, paid only one day
5 late?
6 A. One day, or some limited number of
7 days, yes.
8 Q. And is it not true that if we
9 eliminated from your database the payments
10 that are a week late or less, the total late
11 payments would drop by 75 percent?
12 A. I can't speak to the percentage. I
13 don't have the calculation.
14 Q. Okay. You haven't done that
15 calculation?
16 A. No.
17 Q. Now, there are some license
18 agreements that Harry Fox negotiates that do
19 carry a late payment, aren't there?
20 A. There are some. I alluded to that
21 earlier.
22 Q. And, generally, on those occasions


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1 where Harry Fox does negotiate that, the late
2 payments start 30 days after the payment is
3 due, correct?
4 A. I'm sorry. Say that again.
5 Q. Where Harry Fox does manage to
6 negotiate a late fee, generally speaking, the
7 late fee begins to accrue 30 days after the
8 payment is due, correct?
9 A. I would have to see a specific
10 agreement because, to the extent -- in our
11 normal mechanical licenses, if a late fee
12 provision has been inserted, it's at a rate
13 and in a form that is required by that
14 particular client, that is principal for us,
15 the agency relationship.
16 Q. Isn't it true that, in this data,
17 only 10 percent of the dollars that are late
18 were more than 30-days late?
19 A. I didn't do that calculation, so I
20 can't confirm that. I can only speak to that
21 I'm not surprised by what you're saying in
22 terms of that because the interest that was


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1 calculated, you know, implies that, on a
2 dollar-weighted basis, it's going to be --
3 let's see. They're not nearly as substantial.
4 But it's late. They have already had 45 days
5 in which to pay it.
6 MR. HANDZO: Your Honor, I would
7 offer RIAA Trial Exhibit 94 into evidence.
8 CHIEF JUDGE SLEDGE: Any objection
9 to Exhibit 94?
10 MR. COHEN: No, Your Honor.
11 JUDGE WISNIEWSKI: Not even on
12 environmental grounds?
13 MR. COHEN: Probably have an
14 argument that goes to the weight of the
15 evidence.
16 MR. HANDZO: I'm afraid the
17 environmental cost is sunk, Your Honor.
18 CHIEF JUDGE SLEDGE: Without
19 objection, the exhibit is admitted.
20 (RIAA Trial Exhibit No. 94 was
21 received into evidence.)
22 BY MR. HANDZO:


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1 Q. Thank you, Mr. Pedecine. That's
2 all I have.
3 CHIEF JUDGE SLEDGE: Cross by DiMA?
4 CROSS-EXAMINATION
5 BY MR. LAGUARDA:
6 Q. Good morning, Mr. Pedecine. My
7 name is Fernando Laguarda. I represent the
8 Digital Media Association.
9 You testified that the shift to
10 digital has increased the expense and
11 complexity of your auditing process; is that
12 right?
13 A. Yes. We have seen the start of
14 that.
15 Q. And this isn't because you had any
16 specific problems with data or reports that
17 you have received from digital services, is
18 it?
19 A. I am just trying to remember one
20 particular exam. I think we did have some
21 data problems for one digital service, but --
22 or I've used a digital distributor --


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1 CHIEF JUDGE SLEDGE: Speak up.
2 THE WITNESS: I'm sorry, Your
3 Honor.
4 In one exam where we had a direct
5 license with a digital distributor, I believe
6 we did have some data problems. But the
7 majority of what I am speaking to is the
8 conceptual level of having to assess a
9 computerized environment and so on and so
10 forth that's contained.
11 BY MR. HANDZO:
12 Q. And in your testimony where you
13 talk about how a percentage of revenue rate
14 structure would complicate Harry Fox's royalty
15 compliance audits, how many audits or RCE
16 processes has Harry Fox done with respect to
17 digital music services?
18 A. One, to date.
19 Q. Do you have any idea what that
20 represents as a percentage of all of the RCEs
21 that you have done?
22 A. Relatively small so far because


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1 it's -- by its nature, we're looking backwards
2 to where it's an earlier portion of the growth
3 of the digital business. It's only one
4 distributor with one configuration at that
5 point for permanent downloads. And -- so it
6 would be a small percentage to date. It's a
7 question of looking forward to the future and
8 what we anticipate in terms of a change in the
9 playing field.
10 Q. So as I understand it, your
11 testimony is describing some problems that
12 Harry Fox has been having with licensees and
13 proposing, as a result, adjustments to the
14 statutory license, specifically late fees? Is
15 that one of the things that you're proposing?
16 A. Like I said earlier, I support the
17 late fee proposal, yes.
18 Q. And more recordkeeping
19 requirements; is that another proposal that
20 you're making?
21 A. I believe the copyright owners
22 included some recordkeeping requirements, yes.


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1 And it's in my statement that they do.
2 Q. And more detailed reporting
3 requirements as well? Is that another
4 proposal that you are supporting in changing
5 the statutory license?
6 A. That the detail is laid out, right.
7 Q. And a surcharge for pass-through
8 licensing is another proposal, to change the
9 statutory license terms?
10 A. Yes.
11 Q. And why doesn't Harry Fox just
12 require all of this in marketplace licenses?
13 A. As I believe I stated earlier, we
14 find that where our -- if the requirements of
15 our license vary from the statutory or the
16 compulsory license are less stringent, we
17 typically would not meet with much resistance.
18 If they're more stringent, it becomes
19 difficult.
20 By way of example, our -- I believe
21 our DPD license asks for certain breakdowns
22 and breakouts of information. It's proven


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1 difficult to get from a number of licensees.
2 Some have improved, but it has been over the
3 course of years as opposed to the first time
4 they reported or the second time they
5 reported.
6 Were the reporting provisions
7 required, if you will, in the -- under the
8 statute and the CFR and so forth, if the late
9 payment fee is specified in there, it would be
10 certainly incorporated in ours and I would
11 expect far more likely to be taken into
12 consideration and/or complied with by the
13 licensees.
14 Q. But what you're saying is you can't
15 get any of that in the marketplace, right?
16 A. Not readily. That's why I, for
17 example, said, with respect to the DPD license
18 where we have set out certain requirements for
19 some time now, we have made some progress, but
20 it's not immediate. It's somewhat of an
21 uphill battle.
22 Q. So these terms are better than


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1 marketplace terms is what you're looking for
2 here?
3 A. Better than -- I'm sorry. What do
4 you mean by better than marketplace?
5 MR. LAGUARDA: No further
6 questions. Thank you.
7 CHIEF JUDGE SLEDGE: Redirect?
8 MR. COHEN: No, Your Honor.
9 CHIEF JUDGE SLEDGE: Mr. Pedecine,
10 I have a question similar to what Mr. Laguarda
11 was just asking you, but a little more
12 specific. It appears to me that the request
13 for a fee on pass-through agreements is to
14 compensate for a consequence of the statute
15 that allows pass-through agreements. It does
16 not -- it is not a consequence of any action
17 by participants or parties, but it is a
18 consequence of the provision that allows the
19 labels to authorize this use in a pass-through
20 agreement. Is that a correct understanding?
21 THE WITNESS: I think, if I follow,
22 yes, it's a result of the consequence of


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1 what's being done in the alternative of what
2 could otherwise be done, which would be a
3 direct license to the service, Your Honor.
4 CHIEF JUDGE SLEDGE: So given that,
5 it seems to me that what you're doing is
6 raising an objection to the statutory
7 provision, and you're sad that the statute
8 permits the labels to do this and, because the
9 statute does permit them to do this, then
10 you're seeking some additional revenue as a
11 result of that.
12 THE WITNESS: Well, Your Honor, I
13 haven't thought about being sad, but I guess I
14 am somewhat that the consequence of what is
15 transpiring is likely -- I can only say
16 likely, because we don't have that access to
17 conduct the exams under the so-called
18 pass-through arrangement -- probably less
19 royalties that would otherwise be payable to
20 the publishers, yes, Your Honor.
21 CHIEF JUDGE SLEDGE: And that
22 concern seems to me to be a very valid


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1 concern, but it also seems to me that that's
2 something you have to raise to Congress and
3 not to -- in this proceeding.
4 THE WITNESS: I see.
5 CHIEF JUDGE SLEDGE: Any other
6 questions?
7 Any follow-up?
8 Thank you. That ends your
9 testimony.
10 THE WITNESS: Thank you.
11 (Witness excused.)
12 CHIEF JUDGE SLEDGE: We will recess
13 for one hour.
14 (Recess.)
15
16
17
18
19
20
21
22


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1 A F T E R N O O N S E S S I O N

2 (1:10 p.m.)

3 CHIEF JUDGE SLEDGE: Come to order.

4 Mr. Cohen?

5 MR. COHEN: Your Honor, the

6 copyright owners call William Landes.

7 Whereupon,

8 WILLIAM LANDES,

9 called for examination by counsel, and having

10 been previously sworn by the Chief Judge, was

11 examined and testified as follows:

12 CHIEF JUDGE SLEDGE: Professor

13 Landes, please have a seat and remember that

14 you remain under oath in your testimony.

15 THE WITNESS: Yes.

16 MR. COHEN: May I proceed, Your

17 Honor?

18 CHIEF JUDGE SLEDGE: No.

19 Is there any objection to taking

20 Professor Landes out of order of the witness

21 list submitted?

22 MR. SMITH: Your Honor, it was my


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1 understanding that he was the next witness on
2 the list.
3 CHIEF JUDGE SLEDGE: Mr. Russell is
4 the next witness.
5 MR. COHEN: Your Honor, I don't
6 believe that's true in the last letter that
7 was sent to the court. I apologize if --
8 CHIEF JUDGE SLEDGE: Is there an
9 objection?
10 MR. SMITH: There is no objection,
11 Your Honor.
12 MR. LAGUARDA: None, Your Honor.
13 CHIEF JUDGE SLEDGE: Mr. Cohen.
14 MR. COHEN: Thank you, Your Honor.
15 DIRECT EXAMINATION
16 BY MR. COHEN:
17 Q. Good afternoon, Professor Landes.
18 A. Good afternoon.
19 Q. Do you still teach at the
20 University of Chicago law school?
21 A. Yes.
22 Q. And have there been any changes in


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1 your professional status in any way since you
2 were last here in February?
3 A. Probably a couple of new articles
4 and one honor.
5 Q. And what is that, sir?
6 A. I was recently elected as a fellow
7 of the American Academy of Arts and Sciences.
8 MR. COHEN: Your Honor, may I
9 approach the witness?
10 BY MR. COHEN:
11 Q. Professor Landes, I am going to
12 show you what we have marked as Copyright
13 Owners' 406 for identification. Do you
14 recognize Exhibit 406?
15 A. Yes.
16 Q. Now, sir, I am going to direct your
17 attention to the page after your signature
18 page. Do you see there is an errata sheet
19 there?
20 A. Yes, I do.
21 Q. Now, am I correct that the majority
22 of these errata deal with a study that you


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1 conducted of songwriter mechanical and other
2 income for songwriters whose works are
3 administered by Universal Music Publishing?
4 A. That's correct.
5 Q. Okay. Before we get to that, could
6 you explain to the court what was the purpose
7 of conducting a songwriter study?
8 A. Yes. I think it's fairly
9 straightforward: Because the party that's
10 likely to be most impacted by changes in the
11 mechanical rate are the songwriters. We know
12 that the songwriters receive about 75 percent
13 of the mechanical distributions. Hence, a
14 change in the mechanical rate is clearly going
15 to have an impact on songwriters.
16 I was not aware of any empirical
17 work that dealt with the earnings, the
18 potential impact of changes in the mechanical
19 rate on songwriters, in particular, how
20 important are mechanical royalties to a
21 songwriter relative to its other sources of
22 income.


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1 So the purpose of the study was to
2 provide information, provide statistics,
3 provide data on the earnings of a sample of
4 songwriters. These were songwriters whose
5 songs were administered by Universal.
6 Q. And can you explain to the court
7 the methodology that you used to go about
8 performing your study?
9 MR. SMITH: Objection, Your Honor.
10 We have a pending motion to exclude testimony
11 about this study which I intend to raise once
12 he has elaborated on the corrections that have
13 been made. But to start going into a long
14 exegesis about the substance of the study at
15 this point, when it's not in evidence, seems
16 to me premature and inappropriate.
17 CHIEF JUDGE SLEDGE: Mr. Cohen?
18 MR. COHEN: Your Honor, I don't
19 think we can simply go to the errata without
20 understanding what we're talking about. I am
21 trying to put it in perspective. I am not
22 trying to present the results of the study. I


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1 am well aware of the motion, obviously, but I
2 am trying to lay a foundation for what was
3 done, and then I will address the criticism of
4 the RIAA that was laid out in the motion to
5 exclude.
6 But it's very difficult to do that
7 without putting the study in context.
8 CHIEF JUDGE SLEDGE: Overruled.
9 BY MR. COHEN:
10 Q. Professor Landes, let me rephrase
11 the question. What I am asking is, can you
12 please explain to the court the methodology
13 that you employed to do this study in a
14 general way?
15 A. Well, we had data from Universal on
16 the Universal songs, as well as the
17 songwriters. We had both royalty -- we had --
18 the primary focus was on their -- the royalty
19 file, which gave us information on the
20 royalties directly received by the songwriters
21 from Universal. Since we were interested in
22 looking at the songwriters' overall income,


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1 not just the income from mechanicals, we also
2 wanted to come up with an estimate of what the
3 songwriter was paid directly by one of the
4 performing rights societies. So, for that, we
5 had to use the -- another file, which is the
6 income file. The income file is the income
7 received by the publisher.
8 And we took as an approximation
9 that if the publisher, for example, received
10 $100 in performance royalties from ASCAP, that
11 the songwriter also got a direct check from
12 ASCAP of $100 since my understanding is that
13 the typical arrangement with the performing
14 rights societies is they write a check to the
15 publisher and a check for -- to the songwriter
16 in equal amounts.
17 Q. Now, where was the mechanical? In
18 which database was the mechanical royalty
19 information contained?
20 A. Mechanical royalty information is
21 in the royalty database.
22 Q. And then -- can you tell us, then,


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1 initially and you filed in your written
2 rebuttal testimony.
3 A. Approximately 9,500 songwriters.
4 Q. And how did those songwriters come
5 to be included in the study?
6 A. Well, our interest was to get a
7 consistent group of songwriters, songwriters
8 that appeared in every single year. After
9 all, I mean, if you take an analogy -- don't
10 like to use Paul Weiss as an example, but you
11 can imagine you're looking at the average
12 earnings of partners at Paul Weiss over a five
13 or six-year period, and if in one year, for
14 example, you added a labor practice which,
15 let's say, you hadn't had before and was
16 extremely profitable, if you looked at the
17 average earnings of partners, it may show a
18 substantial increase due to the fact that
19 you've added an additional group of partners
20 in this labor practice.
21 What you're interested in -- what I
22 was interested in is, look, let's take a group


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1 of songwriters that have been in the Universal
2 database for all seven years. Let's not take
3 songwriters who dropped out as well as
4 songwriters that may have been added. What --
5 we were looking at, how is the -- what do the
6 earnings look like? What do the mechanical
7 royalties look like? How important are
8 mechanical royalties relative to other
9 earnings for a group of songwriters that are
10 in the sample for the full seven years?
11 Q. And did you also look at some kind
12 of subgroup?
13 A. We also looked at a subgroup to
14 eliminate extreme values, the top 1 percent of
15 songwriters as well as those songwriters that
16 earn approximately less than a thousand
17 dollars -- on average, a thousand dollars per
18 year. So that gave us a narrower group of
19 songwriters of about 4500.
20 The idea behind that was to pick
21 out another consistent sample that wasn't
22 influenced by a few songwriters earning a


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1 great deal of money and a large number of
2 songwriters earning, on average, less than a
3 thousand per year.
4 Q. How many songs were in the study
5 that you performed that are reflected in your
6 written rebuttal testimony that was filed
7 earlier in April?
8 A. Well, the number of songs varied
9 per year. They were typically in the order
10 of 90,000, although the last two years, 2005
11 and 2006, the data we received from Universal
12 truncated the number of songs at 99,999.
13 Q. Now, are you aware, sir, that last
14 week the RIAA filed a motion to exclude your
15 study?
16 A. Yes.
17 Q. And do you have an understanding of
18 what the criticism is of the study that you
19 originally performed?
20 A. Yes, I do.
21 Q. Could you tell us what that is?
22 A. Well, it results from the


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1 truncation problem, and that is in the two
2 years, 2005 and 2006, the songs on the -- that
3 received royalties as opposed to the songs
4 that received income -- income being what was
5 paid to Universal; royalties is basically what
6 the songwriter earned. On the royalty
7 database, it was truncated at, as I said,
8 99,999. So I knew that a handful, a number of
9 songs were excluded.
10 But these songs in 2005, in terms
11 of royalties, all earned -- none of them
12 earned more than the lowest earnings of the
13 99,999th song, which I think in -- I don't
14 remember the exact numbers, but it was
15 somewhere on the order of $2. So you were
16 excluding songs that in the royalty database
17 earned very little.
18 Similarly, in 2006, you were
19 excluding songs in the royalty database that
20 earned less than -- I think it's about $4.20.
21 So we're basically -- what I
22 thought we were doing was we were eliminating


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1 some songs that earned very little, that if we
2 had had the information on those songs, it
3 would not have changed our analysis one whit.
4 Q. Why not?
5 A. Because the songs excluded -- at
6 least the songs that I thought were excluded
7 all had earnings of less than, in the royalty
8 database, of $2.00 or $4.00 for the year 2006.
9 So it's true we might have been excluding the
10 earnings of some songwriters. If they had --
11 they were included in our sample and they had
12 songs that earned more than these threshold
13 low values, we would have excluded some of
14 their income that arose from those low-earning
15 songs.
16 Q. And since receiving the RIAA
17 motion, have you had a chance to rerun your
18 analysis to take into account the truncation
19 problem that was identified in that motion?
20 A. Yes, I have.
21 Q. And what impact, if any, did that
22 reanalysis have on your findings and


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1 conclusions?
2 A. Negligible --
3 Q. Could you be more specific?
4 A. -- in that if you look through the
5 figures, I don't think you could -- if you
6 looked at the two figures side -- any of the
7 two figures -- any figures side by side, you
8 could detect which one has the error by
9 eliminating some earnings. It turns out,
10 because of the coding procedure it used, we
11 also eliminated some songwriters as well.
12 But, again, I don't think -- if you look at
13 the charts, you couldn't tell them apart.
14 Q. Could you turn to tab 2 in
15 Exhibit 406, which is average mechanical
16 royalty -- you will see a Figure 2-A and a
17 corrected 2-A. Do you see that? Behind
18 tab -- it's behind tab 2-A.
19 A. Yes, I do.
20 Q. Now, could you walk us through the
21 original and the changes as a result of
22 correcting for the truncation problem to


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1 illustrate that point?
2 A. Well, the original has, as I
3 mentioned earlier, about 9500 songwriters.
4 This is their average income for -- average
5 mechanical royalty income that we extract from
6 the royalty database.
7 And as you can see, it starts in
8 real terms -- everything is put in 2007
9 dollars -- somewhere a little bit under
10 13,000, and then ends up in 2006 somewhere on
11 the order of 10,000.
12 If you turn to the next page,
13 right, which is corrected Figure 2-A, that
14 does two things that relative to Figure -- the
15 first 2-A, the uncorrected one. The two
16 things being, one, it takes account of these
17 low values that were -- low values, low
18 earnings for songwriters or low earnings -- I
19 should say, to be more explicit, low earnings
20 for songs that were excluded. That's one
21 thing. So it would tend to -- one of the
22 adjustments would be to increase slightly the


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1 earnings of some of the 9500 songwriters in
2 our sample.
3 In addition, because of our desire
4 to have a consistent set of songwriters --
5 that is, songwriters that appear in all seven
6 years -- it meant that some songwriters,
7 because they were below -- their songs were
8 below the threshold in 2005 and 2006, they did
9 not appear as songwriters; therefore, they
10 were excluded from our analysis.
11 So that led us to increase -- that
12 adjustment leads us to increase the number of
13 songwriters from about 9500 to 10,200. So
14 we're adding 700 songwriters. Typically, and
15 not surprisingly, these are going to be
16 songwriters who, on average, have relatively
17 low royalty income, low mechanicals, because
18 the reason why they were excluded was because
19 their mechanical earnings in 2005 and 2006
20 were below the threshold.
21 So once we add those songwriters
22 back to our analysis, we come up with more


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1 songwriters but, on average, the effect is to
2 reduce slightly, all right, the mean
3 mechanical royalty income for our full sample
4 of songwriters.
5 As I said, we have more
6 songwriters -- 700 more songwriters. And in
7 addition to that, we have slightly higher
8 income in two years, 2005 and 2006, for those
9 songwriters whose songs were excluded because
10 they fell below the thresholds.
11 Q. The truncation problem that you
12 mentioned, does it affect any of the years
13 2000 through 2004 in terms of the data that
14 you used?
15 A. Well, it does not affect it for the
16 initial songwriters in our sample, for the
17 songwriters in our sample who were there
18 between -- you know, the 9500 songwriters. It
19 only affects those songwriters' income in the
20 years in which some of their songs dip below
21 the threshold because, in the other years,
22 there was no truncation problem. We had


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1 royalty income for every single song.
2 So although it was high -- the
3 number of songs could be 92,000, 93,000 --
4 there were no songs that dipped below a
5 threshold of, you know, the 102nd song or --
6 the 101,000th song or the 101,001th song. In
7 principle, those songs did not exist from the
8 years 2000 to 2004.
9 Q. Would you turn to Figure 3-A. Is
10 this analysis with respect to what you have
11 called the songwriter subgroup?
12 A. Yes.
13 Q. And just remind us again how that
14 subgroup was constructed.
15 A. This was an effort to eliminate
16 songwriters at both extremes, those
17 songwriters that one might think are not
18 typical who earn extraordinarily large sums of
19 money, and at the same time those songwriters
20 who, for whatever reason, are earning
21 relatively little income. So that reduced our
22 sample from 9500 songwriters to approximately


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1 4500 songwriters. And that's what we refer to
2 as the songwriter subgroup.
3 So we have eliminated about 95 very
4 high earners, but we have eliminated, right,
5 close to 4,000 people whose average
6 earnings -- or average royalties, I should
7 say -- average royalties is less than a
8 thousand dollars per year.
9 Q. And if you look at Figure 3-A in
10 what you have labeled as corrected Figure 3-A,
11 does correcting for that truncation problem
12 have any material effect on what you find with
13 respect to mechanical income for the
14 songwriter subgroup?
15 A. No. I mean, you know, anyone who
16 looks at it -- you don't have to be an
17 economist to look at it -- you would say those
18 two figures are identical. They're virtually
19 identical. There are small differences, but
20 given the scales that we have, you're not
21 going to be able to detect those differences
22 even though the songwriter subgroup contains


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1 additional songwriters, because it's based on
2 selecting from the songwriter group of 10,200
3 to whittle it down to eliminate the extremes,
4 so you're getting more songwriters in this
5 sample on 3-A.
6 On the other hand, there is no
7 difference between the original 3-A and the
8 corrected 3-A.
9 JUDGE WISNIEWSKI: You say there is
10 no difference. Are you just talking about the
11 shape of the curve as opposed to its position
12 on the axis?
13 THE WITNESS: I am talking, one,
14 about the shape and, one, about the average
15 values. They're very small.
16 JUDGE WISNIEWSKI: But there is a
17 difference.
18 THE WITNESS: Yes, and we reproduce
19 that difference. It's a few dollars. It's
20 not a big difference.
21 JUDGE WISNIEWSKI: And the latter
22 would be -- the corrected version is slightly


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1 lower.

2 THE WITNESS: Slightly lower.

3 JUDGE WISNIEWSKI: Throughout

4 the --

5 THE WITNESS: Right. Which you

6 would expect, right, precisely because you're

7 adding songwriters --

8 JUDGE WISNIEWSKI: I just wanted to

9 make sure that we're talking about the same

10 thing.

11 THE WITNESS: I don't mean to say

12 that there is no effect of this, just that the

13 effect is negligible, and negligible meaning a

14 few dollars.

15 BY MR. COHEN:

16 Q. Let me turn your attention to tab 8

17 which reflects -- which has Figure 8 and

18 corrected Figure 8. Let me know when you're

19 there.

20 So starting with Figure 8, not the

21 corrected Figure 8, what were you trying to

22 portray in these series of bar graphs?


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1 A. Well, because this proceeding has
2 to do with mechanical royalties, and since the
3 songwriters are the ones that are principally
4 impacted by changes in mechanical royalties --
5 and we do know that songwriters have other
6 sources of royalty income. Some receive
7 synchronization, performance income or
8 royalties from sheet music and so forth.
9 What I was interested in addressing
10 was -- the question is, how important are
11 mechanical royalties for a songwriter relative
12 to its total royalty income, including, right,
13 our estimate of the performance royalties paid
14 directly to the songwriter?
15 So if you look at Figure 8, for
16 example, you will see that -- this is the
17 uncorrected, or our original -- you will see
18 that over 14 percent of the songwriters
19 receive between 95 and 100 percent of their
20 royalty income from mechanicals. You don't
21 have to go down it one by one, but it's close
22 to 40 percent of the songwriters receive more


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1 than 75 percent of their royalties from
2 mechanicals, and more than 50 percent of the
3 songwriters receive more than 50 percent of
4 their royalties from mechanicals.
5 Q. Now, would you turn the page and
6 look at the corrected figure?
7 A. The corrected one is very similar.
8 I mean, I look at the corrected one, and there
9 are some small changes. It may not be 40
10 percent -- I don't have the figures in front
11 of me. It may not be that 40 percent receive
12 75 percent of their mechanicals from -- excuse
13 me -- 40 percent receive 75 percent of their
14 royalties from mechanicals. I think it may go
15 down to, you know, 38 percent or something
16 along those lines.
17 So there are some small numerical
18 changes. But the purpose of using these
19 figures -- the main purpose was not to say,
20 well, it has to be 40 percent, and if it's
21 42 percent or 45 percent, that's important.
22 What we were trying to illuminate or try to


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1 answer the question was, how important are
2 mechanical royalties for songwriters relative
3 to the overall royalties they receive?
4 And I think in both figures
5 Figure 8 and the corrected Figure 8, they
6 strongly make the point that a significant --
7 for a significant fraction of songwriters,
8 mechanical royalties are an important source
9 of their royalty income.
10 Q. And do Figure 9 and corrected
11 Figure 9 portray what we find per share for
12 the songwriter subgroup?
13 A. Yes. This is the songwriter
14 subgroup, which eliminates the -- as I said
15 before -- the songwriters at the extremes,
16 those that have earnings -- royalties on
17 average less than 10,000, those -- the top
18 1 percent which, on average, have royalties
19 close to 500,000 a year.
20 Here, it's somewhat flatter. But,
21 again, the same point holds, that a
22 significant fraction of this subgroup in


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1 Figure 9, as well as in corrected Figure 9, a
2 significant fraction, right -- it's close to
3 40 percent, probably 35 percent receive more
4 than 75 percent of their royalty income is a
5 result of mechanical royalty.
6 Q. Professor Landes, you said you
7 didn't have the numbers in front of you, but
8 let me direct you to the errata sheet
9 following your signature page in front of the
10 exhibits, sir?
11 Do you see that errata sheet?
12 A. Yes, I do.
13 Q. And then would you look at page 11,
14 paragraph 21. Is this where you make these
15 corrections with respect to mechanical share?
16 I wonder if you could review this with the
17 court, because I think you have the actual
18 numbers set out here.
19 A. Page 11, paragraph 21?
20 Q. Page 11, paragraph 21.
21 A. So it's the bottom of the first
22 page on the errata?


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1 Q. Yes, sir.
2 A. The third sentence specifically
3 reads, "Almost two-thirds of the songwriters
4 in the full songwriter sample receive one-half
5 or more of their royalty income from
6 mechanical revenues, and almost 40 percent
7 receive three-quarters or more of their
8 royalty income from mechanical revenues."
9 It should read, specifically,
10 "61 percent" -- instead of almost
11 two-thirds -- "61 percent of the songwriters
12 in the full sample receive one-half or more of
13 their royalty income from mechanicals, and
14 39 percent" -- not 40 percent -- receive
15 three-quarters of their royalty income from
16 mechanical revenues."
17 Q. And what are the corresponding
18 changes in the subgroup?
19 A. And the corresponding figures in
20 the next group are for the subgroup of
21 songwriters, those that eliminate the
22 extremes. And there it goes without --


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1 55 percent of songwriters receive one-half or
2 more of their royalty income from mechanicals;
3 30 percent receive three-quarters or more.
4 And in the second sentence --
5 second part of that it should read, if you use
6 the corrected figures, 54 percent, instead of
7 55 percent, and 28 percent instead of 30.
8 But, again, you know, it doesn't
9 change at all any of the conclusions that I
10 drew from this analysis.
11 Q. Sir, let me also direct your --
12 JUDGE WISNIEWSKI: Professor
13 Landes -- if you would --
14 MR. COHEN: Yes, of course, Your
15 Honor.
16 JUDGE WISNIEWSKI: I just wanted to
17 clarify something for purposes of the record,
18 because I think you used a different number
19 earlier when you were testifying without
20 looking at the numbers.
21 THE WITNESS: I'm sure I was.
22 JUDGE WISNIEWSKI: I think you said


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1 that this latter number that's 28 percent that
2 you just articulated was 35.
3 THE WITNESS: I thought I was
4 referring not to the subgroup, but to the
5 first --
6 JUDGE WISNIEWSKI: No, actually,
7 you were because you were contrasting it with
8 the close to 40 percent for the whole group.
9 THE WITNESS: I see. Well, I
10 was -- I meant -- the comparison between the
11 uncorrected and corrected, or the first
12 figures and the uncorrected, is 38 versus
13 28 percent.
14 JUDGE WISNIEWSKI: Thank you.
15 THE WITNESS: Yes.
16 BY MR. COHEN:
17 Q. I think you misspoke again just
18 now, Professor Landes. You mean between
19 30 percent and 28 percent; is that what you're
20 talking about? If you'd please look -- let's
21 look at the actual numbers. I think Judge
22 Wisniewski is trying to get an accurate


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1 record.
2 A. Yes. I'm sorry. I thought --
3 Q. What has happened to the difference
4 for the songwriter subgroup with respect to
5 those who receive 75 percent or more of
6 mechanicals? Could you please look at --
7 A. Yes.
8 Q. -- page 2 of your errata sheet.
9 A. I see. In the Figure 9 it was
10 30 percent. In the corrected Figure 9 it
11 falls to 28 percent.
12 Q. Now, sir, there is one other
13 correction in your report, and that's behind
14 tab 1. Do you see that there is a Figure 1
15 and a corrected Figure 1?
16 A. Yes.
17 Q. And starting with the first
18 Figure 1, can you tell us what you were trying
19 to address in this figure?
20 A. Well, our intent was to get an
21 estimate of total mechanical revenues earned
22 in the United States; that is, mechanical


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1 revenues that come within section 115.
2 So our intent was not to include
3 foreign mechanicals; that is, mechanicals that
4 might be earned by a U.S. songwriter or a U.S.
5 song that might be earned when that song is
6 embodied in a CD in France or Germany or
7 somewhere outside the United States. So our
8 focus was on, to make it simple, domestic
9 mechanicals, total -- an estimate of total
10 domestic mechanical royalties.
11 Q. And were there industry-wide data
12 available to you that would do this for the
13 entire U.S. publishing industry?
14 A. Not for this period of time.
15 Q. So would you explain to us how you
16 went about constructing the estimate that's
17 reflected on Figure 1?
18 A. Well, we first got from Harry Fox
19 the mechanical revenues that pass through --
20 that went through Harry Fox. We then also,
21 from the Harry Fox data, we were able to --
22 and these were, as I understand it, domestic


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1 mechanical revenues. From the Harry Fox data,
2 we were able to get information on what the
3 five major publishers -- there are now four --
4 what the earnings that they received were from
5 Harry Fox, what the mechanical -- excuse me --
6 mechanical royalties that they received from
7 Harry Fox. And those were EMI, Universal, BMG
8 Sony and Warner/Chappell.
9 So we then -- we backed that out of
10 the Harry Fox data as a first step. We then
11 had to get the total mechanicals -- again,
12 domestic mechanicals -- for those five
13 publishers because those five publishers not
14 only earned mechanicals from Harry Fox, but
15 they also engage in what's referred to as
16 direct licensing where they license the songs
17 directly and receive mechanicals directly that
18 don't go through Harry Fox.
19 So we got information on the total
20 mechanical royalties for the publishers. We
21 could then extract from that what they
22 received from Harry Fox. That gave us an


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1 estimate of direct mechanical revenues for the
2 five publishers. We then added that back to
3 the Harry Fox totals to get an estimate of
4 total U.S. mechanical royalties and -- or
5 total mechanical revenue.
6 So it's a combination of what goes
7 through Harry Fox and what does not go through
8 Harry Fox for the five majors. So it's an
9 estimate of their direct licensing.
10 Q. And why did you limit the direct
11 licensing to the five majors?
12 A. Because we understood -- or I
13 understood that the overwhelming bulk of
14 direct licensing is done by the five majors,
15 that the smaller publishers -- they may
16 occasionally do direct licensing, but my
17 understanding was that the bulk of direct
18 licensing goes through -- well, there are now
19 four, but for most of our sample there were
20 five majors.
21 Q. When you say majors, you mean the
22 major publishers?


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1 A. Major publishers, yes.
2 Q. And could you tell us where you got
3 the data from with respect to the major
4 publishers that you used in your original
5 Figure 1?
6 A. Well, we requested the data from
7 the publishers. So it came from the
8 publishers.
9 Q. And subsequent to filing your
10 report, did you get data from one or more
11 publishers that was different than the data
12 you used in Figure 1?
13 A. Yes, we did.
14 Q. Could you explain what happened?
15 A. We had earlier received data from
16 Warner --
17 Q. That's Warner/Chappell?
18 A. -- Warner/Chappell, purporting to
19 be their domestic mechanical royalties. Last
20 week we received some data that it produced,
21 which was clearly after my deposition and
22 after my revised -- after my rebuttal report,


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1 we received information from Warner/Chappell
2 that indicated that the domestic mechanical
3 revenue was less than they had given us the
4 first time, less because, apparently, the
5 first one also included some foreign
6 mechanical revenue.
7 So although our intent was at the
8 outset to get just domestic mechanical
9 revenues, the first Warner/Chappell
10 information we got included, I believe, some
11 mechanicals that were earned outside the
12 United States. So that would account for the
13 difference between what we received initially
14 and what we received last week.
15 Q. And after reviewing the new
16 Warner/Chappell data, did you go back and look
17 at the data you had received from the other
18 publishers?
19 A. Yes. I decided I was going to look
20 back at the other four publishers. It was
21 clear in the material that we were given from
22 Universal, from Sony BMG and from -- now I've


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1 forgotten the name of the -- and one of the
2 other -- the other publisher, it was clear
3 that the information was -- it was clearly
4 marked as domestic.
5 The EMI data that we received, what
6 we had used -- and this came through -- we
7 inquired about this, obviously, at the time.
8 There was a line referred to as U.S.
9 mechanical royalties, or U.S. mechanical
10 revenue. We were told that that was U.S.
11 mechanical revenue that was earned in the
12 United States.
13 It turned out that -- going back
14 and checking again with EMI, we discovered
15 that there are two separate categories, what's
16 referred to as intercompany and intracompany.
17 And the intra was actually mechanicals earned
18 in the United States, but they were actually
19 earned outside the United States. So they
20 include some foreign mechanicals.
21 So we had to revise the EMI data,
22 revise the Warner/Chappell data. The other


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1 data stood -- the other three publishing
2 companies' data stood.
3 Q. Okay. And are the results of those
4 revisions reflected in corrected Figure 1 that
5 follow Figure 1 in Exhibit 406?
6 A. Yes, they are.
7 Q. And do those corrections alter any
8 of the conclusions that you have drawn with
9 respect to whether or not there has been a
10 decline in mechanical licensing revenue, U.S.
11 mechanical licensing revenue, in real dollars?
12 A. The absolute amounts are clearly
13 different. If you look at Figure 1 and
14 corrected Figure 1, corrected Figure 1 has an
15 estimate in excess of $800 million -- this is
16 putting everything in 2007 dollars -- where
17 corrected Figure 1 is under 800 million. Now,
18 you know the estimates in the corrected have
19 to be lower than the estimates in Figure 1
20 because I have just indicated we included in
21 Figure 1 some foreign mechanical royalties
22 that were earned by Warner/Chappell as well as


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1 EMI. Those are excluded from the corrected
2 Figure 1. So, as expected, each year the
3 numbers are lower in the corrected Figure 1
4 than they are in Figure 1.
5 But again, what did we use this
6 for? We used it to make a relatively simple
7 point, that mechanical revenues have been
8 declining in real terms over the period 2000
9 to 2006. What do we observe in the corrected
10 Figure 1? The same thing. Mechanical
11 revenues have been declining in real terms
12 over this period.
13 Q. Now, could we go back to the errata
14 sheet, please, Professor Landes, which is the
15 two pages just before tab 1? Do you have that
16 in front of you?
17 A. Yes.
18 Q. Am I correct that the first four
19 entries relating to page 8 -- paragraph 11,
20 page 8, footnote 11, page 9, paragraph 16, and
21 page 11, paragraph 21 all deal with the
22 songwriter study?


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1 A. That's correct.
2 Q. And is there one more errata that
3 you picked up in connection with your work,
4 which is page 13, paragraph 25?
5 A. Yes. But, again, this deals with
6 the coefficient of variation or measure of the
7 riskiness of songwriting, and that also comes
8 from the Universal songwriter sample.
9 Q. And what change did you find?
10 A. That using a measure of risk, which
11 is a standard measure of riskiness, the
12 coefficient of variation -- after all, it's
13 the same measure that Professor Teece used
14 when he was comparing publishers to the record
15 industry -- there's virtually no change. When
16 you correct the songwriter -- when you correct
17 the miscoding in the songwriter data, you wind
18 up with a slightly higher, 92 percent
19 coefficient of variation versus 91.
20 So, again, no significant
21 difference. Just continues to support the
22 point I made earlier that the coding mishaps


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1 in the songwriter data had an overall
2 negligible effect on anything we used that
3 data for.
4 Q. Now, sir, would you turn to your
5 signature page that precedes the errata page?
6 Do you see that?
7 A. Yes, I do.
8 Q. Is that your signature?
9 A. Yes, it is.
10 Q. And did you believe this statement
11 to be true when you executed this in April?
12 A. Yes, I did.
13 Q. And with the corrections that
14 you've testified about today, is your
15 statement true?
16 A. Yes.
17 MR. COHEN: I offer Exhibit 406,
18 Your Honor.
19 CHIEF JUDGE SLEDGE: Any
20 objections?
21 MR. SMITH: There is an objection,
22 Your Honor. Might I have the opportunity to


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1 voir dire the witness on some of his testimony
2 here?
3 CHIEF JUDGE SLEDGE: Will this
4 cover your motion and your objections --
5 MR. SMITH: Yes, Your Honor.
6 CHIEF JUDGE SLEDGE: -- or just
7 your objections?
8 MR. SMITH: Yes, Your Honor.
9 CHIEF JUDGE SLEDGE: Go ahead.
10 VOIR DIRE
11 BY MR. SMITH:
12 Q. Good afternoon, Dr. Landes. How
13 are you?
14 A. Good afternoon.
15 Q. Let me see if we can bring out a
16 little bit more detail about what you call the
17 truncation problem in years 2005 and 2006 on
18 the Universal songwriter study. First of all,
19 you said that you only got information about
20 99,999 songs in those years from Universal?
21 A. Well, there were 99,999 songs that
22 were listed in the royalty song file. There


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1 were 99,999 songs listed in the income song
2 file. We could have had, and we did have,
3 some -- the source of the problem arose
4 because some of the songs listed in the
5 royalty song file were not in the income song
6 file, and some of the songs listed in the
7 income song file were not in the royalty song
8 file.
9 So we had -- if you take the two
10 song files together, we had information on
11 more than 99,999 songs.
12 Q. And, in fact, in both 2005 and 2006
13 there were more than -- substantially more
14 than 99,999 songs that Universal had in its
15 databases, correct?
16 A. When you look at the two song
17 files.
18 Q. In general, they just had more than
19 99,999 songs that they were paying royalties
20 on, correct?
21 A. They must have had. The only
22 information we have was truncated in each of


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1 these two files at 99,999. We knew they were
2 paying something, right, for songs that fell
3 below that, but we didn't know which -- you
4 know, what those songs were.
5 Q. Can you tell us why you didn't get
6 information on all the songs in the databases
7 during those two years?
8 A. Why we didn't get more than
9 99,000 --
10 Q. -- 999?
11 A. I didn't think it was really an
12 important issue because of the fact that the
13 dollar amounts were trivial below that. After
14 all, you're talking about, on the royalty song
15 file, amounts earned by a song of less than
16 $4.00 or less than $2.00. On the income song
17 file, you're talking about amounts earned that
18 were less than $11.00 or less than $7.00. So
19 I just didn't think it was a problem that --
20 the fact that some songs were excluded.
21 Q. Who decided to exclude those songs?
22 A. It was the way the data was given


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1 to us.
2 Q. So somebody at Universal said, we
3 just aren't going to give you the information
4 about all the songs?
5 A. I don't think somebody at Universal
6 said that. They just said, our database is
7 truncated at 99,999 songs. I don't know
8 exactly why that was.
9 Q. And the problem got more
10 complicated because they were truncated twice
11 so that the royalty list didn't match the
12 income list; is that right?
13 A. That's correct.
14 Q. You had the highest 99,999 on the
15 income list, and you had a very different
16 highest list on the royalty database, right?
17 A. Yes.
18 Q. And in addition to that, the way
19 you wrote your code, if it didn't appear in
20 both databases, then the income in either one
21 disappeared from the analysis, correct?
22 A. Well, the song disappeared from the


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1 analysis.
2 Q. It was treated as if it didn't have
3 any income at all in that year, correct?
4 A. It was treated as a song -- it was
5 treated as you can either say it was -- the
6 song was excluded or the song was excluded
7 because when we added an amount that was
8 positive to an amount in which we had no
9 information, the way the code was written, it
10 treated that as a song without information on
11 royalties or income.
12 Q. It's true, isn't it, that the
13 effect of all these things we have been
14 talking about was for you to improperly
15 exclude about 37,000 songs from your analysis
16 as it was first presented to us?
17 A. Actually, I don't remember the
18 number of songs that were excluded.
19 MR. SMITH: If I might, Your Honor.
20 BY MR. SMITH:
21 Q. I've handed you what we have marked
22 as RIAA Trial Exhibit 96.


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1 Dr. Landes, this is the Alfaro
2 declaration that was attached to the motion to
3 exclude which we filed last week. Is that
4 correct, Dr. Landes?
5 A. Yes, I believe it is.
6 Q. You reviewed this document when it
7 was filed?
8 A. Yes, or shortly thereafter.
9 Q. And is it true that you ascertained
10 that the facts set forth in this affidavit, or
11 this declaration, are correct?
12 A. Well, the fact set forth was that
13 we excluded songs that dipped below either the
14 99,9 -- I keep repeating it -- 99,999th song
15 on the royalty or the income files. We
16 excluded those songs from our analysis.
17 Q. Yes. My question was, did you find
18 any errors in the Alfaro declaration,
19 Exhibit 96?
20 A. Not with respect to that
21 information, no.
22 Q. With respect to something else?


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1 A. Well, I mean, I would have to
2 spend -- I don't believe so, but I haven't,
3 you know, gone -- my interest was trying to
4 make the adjustments in our code so we met the
5 objection to include songs that were excluded
6 and to include some songwriters that were
7 excluded by our method.
8 Q. Now, let me ask you to turn over to
9 paragraph 40 of Exhibit 96, page 9. That says
10 that you had 37,246 orphaned songs. Does that
11 refresh your recollection about how many songs
12 were excluded from your analysis because you
13 used these two different lists of 99,000 --
14 A. Well, the only reason I --
15 Q. Excuse me. I really just have to
16 finish the questions.
17 A. Okay. I'm sorry.
18 Q. -- two different lists of 99,999
19 songs?
20 A. The only reason I appear to be
21 pausing on this is because there is a large
22 group -- a large number of these songs fell


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1 below the threshold on both the earnings and
2 the income song files. Right? We excluded
3 some songs that were above the threshold. For
4 example, a song might have earned $100 in
5 royalties, but $6 in the income file. Right?
6 It didn't appear in the income file as earning
7 because it was below the threshold, let's say,
8 of $11.00. Those songs were excluded.
9 Similarly, we excluded a song who,
10 on the income side -- and, remember, we're
11 only using the income side to get an estimate
12 of the direct payments from the performing
13 rights societies to the songwriter. So we may
14 have had a case where, on the income side, a
15 song earned $5,000, but on the royalty side,
16 which were the payments directly to the
17 songwriter, the song earned $2.01. And with
18 the threshold being $2.10, that song was below
19 the threshold; therefore, that song was
20 excluded.
21 We also excluded, right, songs that
22 earned less than the threshold on the royalty


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1 side and less than the threshold number on the
2 income side. So we were excluding a song that
3 both earned, for example, less than $2.00 in
4 mechanicals and less than $7.00 in income,
5 less than $4.00 in -- if it was in the other
6 year, the later year, less than $4.00 in
7 mechanicals and less than $11.00 in income.
8 Q. But those songs --
9 A. Those -- is that what you mean by
10 the orphaned -- they were orphaned songs.
11 We also included songs where we
12 didn't know who the songwriter was.
13 Q. Let's focus on one thing at a time,
14 if we can. All right? The 37,246 songs here
15 appeared in one or the other of the two
16 databases, correct?
17 THE WITNESS: Yes, I see what he is
18 referring to. That's what it appears to be.
19 BY MR. SMITH:
20 Q. And you don't have any basis to
21 suggest that's not correct, right?
22 A. No, other than that I know the


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1 effect of the exclusion was negligible.
2 Q. I didn't ask you that question, did
3 I, Doctor?
4 A. I know, but it's relevant to me.
5 Q. Now, the count of songs that were
6 below the threshold and, therefore, didn't
7 appear in either database you can't do and
8 Mr. Alfaro can't do and I can't do because
9 it's not in the data, right?
10 A. Correct.
11 Q. Now, there are songs out there that
12 earned royalties in one or the other or both
13 of these databases in 2005 or 2006 but simply
14 weren't given to you because they didn't get
15 above that threshold in either one, right?
16 A. That's correct, but that would be a
17 very small dollar amount.
18 Q. In those years?
19 A. In those cases, in those years.
20 Q. And if it turned out that was the
21 only song that a particular songwriter had in
22 those years, the way you did your study meant


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1 that that songwriter was eliminated from the
2 study altogether, going back to the year 2000,
3 right?
4 A. That's correct, because we -- the
5 study required that you be -- consistent set
6 of songwriters, you had to appear in the
7 royalty -- you had to appear in the song file,
8 royalty song file, in every period, every
9 year.
10 Q. So even if a songwriter earned a
11 million dollars in the year 2000 and even if
12 he earned some royalties in the year 2006, if
13 they were below these artificial thresholds
14 that were created by the truncation, that
15 person was -- should have been included in
16 your study; was excluded from your study,
17 right?
18 A. That's correct.
19 Q. And none of us know how many such
20 people exist because we still don't know how
21 many songwriters fell below these
22 thresholds that were never given to you -- how


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1 many songs fell below those thresholds and,
2 therefore, we never got the data, right?
3 A. That's correct, although what we do
4 know is that if they -- if the song was
5 excluded and the songwriter was excluded,
6 because either in the income or royalty file
7 the songwriter appeared below the threshold --
8 right -- that songwriter was now included in
9 our corrected data.
10 MR. SMITH: Your Honor, I would
11 move the admission of Exhibit 96.
12 CHIEF JUDGE SLEDGE: Any objection
13 to Exhibit 96?
14 MR. COHEN: Yes, Your Honor. I
15 object. It's hearsay. As we said in our
16 motion, Mr. Alfaro's declaration is
17 essentially a surrebuttal report.
18 CHIEF JUDGE SLEDGE: Is what?
19 MR. COHEN: A surrebuttal report
20 that -- there is no opportunity in this case
21 that I am aware of for witnesses to come in
22 and criticize, by way of testimony, the


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1 rebuttal testimony. We were not in
2 position -- we got rebuttal reports from the
3 RIAA. I couldn't put in surrebuttal reports
4 to deal with this.
5 Mr. Alfaro testified earlier in
6 this proceeding. He did not testify with
7 respect to this matter. The data upon which
8 his analysis is -- is based was turned over on
9 April 10, well before he appeared in this
10 proceeding. I do not believe every statement
11 in this is accurate. And Mr. -- Dr. Landes
12 was not in a position to deal with all of
13 those things.
14 We are not contesting his data
15 work, but there are opinions and there are
16 inferences drawn on this. He is not subject
17 to cross-examination. It's improper.
18 CHIEF JUDGE SLEDGE: So you're
19 making the same objection to this that
20 Mr. Smith is making to your corrections.
21 MR. COHEN: I don't think that's
22 his objection to my corrections, Your Honor,


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1 because all --

2 CHIEF JUDGE SLEDGE: I'm just

3 saying that your corrections are surrebuttal.

4 MR. COHEN: No, he's saying -- I

5 don't think he has said that yet, Your Honor.

6 And that would be surprising because all of

7 his witnesses submitted corrections. So

8 that -- Mr. Alfaro is not here to be

9 cross-examined. I don't think there is any

10 procedure in this court for submitting a

11 declaration.

12 I think that's a very different

13 thing than a witness who is here and is

14 testifying and who was listed as rebuttal

15 witness making corrections. Dr. Teece made

16 corrections, Ms. McLaughlin made corrections.

17 Mr. Alfaro himself submitted a corrected

18 report, which he testified about, which was

19 totally different that the report he filed at

20 the time rebuttal reports were made.

21 Mr. Benson submitted corrections. Ms. Santisi

22 submitted corrections.


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1 There has been a pattern of the
2 witnesses, both expert and lay, and all of
3 those who have been dealing with the empirical
4 work, submitting corrections. That's quite
5 different -- Professor Landes is here to be
6 cross-examined by Mr. Smith about any of his
7 corrections. Mr. Alfaro is not a witness.
8 JUDGE ROBERTS: Mr. Smith, in your
9 questions to Dr. Landes, you asked him if, by
10 way of example, if the song earned a million
11 dollars early in the period examined but
12 earned something below the threshold later in
13 the period, it was excluded from the survey.
14 And Dr. Landes answered yes, I believe.
15 THE WITNESS: I said it could be.
16 It depends why it was excluded. If it was
17 excluded in, say, the -- because it's -- on
18 the income side it dipped below the threshold
19 but on the royalty side it did not, that is --
20 those songs are added back. Right?
21 If it turned out it earned
22 virtually nothing, either on the royalty side


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1 or the income side, because it dipped below
2 the threshold in both the royalty and the
3 income, that song was excluded. If that was
4 the only song that that million dollar
5 songwriter had written that had survived into
6 the period 2005 and 2006, that songwriter
7 would have been excluded from our sample, in
8 this case, of 10,000 -- the expanded sample of
9 10,250.
10 JUDGE ROBERTS: My question to you,
11 Mr. Smith, is what is the likelihood of that?
12 I don't see Mr. Alfaro offering any testimony
13 along that line.
14 MR. SMITH: Your Honor, it's
15 impossible to know what songs were excluded
16 because they're not in the data. I was merely
17 asking him to articulate the possible effects
18 of having a song disappear from the data in
19 2006, and if that was a songwriter's only
20 income in that year, then that songwriter was
21 taken out of the study altogether.
22 JUDGE ROBERTS: But it does seem to


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1 me that the magnitude of what you offered in
2 the example has a bearing on that. If it's a
3 high dollar amount of money and then that
4 person is excluded, then that does seem to
5 have some impact on the data. If it's a low
6 dollar amount, it seems to probably be a
7 minimal impact. And I am asking what could be
8 offered to show the likelihood of those kinds
9 of turns.
10 MR. SMITH: Well, we have, in
11 Appendix A to Mr. Alfaro's declaration, an
12 example of a songwriter named Amy Lee who was
13 excluded because she did not appear in both
14 the royalty and income databases and had
15 income that was substantial.
16 So -- let me see if I can
17 reconstruct this. She disappeared from the
18 database in 2005 because of the way that the
19 truncation worked and had income in 2006
20 exceeding $200,000, but disappeared from the
21 study altogether because she didn't appear in
22 both databases in 2005.


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1 JUDGE ROBERTS: Now, Mr. Alfaro
2 gave these by way of examples. Did he give
3 you any analysis -- attempt to quantify
4 overall?
5 MR. SMITH: Well, we know that --
6 JUDGE ROBERTS: You're saying that
7 he can't identify it because you just simply
8 don't know --
9 MR. SMITH: Well, there's two
10 aspects, Your Honor. With respect to the
11 people who appeared in one of the databases
12 but were excluded because they didn't appear
13 in both, we know how many of those there were;
14 there were 756. Mr. Alfaro found that,
15 reported it, and now -- Dr. Landes now
16 apparently knows it as well.
17 With respect to the people who were
18 excluded because they didn't get above the
19 threshold in either database in a given year,
20 the data simply were never provided to
21 Dr. Landes and, therefore, never provided to
22 us. There could be thousands of them that met

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1 the criterion of being included but were
2 excluded for that reason.
3 We can speculate that they might
4 not have had a lot of income earlier in the
5 period because they were very low in 2005 and
6 2006, but as this example suggests, you
7 shouldn't always assume that.
8 We have what -- the other
9 songwriter's income here, Mr. Stockdale -- his
10 income for performance goes from $2.00 to
11 $12,000 to $109,000 and then back to $5,000.
12 There was a great deal of variation from year
13 to year in the income reported for these
14 individuals. And so a very low figure in
15 one year does not imply that it would have
16 been low earlier in the period.
17 JUDGE ROBERTS: How did Mr. Alfaro
18 come upon these two?
19 MR. SMITH: By looking at the data
20 and finding examples of what the effect was,
21 Your Honor.
22 JUDGE ROBERTS: But you're saying


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1 he can't give an overall analysis?
2 MR. SMITH: Well, in paragraph 40
3 he was the first to identify that there were
4 756 composers who were excluded altogether,
5 and 4,432 composers who had lost income,
6 improperly excluded. That is certainly an
7 incomplete summary of all of the effects of
8 having these -- not having gotten all the
9 data, but it is a summary of the effects of
10 having two different truncations go on where
11 you excluded different sets of data from the
12 two databases. That's a different phenomenon
13 from not getting all the data to begin with.
14 JUDGE ROBERTS: And these
15 criticisms that Mr. Alfaro has, how do these
16 not go simply to the weight to be given to
17 Dr. Landes' testimony but, rather, rise,
18 apparently in your view, that the testimony
19 should be excluded.
20 MR. SMITH: Well, what has happened
21 now, Your Honor, is that the publishers have
22 essentially agreed with everything that was


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1 presented in our motion, and presented their
2 attempt to correct all of these problems,
3 which we received on Saturday. We received
4 the code that they used on Sunday. And we
5 received a declaration from Dr. Landes this
6 morning after court convened, purporting to
7 talk about what the effects of all these
8 changes were and whether they make a big
9 difference or not.
10 Our main point at this point is
11 that we filed a well-founded motion to strike
12 because his basic methodology was a mess. And
13 their response was two days before he took the
14 stand, on a weekend, to come in with an
15 entirely new data analysis using entirely new
16 numbers and give us the code less than
17 24 hours before he took the stand, long after
18 the deposition, way too late in the process
19 for us to do any meaningful preparation for
20 cross-examination or have any sense of what
21 really has gone on in his third version of
22 what he has done here.


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1 We have here a witness that every
2 time he has undertaken quantitative analysis,
3 going back to the direct phase, once you
4 finally sit down and see what he really did at
5 the detail level, it turns out there's all
6 kinds of data that was mishandled. That's
7 what Mr. Alfaro's testimony earlier in the
8 rebuttal phase was about. That's what this
9 declaration illustrates.
10 And I think it's unfair for us to
11 be expected to have all of this new analysis
12 that was completed in the last 24 to 48 hours
13 dumped into the record without a meaningful
14 opportunity to scrutinize that as well.
15 JUDGE ROBERTS: So this is an
16 amendment, then, to your motion in limine?
17 MR. SMITH: Yes, Your Honor. They
18 have essentially conceded that the motion was
19 correct. They have essentially withdrawn all
20 of the data that we said was inaccurate -- to
21 the extent anybody can, because we don't have
22 all the data, but they have come up with a


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1 solution they think at least largely addresses
2 that problem.
3 I have no way to know whether it
4 was a good solution or not. I have been doing
5 my best in the last 24 hours to figure out
6 what they have done. But I think it is too
7 late in the day for them to be substituting an
8 entirely new quantitative analysis for what
9 should have been done a long time ago.
10 I would also note that Figure 1 and
11 that whole analysis of total mechanicals was
12 not addressed in our motion. We got
13 information that they had completely revised
14 that analysis on Saturday, with no explanation
15 at all about what the reasons were. Just
16 simply said, here's new numbers we have come
17 up with on Saturday.
18 And so the first time I learned
19 what -- the reasons for those changes which,
20 by the way, reduced the estimates by
21 $100 million a year, was sitting here this
22 afternoon listening to this testimony. That's


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1 not appropriate. How am I supposed to know
2 whether he got the right Warner/Chappell and
3 EMI data now? Have we seen the data? We just
4 got a printout sent to us on Saturday that has
5 a bunch of new numbers on it. No backup, no
6 explanation. I mean, we have no deposition,
7 no way to talk about, how did this happen?
8 How did -- what safeguards did you put in
9 place to get the right data before you swore
10 to it the first time and then vouched for it
11 again at your deposition?
12 I think this is just entirely too
13 late to repair these problems. And to suggest
14 that this situation remotely resembles the
15 kinds of corrections that have been made in
16 the past by other witnesses simply misses the
17 substance. Any corrections of data that were
18 made by Santisi and Benson and others were
19 brought out and discussed at the depositions.
20 Many of the other corrections that we've had
21 were typographical errors.
22 This is his entire quantitative


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1 analysis being completely redone with all new
2 numbers two days before he testifies on a
3 Saturday, with some of the information needed
4 to assess it not being provided until Sunday
5 and Monday.
6 So that is the essence of our
7 objection at this point. There isn't much to
8 talk about about the motion that we filed last
9 week because, for all intents and purposes,
10 they acknowledged we were right. But I think
11 it's too late in the day for them to say,
12 well, sure, you told us about all these
13 problems, but here is our best attempt to fix
14 it. Give it to you on Saturday. Let him
15 testify on Monday about it.
16 I think that given the requirements
17 of good form and due process and the way this
18 is supposed to work, this is something the
19 court should not allow.
20 MR. COHEN: Your Honor, may I
21 respond?
22 CHIEF JUDGE SLEDGE: Yes, sir.


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1 MR. COHEN: Mr. Smith, may I take
2 the podium?
3 CHIEF JUDGE SLEDGE: One thing
4 that's not clear. Mr. Smith, are you through
5 with your examination and your presentation of
6 your motion?
7 MR. SMITH: No, Your Honor. I
8 would hope to continue my examination.
9 CHIEF JUDGE SLEDGE: Sorry.
10 MR. COHEN: Yes, sir.
11 CHIEF JUDGE SLEDGE: Mr. Smith,
12 please continue. I wasn't paying close enough
13 attention.
14 MR. SMITH: Your Honor, I think we
15 were still awaiting a ruling on the admission
16 of Exhibit 96.
17 CHIEF JUDGE SLEDGE: We will
18 address that at the recess when we consider
19 all these pending matters.
20 MR. SMITH: Thank you, Your Honor.
21 BY MR. SMITH:
22 Q. Now, your testimony today, Doctor,


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1 was that leaving out 750 songwriters and
2 37,000 songs from your analysis didn't make
3 much difference in the results?
4 A. That's correct.
5 Q. And that's largely a coincidence,
6 isn't it, that basically that didn't come
7 out --
8 A. I don't think so. I think that's
9 exactly what you would have predicted. It's
10 not a coincidence.
11 Q. Now, in order to fix this problem
12 in your latest version of the analysis, you
13 didn't actually go back and get any more data,
14 right?
15 A. That's correct.
16 Q. You basically assigned proxy values
17 for royalties earned by these 37,000 songs?
18 A. I made assumptions that were most
19 conservative to my analysis, correct.
20 Q. You basically assigned numbers that
21 you didn't have from data?
22 A. Yes, if something -- if I could


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1 explain. May I explain?
2 Q. Please.
3 A. Oh. If the performance -- if, on
4 the income statement, the income file, if,
5 let's say, the song was excluded because the
6 income was below $7.00, which is the
7 threshold, roughly -- I think it's 7.20 for
8 the first year. Right? We know that song
9 earned less than 7.20. The assumption we made
10 was that not only did that song earn 7.20, but
11 the performance royalties that were paid
12 directly to Universal were $7.20.
13 Therefore, when adding it back to
14 the songwriter's earning for that song, we
15 overestimated by a small amount, the
16 difference between maybe $2.00 and $7.00. But
17 we tended to overstate, however slightly, the
18 songwriter's income.
19 We did the same thing on the other
20 side with mechanicals. We did -- we assumed,
21 if it fell below the threshold that -- on the
22 royalty database, that your royalty earnings


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1 were equal to the low level, $2.10, even
2 though they may have been a $1.60, $1.05, or
3 50 cents.
4 So we basically -- the effect was
5 to add to the songwriter's income -- add to
6 the songwriter's royalty income when we were
7 adding income to songwriters whose songs were
8 excluded, was to overstate a little bit,
9 right, what they actually received by using,
10 in your terms, a proxy based on the lower
11 values or the threshold values.
12 Q. Now, the alternative would have
13 been to go back and get the actual figures
14 from the database that Universal maintains,
15 right?
16 A. I don't know how we would have been
17 able to do that in the few days that we had to
18 respond, because we only received your
19 information -- your -- Alfaro's declaration --
20 we only received that in the middle of last
21 week.
22 Q. If you had done that, though, you


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1 would have also been able to learn how many
2 additional songs earned royalties in 2005 and
3 2006 but had been excluded altogether from
4 your analysis, right?
5 A. I don't know if we could have. I
6 assume so, but again, the data that Universal
7 had that they gave to us was limited to a list
8 of songs in the top 99,999. There were some
9 that dipped below that on either the royalty
10 or the income song file, and they were
11 excluded. There were others who dipped below
12 both of them, and they were excluded.
13 But obviously that would have to be
14 a very small dollar amount.
15 Q. Now, it's true, isn't it, that the
16 errata sheet was first given to us on Saturday
17 afternoon?
18 A. I believe so, yes.
19 Q. And on Sunday was the first time we
20 got a list of 750 songwriters that had been
21 added to your study?
22 A. I believe so.


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1 Q. Now, you mentioned that you didn't
2 get the Alfaro declaration until Wednesday,
3 but you and I had an extended conversation
4 about this question back at your deposition,
5 didn't we?
6 A. Yes.
7 Q. And you weren't aware at the time
8 that there even was an income database and a
9 royalty database, right?
10 A. I thought -- my recollection from
11 the deposition was that I knew we had -- our
12 principal interest was in the royalty
13 database. We were only using the income from
14 Universal to supplement the performance
15 royalties; that is, to get a rough estimate of
16 what ASCAP paid directly to the songwriter or
17 what BMI paid directly to the songwriter. My
18 assumption was that we had the same set of
19 songs in both files.
20 So I didn't focus on or think of
21 the income file as a separate file. I just
22 thought of it as income that Universal had


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1 received from the performing rights societies,
2 and we were using that estimate of income to
3 get an estimate of the performance royalties
4 that were paid directly by ASCAP and BMI.
5 Q. And I asked you as well, did you do
6 anything to assure that you had the same data
7 set in the two databases, right?
8 A. I did not, no. I just had assumed
9 that we had, and I know there were songs cut
10 off by the threshold, but I thought that
11 factor would be unimportant and, as it turns
12 out, it is completely unimportant; it has no
13 material effect. It has only a negligible
14 effect on our study.
15 Q. Now, after we had this extended
16 conversation on April 28, did you go back and
17 check whether you had the same songs in the
18 two lists?
19 A. I don't recall. I knew I went back
20 and looked at the truncation problem and
21 realized we had -- I knew that we had
22 truncated songs. Right. But I -- no, the


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1 answer is no, I did not go back and check to
2 see what did the two song files look like.
3 Q. Let me ask you a couple more
4 questions about Figure 1 and your estimate of
5 total mechanicals. It's true, isn't it, that
6 that issue was not one that was raised in the
7 motion we filed last week; those changes were
8 not prompted by us?
9 A. That's correct.
10 Q. Now, you said you learned sometime,
11 I believe you said last week, that the data
12 you got from Warner/Chappell was incorrect?
13 A. That's correct.
14 Q. Can you tell us more specifically
15 when you learned about that?
16 A. It was sometime during the week. I
17 believe Warner/Chappell had submitted
18 additional data after Santisi's testimony, and
19 that data turned out to be different from the
20 data we had.
21 Q. And you then redid your estimate
22 providing that information to us for the first


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1 time on Saturday?
2 A. I believe it was Saturday, yes.
3 Q. And am I right that it lowered the
4 overall figures per year by about
5 $100 million?
6 A. Yes. I mentioned that earlier.
7 Q. And was any explanation of the
8 reasons for these changes provided to us
9 before you took the stand this afternoon?
10 A. I don't know.
11 MR. SMITH: I have nothing further
12 at the moment, Your Honor.
13 CHIEF JUDGE SLEDGE: Anything from
14 DiMA?
15 MR. LAGUARDA: Not with respect to
16 Mr. Smith's motion, Your Honor. I have a
17 separate motion to make on Dr. Landes'
18 testimony. I will take it up whenever you
19 would like.
20 CHIEF JUDGE SLEDGE: On what
21 aspect?
22 MR. LAGUARDA: Section 5 of


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1 Dr. Landes' written rebuttal testimony is
2 inappropriate rebuttal. It contains --
3 CHIEF JUDGE SLEDGE: All right. We
4 will address that later.
5 Mr. Cohen?
6 MR. COHEN: Your Honor, I have no
7 further questions for Professor Landes. I do
8 want to address a couple of Mr. Smith's points
9 of argument in response to Judge Roberts'
10 questions.
11 Let me start with this question of
12 delay because I think we have this question of
13 unfair surprise as presented by Mr. Smith
14 essentially upside-down. It is clear from
15 what Mr. Smith said today, and as we have
16 asserted in our response to in limine motion,
17 that the RIAA, at the time of Professor
18 Landes' deposition on April 28, was aware of
19 this issue. We had provided this very
20 database to the RIAA, the database that is the
21 subject of the in limine notion and is the
22 subject of the objection today, on April 10.


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1 It is clear to us now, with
2 hindsight, although it was not clear to us at
3 the deposition from the questions that were
4 asked, that the truncation problem and the
5 problem which is the foundation for this
6 motion was known to the RIAA if not at the
7 time of that deposition on April 28, at least
8 well before May 14.
9 Nonetheless, the RIAA made a
10 tactical decision to wait until May 14, which
11 was Wednesday -- and I got it while we were in
12 court on Wednesday, the middle of the court
13 day on Wednesday, saying the data work is
14 wrong; oh, my God. We just discovered this.
15 And now claims it's too late because we gave
16 you this on Wednesday afternoon. We took
17 48 hours to actually try to confirm whether or
18 not there were any mistakes because nobody
19 wants to make any mistakes a second time
20 around.
21 We gave them the information on
22 Saturday. It is true we gave them the backup


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1 on Sunday. That's when they asked for it.
2 And at 10:30 in the morning on Sunday we got
3 an e-mail that said, can you give us the code
4 that underlays Professor Landes' new analysis?
5 And we give it to them at 12:30, 1:00, so it
6 was about a two-hour turnaround.
7 But to the extent that we find
8 ourselves late in the day for Mr. Smith to
9 question Professor Landes, that is the direct
10 result of a tactical decision by the RIAA.
11 And in a study of this importance -- this is
12 the only empirical data to be presented for
13 the court -- shouldn't be decided on the basis
14 of, essentially, a "gotcha."
15 Now, with respect to reliability,
16 we don't concede your motion. The first set
17 of data satisfies Daubert. Daubert does not
18 require absolute precision. And let's look at
19 the data work that has been done in the course
20 of this case.
21 Professor Wildman came here and he
22 testified about average rates based on one


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1 quarter of songs. He couldn't tell whether
2 the data was representative. He couldn't tell
3 whether the data was complete. He didn't have
4 any discussions with anyone from a record
5 company. Mr. Benson came in and said
6 everything that Ms. McLaughlin did and swore
7 to under oath in the first trial is incorrect.
8 So there is a completely
9 inconsistent standard with respect to
10 reliability that's being urged upon the court
11 by the RIAA. Their witnesses have time and
12 again made corrections. They have never done
13 any empirical work of this order of magnitude.
14 They have made mistakes in all of their
15 empirical work.
16 And what Daubert says,
17 respectfully, is, as gatekeepers in the
18 question of admissibility as opposed to
19 weight, is it junk science or is it perfect --
20 is it junk science? It doesn't have to be
21 perfect.
22 And what Professor Landes has said


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1 is that his first study was well-founded. He
2 was aware that it eliminated certain
3 songwriters. He expected the effects to be
4 trivial and, in fact, the effects are trivial.
5 So the question is, is this court
6 better assisted in connection with determining
7 what the mechanical royalty rate should be --
8 and, in fact, one of the 801(b) factors is a
9 fair rate of return to songwriters -- to have
10 information about 9500 or 10,000 songwriters
11 at Universal, with RIAA able to argue all that
12 it wants about the infirmities in the motion,
13 or are we better off excluding something by
14 applying a standard that each and every one of
15 their experts would fail? I don't see the
16 argument.
17 With respect to the question of
18 Figure 1, that did come late in the day. And
19 we have had the same data problems that they
20 have had with respect to data, getting
21 accurate data from the clients. I think the
22 testimony was quite clear. We asked for U.S.


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1 mechanical information. We were given
2 domestic receipts instead of actually
3 mechanicals that are subject to 115.
4 The document that caused Professor
5 Landes to realize that he had wrong data was
6 actually a document that was produced to the
7 RIAA ten days ago or so by Warner/Chappell.
8 It took us some time to run down to make sure
9 that the data that was given to us before was
10 the same or not. And I felt an obligation to
11 come and correct that testimony because I was
12 certainly aware by the weekend, but not before
13 the weekend, that the data that Professor
14 Landes had used in his first study was not
15 actually what had been represented to him by
16 various companies. And I felt an obligation
17 to correct his analysis in light of the fact
18 that we knew that that information was wrong.
19 That is a different situation than with
20 respect to the songwriter analysis.
21 But with respect to the songwriter
22 analysis, we have a computational error, a


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1 coding error that does not alter the
2 fundamental gist of his testimony. It does
3 not alter any of his conclusions. It is a
4 rich set of data, and it satisfies any
5 standard of Daubert. So to say that we
6 concede the motion is absolutely incorrect.
7 We think the Daubert motion should
8 be excluded, and we think that the testimony
9 should come in as corrected so that the court
10 has before it as accurate data as it is
11 possible to present from very difficult data
12 sets which give the court a lot of information
13 about what mechanical royalties are and how
14 important they are. The RIAA is free to
15 continue to cross-examine Professor Landes.
16 They are free to argue anything they want
17 about what weight should be given to that
18 data. But I don't see it as a question of
19 admissibility.
20 CHIEF JUDGE SLEDGE: Mr. Cohen, I
21 have asked this before, and I am asking it
22 again because I have never been satisfied by


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1 any answer. Why is testimony of relative
2 royalty income to mechanical royalty income
3 even relevant, much less, as you say, of such
4 critical importance?
5 MR. COHEN: There are two pieces to
6 that. First is the amount of mechanical
7 income, which is part of Professor Landes'
8 study, which are in Figures 2-A and 2-B and
9 3-A and 3-B, and I think it's in Figures 4 and
10 5. So that's just straight, what is the
11 mechanical income of the songwriters?
12 CHIEF JUDGE SLEDGE: That's not my
13 question.
14 MR. COHEN: With respect to the
15 relative testimony, Your Honor, this was
16 intended as rebuttal testimony. In the direct
17 case, what Professor Teece -- I agree with
18 you, Your Honor, none of the other income
19 should make a difference. But in the direct
20 case --
21 CHIEF JUDGE SLEDGE: Wait a minute.
22 I want to write that down.


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1 Go ahead.

2 MR. COHEN: In the direct case,

3 Professor Teece made the argument that any

4 decline in mechanicals would be offset by an

5 increase in performance and sync royalties.

6 The RIAA has argued consistently

7 through the course of this case that any

8 increase or decrease in mechanical should take

9 into account that performance royalties have

10 been increasing and that mechanical royalties

11 have been increasing. We have offered this

12 testimony as rebuttal. We are somewhat

13 hamstrung.

14 The court has not ruled on the

15 question of whether performance and sync are

16 relevant or not. It was actually the subject

17 of an in limine motion that we made way back

18 in January. So the RIAA has presented a fair

19 amount of testimony, both factual and expert,

20 all of which is designed to show that the

21 mechanical income may be declining -- or

22 whatever it's doing, it is only one piece of


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1 songwriter and publisher royalties. And they
2 argued, don't worry about the mechanical;
3 performance income is going up and sync is
4 going up. That evidence is in the record.
5 Professor Landes' evidence is
6 directly designed to rebut that evidence. I
7 mean, if this court were to conclude as a
8 matter of law -- and I don't think the court
9 has yet ruled on that -- that evidence
10 relating to the performance royalties and sync
11 royalties of publishers and songwriters were
12 irrelevant to your determination under 801(b),
13 that piece of Professor Landes' testimony
14 would not be needed, but we would also have to
15 strike all of the RIAA's -- or essentially
16 ignore all of the RIAA's testimony to the
17 contrary.
18 That still leaves the question of
19 mechanical income. And there is a rich amount
20 of data in Professor Landes' study with
21 respect to the amount of mechanical income,
22 leaving to one side what share it is, of


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1 performance -- or total income, which goes
2 directly to one of the 801(b) factors, which
3 is, what is a fair rate of return for
4 songwriters?
5 So, Your Honor, I understand the
6 question, but --
7 CHIEF JUDGE SLEDGE: I think you've
8 answered it.
9 MR. COHEN: Thank you, Your Honor.
10 CHIEF JUDGE SLEDGE: Any other
11 questions?
12 Mr. Smith, we're ready to move on
13 to DiMA's motion. Mr. Laguarda?
14 MR. LAGUARDA: Your Honor, DiMA
15 objects to the admission of section 5 of
16 Dr. Landes' testimony. Section 5 --
17 JUDGE ROBERTS: What pages,
18 Mr. Laguarda?
19 MR. LAGUARDA: Pages 27 to 41 of
20 the written rebuttal testimony. Really, they
21 just are further answers to various lines of
22 questioning on cross-examination that


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1 Dr. Landes testified here originally. It's
2 hardly rebuttal testimony under 351.11 of the
3 rules. In addition, under 351.10(a) and
4 351.10(b) of the rules, the testimony is -- if
5 anything, it's cumulative and repetitious.
6 Dr. Landes just goes back to lines of
7 questioning on cross-examination and provides
8 additional testimony seeking to bolster his
9 initial answers.
10 Nineteen of the paragraphs do that
11 directly. Six of the paragraphs merely
12 restate his written direct testimony but
13 provide additional elucidations on them. One
14 of the paragraphs seeks to rebut testimony
15 that Mr. Peer provided regarding ring tones
16 and the songs that are licensed for ring
17 tones. And one of the paragraphs refers to
18 the decision in the satellite SDARS case of
19 this court, attempting to link it to Professor
20 Landes' direct testimony. But none of it is
21 rebuttal.
22 It seems to me that providing


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1 nearly ten pages --

2 CHIEF JUDGE SLEDGE: I thought you

3 just said that he was rebutting on ring tones

4 in one paragraph.

5 MR. LAGUARDA: Well, he is

6 rebutting his own witness. It's unclear to me

7 how that's rebuttal.

8 CHIEF JUDGE SLEDGE: Okay.

9 MR. LAGUARDA: Paragraph 60, where

10 he discusses the cross-examination of

11 Mr. Peer -- but, again, all of the testimony

12 essentially points to lines of questioning on

13 direct, one or two introductory paragraphs or

14 a statement that nothing has changed his views

15 I can understand as being permissible in

16 rebuttal testimony, but so many pages and so

17 much additional bolstering seems far beyond

18 what the rules are intended to provide.

19 CHIEF JUDGE SLEDGE: Mr. Cohen?

20 MR. COHEN: Your Honor, let me just

21 disagree. We think that the matters on these

22 pages are well within the scope of permissible


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1 rebuttal, some of which was raised by the
2 court. My understanding in prior proceedings
3 is that rebuttal witnesses have tried to
4 clarify questions addressed by the court.
5 That's some of what we did, but almost all of
6 it directly rebuts the arguments that were
7 being made and, in fact, are being made with
8 respect to how the statutory rate should be
9 set and what's the relevance of first use
10 licensing and what's the relevance of
11 controlled compositions, and whether ring
12 tones are an appropriate benchmark.
13 So I don't even think it's -- I am
14 just at a loss to understand fully
15 Mr. Laguarda's point. I don't think it's
16 anything outside the scope of what is
17 contemplated by rebuttal in this court.
18 CHIEF JUDGE SLEDGE: Mr. Smith?
19 MR. SMITH: I have no contribution
20 to make to this debate, Your Honor.
21 CHIEF JUDGE SLEDGE: Do you have
22 anything further on your motion?


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1 MR. SMITH: If I could just make a
2 couple of points, if I might, Your Honor.
3 CHIEF JUDGE SLEDGE: All right.
4 MR. SMITH: To begin with, I think
5 it's inappropriate to suggest that somewhere
6 we were dilatory in this matter. We had no
7 obligation to raise this motion at any point
8 that was convenient for them to have the
9 opportunity to correct their testimony.
10 Once it became clear at the
11 deposition that this witness was so unfamiliar
12 with his data analysis that he couldn't even
13 answer the beginning questions about these
14 issues, we had to go ahead and figure out a
15 way to present this, and that took the
16 preparation of a formal written motion and a
17 formal declaration, which took some time.
18 JUDGE ROBERTS: What was the day of
19 his deposition, Mr. Smith?
20 MR. SMITH: The 28th of April, Your
21 Honor.
22 My understanding from Mr. Cohen was


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1 also that there was some possibility that
2 corrections were coming from Mr. Landes, so
3 that caused us to delay filing for a couple of
4 days.
5 The only other point I would make
6 is I don't think you should accept at face
7 value the notion that what we're now being
8 told by Dr. Landes about what the data shows
9 and why it doesn't make much difference is any
10 more accurate than what he presented the last
11 time. We don't have any way to test that.
12 And it's too late in the day for us to have a
13 deposition and have Mr. Alfaro go through it
14 again and figure all this stuff out.
15 Thank you.
16 CHIEF JUDGE SLEDGE: Any questions?
17 JUDGE WISNIEWSKI: Yes. Mr. Smith,
18 am I misunderstanding you -- is the gist of
19 your current motion now, as you're making it
20 as you stand here today, one of surprise?
21 MR. SMITH: Too late in the day.
22 Surprise -- too late for us to have the


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1 opportunity to prepare to analyze the data.
2 The reports were supposed to be provided
3 before depositions, et cetera. So I guess I
4 should have just said yes, Your Honor.
5 JUDGE WISNIEWSKI: Thank you.
6 CHIEF JUDGE SLEDGE: We will
7 recess.
8 (Recess.)
9 CHIEF JUDGE SLEDGE: We will come
10 to order.
11 Somebody keep score and make sure I
12 get all the matters that are pending
13 determined.
14 The motion by DiMA objecting to the
15 rebuttal section 5 as not being proper
16 rebuttal is overruled. The -- section 5
17 responds to criticism of the direct testimony
18 and satisfies rebuttal, although it's written
19 in a format that is unusual as it does not
20 identify the points to which it is
21 responding -- but the format is not enough to
22 sustain the objection.


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1 The motion in limine by RIAA on the
2 portions of the written rebuttal testimony of
3 Professor Landes is denied. The expertise
4 required for admission of the statement is
5 established.
6 The objection to admission of
7 Exhibit 406 as evidence on the ground of
8 surprise as the corrections were not presented
9 to the opposing side in a timely manner is
10 sustained, and the exhibit is not admitted.
11 The argument during the issues
12 presented by the copyright owners on the
13 motion in limine on relevance should be
14 clarified. That motion in limine was filed
15 and never presented to the judges.
16 The issues of relevance are no
17 longer pending, as the movant has waived that
18 argument by virtue of the entire trial being
19 presented without that issue being
20 established, and it's too late now to unring
21 the bell and determine how the record can be
22 cleared to extract the evidence on


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1 nonmechanical royalty revenues being
2 presented.
3 And the way that the motion has
4 been handled leaves the judges with the -- in
5 the position that the relevance of that
6 revenue will have to be treated as a matter of
7 weight as opposed to admissibility. And the
8 numerous questions by this judge as to why is
9 that being presented will have to be
10 considered in the deliberations as to what, if
11 any, weight to give to evidence on revenue
12 other than mechanical royalty revenue.
13 I believe that covers everything
14 that's pending. Is there anything I have
15 overlooked?
16 The objection to Mr. Alfaro's
17 declaration, RIAA Exhibit 96, is sustained.
18 That declaration constitutes an improper
19 attempt to establish evidence without the
20 required steps of written statements,
21 discovery, and does constitute, as argued, a
22 surrebuttal proffer.


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1 Have I covered all of the pending
2 matters?
3 MR. COHEN: Yes, Your Honor.
4 MR. SMITH: Yes, Your Honor.
5 MR. COHEN: Your Honor, may I
6 proceed?
7 CHIEF JUDGE SLEDGE: Yes, sir.
8 DIRECT EXAMINATION (RESUMED)
9 BY MR. COHEN:
10 Q. Professor Landes, do you stand by
11 the conclusions in Exhibit 406 with respect to
12 your original songwriter study?
13 A. I guess I'm a little bit confused
14 with the exhibit numbers of what's --
15 Q. 406 --
16 A. -- in and what's not.
17 Q. I am asking you whether -- to
18 ignore for the moment the corrections that
19 were made. And I am asking you -- and we will
20 have to put together the exhibit, but ignoring
21 the changes in your songwriter study and
22 resting on your songwriter study as you


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1 presented it in your written testimony, do you
2 stand by the conclusions you draw from that
3 study?
4 A. I certainly stand by the
5 conclusions drawn, yes.
6 MR. COHEN: Your Honor, I would
7 reoffer 406 with two exceptions. I would
8 withdraw the errata and all of the corrected
9 figures, 2 through 9, including As and Bs --
10 so I would go back to the original study
11 against which the in limine motion was made,
12 which has been denied and which obviously
13 could not be grounds for surprise. I would
14 also, though, withdraw Exhibit 1 if that was
15 within the court's ruling because I do not
16 believe -- Figure 1, rather. I do not believe
17 Figure 1 is accurate, based on the information
18 that was acquired by Professor Landes
19 subsequent to filing the report, and I don't
20 think it would be appropriate for Professor
21 Landes to sponsor Figure 1.
22 So I am offering 406 without


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1 Figure 1 and any references in the text to
2 Figure 1. And I am offering the original
3 written testimony and the original tables 2-A
4 through 11, and 2-A through 9 being the ones
5 that were corrected. And we would, in the new
6 offer for 406, remove the errata with respect
7 to the songwriter study and remove the
8 corrected tables.
9 CHIEF JUDGE SLEDGE: Any objection?
10 MR. SMITH: We do object, Your
11 Honor.
12 CHIEF JUDGE SLEDGE: All right.
13 MR. SMITH: The witness has already
14 testified that the data reported in the
15 original report were inaccurate, that there
16 were miscodings and data mishaps. I can't
17 imagine that on the record as it now stands
18 the original data could be put into evidence
19 given that, under Daubert, the witness himself
20 has admitted that the methodology used and the
21 results found and reported found there are
22 inaccurate.


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1 CHIEF JUDGE SLEDGE: DiMA?
2 MR. LAGUARDA: No, Your Honor.
3 CHIEF JUDGE SLEDGE: The objection
4 is overruled. The exhibit is admitted.
5 (Copyright Owners' Trial Exhibit
6 No. 406 was received into evidence.)
7 BY MR. COHEN:
8 Q. Now, Professor Landes, if you would
9 turn, please, to -- and I am only going to ask
10 you about the original figures in your
11 study -- Figure 2-A. And this is average
12 mechanical royalty income for Universal
13 songwriters. And, again, I want to, if we
14 can, go through these tables quickly so that
15 you can tell us what the study was that you
16 did and what conclusions you drew. We are
17 talking about your original figure.
18 So if you would turn to Figure 2A,
19 sir, average mechanical royalty income for
20 Universal songwriters. Would you tell us what
21 you did and what conclusions you drew from
22 that.


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1 MR. COHEN: And, Your Honor, I'm
2 actually being reminded that I need to make an
3 application for the protective order with
4 respect to some of the data in 406. I
5 apologize for doing this slightly out of
6 order.
7 The information with respect to the
8 songwriter study contained internal sensitive
9 information from Universal's royalty database.
10 It's not public. And the amounts that are
11 revealed in the text of the report and in the
12 tables could put Universal at a competitive
13 disadvantage vis-a-vis another music publisher
14 who might make the argument that Universal is
15 not doing what it should do to fully exploit
16 the value of the copyright. So this is not
17 information that's known in the ordinary
18 course.
19 And I have a chart listed as 408 of
20 the proposed redactions.
21 JUDGE ROBERTS: On page 2 --
22 MR. COHEN: Yes, Your Honor.


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1 JUDGE ROBERTS: Page 10,
2 footnote 13, please help me understand why
3 that's confidential.
4 MR. COHEN: I withdraw that, Your
5 Honor. I understood that to be something
6 else.
7 JUDGE ROBERTS: Thank you.
8 JUDGE WISNIEWSKI: Mr. Cohen, help
9 me to understand how Universal would be at a
10 competitive disadvantage by having some
11 aggregate numbers on a partial database
12 provided to anybody.
13 MR. COHEN: I think the thing that
14 Universal would be concerned about, Your
15 Honor, is that another music publisher, if
16 this information were public, in trying -- you
17 know, there is competition among music
18 publishers to sign songwriters. That another
19 music publisher would use this information as
20 a way of suggesting that Universal, on
21 average, does a bad job of exploiting
22 copyrights and that it actually does a better


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1 job. Universal doesn't have access to the
2 corresponding data for other music publishers.
3 So that's the concern of Universal.
4 JUDGE WISNIEWSKI: But they
5 couldn't actually say anything about it on
6 average, because this is, as I understand it,
7 only a portion of the full database.
8 MR. COHEN: Of course it is, but it
9 does reflect 9500 songwriters. It's not just
10 a few. But that is -- that is the competitive
11 argument that Universal believes why it would
12 be disadvantaged. I understand your point
13 that it's not complete data, but it's
14 certainly data that, even in this form, is not
15 in the public domain.
16 JUDGE WISNIEWSKI: Can you also
17 explain to me the rationale for the items on
18 page 13, line 16, page 13, line 17, page 14,
19 line 1.
20 MR. COHEN: All of those advances
21 have been protected in connection with prior
22 testimony on the theory, again, that the


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1 amount of advances that -- the amount of
2 advances that are made by each of these music
3 publishers is not a public number.
4 JUDGE WISNIEWSKI: Are you certain
5 we provided protection to the aggregate number
6 from the whole period?
7 MR. COHEN: I believe so, Your
8 Honor. I would not have done it otherwise. I
9 can't think of any point -- and I am thinking
10 of the EMI data specifically -- where I
11 believe the EMI advance data in Mr. Faxon's
12 original rebuttal testimony was protected with
13 respect to the whole period. That's the basis
14 on which the application was made, and I
15 believe that to be true.
16 Let me be more specific. I
17 actually think I understand Your Honor's
18 question. If you're asking me, did you
19 protect year-by-year data as opposed to an
20 average data, I'm not --
21 JUDGE WISNIEWSKI: Aggregate data.
22 MR. COHEN: Well, I think the


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1 average data reveals a lot about the
2 year-by-year data. What I don't recall is
3 whether the court protected average data as
4 opposed to year-by-year. I know you
5 protect --
6 JUDGE WISNIEWSKI: That wasn't my
7 question.
8 MR. COHEN: -- aggregate data.
9 JUDGE WISNIEWSKI: Yes. What
10 you're asking here is for protection to, as I
11 understand it, aggregate data that covers the
12 whole period 2001 to 2007.
13 MR. COHEN: And I believe this --
14 JUDGE WISNIEWSKI: 2000 to 2007.
15 MR. COHEN: The data that was
16 protected was year-by-year data as opposed to
17 aggregate for the entire period in the prior
18 witness. But I think that one could draw some
19 reasonable inferences from the average
20 aggregated data.
21 JUDGE WISNIEWSKI: I take it the
22 last item on page 7 applies only to the


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1 figures that have currently been --
2 MR. COHEN: Absolutely, Your Honor.
3 I'm sorry. We prepared the log in advance of,
4 obviously, the court's ruling with respect to
5 the corrections.
6 CHIEF JUDGE SLEDGE: Any objection,
7 Mr. Smith?
8 MR. SMITH: No, thank you, Your
9 Honor.
10 CHIEF JUDGE SLEDGE: We will
11 recess.
12 (Recess.)
13 CHIEF JUDGE SLEDGE: We will come
14 to order.
15 Weighing the public right versus
16 these figures, it seems not to adversely
17 impact the public as great as other things.
18 The motion is granted.
19 MR. COHEN: May I proceed? Thank
20 you.
21 BY MR. COHEN:
22 Q. Professor Landes, we're going to


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1 turn to Figure 2 and what's just happened -- I
2 am going to ask you not to use the actual
3 numbers, okay, on your chart. I am going to
4 ask you to talk about trends rather than
5 actual numbers. Okay, sir?
6 A. We're talking about figures 2-A --
7 Q. 2-A --
8 A. -- 2-B.
9 Q. Yes.
10 A. Not the corrected 2-A.
11 Q. I am not asking you to look at the
12 corrected -- the corrected testimony is not in
13 evidence, sir. Okay?
14 Would you look at Figure 2-A, the
15 average mechanical royalty income for
16 Universal songwriters? And could you just,
17 again, quickly tell us how you --
18 A. Yes. This --
19 Q. Let me finish the question, please.
20 A. I'm sorry.
21 Q. -- how you put this together and
22 how you plotted this graph?


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1 A. Right. This is based on the
2 Universal royalty file. It is -- we were able
3 to link up the royalties earned by a song to
4 the royalties earned by songwriters. As I
5 mentioned earlier, we wanted a consistent set
6 of songwriters. The full sample is the 9500
7 songwriters that appear in the royalty file in
8 every year, 2000 to 2006, with the
9 qualification having to do with the truncation
10 which I discussed earlier.
11 This just measures the average
12 mechanical of those 9500 songwriters, again,
13 in real terms where we put everything in
14 207 [sic] values. So what the chart shows in
15 real terms is a decline in these six or seven
16 years in the real average mechanical royalties
17 of this sample of Universal songwriters.
18 Q. Now, one question I didn't ask you
19 before is, did you try to acquire information
20 for publishers other than Universal in trying
21 to do this study?
22 A. Yes, we did.


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1 Q. And could you explain to the court
2 why just Universal is in this study?
3 A. The original data was, I believe,
4 produced at RIAA's request. The difficulty
5 with using the original data is we couldn't
6 link the information on song earnings to
7 songwriters. So we then went to each of the
8 publishers, the major publishers. And the
9 only one where we could link the songwriter to
10 the song was Universal.
11 We had other publishers -- I
12 believe Warner/Chappell. They could link the
13 song data, the royalties on the songs, to whom
14 they cut a check for. The problem with whom
15 they cut a check for is it's often not an
16 individual songwriter, but it could be a
17 subpublisher or even NBC.
18 The other two publishers we
19 contacted, we just -- they could not provide
20 us with data that would allow us to link the
21 songs to the songwriter. So we were left
22 with -- we would have liked more. Right? We


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1 would have liked to do it for all four of the
2 publishers. But all we had data for where we
3 could link the song royalties to the
4 songwriter was for Universal.
5 Q. Sir, would you turn to Figure 2-B
6 and just briefly tell us what's represented
7 there?
8 A. Yes. 2-B is the -- based on the
9 same songwriters that are in 2-A, and it's
10 also limited just to mechanical royalties.
11 But what we're using is the median rather than
12 the mean. And although the pattern is one
13 where the median in real terms is, again,
14 declining, it's transparent from the
15 comparison of Figure 2-A and 2-B that there
16 are a very large number of songwriters in
17 our --
18 JUDGE WISNIEWSKI: We don't have
19 Figure 2-B, Professor.
20 THE WITNESS: You don't have 2-B?
21 MR. COHEN: Your Honor, I think you
22 have 2-B just behind tab 2-B.


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1 JUDGE WISNIEWSKI: Yes, we do.
2 MR. COHEN: I'm sorry, Your Honor.
3 THE WITNESS: I'm sorry.
4 JUDGE WISNIEWSKI: Yes, we do.
5 THE WITNESS: What's transparent in
6 comparing 2-A and 2-B is that although the
7 average, or the mean, is in the order of --
8 BY MR. COHEN:
9 Q. Please don't give the number.
10 A. Okay. The average, or the mean, is
11 quite high -- the average or the mean is --
12 the median is much -- let me step back.
13 The median is much lower than the
14 mean, or the average, which implies or
15 suggests that there are a very large number of
16 songwriters that have very low mechanical
17 earnings, mechanical royalties.
18 Q. And if you turn to Figure 3-A,
19 that's what you call the songwriter subgroup.
20 And, again, just briefly -- I don't want to
21 repeat everything we did this morning, but
22 just to put it in perspective, tell us how you


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1 constructed the subgroup.
2 A. Yes. The subgroup is a smaller
3 sample that eliminates roughly 5,000
4 songwriters. And what it does do is it
5 eliminates the songwriters at the very top,
6 the top 1 percent, as well as those, on
7 average, who had royalties over the seven-year
8 period in the aggregate of less than $7,000.
9 So you're basically getting rid
10 of -- in this subgroup, you're getting rid of
11 the people at the very high end and you're
12 getting rid of a very large number, nearly
13 5,000, at the very low end.
14 Q. And what do Figures 3-A and 3-B
15 tell you about the direction of mechanical
16 royalties over this period for the subgroup,
17 for both mean and median?
18 A. The median and mean, they are
19 similar to what you observe in the earlier
20 figures but, in addition, the median is now
21 not way below the mean, as it was when we
22 looked at 2-A and 2-B. The median is still


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1 below the mean, but not nearly as far below
2 the mean as earlier, which is not surprising
3 because what we're doing is eliminating -- in
4 this subsample, we are eliminating a very
5 large number of songwriters who had very
6 little mechanical royalties.
7 Q. Now, sir, would you turn to
8 Figure 4-A and tell us --
9 JUDGE WISNIEWSKI: Before you do
10 that, Professor, what would you attribute
11 the -- if you look at 3-A and 3-B, what would
12 you attribute the difference in the slope in
13 the latter years of the average to median?
14 What would you attribute that to?
15 THE WITNESS: Well, I can infer
16 what has happened is some of the people in
17 the -- who have higher earnings in the
18 subgroup, right, their incomes probably rose
19 relative to others so that the median fell,
20 but the average then gets pulled up at the end
21 by some of -- after all, we are excluding the
22 very high earning songwriters. But even among


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1 those that are not in the top 1 percent, some
2 of those are obviously, on average, doing
3 better, which is pulling up the mean. Whereas
4 the median is largely influenced by the
5 50 percent. Right? The 50 percent is not
6 going to be affected by higher earnings for
7 the top people.
8 JUDGE WISNIEWSKI: Thank you.
9 MR. COHEN: May I proceed, Your
10 Honor?
11 JUDGE WISNIEWSKI: Yes.
12 BY MR. COHEN:
13 Q. Professor Landes, turn to
14 Figure 4-A and tell us what's plotted here.
15 A. Well, 4-A, as opposed to
16 Figure 2-A -- we are back now to the full 9500
17 songwriters. And what we are looking at now
18 is not simply average mechanical royalties but
19 average royalty income. So we've added to
20 that performance, sync, other sources of
21 royalties such as sheet music. And in
22 addition -- and I suppose more important -- we


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1 have to use, then, the income file to estimate
2 what the direct payments were from ASCAP to
3 BMI to the songwriters. And we do that by
4 looking at what Universal received from the
5 performing rights society and the assumption
6 that if Universal received $100 for a song
7 from the performing rights society, that the
8 songwriter directly received a performance
9 royalty also of $100.
10 Q. What does Figure 4-A show about
11 total royalty income for the songwriter for
12 the full group over this period?
13 A. In real terms, it's flat. I mean,
14 without going into what the numbers are, in
15 real terms, it stays flat during this period.
16 Q. And in 4-B you do the same thing on
17 a median basis?
18 A. 4-B is the median. The median
19 declines.
20 Q. And can you infer -- to follow up
21 on Judge Wisniewski's question, can you infer
22 why the median and mean might be moving


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1 differently over the period for this group?
2 A. Yes. Because the people who were
3 doing really well were probably doing, on
4 average, a little better in the last few
5 years, and that pulls up the mean but does not
6 have any impact on the median.
7 Q. Now, is Figure 5-A the same kind of
8 analysis, again, for this subgroup of
9 4,000-some-odd writers?
10 A. Yes, this is for the limited -- the
11 subgroup, which excludes people at the tail of
12 the distribution; that is, those people with
13 very high total royalties as well as people
14 with low total royalties. So we're excluding
15 the 5,000.
16 Q. And, again, generally, what's
17 depicted in Figure 5-A?
18 A. It seems, with the smaller group,
19 it's very, very similar. Again, the
20 difference between median and mean is not as
21 great when you look at the subgroup compared
22 to when you look at the full songwriter


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1 sample.

2 Q. Professor Landes, would you turn to

3 Figure 6, please? This is a series of bar

4 graphs. And can you tell us what you have

5 plotted there, from your study?

6 A. Yes. This is a chart that depicts

7 the distribution of royalty income on average

8 for the seven years across the full songwriter

9 sample of 9500. So what you observe from this

10 distribution is -- and it's not surprising in

11 light of how low the median is relative to the

12 mean -- is that there is a very large

13 fraction -- 80 percent of your songwriters are

14 earning less than --

15 Q. Don't give me the number, please.

16 A. Excuse me. Eighty percent -- it's

17 very hard for me to, you know, talk about

18 these things but keep in mind that I shouldn't

19 use the numbers.

20 Eighty percent of the songwriters

21 are earning, on average, a very small annual

22 royalty income. And at the other extreme,


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1 there are a small number -- in the order of
2 5 percent -- who are earning significantly
3 very high royalties during this period.
4 Q. And if you turn to Figure 7, is
5 that the same analysis for your subgroup, but
6 takes out the low earners and high earners?
7 A. Yes. And the distribution still
8 shows that same pattern, although the fraction
9 of low earners among this sample has fallen
10 from over 80 percent to somewhere in the range
11 of 63 or 64 percent. And, again, the fraction
12 of high earners of the sample -- since you
13 have thrown out so many low earners and you
14 have only thrown about 95 of the really high
15 earners, the fraction who are earning above a
16 substantial amount that I will not name is now
17 close to 10 percent -- 8 percent.
18 Q. Two more figures, Professor Landes.
19 Will you turn to Figure 8, please. And we
20 touched on this briefly earlier --
21 A. Which figure, now?
22 Q. Figure 8.


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1 A. Yes.
2 Q. And, again, tell us how you have
3 computed Figure 8.
4 A. Well, I think I should step back
5 and say that the purpose of Figure 8 was to
6 get a handle on, for songwriters, the relative
7 importance to songwriters of mechanical
8 royalties. So what I wanted to look at there
9 was what fraction of your royalty income came
10 from mechanical royalties?
11 And what you observe in Figure 8 is
12 that somewhere close to 65 percent, between 60
13 and 65 percent of the songwriters are --
14 receive 75 percent of their royalties from
15 mechanicals. And a majority of songwriters
16 receive more than 50 percent of their
17 royalties from mechanicals.
18 Q. I think you may have misspoke, so
19 why don't we turn to paragraph 21 where -- is
20 that where you lay out the actual percentages?
21 I think you may have reversed yourself in your
22 prior answer. Look at paragraph 21 on page 11


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1 of your report, sir.
2 A. Paragraph 21?
3 Q. Yes, sir.
4 A. Yes. Oh, yes, I did. What I meant
5 to say is two-thirds of the songwriters in the
6 full sample receive one-half of their royalty
7 income from mechanicals, and almost 40 percent
8 receive three-quarters from mechanicals. And
9 if you look at the subsample, which is the
10 smaller sample that excludes --
11 Q. And that would be in Figure 9,
12 right?
13 A. In Figure 9, we are still dealing
14 with a substantial number of songwriters in
15 relative terms that are receiving a
16 significant fraction of their royalties from
17 mechanicals. The numbers here are 55 percent
18 receive one-half or more, and 30 percent
19 three-quarters or more from mechanical.
20 Q. Professor Landes, I want to switch
21 topics now. And do you recall --
22 JUDGE ROBERTS: Before we leave


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1 Figure 8, Mr. Cohen --

2 MR. COHEN: Yes, sir.

3 JUDGE ROBERTS: Professor Landes,

4 any explanation as to, after the 95 to

5 100 percent of mechanical royalties earned by

6 songwriters being by far the highest number --

7 THE WITNESS: Which?

8 JUDGE ROBERTS: This is Figure 8.

9 THE WITNESS: Excuse me. What's

10 the --

11 JUDGE ROBERTS: The question is, I

12 see that 95 to 100 percent is the highest --

13 gets the highest response from songwriters.

14 Any idea of why the second highest response is

15 those saying they get virtually none of my

16 royalties from mechanicals, which would then

17 suggest that royalties -- most of their

18 royalties are coming from another source, and

19 I am wondering why that would be the case?

20 THE WITNESS: Actually, what it

21 suggests to me is that you've got two

22 extremes. You have some songwriters who are


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1 receiving a very large percent from
2 mechanicals. You have other songwriters on
3 the left-hand side who are receiving a
4 relatively small amount. And, indeed, if you
5 look at the zero to 5 percent class, it
6 actually turns up.
7 Now, I haven't identified what the
8 incomes of these groups are. Right? All I
9 have here is the fraction of their total
10 royalties that is coming from mechanicals. I
11 don't know in this table if the group -- if
12 people who are receiving 95 to 100 percent --
13 I don't know what their total royalties are
14 from looking at this table alone.
15 Similarly, I don't know what the
16 total royalties are of people who are at the
17 other extreme who were receiving very little
18 income from mechanicals.
19 JUDGE ROBERTS: So you may be
20 telling me that it isn't necessarily that in
21 the zero to 5 percent that they're receiving
22 their royalties from another source; it may be


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1 simply that they're not receiving any
2 royalties, period, for their song?
3 THE WITNESS: If they were
4 receiving no royalties --
5 JUDGE ROBERTS: From any source.
6 THE WITNESS: -- from any source --
7 JUDGE ROBERTS: From performance,
8 sync, whatever.
9 THE WITNESS: Right.
10 JUDGE ROBERTS: Are they going to
11 be reflected in the zero to 5 percent?
12 THE WITNESS: They could be
13 reflected in zero to 5 percent. On the other
14 hand, if they were receiving $2.00 in
15 royalties, on average, during this period, and
16 they were receiving $1.90 of that from
17 performance, they would be all the way up on
18 the other side because they would be receiving
19 over 90 percent of their royalties.
20 So I don't know what the income --
21 from this chart alone, it's -- I do not know
22 what the average royalties are for each of the


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1 groups that are listed here. I just know what
2 fraction.
3 JUDGE ROBERTS: Thank you.
4 JUDGE WISNIEWSKI: Professor, just
5 to follow up on a couple of questions. We
6 don't know what periods the songs were
7 released in that account for the income that
8 you have in this chart, do we?
9 THE WITNESS: No, we don't. We
10 know these are active songwriters in the
11 period 2000 to 2006. But we don't know when
12 the songs were first released.
13 JUDGE WISNIEWSKI: One other.
14 Going back to Figure 7 -- I don't know if I'm
15 reading the chart correctly or not. Help me
16 out. The first bar on Figure 7 --
17 THE WITNESS: Yes.
18 JUDGE WISNIEWSKI: -- it's
19 identified as beginning as zero dollars. Is
20 that possible, given your footnote?
21 THE WITNESS: Could they be earning
22 zero dollars? No, they had to be earning at


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1 least, on average, a thousand dollars per
2 year.
3 JUDGE WISNIEWSKI: Thank you.
4 BY MR. COHEN:
5 Q. Professor Landes, I am going to
6 turn to a different subject. Do you recall
7 that in your direct testimony you presented
8 the results of an analysis that you did of the
9 Harry Fox licensing database?
10 A. Yes, I do.
11 Q. And have you done some additional
12 work on rebuttal?
13 A. Yes, I did.
14 Q. Now, before we turn to that, can
15 you just briefly remind us what study you did
16 with respect to the Harry Fox database that
17 you presented in your direct testimony and
18 your conclusions?
19 A. Yes. We used the Harry Fox
20 database to try to get, again, an estimate of
21 whether the stat rate, or the statutory rate,
22 has become increasingly more binding and, if


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1 it has, what we would expect would be that the
2 fraction of licenses negotiated under the
3 statutory rate would be diminishing over time.
4 That is, you can think of it in the
5 sense that you have a distribution across
6 users of music with respect to how much
7 they're willing to pay based on the value to
8 them of the music. And their willingness to
9 pay -- to the extent the distribution is
10 rising over time, a greater proportion of
11 these users would be willing to pay a rate
12 equal to or greater than the stat. So what
13 you would expect to find is if the value to
14 users of the music has been rising over
15 time -- that is, the use as mechanical uses --
16 that you would expect to see a diminishing
17 fraction negotiating rates below the statutory
18 rate.
19 So that was the purpose of what we
20 did in my -- the direct part of my testimony
21 or what was contained in the -- I forget what
22 the exact -- the amended report for my first


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1 testimony.

2 Q. And did your analysis the first

3 time around include licenses for which

4 controlled composition clauses applied?

5 A. Yes. I was aware that it excluded

6 controlled composition --

7 Q. I asked, did it include it?

8 A. Yes, and it excluded it.

9 Q. Let me try again.

10 A. It excluded controlled composition.

11 Q. Okay. And have you now done an

12 analysis inclusive of controlled composition?

13 A. Yes.

14 Q. Would you turn to Figure 10,

15 please? Does that show the result of your

16 analysis?

17 A. Yes, Figures 10 and 11.

18 Q. Okay. Could you explain to the

19 court, please, what information is contained

20 in Figures 10 and 11 and how you derived it?

21 A. Yes. These are licenses issued by

22 Harry Fox each year. And these are for


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1 physical, which is CDs, cassettes and so
2 forth.
3 And the column, for example -- the
4 columns -- five columns, or five bars, under
5 the year 1996 indicates that including the
6 controlled compensation clauses as part of
7 licenses issued by Harry Fox, roughly
8 80 percent of these licenses were stat and, in
9 sum, with respect to the others, they account
10 for about 20 percent of the licenses were
11 below stat.
12 Q. And as you move up along the chart,
13 what you observe gradually over time, with a
14 decline in 204 and 205 is that gradually over
15 time the fraction of licenses issued at stat
16 has risen from around 80 percent, including
17 the controlled compositions to somewhere in
18 the range of 85 to 88 percent?
19 Q. And Figure 11 tells us what?
20 A. Well, what Figure 11 -- Figure 10
21 is licenses issued. Some of these licenses
22 are issued, but they may generate very few


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1 mechanical revenues. So what Figure 10 does
2 is weight these licenses issued in that year
3 by the number of units sold during that year.
4 And so, therefore, you find that the fraction
5 of units sold by percent of the statutory
6 in '96 is now somewhere between 60 and
7 70 percent. And over this period it rises to
8 somewhere in the order of 70 percent, probably
9 a little bit higher than 70 percent, but I
10 just have the graph in front of me.
11 So, again, it's consistent with
12 the -- what we found in the first report,
13 which is when you add back the controlled
14 licenses, you still observe a declining
15 fraction of licenses at below the statutory
16 rate.
17 Q. And as between your first report,
18 where you excluded controlled composition, and
19 this report, do you have a view as to which is
20 the better way to look at this issue?
21 A. Yes, I still continue to believe
22 that the best way is not to include licenses

1 with controlled composition clauses.
2 Q. Why is that?
3 A. Because most of the licenses with
4 controlled composition clauses involve
5 singer/songwriter licenses in which the
6 controlled composition clause is actually part
7 of the license agreement between the label and
8 the songwriter. And it involves many, many
9 terms. So you can't infer what the term is
10 for the music when, in fact, it's embedded in
11 a contract that includes all sorts of things
12 related to the artist/songwriter in terms of
13 advances, payments upfront and so forth.
14 Q. Professor Landes, are you aware
15 that both the RIAA and DiMA have proposed in
16 this matter that royalties be expressed on a
17 percentage of revenue basis?
18 A. Yes.
19 Q. And do you recall Professor Teece's
20 testimony in the first phase of this
21 proceeding in which he asserted that a
22 percentage of revenue would cause -- a


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1 percentage of revenue rate would cause
2 publishers and songwriters to bear an
3 increased share of the risk faced by record
4 companies? Do you recall that testimony by
5 him?
6 A. Yes.
7 Q. And can you tell us what economic
8 theory has to say about Professor Teece's view
9 of shifting of the risk?
10 A. Well, if you ask from an economic
11 standpoint what are the fundamental reasons
12 one would shift risk away from party B to
13 party A -- suppose party A and B are involved
14 in some kind of joint venture or, in this
15 case, the -- a recording where you have a
16 publisher and a recording company -- I mean,
17 one argument for shifting risk, say to
18 party A, would be that party A loves to bear
19 risk.
20 I mean, you could imagine two
21 individuals, and B is risk-averse and A says,
22 wow, you know, I like to jump out of


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1 airplanes. I like to do all sorts of -- with
2 a parachute, of course. I like to ride a
3 motorcycle and so forth. And that's an
4 individual presumably who enjoys the thrill of
5 bearing risk.
6 Well, that would be an argument
7 that both parties, in a sense, A and B could
8 be made better off by reaching an arrangement
9 where you shift more of the risk onto A and
10 away from B. Let's say B is a relatively
11 conservative person and prefers not to live
12 with the prospect of a significant amount of
13 risk. That would be one reason.
14 A second reason would be if -- the
15 parties could have equal preferences for risk,
16 but one party may be in a position to more
17 effectively deal with the risk; that is, we
18 would say A, for example, in my -- A and B
19 have equal preferences with respect to risk,
20 but A is in the position to effectively use
21 resources to reduce significantly the
22 probability of these adverse outcomes in a


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1 position compared to B. B may be able to do
2 something also. Sometimes, in the
3 economics -- or law and economics
4 literature -- we would say that A is the
5 cheaper cost-avoider.
6 What we have in mind is that one
7 party is in a better position to avoid the
8 risk. For example, in the context -- you
9 could think of piracy, right, as a risk of
10 losses to both the publisher and the label.
11 If, for example, the publisher was in a much
12 better position to effectively deal with
13 piracy than the record companies were in terms
14 of the use of resources to reduce the
15 likelihood or incidence of piracy, that would
16 be an argument for shifting more of the risk
17 to the publisher.
18 There is no evidence that I have
19 seen of that in this case, nor is there any
20 evidence that one party or the other, the
21 labels or the publishers, have different
22 preferences -- systematic different

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1 preferences for risk.

2 The third argument is basically a

3 fundamental argument of finance, which is

4 diversification. Right? The better able you

5 are to diversify across different risky

6 outcomes, right, the less risky, on average,

7 will be your overall portfolio.

8 So, again, if there was evidence --

9 and I am not aware of evidence -- that somehow

10 the publishers are in a better position to

11 diversify against variations in income than

12 the labels, that would be an argument in favor

13 of shifting more of the risk to the

14 publishers.

15 But, you know, underlying all of

16 this, when I have been illustrating these

17 points with respect to publisher and label, is

18 that I have ignored the songwriter. And if

19 you think of the songwriter as the party most

20 affected by changes in mechanicals, it's hard

21 to see that the songwriter is in a position to

22 diversify risk compared to, say, a record


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1 label or even a publisher. Songwriters --
2 human capital. It's hard to diversify your
3 human capital. You know, I am an economist
4 now. I am doing fine as an economist. It
5 would be hard for me to switch careers at this
6 time.
7 Q. Do you recall Professor Teece also
8 offering some testimony about a percentage of
9 revenue aligning the interest of the parties
10 better than a penny rate?
11 A. Yes, I do.
12 Q. And do you agree with his
13 conclusions with respect to that issue?
14 A. No.
15 Q. Can you tell us why?
16 A. Well, he made the point that the
17 advantage of a percentage rate is that it
18 better aligns the interests of the two
19 parties, that is, compared to a fixed or penny
20 rate.
21 I came up with a very simple
22 numerical example in the rebuttal report which


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1 shows how the interests actually diverge with
2 respect to a percentage rate, but they would
3 be better aligned with respect to a penny
4 rate.
5 Q. And is that example in paragraph 40
6 on page 22?
7 A. I believe it is.
8 Q. Could you take a look, please?
9 A. Yes. That's the example.
10 Q. Can you walk us through it just so
11 we understand it briefly?
12 A. I think I can, yes. Suppose a
13 product sells at $100 and costs $95 to
14 produce. And assume that the producer is also
15 paying a fixed royalty to another party of
16 $4.00. So the producer is earning $100 minus
17 $95 minus the $4.00 royalty, or earning a
18 dollar profit.
19 Now, imagine that you come up with
20 an efficient innovation. All right. Maybe
21 you improve the quality of the product. It
22 costs you $9.75 to do this, but it generates


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1 an additional income of $10. So from the
2 standpoint of social welfare or society we
3 would say this is a net 25 cent gain because
4 we're spending, in costs, 9.75 to achieve, in
5 benefits, $10.00.
6 Now, if you had a fixed rate of
7 $4.00, it would clearly be in the interests of
8 the producer to undertake that invention
9 because he would continue to pay the $4.00 --
10 right? It doesn't affect his incremental
11 costs of 9.75. So he winds up with a higher
12 profit of 25 cents. So having paid the fixed
13 royalty of $4.00 creates an incentive for him
14 to undertake the efficient expenditures to
15 enhance the value of the product.
16 Now suppose you go back to the
17 percentage royalty and start with the same
18 assumption, that you're paying a 4 percent
19 royalty. So in the first case, 4 percent
20 royalty, you're paying $4.00, you're getting
21 the product at $100, your profits are a
22 dollar. Now if have you to pay -- continue to


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1 pay a royalty of 4 percent, there will be an
2 extra 40 cents that the producer would have to
3 incur if he adopts this innovation. So his
4 costs would go up by 9.75. His royalties
5 would go up by 40 cents, from $4.00 to $4.40.
6 So he would actually be worse off by adopting
7 the innovation and, therefore, he would choose
8 not to.
9 So that's a good example where, if
10 you have a penny rate, right, you induce the
11 party, the producer, the licensee, to
12 undertake the right expenditures to improve
13 the quality of the work where, if you're stuck
14 with a percentage rate and you can't
15 renegotiate the percentage rate, right, you
16 then would have a disincentive to engage in
17 what would otherwise be an efficient
18 value-enhancing innovation.
19 Q. Now, Professor Landes, do you
20 recall Ms. Guerin-Calvert also testifying
21 about reasons in favor of a percentage of
22 revenue rate at the first trial?


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1 A. Yes, I do.
2 Q. And what is your recollection of
3 what arguments she advanced in favor of a
4 percentage of revenue rate?
5 A. Yes. We're not talking now about,
6 I assume, issues of monitoring and figuring
7 out what revenue is. She used the example
8 that somehow you want a percentage rate in
9 order to encourage new forms, new uses of
10 music, the idea being new uses might be
11 relatively unprofitable, and if somebody had
12 to pay a fixed rate, they would be discouraged
13 from those uses.
14 Q. Do you agree with her reasoning as
15 a matter of economics?
16 A. No, I don't, because the converse
17 problem is you could wind up subsidizing uses
18 of music. People that use a good deal of
19 music but have very uneconomical business
20 plans, they may find it attractive because,
21 under a percentage rate, they're paying so
22 little royalties.


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1 I mean, in the extreme example,
2 they're earning income from something else,
3 and they're practically giving away their
4 music. So if the royalties were based on what
5 they were charging for the music, what would
6 be received by the copyright holders of music
7 would be extremely low.
8 Now, this would have adverse
9 consequences on other competitors. People who
10 have, you know, efficient good business
11 models, they would, in effect, be competing
12 against firms that have inefficient business
13 models that probably, from a society
14 standpoint, would be better off without.
15 Plus, you know, if you thought --
16 if the label -- excuse me. If the publishers
17 thought these models were, you know,
18 potentially very lucrative, they might -- at
19 the outset, they should be willing, then, to
20 negotiate lower rates because all of this is
21 in the background that the stat rate is a
22 ceiling but not a floor.


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1 Q. Now, a couple of minutes ago you
2 mentioned something about monitoring issues
3 with respect to percentage of revenue. What
4 were you referring to?
5 A. Oh, I was referring to a point that
6 I had made at my earlier testimony, which was
7 that additional monitoring is required if
8 you're going to have a royalty rate based on a
9 percent of revenue because revenue is the
10 product of two things: Price and quantity.
11 Whereas if you have a penny rate, you still
12 have monitoring problems, but you only have to
13 monitor quantity because it's based on units.
14 So there's additional monitoring
15 costs which is another factor that would be
16 adverse with respect to choices between a
17 royalty based on a percentage of income versus
18 a penny rate.
19 Q. Now, in addition to those
20 monitoring costs, are there any issues with
21 respect to defining revenue in a percentage of
22 revenue model?


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1 A. Yes. I mean, there are a large
2 number of issues that would have to do with,
3 how does one define revenue? What revenue is
4 attributable to music and what revenue is not
5 attributable to music, particularly if, in
6 fact, the party who is using or licensing the
7 music and then reselling a product is simply
8 not reselling the product, not simply
9 reselling music, but is including it with
10 other sources of revenue that the firm
11 receives that are not directly charged for but
12 are clearly attributable to music.
13 The example I think I used on my
14 earlier testimony was if Apple decides to
15 charge a very low rate for iTunes, presumably
16 they would only do so because they're making
17 most of their money from the selling of iPods,
18 and this would be a factor that would increase
19 the demand for, increase the profits from
20 iPods.
21 On the other hand, it is
22 attributable to the music itself, and it would


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1 be difficult, if you had a royalty that was
2 simply based on iTunes revenue, to take
3 account of additional revenues attributable to
4 music.
5 Similarly, if you have advertising,
6 if you are -- if you are offering music to
7 consumers on the internet and, at the same
8 time, you're selling advertising space to
9 advertisers, the consumers are visiting the
10 site to get access to the music. That makes
11 possible the revenue from advertising that the
12 owner of the site gets as a result of being
13 able to offer music.
14 So that also is attributable to
15 music, but makes it difficult to figure out
16 exactly what revenue basis you should use in a
17 royalty which is based on revenue.
18 Q. Have you reviewed the copyright
19 owners' amended definition of revenue in this
20 proceeding?
21 A. Yes, I have.
22 Q. Were you the architect of that


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1 definition?
2 A. No.
3 Q. Have you considered whether the
4 copyright owners' definition is reasonable
5 from an economic perspective?
6 A. Yes.
7 Q. And can you tell us what your
8 conclusion is?
9 A. I think it fits into -- I mean, it
10 does show the difficulties of using a revenue
11 basis because it's an effort by the copyright
12 holders to find those revenues that are
13 directly or indirectly attributable to the
14 licensing of music. So it's an effort to
15 capture some of these revenues that are the
16 result of the licensee licensing music. So
17 it's an effort -- and there are a number of
18 provisions which are attempts in one way or
19 another to capture those revenues.
20 So to the more -- the more -- put
21 it another way. If you're using a revenue
22 basis, right, the revenue basis would be more


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1 attractive the more you're able to capture the
2 revenue that's attributable to music even
3 though it's revenue that is not the result of
4 a direct charge for the music.
5 JUDGE WISNIEWSKI: I don't think
6 you answered Mr. Cohen's question, though. He
7 asked you if it was reasonable.
8 THE WITNESS: I think I did say
9 reasonable, yes.
10 BY MR. COHEN:
11 Q. Well, would you please answer Judge
12 Wisniewski's question directly, Professor
13 Landes? Have you reached a conclusion as to
14 whether that proposed definition is
15 reasonable?
16 A. It's reasonable in the sense that
17 it tries to capture revenue attributable to
18 music. That's what I meant by reasonable.
19 MR. COHEN: Your Honor, I have one
20 more line of direct. It would take, you know,
21 15 or 20 minutes. Professor Landes is
22 obviously planning on being here all day

1 tomorrow. So I could continue or -- it's
2 4:30. Whatever the court's pleasure is.
3 CHIEF JUDGE SLEDGE: Given that we
4 won't continue today.
5 JUDGE WISNIEWSKI: However, I do
6 have one question.
7 MR. COHEN: Of course, Your Honor.
8 JUDGE WISNIEWSKI: It's a quick
9 question on sources, Dr. Landes. Your various
10 figures, 2 through 5, if you look at 2-A --
11 all those figures, 2 through 5, talk about
12 these numbers in terms of 2007 dollars. You
13 don't have a source listed in 2-A, but
14 beginning with, it looks like -- actually, you
15 don't have a source listed in any of the eight
16 tables.
17 What I am trying to get at is what
18 data series did you use to convert to 2007
19 dollars?
20 THE WITNESS: Yes. Well, we --
21 it's -- we should have added it to 2-A, but
22 it's the U.S. Bureau of Labor Statistics was


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1 the -- where we got the Consumer Price Index.
2 And what we used was the broadest base
3 Consumer Price Index, which has to do with
4 urban and clerical workers.
5 JUDGE WISNIEWSKI: So you used the
6 CPIU to make the adjustment?
7 THE WITNESS: Yes.
8 JUDGE WISNIEWSKI: Thank you.
9 That's all.
10 MR. COHEN: I think this would be
11 an appropriate point, Your Honor, if it
12 pleases the court.
13 CHIEF JUDGE SLEDGE: We will recess
14 until 9:30.
15
16 (Whereupon, at 4:32 p.m., the
17 proceedings concluded.)
18
19
20
21
22


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1 CERTIFICATE OF NOTARY PUBLIC

2 I, Deborah Larson Hommer, RPR, the officer
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