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HEARING

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In re: Determination of  
 Statutory License Terms  
 and Rates for Certain  
 Digital Subscription  
 Transmissions of Sound  
 Recordings

No. 96-5  
 CARP DSTRA

ORIGINAL

Tuesday  
 June 10, 1997

Library of Congress  
 James Madison Building  
 101 Independence Avenue, S.E.  
 Room LM414  
 Washington, D.C. 20540

The above-entitled matter came on for hearing,  
 pursuant to notice, at 10:00 a.m.

BEFORE:

THE HONORABLE LEONORE EHRIG, CHAIRPERSON

THE HONORABLE THOMAS A. FORTKORT

THE HONORABLE SHARON T. NELSON

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ALSO PRESENT:

Jason Berman	Witness
Rene Brown	Summer Clerk
Army Bushyeager	Mintz, Levin, et al
Emily Goldberg	Mintz, Levin, et al
Jeffrey Harleston	Universal
Jean Kang	Intern
Mavis Masaki	Intern
Bruce Massarsky	Witness
Hilary Rosen	Witness
Tanya Sandros, Esq.	CARP
Amelia Sedano	Intern
Karen Tansey	Paralegal
John Woodbury	Witness
Sara Yoon	Paralegal

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

<u>WITNESS</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
<b>Zachary Horowitz</b>				
By Mr. Marks	285		356	
By MR. Laguarda		310		358
<b>James Trautman</b>				
By Mr. Garrett	359/368		413	
By Ms. Lupowitz		392		418
By Mr. Praed		412		

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<u>EXHIBIT NO.</u>	<u>DESCRIPTION</u>	<u>MARK</u>	<u>RECD</u>
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1-X	Wall Street Journal Article	317	
2-X	<u>This Business of Music</u>	324	
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4-X	New York Daily News Article	336	
5-X	Summary of Proposed Findings of Fact and Conclusions of Law of the Recording Industry Association of America	338	
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6-X	Washington Post Article	352	
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1 P-R-O-C-E-E-D-I-N-G

2 (10:07 a.m.)

3 CHAIRPERSON EHRIG: Let's go on the  
4 record. I assume there are no changes in the  
5 appearances. Okay.

6 One housekeeping matter, can we have the  
7 witness list for the Services cases at your earliest  
8 convenience. Okay?

9 I guess we go with Mr. Horowitz now.

10 MR. MARKS: Yes, the Recording Industry  
11 Association calls Zachary Horowitz.

12 WHEREUPON,

13 ZACHARY HOROWITZ

14 was called as a witness for the Recording Industry  
15 Association, having first been duly sworn, assumed the  
16 witness stand, was examined and testified as follows:

17 CHAIRPERSON EHRIG: Mr. Marks?

18 MR. MARKS: Thank you, Your Honor.

19 DIRECT EXAMINATION

20 BY MR. MARKS:

21 Q Would you please state your name for the  
22 record?

1 A Zachary Horowitz.

2 Q Mr. Horowitz, where are you presently  
3 employed and what is your position?

4 A I'm the President of the Universal Music  
5 Group.

6 Q And what is the Universal Music Group?

7 A The Universal Music Group is a collection  
8 of music-related companies, a number of record  
9 companies including MCA Records, Geffen Records,  
10 Interscope Records, GRP Records, a concert promotion  
11 company, a music publishing company and some 26  
12 international companies around the world.

13 Q Now as a point of clarification it says in  
14 your written testimony that you were the President of  
15 MCA Music Entertainment Group. Could you just explain  
16 what the change has been since the written testimony  
17 was submitted?

18 A The parent company was called MCA, Inc.  
19 until January at which point the name was changed to  
20 Universal Studios and we became the Universal Music  
21 Group.

22 CHAIRPERSON EHRIG: Does the Panel have a

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1 copy of the written testimony?

2 BY MR. MARKS:

3 Q Who are some of the artists that record on  
4 the labels within the Universal Music Group?

5 A We have such artists as Dolly Parton, Reba  
6 McIntyre, Gladys Knight, B.B. King. We also are  
7 responsible for the Al Jolson catalog, the Patsy Cline  
8 catalog, the Bing Crosby catalog.

9 Q And when you say you're responsible for  
10 the catalog, could you explain what that means?

11 A We own the master recordings and are  
12 responsible for marketing and promoting the catalog.

13 Q What other positions have you held at  
14 Universal?

15 A I've been the Chief Operating Officer, the  
16 Executive Vice President, and the head of Business and  
17 Legal Affairs.

18 Q Could you explain your duties generally in  
19 the positions that you've held at Universal?

20 A As President of the Music Group, I oversee  
21 the various divisions so that I'm familiar, generally,  
22 with the various departments and how they function.

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1 I started off in the Business and Legal Affairs  
2 Department so I was responsible for the negotiation of  
3 the various contracts to sign the artists.

4 Q And in your position today, are you  
5 familiar with and involved in the artists' contracts  
6 that are signed by the companies in the Group?

7 A Yes, I still see a deal memo that embodies  
8 all the terms of the various contracts that we enter  
9 into.

10 Q Where did you work before you joined  
11 Universal?

12 A I worked for five years with CBS Records,  
13 now Sony Records.

14 Q What is your educational background, Mr.  
15 Horowitz?

16 A I graduated from Stanford Law School and  
17 before that I was at the Claremont Colleges.

18 MR. MARKS: I would offer Mr. Horowitz for  
19 voir dire.

20 CHAIRPERSON EHRIG: Any questions? Okay,  
21 you may continue.

22 BY MR. MARKS:

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1 Q Is Universal a member of the Recording  
2 Industry Association of America?

3 A Yes.

4 Q And do you have a position on the board?

5 A Yes.

6 Q How long have you been on the Board of  
7 Directors at RAA?

8 A Over five years.

9 Q Now I'd like to talk to you about the role  
10 of the recording company in creating a sound  
11 recording.

12 What do you see as the general role of the  
13 recording company in completing a finished musical  
14 product?

15 A The record company is involved in all  
16 aspects of the acquisition of the talent, the creation  
17 of the sound recording, the manufacturing of the  
18 compact disks and cassettes that represent that work,  
19 the marketing and promotion of the album at retail, at  
20 radio and to the ultimate consumer.

21 Q Could you identify for the Panel the  
22 categories of costs that are associated with creating

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1 a sound recording?

2 A Well, there are -- the first costs are the  
3 acquisition of the talent itself. There are --

4 Q I'll write these up here as you go through  
5 them.

6 A Okay. There are monies paid to the  
7 artists, typically on signing of the contract and then  
8 in connection with each of the albums that he or she  
9 records. There are recording costs for each of the  
10 albums that are recorded. There are manufacturing  
11 costs that the record company pays. There are  
12 marketing costs. There are then royalties that are  
13 paid to the artists on the sale of the records as well  
14 as mechanical royalties that are paid to the  
15 publishers. There are advertising costs, things of  
16 that sort.

17 Q One of the issues that came up yesterday  
18 and was at the ability of record company to recoup  
19 some of the costs, I was wondering if we could maybe  
20 go through this list and you could identify what's  
21 recoupable, generally, and what's not for a record  
22 company.

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1 A Okay.

2 Q Starting with the acquisition of talent.

3 MR. LAGUARDA: Can I, just as a plan, I  
4 want to know is the witness familiar with the  
5 testimony yesterday? Is he testifying as to his own  
6 testimony or has he read the record?

7 MR. MARKS: He has not read the record.  
8 I'm just stating generally that the issue was brought  
9 up and I'm asking if he can testify as to recoupment.

10 JUDGE FORTKORT: Before you move on, let  
11 me just ask --

12 MR. GREENSTEIN: Before you move on,  
13 Judge, just as a point of clarification, I don't  
14 believe that this particular point was addressed in  
15 Mr. Horowitz's written testimony, so I'd like to know  
16 just as a general rule whether the Panel is going to  
17 allow in the direct case the kind of testimony that  
18 goes beyond the written testimony -- goes to questions  
19 that were asked of the previous witness or whether we  
20 can save that for a rebuttal case?

21 MR. MARKS: If I can respond to that. I  
22 don't think this is beyond his written testimony. His

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1 written testimony deals extensively with the costs  
2 associated with creating a sound recording and the  
3 risks that are involved for a record company with  
4 regard to that creation. I think this is direct --  
5 goes to the heart --

6 JUDGE NELSON: Maybe you would prefer to  
7 restate your question.

8 MR. MARKS: Okay.

9 CHAIRPERSON EHRIG: Without the  
10 preliminary part that --

11 JUDGE FORTKORT: Before you do that, I  
12 just have a question. You refer to the publisher as  
13 precisely who are the publishers, who do you mean?

14 THE WITNESS: I think I referred to the  
15 publishers in the context of the mechanical royalty  
16 rates, on the sale of every one of our record albums,  
17 there is a requirement that we pay the owner of the  
18 song copyright a royalty, separate and apart from the  
19 artist, the recording artist.

20 JUDGE FORTKORT: So you're talking about  
21 the writer of the song and the writer of the music?

22 THE WITNESS: Right.

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1 CHAIRPERSON EHRIG: Could you state your  
2 question?

3 BY MR. MARKS:

4 Q I'll restate the question. With regard to  
5 these categories of costs that you've identified,  
6 could you identify which of these are generally  
7 recoupable by a record company from an artist?

8 A The acquisition of talent costs which are  
9 paid are generally recoupable. The recording costs  
10 are generally recoupable. The manufacturing costs are  
11 not recoupable. The vast bulk of marketing costs are  
12 not recoupable. The royalties are not recoupable.  
13 And the advertising costs are not recoupable.

14 JUDGE NELSON: Do you want to define what  
15 you mean by recoupable?

16 MR. MARKS: Maybe the witness could do  
17 that better than I could.

18 THE WITNESS: In effect, there are certain  
19 monies that are paid to the artist in advance, hence,  
20 they're called an advance and those monies are charged  
21 against royalties. It's like a loan.

22 So you pay out some money early and you're

1 able to recoup the monies from the sale of records.  
2 The fact that contractually something is recoupable  
3 doesn't mean that you will actually recoup it because  
4 it's totally contingent upon the sale of records. Is  
5 that clear?

6 JUDGE NELSON: So you mean that your  
7 definition of recoupable means taking off the top?

8 THE WITNESS: The definition of recoupable  
9 means you have a contractual right.

10 JUDGE NELSON: To take it --

11 THE WITNESS: To get the money back from  
12 the royalty that is due the artist.

13 JUDGE NELSON: I'm sorry, I have an  
14 accounting background so recoup to me means something  
15 else, but I'll accept your definition.

16 THE WITNESS: Okay.

17 BY MR. MARKS:

18 Q Now in order for the record company to be  
19 able to recoup costs, there has to be some sales of  
20 the recording for that to happen, is that correct?

21 A Right. As I think we'll get into later,  
22 there are literally hundreds and hundreds of thousands

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1 of dollars of costs that a record company pays in  
2 connection with each of these albums and whether or  
3 not those monies are recoupable depend upon whether or  
4 not there are actual sales where the artist is  
5 entitled to a royalty that you can then recoup these  
6 advances against.

7 So that's why I say contractually, we may  
8 have right to recoup monies, but in reality, we may  
9 not actually be able to recoup them.

10 Q It might be a good time now just to talk  
11 more specifically about how many sound recordings  
12 actually break even or are successful.

13 Can you discuss what your general  
14 knowledge is with regard to how many are successful?

15 A Generally speaking, we typically assume  
16 that about 15 percent of the album projects that we do  
17 will ever recoup. The vast bulk of projects that we  
18 do do not recoup which means that in effect the  
19 successful artists have to pay for all the losses on  
20 the unsuccessful artists.

21 Q I'd like to talk about each of the  
22 categories you've identified in a little bit more

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1 detail. On page 3 of your testimony, you discuss the  
2 first component here that you've identified which was  
3 the acquisition of talent.

4 How does a recording company go about  
5 finding talent?

6 A We have talent scouts that work at the  
7 company. They are called typically A & R people. It  
8 stands for artist and repertoire. And their job is to  
9 listen to literally hundreds of tapes during the  
10 course of the year, sometimes thousands of tapes.  
11 They go to concerts. They go to small clubs. They  
12 fly around the world looking for the right artists  
13 that they think will be commercially viable.

14 And it's their job in the first instance  
15 to try to ferret out the artists that they believe in  
16 the years to come will actually be able to sell  
17 records.

18 Q Now on page 3, your testimony, you say the  
19 talent scouts perform a creative function. What do  
20 you mean by that?

21 A Well, the first role of a good talent  
22 scout is to have the vision to see that an artist

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1 that's playing in a small club will somehow tap into  
2 what the audience wants to hear a year later when that  
3 artist's first album comes out.

4           And the A & R person will work closely  
5 with the recording artist throughout the project,  
6 sometimes picking out songs, sometimes working with  
7 the artist to figure out how to change a song, to make  
8 it more successful and will help the artist in the  
9 studio, will help the artist potentially find the  
10 producer of the record who helps shape the record in  
11 the studio, will surround the artist occasionally with  
12 musicians, will sometimes pick the recording studio  
13 where the artist records. He or she is involved  
14 literally in every aspect of the album project,  
15 working hand in hand with the artist.

16           Q       Now after an artist is identified, what  
17 does the record company do at that point?

18           A       The talent scout will bring an artist into  
19 the company. It will usually be a number of people  
20 who will make a decision as to whether or not the  
21 record company actually wants to try to sign the  
22 artist. Once that decision is made, there are

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1 business and legal affairs people who work with the A  
2 & R person with other executives at the company to try  
3 to craft a deal that will entice the artist to sign  
4 with a particular record company.

5 Q What factors play a role in whether a  
6 particular record company is successful in signing a  
7 particular artist?

8 A There are a host of factors, everything  
9 from the amount of money that is paid upon signing to  
10 the amount of money that will be paid in connection  
11 with the album project, what the budget will be for  
12 the album, how high the royalty is to the artist, the  
13 amount that will be paid to the artist as his or her  
14 fee each time the album is sold, the number of albums  
15 that the record company is prepared to contractually  
16 commit to as a guarantee, the kinds of creative  
17 controls that the artist will have, vis-a-vis the  
18 record company, release commitments of albums that the  
19 record company is prepared to make, marketing  
20 commitments that the record company contractually is  
21 prepared to make and then the personalities themselves  
22 and how they mesh.

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1 Q Is the negotiating process an easy task?

2 A There is such a premium on talent today,  
3 as there always has been because ultimately it's about  
4 the magic that that artist is able to put on that  
5 record. And once an artist is discovered, there are  
6 usually other record companies who are also interested  
7 in signing the artist. There are significant bidding  
8 wars to try to sign the artist. And what was probably  
9 a 25 page recording contract when I first started in  
10 the record business 20 years ago, has not mushroomed  
11 into a 75 page contract with paragraph after paragraph  
12 that deals with rights and obligations.

13 Q So it's safe to say these aren't standard  
14 form contracts?

15 A No.

16 Q Can you quantify the amount that's usually  
17 paid as an advance to a new artist that has commercial  
18 potential?

19 A The advances are always a function of just  
20 how excited the record company is sign the artist and  
21 how many other record companies are also trying to  
22 sign an artist at the time.

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1           It's not unusual for a new artist to  
2 receive hundreds of thousands of dollars, \$200,000 for  
3 a recording budget and an advance that may go anywhere  
4 from \$10,000 to hundreds of thousands of dollars on  
5 top of that which would be the artist's compensation  
6 for that particular album.

7           Depending upon the particular  
8 negotiations, the artists are always anxious to try to  
9 get the record company to commit to as many albums,  
10 contractually, as they can and even for new artists  
11 the financial commitment just in terms of acquisition  
12 costs and guaranteed recording costs may be as much as  
13 \$1 million.

14           Q       And what happens to those monies if the  
15 new artist turns out to be one of the 85 percent who  
16 is unsuccessful?

17           A       The record company eats the costs that are  
18 not recouped.

19           Q       What is your knowledge of these artists'  
20 contracts based on? I know that you said before that  
21 you review the deals. Is this something that you do  
22 in your day to day capacity?

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1           A       I started in the business drafting  
2 contracts. I'm still involved today in negotiating  
3 some of the terms of the contracts and I'm generally  
4 familiar with almost all of the deal points for the  
5 various contracts that we enter into.

6           Q       Can you quantify how much the record  
7 companies, for instance, your record company would  
8 spend every year in acquiring and recording talent?

9           A       Including the artists already signed to  
10 the label where we have different obligations, on a  
11 going forward basis, it's clearly in the tens of  
12 millions of dollars.

13          Q       For those 15 percent that end up being  
14 successful, is it common for them to attempt to  
15 renegotiate their contract once they do reach success?

16          A       Yes, our recording contracts are organic  
17 in that we enter into deals that may last five or six  
18 or seven albums which may be the entire lifespan of an  
19 artist. And once that artist has success, the artist  
20 on a regular basis comes back in to renegotiate  
21 different terms to ask for additional advances, so we  
22 are in a constant process of renegotiating deals.

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1 Q Now what role does the record company play  
2 after the artist is signed?

3 A The record company, as I mentioned, will  
4 be involved in helping the artist record his or her  
5 album. That will include everything from helping the  
6 artist craft the songs, find the producer, find the  
7 musicians who will work in the studio.

8 The record company will generally help to  
9 shape the image of the artist which is tied to what  
10 the artist has to say on his or her album. They'll be  
11 involved in listening to the album and listening to  
12 what the artist is about and then trying to work out  
13 a marketing campaign in connection with the album that  
14 maximizes the artist's image.

15 Q So is there kind of an on-going dialogue  
16 between the record company and the artist during the  
17 recording process?

18 A Right, the best record companies are the  
19 companies that truly understand what the artist is all  
20 about and then work hand in hand with the artist to  
21 try to get that message out to the public.

22 Q Now in addition to the costs for recording

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1 an album, are there other costs that are borne by the  
2 record companies?

3 A Yes. Once an album is recorded the album  
4 needs to be manufactured and there's a complicated  
5 process in the studio where various tracks, the  
6 various layers of recording are put into what is  
7 called a master and that master then issued to  
8 manufacture compact disks and cassettes that people  
9 can listen to.

10 And most of the record companies have  
11 their own manufacturing people, those who don't pay  
12 for outside companies to do the manufacturing for  
13 them.

14 Q Who pays for the cover art and the  
15 graphics?

16 A The record company pays for the cover art  
17 and the graphics. Most of the bigger record companies  
18 have a rather large staff that try to capture the  
19 artist's image on the album cover. And then that  
20 staff may also work on the entire advertising campaign  
21 to make sure that the image that is used of the artist  
22 on the album is consistent with the image that is used

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1 in various ads that the record company will place  
2 later on.

3 Q Will you describe this as a creative  
4 effort?

5 A Yes.

6 Q How much is spent annually on cover art  
7 and graphics?

8 A It's in the millions of dollars at each  
9 record company for sure.

10 Q Can you describe what happens in the  
11 distribution and the sales process?

12 A Once an album is recorded and  
13 manufactured, there is a significant investment in an  
14 infrastructure by the major record companies and there  
15 is a distribution system where there are people who  
16 literally pick, pack and ship each particular compact  
17 disk so that it can then be sent to record stores  
18 around the country.

19 I believe there are something like 18,000  
20 people who are affiliated across the country in one  
21 form or another with distribution and those record  
22 companies who don't have their own distribution people

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1 outsource that. They pay for the cost of that.

2 Q Now is piracy, which is the unauthorized  
3 manufacture and sales of sound recordings a problem  
4 for the recording industry?

5 A Yes, it is. We, the RIAA estimates that  
6 each year we lose as an industry about \$300 million  
7 and the record companies as a result are investing  
8 millions of dollars each year, trying to fight piracy.

9 Q Okay, I think we've gone through  
10 everything up to the marketing and promotion of an  
11 album.

12 Can you discuss that?

13 A Yes, of course. There are thousands of  
14 albums that come out every year and so the challenge  
15 for each of the record companies is to do things that  
16 distinguish their artists from the albums that are  
17 coming out by other record companies.

18 And this is a very expensive process. It  
19 involves what can be hundreds of thousands of dollars  
20 to literally millions of dollars on a particular album  
21 project for such things as music videos which can cost  
22 anywhere from \$50,000 to in excess of \$500,000 and

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1 sometimes we do two, three, four videos for each of  
2 our albums.

3 It can involve putting the artist on a  
4 concert tour around the country, particularly with new  
5 artists, the artists do not have the funds to actually  
6 pay for the shortfall on these tours so the record  
7 company will pay for those costs.

8 There are costs for advertising in  
9 consumer magazines. There are costs for  
10 advertisements that we will take out on television  
11 shows. There are costs for personal appearances where  
12 we will send the artists to radio stations or to  
13 popular television shows.

14 And there are costs for things like  
15 promotional material, hats and t-shirts that we hope  
16 will catch the eye of people and distinguish our  
17 artists from other people's, but it is a -- it goes to  
18 the heart of what we do as a record company and then  
19 there are costs for hiring people to help us get the  
20 music played at radio which is at times significant,  
21 literally in the hundreds of thousands of dollars.

22 Q Now these hundreds of thousands or

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1 millions of dollars, is this, are these funds  
2 recoupable?

3 A It depends upon the type of cost. Towards  
4 support, for example, may be recoupable. The vast  
5 bulk of marketing costs, the advertising costs, the  
6 radio promotion costs are not generally recoupable and  
7 it also depends upon the clout of the artist. The  
8 more clout that the artist has, the less likely it  
9 will be that these costs will be recoupable.

10 Q On page 9 of your testimony, you discuss  
11 in a little more detail the risks that a record  
12 company faces in creating a sound recording and I  
13 think you alluded to this a little bit earlier in your  
14 testimony, but I'm wondering if you could expand on it  
15 a little bit now.

16 A I think the important thing to note is  
17 that most record companies, at least the majors, are  
18 putting out somewhere between 60 and 100 albums every  
19 year. And each year we know going into that year that  
20 the vast number of those albums will not be  
21 successful. I think there's a company called  
22 Soundscan that measures the over-the-counter sales of

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1 records, retail counts, and they've estimated that  
2 last year two-third's of the albums that were released  
3 did not sell one thousand units. Now for record  
4 companies, because of the substantial investments that  
5 they have in these projects to break even, you  
6 literally need to sell hundreds of thousands of units.

7 I think one percent of all the albums that  
8 were released last year paid for 50 percent, accounted  
9 for 50 percent of the total revenues, so it's a very  
10 small number of albums that are actually responsible  
11 for the major sales in the industry.

12 Q Are there other challenges in the market  
13 place that are facing record companies today?

14 A There are a number of challenges, aside  
15 from piracy which is a significant challenge. There  
16 are copyright concerns in terms of the Internet, with  
17 people using our music and not compensating us or our  
18 artists. And there are concerns at retail. In the  
19 last few years a number of the major retail chains,  
20 Camelot, Warehouse, have gone into bankruptcy and each  
21 time they go into bankruptcy, there are tens of  
22 millions of dollars at stake in terms of records that

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1 were given to the retail account which are now not  
2 going to be paid for and it's the record companies in  
3 each instance, not the artist, not the music publisher  
4 who pays for the costs of those records.

5 Q Now in conclusion, why do you consider the  
6 license fee that the Panel will set in this proceeding  
7 to be important to the record companies and the  
8 artists?

9 A I think what I've tried to sketch today is  
10 the enormous contribution, the significant risks that  
11 record companies take and the artists as well take  
12 significant risks from putting their life into these  
13 projects. And we believe that the -- I believe that  
14 the fee that we're talking about here is essential to  
15 compensate both the artists and the record companies  
16 for their risks involved and the costs that are  
17 involved.

18 MR. MARKS: I have no further questions.

19 CHAIRPERSON EHRIG: Thank you. Mr.  
20 Laguarda?

21 MR. LAGUARDA: Thank you, Your Honor.

22 CROSS EXAMINATION

1 BY MR. LAGUARDA:

2 Q Good morning, Mr. Horowitz.

3 A Good morning.

4 Q Are you generally familiar with the terms  
5 under which the digital audio services will be  
6 licensed to perform sound recordings under the  
7 statutory license at issue here?

8 A I'm generally familiar. I'm really not an  
9 expert on it.

10 Q Do you know the term "sound recording  
11 performance complement"? Does that mean anything to  
12 you?

13 A I've heard the term, yes.

14 Q Do you know about the restriction in the  
15 statute on pre-announcing plays by the digital audio  
16 services?

17 A On pre-announcing? Why don't you explain  
18 it to me.

19 Q Do you know about the requirement to  
20 provide subscribers with song identifying information  
21 along with transmissions that are made?

22 A I don't know in what detail you're asking

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1 about.

2 Q Just in general, are you familiar?

3 A Yes.

4 Q In your knowledge and experience of the  
5 recording industry, do any of these restrictions apply  
6 to broadcast radio?

7 A I just want to make sure exactly what  
8 restrictions you're asking me about.

9 Q There are restrictions that apply under  
10 the terms of the statutory license to digital audio  
11 services. Do they also apply to broadcast radio?

12 MR. MARKS: I think you might want to list  
13 them or provide him with a copy of the statute. I  
14 think he's said he's generally familiar, but not an  
15 expert, so he might now know the specific --

16 MR. LAGUARDA: Okay.

17 BY MR. LAGUARDA:

18 Q I only have one copy of this and I'd like  
19 to show --

20 JUDGE NELSON: One copy of what?

21 MR. LAGUARDA: Oh, this is -- let the  
22 record reflect that I am holding a copy of Public Law

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1 10439, the Digital Performance Right and Sound  
2 Recordings Act of 1995. And simply for purposes of  
3 aiding the witness and placing before him the  
4 provision at Section 3(d)(2), subscription  
5 transmissions. Subject, statutory license, if they  
6 perform sound recordings in accordance with the  
7 following provisions. And those are right here.

8 I'm indicating to the witness the  
9 provisions.

10 MR. MARKS: Your Honors, can we have an  
11 indication of where counsel is going with this? I'm  
12 not sure that this was within the scope of the direct  
13 examination and testimony that was given by the  
14 witness.

15 MR. LAGUARDA: Certainly. Your Honors,  
16 I'm just simply trying to establish the fact that the  
17 witness understands that the types of performances  
18 played at issue here are subject to restrictions that  
19 do not apply to the performance of sound recordings in  
20 other contexts. As a recording company executive,  
21 that he's familiar with that.

22 CHAIRPERSON EHRIG: Wherein does that

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1 discussion appear in his direct testimony?

2 MR. LAGUARDA: It comes out of the fact  
3 that the witness testified about the importance of  
4 exposure of sound recordings and radio performances  
5 and video performances and other exposures of the  
6 work.

7 MR. MARKS: I think that's a mighty  
8 stretch of what the witness testified. I think the  
9 crux of his testimony was about the costs and the  
10 risks that are associated with the sound recording.  
11 He didn't state anything about the statute or being  
12 familiar with the statute or anything of that nature.  
13 I think it's beyond the scope.

14 CHAIRPERSON EHRIG: Do you have many  
15 questions in this area?

16 MR. LAGUARDA: I don't. I would like to  
17 point out that the witness is testifying about the  
18 importance to his industry of this license fee and the  
19 license is going to be paid pursuant to statutory  
20 conditions that are imposed on my client and other  
21 subscription services and therefore as part of the  
22 conditions for obtaining that license fee and for

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1 using the sound recordings at issue, the subscription  
2 services must comply with the conditions imposed on  
3 them by the statute.

4 CHAIRPERSON EHRIG: Sounds to me like  
5 you're making a legal argument and I don't see where  
6 this witness can help in that direction. Your  
7 objection is sustained.

8 BY MR. LAGUARDA:

9 Q Mr. Horowitz, you've provided as part of  
10 your testimony a videotape that was created by the  
11 Canadian Recording Industry Association? Is that  
12 correct?

13 A Yes.

14 Q Would you say that the information  
15 contained in the videotape is accurate?

16 A I think that the - it's been a while since  
17 I watched that videotape, but I think that it's an  
18 attempt in a condensed period of time to capture the  
19 essence of what goes on. I can't tell you if every  
20 single sentence in that is totally accurate.

21 Q Were you involved at all in the production  
22 of the videotape?

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1 A No.

2 Q Do you know the source of any of the  
3 numbers?

4 CHAIRPERSON EHRIG: If I can stop you for  
5 a minute. Is this videotape going to be offered or  
6 are we going to be shown it?

7 (Pause.)

8 MR. MARKS: We will just withdraw the  
9 videotape at this time.

10 CHAIRPERSON EHRIG: Thank you. Moving  
11 right along.

12 BY MR. LAGUARDA:

13 Q Moving right along --

14 (Laughter.)

15 MR. SUKLER: You were successful --

16 (Laughter.)

17 BY MR. LAGUARDA:

18 Q Mr. Horowitz, you testified with respect  
19 to the acquisition of talent by your record company.  
20 Is it fair to say that Universal Records has been  
21 successful recently because it is offering new talent,  
22 promoting new talent? Is that a fair statement?

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1           A     Well, I think it's fair to say that all  
2 record companies are successful to the extent they  
3 find quality acts and tap into the public's desire to  
4 hear that act.

5           Q     Would you agree with the statement that  
6 new talent generally is less costly for a record  
7 company than an established sound recording artist?

8           MR. MARKS: Can I just have that repeated?  
9 I'm sorry.

10          BY MR. LAGUARDA:

11          Q     Are the costs associated with the  
12 production of a sound recording that involves a new  
13 recording artist, new talent, as set forth in your  
14 testimony, lower than the costs for an established  
15 sound recording artist?

16          A     I think generally speaking the more  
17 successful an artist is, the more money the record  
18 company is contractually required to pay to that  
19 artist. But there may be some established acts that,  
20 depending upon how established they are and depending  
21 upon what level of success they have, that may  
22 actually require less than a new artist in a major

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1 bidding war.

2 Q So it would be fair to say that MCA's or  
3 Universal's return on investment for a new artist is  
4 substantially higher than for an established star in  
5 general?

6 A No. I think just to elaborate so that  
7 it's clear what I'm taking about, the risks associated  
8 with a new artist are significant and what one hopes  
9 is that although you're paying out more money than on  
10 an established super star, that the established super  
11 star is going to sell more. But your margin may be  
12 substantially less.

13 Q Let the record reflect that I'm marking  
14 for identification as DCR X1 or 1X.

15 (The document referred to was  
16 marked for identification as  
17 DCR Exhibit 1X.)

18 (Pause.)

19 Mr. Horowitz, if I could direct your  
20 attention to this article which is taken from the Wall  
21 Street Journal daily edition, Thursday, May 29, 1997.  
22 Have you seen this article?

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1 A Yes.

2 Q Could you direct your attention to the  
3 third column, the first full sentence and just begin  
4 reading there and end at the end of the sentence?

5 A This is the sentence that begins "critics  
6 snipe"?

7 Q After spending? Third column, bottom of  
8 the column, the sentence that begins "after spending."

9 A Okay. You want me to read it out loud?

10 Q Could you?

11 A Universal is now making deals with young  
12 labels that can find promising, but low costs new  
13 artists to develop.

14 Q Is it a fair characterization that low  
15 cost new artists, strike that. I withdraw the  
16 question.

17 Mr. Horowitz, you testified --

18 MR. MARKS: Are you going to ask any more  
19 questions about that?

20 MR. LAGUARDA: Yes.

21 BY MR. LAGUARDA:

22 Q You testified as to innovations of

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1 stereophonic sound, reel to reel tape, 8 track and  
2 analog cassettes and compact disks in your testimony  
3 --

4 MR. MARKS: I don't want to interrupt.  
5 I'm sorry to interrupt you again. Are you going to  
6 ask any questions regarding this statement that you  
7 just had him read?

8 MR. LAGUARDA: Yes, I am going to.

9 CHAIRPERSON EHRIG: I'm wondering if this  
10 is the appropriate witness. Mr. Morris is going to be  
11 testifying and he apparently --

12 JUDGE NELSON: It's a different Morris.

13 CHAIRPERSON EHRIG: Oh, it's a different  
14 Morris. Okay. Strike all that.

15 BY MR. LAGUARDA:

16 Q If I could set it aside for a minute. You  
17 have your testimony in front of you. On page 6, Mr.  
18 Horowitz, you testified about the innovations such as  
19 stereophonic sound, reel to reel tape, 8 track and  
20 analog cassettes and compact disks.

21 Would it be fair to state that these  
22 technological changes did not result in fewer sales

1 for the recording industry?

2 A Did not result in fewer sales? I'm not  
3 exactly sure what you mean. We sold music on these  
4 configurations.

5 Q Did sales increase as a result of these  
6 technological innovations?

7 A Some of them, yes, I believe so.

8 Q Has MCA or now Universal performed any  
9 studies regarding the effect of recent technological  
10 innovations on the purchase of sound recordings?

11 A What kind of studies?

12 MR. MARKS: And what kind of innovations  
13 if I can ask?

14 BY MR. LAGUARDA:

15 Q Has Universal performed any studies  
16 regarding the effect of digital audio services on the  
17 purchase of sound recordings?

18 A I don't know of any studies that we've  
19 done about digital audio services, no.

20 Q Would you be familiar with any studies, if  
21 the company had done any?

22 A It would depend on the study.

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1           Q       You testified as to substantial  
2       responsibilities and costs involved in marketing and  
3       promoting sound recordings. Would you agree that MCA  
4       incurs substantial costs in promoting marketing and  
5       merchandizing records to the public?

6           A       Yes.

7           Q       Would you agree that these costs are  
8       necessary to increase the volume, the number of the  
9       records sold?

10          A       Yes, but not solely for that purpose, but  
11       yes.

12          Q       You testified that your activities consist  
13       of marketing to radio. That's part of what MCA does?

14          A       Yes.

15          Q       And you testified that record companies  
16       fund the production of music videos, because music  
17       videos are essential to the promotion of an album, is  
18       that correct?

19          A       I don't believe I said they were  
20       essential, but I said that we do fund videos and from  
21       -- on a case by case basis they may be essential.

22          Q       Can I direct your attention to the bottom

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1 paragraph on page 8 of your testimony?

2 A Okay. I think that's what I'm saying now.  
3 That they're often essential.

4 Q So it's your testimony that music videos  
5 are often essential to the promotion of an album?

6 A Yes.

7 Q Is it fair to say that record companies  
8 typically own the videos that they produce?

9 A Yes.

10 Q Do the record companies have exclusive  
11 right to publicly perform these videos?

12 A You're talking about legally or are you  
13 talking about in artists' contracts?

14 Q I'm talking about legally, does the owner  
15 of a video, a music video such as the type that MCA or  
16 Universal produces, does the owner of the video have  
17 the right to publicly perform it?

18 MR. MARKS: Objection, calls for a legal  
19 conclusion.

20 CHAIRPERSON EHRIG: Sustained.

21 BY MR. LAGUARDA:

22 Q Does MCA --

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1 JUDGE NELSON: Now Universal.

2 BY MR. LAGUARDA:

3 Q Now Universal, give away videos for  
4 performance to channels like MTV and VH-1?

5 A The two that you mentioned, no, we do not  
6 give them away.

7 Q Does Universal give away videos to any  
8 channel for public performance?

9 A I think that what happens is on a case by  
10 case basis, Universal decides whether or not they want  
11 to enter into a license with the video exhibitor. At  
12 times, they -- we may decide to that without  
13 compensation, but other times we may decide not to do  
14 it at all on a particular video and at other times  
15 we'll only do it if we are compensated.

16 Q What factors --

17 JUDGE NELSON: Can I just ask a question  
18 here, just to show my total -- when you're marketing  
19 these videos, are they marketed primarily to  
20 television or is there something else that we're  
21 missing? Once upon a time I remember clubs used to  
22 show videos.

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1 THE WITNESS: No, they still do that.

2 JUDGE NELSON: But that's not your major  
3 market?

4 THE WITNESS: No, the major marketing is  
5 probably for most of these videos probably MTV, a 24-  
6 hour music video channel.

7 JUDGE NELSON: Thank you. Sorry for the  
8 interruption.

9 MR. LAGUARDA: That's fine, Your Honor.

10 BY MR. LAGUARDA:

11 Q I just want to let the record reflect that  
12 I'm presenting to be marked for identification as DCR  
13 X2 and excerpts from the book. This is DCR 2X or X2,  
14 however they are being numbered.

15 (The document referred to was  
16 marked for identification as  
17 DCR Exhibit No. 2.)

18 A Do I need a copy?

19 Q Mr. Horowitz, can you identify the book  
20 that I've handed to you?

21 A Identify it in which sense?

22 Q Do you recognize this book? Have you seen

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1 this title before?

2 A I have heard of this book, yes.

3 CHAIRPERSON EHRIG: Can you tell us what  
4 it is?

5 THE WITNESS: I have never read this book,  
6 so I'm probably not the best one to tell you what it  
7 is.

8 CHAIRPERSON EHRIG: Read it off the spine.

9 THE WITNESS: Okay, what's the name of it.  
10 This Business of Music by Sidney Shemel and William  
11 Krasilovsky.

12 CHAIRPERSON EHRIG: Thank you.

13 BY MR. LAGUARDA:

14 Q Before we open this, I'm curious, what's  
15 the range of license fees that Universal has received  
16 from music videos?

17 MR. MARKS: Hold on. I would object. I  
18 don't see how that's relevant to his testimony.

19 MR. LAGUARDA: Mr. Horowitz has clearly  
20 testified as to the importance of music videos and for  
21 promoting sound recordings and he's testified that in  
22 many cases record companies make decisions as to

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1 whether or not to charge a fee for the promotion.

2 The very subject that's at issue in this  
3 proceeding is the amount of a license fee that should  
4 be charged by record companies for their sound  
5 recording product. I think it's very relevant what  
6 they charge for their video product.

7 CHAIRPERSON EHRIG: The objection is  
8 overruled. You may answer.

9 THE WITNESS: Well, I think the first and  
10 most important thing to remember is that we are not  
11 required legally to give our videos to anybody. It's  
12 not a statutory license.

13 The range would go anywhere from zero for  
14 particular video channels to literally millions of  
15 dollars a year.

16 BY MR. LAGUARDA:

17 Q Is it fair to say that the license fees  
18 are greater or higher when exclusivity is involved?

19 A I can't tell you exactly how MTV and VH-1  
20 determines exactly what they're going to pay and how  
21 much exclusivity is weighed in that process, but I  
22 would assume that what you're asking is true.

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1 Q So it's fair to say that exclusivity is  
2 valuable to the video channels?

3 A I think that they would probably be better  
4 able to tell you that than I.

5 Q But in your experience as a recording  
6 company executive, it certainly is a factor?

7 MR. MARKS: It's been asked and answered.

8 BY MR. LAGUARDA:

9 Q Mr. Horowitz, turning your attention to  
10 page 77 of the book which has been marked and which is  
11 available in front of -- in the copies that I've  
12 handed out.

13 MR. LAGUARDA: Page 77, Your Honor.

14 JUDGE NELSON: I just have one question.  
15 It seems that we don't have the book. Is there a  
16 publication date on the book?

17 MR. LAGUARDA: I believe that the  
18 publication date is 1985, Your Honor. I'm not sure.

19 CHAIRPERSON EHRIG: 1985

20 MR. LAGUARDA: Yes. I can confirm that  
21 for you.

22 THE WITNESS: It appears to be 1985.

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1 JUDGE FORTKORT: Did you say 1985 or 1995?

2 MR. LAGUARDA: 1985, Your Honor.

3 JUDGE FORTKORT: That's what I thought you  
4 said.

5 BY MR. LAGUARDA:

6 Q Before turning to this page, I just want  
7 to make it clear as a seller of videos, music videos,  
8 do you give exclusivity away for free?

9 A It depends upon the circumstances.

10 Q Could you enlighten as to what those  
11 circumstances might be?

12 A Well, in each particular case when there  
13 is a request for a video or for a video license, we  
14 make a determination as to the relative benefits that  
15 we're going to get versus the relative costs of giving  
16 up a video that we have a substantial investment in  
17 for free.

18 Q Would it be fair to say that you rarely  
19 give exclusivity for free?

20 A I would say that that's probably fair to  
21 say, yes.

22 Q Sorry, turning to page 77, the first full

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1 paragraph beginning with the word "under". Could you  
2 just read that?

3 A Do you want me to read it out loud?

4 Q Please.

5 A "Under most record artists' contracts, the  
6 record company becomes entitled to recoup a certain  
7 percentage of the video production costs out of the  
8 artist's record royalties or the artist's share of the  
9 video income or a combination of both."

10 Q Would you agree that that is a fair  
11 characterization of the practice at Universal?

12 A Yes, I would say under most record  
13 artist's contracts, that is true, that some percentage  
14 is recoupable and again, depending upon the clout of  
15 the artist, and a number of other circumstances, what  
16 that percentage is will vary.

17 Q Skipping down a little bit to the third  
18 full paragraph with the sentence beginning "under",  
19 could you read that again out loud?

20 A "Under recoupment from the combination of  
21 record royalties and the artist's share of net video  
22 receipts of his video royalties, the artist may well

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1 bear at least 75 percent and at least as much as 100  
2 percent of the video costs."

3 Q Mr. Horowitz, is that a fair  
4 characterization of industry practices at Universal?

5 A No. I would say it's much less that this  
6 amount and again I think it has to be stressed,  
7 whatever contractual right we may have to recoup, is  
8 obviously subject to the artist's selling of records  
9 so that there's something to recoup it from and in  
10 most cases that just isn't the case.

11 Q Thank you. Mr. Horowitz, in testifying  
12 about promotional activities, would you agree that  
13 promotional activities also consist of providing air  
14 play of sound recordings free over the Internet?

15 A I'm not sure I understand your question.

16 Q Does Universal or MCA provide sound  
17 recordings over the Internet?

18 A In what context?

19 Q Are you familiar with the Internet?

20 A Yes.

21 Q Are you familiar with the practice of  
22 companies to establish so-called homepages or web

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1 pages on the Internet?

2 A Yes.

3 Q Does MCA or Universal have such a page?

4 A Yes.

5 Q Does MCA or Universal provide sound  
6 recordings on that page?

7 A Yes, I think the reason I'm having trouble  
8 with your question is when you say sound recordings it  
9 sounds as if we're giving an entire album or we're  
10 giving an entire song. That's not what we're doing.

11 Q Could you tell me what it is?

12 A What typically happens is there's a teaser  
13 for a song which may last for 30 seconds and that's  
14 the kind of thing that we would put on the web page.  
15 We're very concerned, generally speaking, about  
16 putting too much music on the Internet for fear that  
17 someone may download it and therefore we would lose  
18 sales.

19 Q Let the record reflect that I'm presenting  
20 for identification a printed out copy of the MCA  
21 Records web page and I'm marking for identification as  
22 DCR 3X.

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1 (The document referred to was  
2 marked for identification as  
3 DCR Exhibit No. 3.)

4 Mr. Horowitz, have you been to the MCA web  
5 page on the Internet?

6 A Yes. I have not been -- the web page  
7 changes regularly, so I can't say I've seen every web  
8 page, but yes, I've been there.

9 Q If you could just turn to the third page  
10 in. Can you identify for the Panel the markings that  
11 appear at the center of the page that are underscored  
12 and then in parentheses followed by a numeral marking?

13 A No.

14 Q Mr. Horowitz, when you've been to the MCA  
15 web page, have you listened to any music through the  
16 web page?

17 A Yes.

18 Q How is that done? Can you explain that  
19 for the Panel?

20 A How technically is it done?

21 Q No, how would somebody who visits the web  
22 page listen to music? How is it made available?

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1           A       I'm not following the thrust of the  
2 question. You mean how physically does someone hear  
3 the music once they're on the web page?

4           Q       If I'm using a computer to browse the  
5 Internet and I go to the MCA web page, will I be able  
6 to hear MCA recording artists, MCA sound recordings?

7           A       Yes, snippets, generally speaking of sound  
8 recordings.

9           Q       Can you explain to me how I would  
10 accomplish that?

11          A       Technically?

12          Q       If you were to provide the Panel with  
13 directions as to what they would do if they visited  
14 the MCA web page and wanted to listen to MCA sound  
15 recordings, what would they have to do?

16          A       Once they got to the web page, typically,  
17 a matter of moving a mouse and clicking.

18          Q       And then after you click, when you click,  
19 what do you click on?

20          A       There's some sort of image, depending upon  
21 the web page and typically speaking they would find an  
22 image and click on it.

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1 Q Okay, and what would happen after they  
2 click on it?

3 A It depends upon the web page, but in most  
4 instances they would be able to hear some amount of  
5 music.

6 Q As the President of MCA or Universal  
7 Records, can you explain for the Panel why music is  
8 provided via the Internet on your web site?

9 A What is generally provided on the web site  
10 is what one might find in a fan club. There's graphic  
11 information. There may be photos of the artists.  
12 There may be information about their tour and there  
13 may be snippets of the song that the person can hear  
14 to learn a little bit about the new album that the  
15 artist has out.

16 Q So would it be fair to say that MCA  
17 Records is attempting to expose consumers to sound  
18 recordings via the Internet?

19 A I would say that we are attempting to like  
20 a fan club, we are attempting to expose the artist and  
21 his or her work to the consumer.

22 Q Has Universal ever provided complete sound

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1 recordings for free to consumers over the Internet?

2 A I don't know of any case where an entire  
3 album has been given away for free. There may be an  
4 instant or two where a particular sound that may or  
5 may not have been on the latest album was on the  
6 Internet for an artist to sample.

7 Q So an entire song could have been listened  
8 to by somebody browsing the Internet for free?

9 A It's possible, yes.

10 Q And Mr. Horowitz, again, just to clarify,  
11 the purpose of that is to expose consumers to the  
12 sound recordings?

13 A It's to expose the consumer to the artist  
14 and to further maximize the general awareness of the  
15 artist, not just the sound recording.

16 MR. LAGUARDA: If I could just have your  
17 indulgence for a moment?

18 (Pause.)

19 BY MR. LAGUARDA:

20 Q Mr. Horowitz, you testified that your  
21 promotional activities also consist of attempting to  
22 obtain airplay for your sound recordings? Is that

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1 correct?

2 A Yes.

3 Q Would you agree that airplay is important  
4 for record sales?

5 A Yes.

6 Q Let the record reflect that I'm presenting  
7 for identification DCR X4, the following articles from  
8 New York Daily News, May 22, 1997, which has been  
9 reprinted from the Nexus news service.

10 (The document referred to was  
11 marked for identification as  
12 DCR Exhibit No. 4.)

13 Have you had a chance to look at it?

14 A Do you want me to read the whole article?

15 Q No. For the moment, if you could just  
16 direct your attention to the first two sentences of  
17 the article, beginning afterwards marked "body" and  
18 specifically to the second sentence, if you could read  
19 that out loud for the Panel.

20 A "This matters because despite video, the  
21 Internet and all the other promotion in the world,  
22 nothing beats radio for delivering music to the

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1 masses."

2 Q Mr. Horowitz, would you agree with that  
3 statement as a fair characterization?

4 A I think it depends upon the artist, but  
5 generally speaking for the vast bulk of artists, radio  
6 is probably the most important promotional tool that  
7 we have.

8 Q Mr. Horowitz, how many consumers of sound  
9 recordings do you think buy a particular Universal  
10 record because they heard it on the radio? Do you  
11 have any idea of what that number might be?

12 A No.

13 Q Would you agree that three quarters of all  
14 consumers buy Universal records because they first  
15 heard them on the radio?

16 A I couldn't tell you what the percentage  
17 is.

18 Q Have you done any studies or has Universal  
19 done any studies on the promotional value of airplay?

20 A I don't know of any studies in particular  
21 done by Universal.

22 Q Let the record reflect that I'm marking

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1 for identification DCR X5, excerpts from a public  
2 document on file with the Copyright Office,  
3 specifically the Copyright Royalty Tribunal.

4 (The document referred to was  
5 marked for identification as  
6 DCR Exhibit No. 5.)

7 MR. MARKS: Do you have a complete copy of  
8 this?

9 MR. LAGUARDA: I do. Your Honors, I would  
10 just like to indicate that the copy that I've handed  
11 out is for the record that it is marked "Summary of  
12 Proposed Findings of Fact and Conclusions of Law of  
13 the Recording Industry Association of America."

14 MR. MARKS: Do you have a whole copy?

15 MR. LAGUARDA: Yes, I do have the entire  
16 copy, however, it's very lengthy and I'm happy to  
17 share it with you, but under the rules I understand  
18 that a public document on file with the Copyright  
19 Office can be made part of the record and that the  
20 Panel can take judicial notice of it, especially  
21 considering its length, I did not prepare separate  
22 sets of the entire document and I merely made copies

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1 of excerpted pages.

2 JUDGE NELSON: Can I just make an  
3 assumption that might be totally wrong. If this is a  
4 filing from the summary, would it be right to say that  
5 it wasn't accepted in the final copy of the Copyright  
6 Royalty Tribunal's order? I don't know.

7 MR. LAGUARDA: That the entire filing was  
8 not accepted?

9 JUDGE NELSON: No, no, no. What you're  
10 showing us, this portion of it that you're interested  
11 in us seeing as a proposed finding of fact was not in  
12 the final edition that was put out by the Tribunal  
13 itself?

14 MR. LAGUARDA: That's correct. Your  
15 Honor, the proposed finding of fact was filed by the  
16 Recording Industry Association in the compulsory  
17 license proceeding and I do not know to the extent  
18 whether or not they were adopted by the Panel. That's  
19 not really the purpose that I'm making --

20 JUDGE NELSON: I will tell you what my  
21 assumptions are, so this is a --

22 MR. MARKS: This is a document, I would

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1 point out that is 17 years old. I also don't think  
2 that the rule regarding judicial notice contemplates  
3 taking official notice of three pages of a document  
4 that we can see at least right here is 297 pages long.

5 MR. LAGUARDA: Oh, it's quite long.

6 CHAIRPERSON EHRIG: What is the purpose of  
7 submitting this? Where are you going with it?

8 MR. LAGUARDA: Your Honor, I'm simply  
9 going to point out to the witness statements made by  
10 the Recording Industry Association of America  
11 beginning at paragraph --

12 CHAIRPERSON EHRIG: In 1980.

13 MR. LAGUARDA: In 1980, yes, Your Honor.  
14 It's been very difficult to obtain any statements from  
15 them in this proceeding, Your Honor. I've had to go  
16 back to 1980.

17 MR. MARKS: I would move to strike that  
18 gratuitous remark. I also would question the use of  
19 a document that's 17 years old that obvious is far  
20 removed from anything in this proceeding.

21 I would also point out that I don't see  
22 really the reason here to impeach a witness who has

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1 already agreed that radio is a promotional benefit.  
2 We keep seeing document after document and he's agreed  
3 that radio is a promotional benefit.

4 (Pause.)

5 CHAIRPERSON EHRIG: Okay, your motion to  
6 strike the gratuitous comment is granted. Your motion  
7 I think it was to strike this document which has been  
8 identified as DCR 5X is denied, assuming you can lay  
9 some kind of a proper foundation for this.

10 MR. MARKS: Your Honor, can I just reserve  
11 the right to object to this document if it's offered  
12 into evidence?

13 CHAIRPERSON EHRIG: Yes, of course.

14 MR. MARKS: Thank you.

15 BY MR. LAGUARDA:

16 Q Mr. Horowitz --

17 MR. MARKS: I'm sorry, has this been  
18 marked?

19 MR. LAGUARDA: DCR 5X.

20 MR. MARKS: I'm sorry.

21 CHAIRPERSON EHRIG: 5X.

22 BY MR. LAGUARDA:

1 Q Mr. Horowitz, is MCA a member of the  
2 Recording Industry Association of America?

3 A Universal is yes.

4 Q Universal, sorry. Thank you for your  
5 patience on that part. Was MCA Records or Universal  
6 or its predecessor a member of the Recording Industry  
7 Association on the date November 17, 1980?

8 A I don't know.

9 CHAIRPERSON EHRIG: I'm frankly troubled  
10 by the relevance of this document.

11 MR. LAGUARDA: Your Honor, if the  
12 Recording Industry would stipulate that there's a  
13 certain time limit for relevancy of documents --

14 CHAIRPERSON EHRIG: I'm not keying it to  
15 the time at all. These are proposed findings which  
16 may or may not be adopted.

17 JUDGE FORTKORT: Well, that's one side of  
18 it.

19 CHAIRPERSON EHRIG: You can go ahead with  
20 your questions and see where they go.

21 MR. LAGUARDA: Well, Your Honor, in the  
22 interest of time I will withdraw the document.

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1 CHAIRPERSON EHRIG: It will be withdrawn.

2 (The document referred to was  
3 marked for identification as  
4 DCR Exhibit No. 5 was  
5 withdrawn.)

6 BY MR. LAGUARDA:

7 Q Mr. Horowitz, do you know what percentage  
8 of MCA's promotion or marketing budget is spent on  
9 promoting airplay?

10 A No.

11 Q Mr. Horowitz, what would happen to  
12 Universal recording artists if they didn't get  
13 airplay?

14 A For most of them it would probably mean  
15 that they would not have a lot of sales.

16 MR. MARKS: I just want to clarify that  
17 that's radio airplay that your answer is directed to?

18 THE WITNESS: Yes, yes.

19 BY MR. LAGUARDA:

20 Q Mr. Horowitz do you know what percentage  
21 of MCA's promotion budget is spent promoting  
22 advertising on radio that is not MCA or Universal

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1 advertising?

2 A No, and again, it would change depending  
3 upon which record company you're talking about.

4 Q Would it be fair to say that your company  
5 does not spend any money on advertising, radio  
6 advertising that is not directly related to a product  
7 in which your company is interested in increasing  
8 sales?

9 JUDGE NELSON: I don't understand the  
10 question because I would assume he's in business to  
11 make money.

12 MR. LAGUARDA: Your Honor, I'm simply  
13 trying to establish that there are a number of things  
14 on radio in which the witness and the witness's  
15 company do not have an interest air time, advertising,  
16 public service announcements, other things that have  
17 been referred to in this proceeding and that the real  
18 value of radio airplay is, in fact, the exposure of  
19 sound recordings.

20 CHAIRPERSON EHRIG: Why don't you ask that  
21 question?

22 JUDGE FORTKORT: Nicely put.

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1 BY MR. LAGUARDA:

2 Q Mr. Horowitz, is the value of radio  
3 airplay the exposure to sound recordings?

4 A Yes. The exposure of sound recordings to  
5 the public, yes.

6 Q Mr. Horowitz, do you have an idea of  
7 approximately how much Universal generates in revenues  
8 on an annual basis?

9 A Universal Music Group?

10 Q Yes.

11 A Yes.

12 Q Could you tell the Panel what that is,  
13 what that amount is?

14 MR. MARKS: First, I'd like to know the  
15 relevancy of it and then we may have some issues here.

16 CHAIRPERSON EHRIG: Of confidentiality.

17 JUDGE NELSON: Is it a public company?

18 THE WITNESS: I don't know how --

19 JUDGE NELSON: Are there two numbers?

20 THE WITNESS: No, there are not two  
21 numbers.

22 (Laughter.)

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1 THE WITNESS: The question is whether they  
2 break out the music group numbers separately from the  
3 other entertainment parts of the company. I don't  
4 know.

5 MR. MARKS: Seagrams is the public  
6 company.

7 THE WITNESS: Right.

8 CHAIRPERSON EHRIG: I think he answered  
9 your question. He doesn't know.

10 THE WITNESS: I know the revenue.

11 JUDGE NELSON: He knows that. He just  
12 didn't know the answer of what was public and what  
13 wasn't public.

14 MR. MARKS: The public company is  
15 Seagrams. I'm not sure that in the 10(k) or whatever,  
16 public document there might be on that company.

17 JUDGE NELSON: I'm sorry --

18 JUDGE FORTKORT: Is your objection that  
19 his stating the revenue of the Universal group is  
20 confidential?

21 MR. MARKS: My first objection is that  
22 it's irrelevant.

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1 CHAIRPERSON EHRIG: I think you're looking  
2 for a percentage, are you not?

3 MR. LAGUARDA: Yes, Your Honor.

4 CHAIRPERSON EHRIG: Again, can you just  
5 ask a question about that and maybe we don't have to  
6 have the exact dollar amounts in there.

7 JUDGE NELSON: I can't count that high  
8 anyway.

9 (Laughter.)

10 MR. MARKS: As long as you can count to  
11 41.9.

12 (Laughter.)

13 MR. LAGUARDA: Your indulgence, Your  
14 Honors.

15 (Pause.)

16 BY MR. LAGUARDA:

17 Q Mr. Horowitz, you testified that the  
18 record industry had more than \$12 billion in sales  
19 last year? Is that correct?

20 A Yes.

21 Q Would additional revenues of approximately  
22 \$3.5 million make a significant impact on the

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1 industry's economics?

2 MR. MARKS: Objection. What is the  
3 relevance of that question?

4 CHAIRPERSON EHRIG: And where did you get  
5 the \$3.5 million?

6 MR. LAGUARDA: Your Honors, you have the  
7 direct testimony, written testimony of Mr. Wilkofsky,  
8 the Recording Industry Association's economist who  
9 will testify and has already in the written record.  
10 Using his procedure, the actual license fee  
11 calculation for DMX in 1995 would be \$3.65 million.  
12 That is in the record as part of the Recording Industry  
13 Association's case so that is simply their number.  
14 I'm just asking Mr. Horowitz to answer my question.

15 CHAIRPERSON EHRIG: Whether a few more  
16 million would be important?

17 MR. MARKS: I still have a relevancy  
18 objection.

19 MR. LAGUARDA: Would it have a significant  
20 impact on the industry's economics.

21 JUDGE NELSON: Well, we know significant  
22 is 10 percent, so we understand that answer or at

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1 least that's the accounting standard for significance  
2 on an accountant's financial statement is 10 percent.  
3 The FTC won't prosecute you for --

4 (Laughter.)

5 JUDGE FORTKORT: The answer, no, will not  
6 have any significant economic advantages.

7 BY MR. LAGUARDA:

8 Q Mr. Horowitz --

9 MR. MARKS: I wouldn't want -- the witness  
10 certainly didn't say that and I just don't think that  
11 this is relevant to what the rate that the Panel has  
12 set, should be.

13 CHAIRPERSON EHRIG: Do you have another  
14 question?

15 MR. LAGUARDA: Yes.

16 BY MR. LAGUARDA:

17 Q Mr. Horowitz, have you ever entered a new  
18 business in the past -- have you ever entered a new  
19 business?

20 A Me, personally?

21 MR. MARKS: Objection. This is outside  
22 the scope of his testimony.

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1 THE WITNESS: The witness has testified as  
2 to his knowledge and experience in the industry and  
3 I'm asking for him to testify as a businessman as to  
4 his experience. I will rephrase the question.

5 JUDGE NELSON: Why don't you ask him just  
6 the real information you want to get from him?

7 BY MR. LAGUARDA:

8 Q Mr. Horowitz, if you entered a business as  
9 a businessman and were later told of a 41.1 percent  
10 royalty, would you agree that this royalty would have  
11 a disruptive impact on the structure of the industry  
12 and on generally prevailing industry practices?

13 MR. MARKS: Same objection.

14 CHAIRPERSON EHRIG: Sustained.

15 JUDGE NELSON: Well, while he's making  
16 another question, let me ask a question, you keep  
17 saying airplay which makes me remember that every time  
18 I've been in an airplane and they have music channels,  
19 do they pay a fee for that? Do the airplanes pay a  
20 fee for that licensing or is that free?

21 THE WITNESS: No, I believe they pay a  
22 fee.

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1 JUDGE NELSON: What do they pay a fee for?  
2 Is that strictly the writers and the music work, the  
3 writers and the lyricists?

4 THE WITNESS: No.

5 JUDGE NELSON: The performers?

6 THE WITNESS: I think they work out a deal  
7 with the record companies where they license the  
8 masters, the sound recording parts, as well as the --  
9 I don't know what they do on the publishing side, but  
10 there is a deal made with the record companies to  
11 license the sound recordings.

12 JUDGE NELSON: So that's a performance  
13 right?

14 THE WITNESS: I guess so.

15 JUDGE NELSON: It's a negotiated  
16 performance right?

17 THE WITNESS: I guess so.

18 JUDGE NELSON: Is there a set percentage  
19 or is that just a floating number?

20 THE WITNESS: I think it's a floating  
21 number. I don't know. I don't deal with that part of  
22 the company.

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1 JUDGE NELSON: You don't know what the  
2 range is?

3 THE WITNESS: No.

4 CHAIRPERSON EHRIG: My suggestion at this  
5 point is we take a 10 minute break, okay?

6 MR. LAGUARDA: Okay.

7 (Whereupon, the proceedings went off the  
8 record at 11:34 a.m. and resumed at 11:44 a.m.)

9 CHAIRPERSON EHRIG: Mr. Laguarda.

10 MR. LAGUARDA: Thank you, your Honor.  
11 Let the record reflect that I'm having marked for  
12 identification DCR 6X.

13 CHAIRPERSON EHRIG: Thank you.

14 MR. LAGUARDA: This is an article entitled  
15 "Why It Costs for a Hit CD" from the Washington Post,  
16 February 15, 1995.

17 (Whereupon, the above-referred  
18 to document was marked as  
19 Exhibit DCR 6X for  
20 identification.)

21 BY MR. LAGUARDA:

22 Q Mr. Horowitz, have you had a minute to

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1 familiarize yourself with this?

2 A Okay.

3 Q Turning your attention to the article,  
4 specifically at the bottom of the page, the sources.  
5 Can you identify those sources of the information in  
6 the article?

7 MR. MARKS: Meaning he knows who they are  
8 or --

9 BY MR. LAGUARDA:

10 Q Are you familiar with obviously the  
11 Recording Association of America and Billboard  
12 Magazine?

13 A Yes.

14 Q What about Sound Data Corp.?

15 A Yes.

16 Q Are you familiar with any of the other  
17 persons or companies named there as sources?

18 A Yes.

19 Q Can you identify for the panel who they  
20 might be?

21 A Donald Passman is an attorney, as is  
22 Krasilovsky and Mr. Cooper.

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1 Q And you are familiar with Time Warner,  
2 Polygram?

3 A Yes.

4 Q Mr. Horowitz, turning your attention to  
5 the column in the article, Costs to Record Label.

6 A Yes.

7 Q Are the numbers that are represented on  
8 this page a fair and accurate representation of the  
9 costs to a record label?

10 A No, not necessarily. I'm not sure, I'm  
11 not sure how this is working. Recording costs they  
12 have as, I guess, 30 cents per unit, for example. I  
13 don't know, I don't know how they have come up with  
14 that number.

15 We would pay recording costs up front. So  
16 if we only sold one unit and recording costs were  
17 \$200,000, then you'd have \$200,000 of costs on that  
18 one unit. So, I'm not certain how they ended up with  
19 these numbers.

20 Q Turning your attention to operating profit  
21 and executive salaries. Is that a reasonable number  
22 in your opinion? Does that represent a reasonable

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1 estimate of operating profit and executive salaries as  
2 a percentage of costs to record label for MCA or  
3 Universal?

4 A Again, I don't know how they are coming up  
5 with these numbers. I just don't -- I don't know the  
6 assumptions that they are making. I really can't  
7 answer that based on this. I think part of their  
8 analysis is whether this is an incremental record or  
9 not an incremental -- I just don't know how they are  
10 coming up with it.

11 Q Mr. Horowitz, in light of the risks that  
12 the record industry undertakes to which you testified  
13 --

14 A Yes?

15 Q Would license fee payments of  
16 approximately \$3.5 million annually recoup the  
17 expenses associated with that risk for the industry?

18 CHAIRPERSON EHRIG: If he knows.

19 THE WITNESS: I think that it would not  
20 recoup all of those risks. Obviously, every dollar  
21 that we take in helps, and we are constantly looking  
22 for as many ways as possible to recoup the costs.

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1 MR. LAGUARDA: That's it. Thank you.

2 CHAIRPERSON EHRIG: Do you have any  
3 redirect, Mr. Marks?

4 MR. MARKS: I just have one question.

5 REDIRECT EXAMINATION BY MR. MARKS

6 BY MR. MARKS:

7 Q Mr. Horowitz, Mr. Laguarda asked you a  
8 series of questions about things that might serve a  
9 promotional benefit. Do you ever receive licenses for  
10 uses that have a promotional benefit also?

11 A Yes, we have a large number of things that  
12 give us promotional benefits where we charge. For  
13 example, MTV which as you have seen in some of the  
14 articles that have been passed out and as I testified,  
15 is a major promotional tool for us, but we get payment  
16 for our videos.

17 Getting one of our sound recordings on a  
18 popular television show is a promotion for that  
19 recording and for the artist and for the album, but we  
20 get paid for that.

21 Licensing a master to a commercial and  
22 sold a significant number of albums with a constant

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1 replay of that master in the recording, but we are  
2 paid significant sums for that.

3 There is a host of things were there is a  
4 promotional benefit, but we are also paid.

5 Q And one final thing, this last DCR 6X.  
6 These costs, it says in the second line here, "in this  
7 example of a million selling album", how many albums  
8 sell a million copies, Mr. Horowitz?

9 A Very few.

10 Q No further questions.

11 CHAIRPERSON EHRIG: Mr. Laguarda, you  
12 failed to offer your exhibits into evidence, did you  
13 mean to do that?

14 MR. LAGUARDA: No, your Honor.

15 CHAIRPERSON EHRIG: You do not. They are  
16 just for purposes of identification.

17 MR. MARKS: Your Honor, I would also move  
18 to strike from the record something that was read into  
19 the record from one of these exhibits. I think it's  
20 Number 1, but I don't have it in front of me. Yes.  
21 The statement that was read from this Wall Street  
22 Journal article.

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1 CHAIRPERSON EHRIG: After spending  
2 200,000,000?

3 MR. MARKS: Correct. There was no  
4 question that was ever asked after that.

5 MR. LAGUARDA: I thought that was  
6 withdrawn.

7 CHAIRPERSON EHRIG: No, are you  
8 withdrawing it now?

9 MR. LAGUARDA: Yes.

10 MR. MARKS: And that the statement that  
11 was read by the witness from the document be stricken.

12 CHAIRPERSON EHRIG: It will be so  
13 stricken.

14 MR. MARKS: Thank you, your Honor.

15 MR. LAGUARDA: I have one question.

16 CHAIRPERSON EHRIG: Only if it concerns  
17 the last two questions that were asked.

18 RE CROSS EXAMINATION BY MR. LAGUARDA

19 MR. LAGUARDA: It does. In those examples  
20 where you get paid for promotional use of your  
21 product, does exclusivity play a role in the amount of  
22 payment?

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1 THE WITNESS: It depends upon the  
2 situation. If, for example, we license a song to a  
3 commercial, television commercial, they will often ask  
4 for exclusivity for a certain period of time.

5 MR. LAGUARDA: Thank you. No further  
6 questions, thank you, your Honor.

7 CHAIRPERSON EHRIG: Thank you. We would  
8 like to give these back to you.

9 MR. LAGUARDA: Thank you very much.

10 CHAIRPERSON EHRIG: Thank you very much.  
11 Who was -- can we start with Mr. Morris now?

12 MR. GARRETT: Actually our next witness,  
13 your Honor, is Mr. Trautman.

14 CHAIRPERSON EHRIG: Mr. Trautman.

15 WHEREUPON,

16 JAMES M. TRAUTMAN  
17 was called by Counsel for the Recording Industry  
18 Association of America and, having been first duly  
19 sworn, assumed the witness stand, was examined and  
20 testified as follows:

21 DIRECT EXAMINATION BY MR. GARRETT

22 Q State your name for the record, please.

1 A James J. Trautman.

2 Q And where are you employed, Mr. Trautman?

3 A I am Senior Vice President of Boertz &  
4 Company, Inc.

5 Q Describe what Boertz & Company is, please.

6 A Boertz & Company is a research and  
7 consulting firm that engages in providing consulting  
8 services to clients in the media industry.

9 Q Can you briefly describe what your job  
10 responsibilities are with Boertz & Company?

11 A Yes, I direct the cable practice of Boertz  
12 & Company and the services that we provide in that  
13 area. My primary responsibilities involve two areas.  
14 The first is providing strategic and business planning  
15 advisory services as well as market research and  
16 competitive analysis for cable programming services  
17 and the various owners of cable programming services  
18 both start-up and existing services.

19 The second area that I have responsibility  
20 for is working with cable system operators, the  
21 companies like TCI which sell you your cable  
22 subscription and providing again strategic and

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1 business planning services to those companies as well  
2 as competitive analysis and marketing analysis.

3 Q Does any of your work involve cable  
4 networks?

5 A Yes. The cable programming services that  
6 I described are also referred to commonly as cable  
7 networks.

8 Q Mr. Trautman, your resume is attached to  
9 your testimony. Could I just ask you -- do you have  
10 a copy of that before you?

11 A Yes.

12 Q Actually, I think it appeared as a  
13 separate document at a tab right before your --

14 A I do not --

15 Q Let me hand you a copy. In your resume  
16 you describe some of the different clients that you  
17 have worked for over the years. Correct?

18 A Yes.

19 Q Could you describe those -- or identify  
20 those clients for us, please?

21 A Yes, in the programming area, clients that  
22 I and my firm represented include Disney, formerly

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1 Capital Cities ABC, CBS, CBS Cable, the Washington  
2 Post Company, PBS, the Public Broadcasting Service,  
3 recently the Arts & Entertainment Network and a  
4 variety of other programming networks.

5 On the operator or cable systems side of  
6 the business, we have worked with TCI, Time Warner,  
7 Cox, Continental which is now a U.S. West company,  
8 Comcast and several others.

9 Q You mentioned TCI. What is TCI?

10 A TeleCommunications Inc. They are the  
11 largest owner of cable systems in the United States.

12 Q Could you just briefly describe some of  
13 the work that you have done for these clients?

14 A Sure. On the -- well on the programming  
15 side, the type of work that we do ranges from  
16 financial feasibility analysis, in other words looking  
17 at what the economic feasibility is of a new cable  
18 programming service. What will it take to get that  
19 service up and running? How long will it be before it  
20 begins to make money? Will it be accepted by the  
21 marketplace? Those types of things.

22 For existing services, we assist them in

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1 -- through various methods. Consumer research as well  
2 as our own experience in identifying how they should  
3 position themselves within the market, the kind of  
4 marketing message they should put out, those types of  
5 things.

6 On the systems side of things, a lot of  
7 the work that we do involves working with the cable  
8 system operators in identifying competitors and the  
9 characteristics of their competition including  
10 satellite companies, and looking at potential future  
11 market share trends and things of that nature.

12 Q Mr. Trautman, there is a report that has  
13 previously been exchanged with the parties and filed  
14 with the Panel, identified as RIAA Exhibit 12. Do you  
15 have a copy of that report before you?

16 A Yes I do.

17 Q And that report -- you are familiar with  
18 that report?

19 A Yes, I am.

20 Q Was that report prepared under your  
21 supervision and direction?

22 A Yes it was.

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1 Q And the name of the report, or the title  
2 of the report is "Analysis of the Subscription  
3 Programming Industry." Correct?

4 A That's correct.

5 Q Could you just briefly tell us what you  
6 mean by subscription programming industry?

7 A Sure. Well, the subscription programming  
8 industry, and I guess is described initially in the  
9 report and what I'm referring to there is the industry  
10 that really began with the launch of the cable  
11 industry back in the 1950s. And what it was  
12 originally consisted of is entrepreneurs and small  
13 markets --

14 Q Mr. Trautman, before you get into a more  
15 detailed description at this point, just briefly  
16 describe what the subscription programming industry is  
17 that you are referring to.

18 A Oh, I'm sorry.

19 Q For background qualifications, that's all.

20 A It's the industry in which programming  
21 services, either individually or in packages, are sold  
22 for a fee to consumers.

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1 Q You have done analyses of the subscription  
2 programming industry in the past?

3 A Yes.

4 Q How long have you worked for Boertz &  
5 Company?

6 A It will be, well I think it just was 14  
7 years. Or I should say and predecessor companies.

8 Q Would you explain who the predecessor  
9 companies are?

10 A Yes. Boertz & Company actually started  
11 business in 1988, but is a company that was formed by  
12 a group of individuals including myself that had  
13 formerly been with Brown, Boertz & Coddington, which  
14 was a consulting firm performing similar type work.

15 Q Mr. Trautman, could you just briefly  
16 explained why you were retained by RIAA in this  
17 proceeding?

18 A Yes, I was retained to prepare an analysis  
19 and overview of the subscription programming industry.

20 Q And that analysis and overview is  
21 contained in RIAA Exhibit 12. Correct?

22 A Yes it is.

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1 Q Have you testified before in proceedings  
2 before copyright arbitration royalty panels?

3 A Yes I have.

4 Q And you testified as my witness in prior  
5 proceedings, correct?

6 A That's correct.

7 Q At this time I will offer Mr. Trautman as  
8 an expert for the matters discussed in RIAA Exhibit  
9 12, and offer him for voir dire.

10 CHAIRPERSON EHRIG: Does anyone have any  
11 questions?

12 MS. LUPOWITZ: Yes, if I have an  
13 opportunity for brief voir dire.

14 CHAIRPERSON EHRIG: Could you tell me --

15 MS. LUPOWITZ: Sure, my name is Joni  
16 Lupowitz and I represent Digital Music Express, or  
17 DMX, Inc. in this proceeding.

18 VOIR DIRE

19 BY MS. LUPOWITZ:

20 Q Mr. Trautman, isn't it true that your  
21 experience is primarily with cable television network  
22 programming and satellite and other means of video

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1 program distribution?

2 A Well, primarily with various forms of  
3 cable programming services and other services that  
4 cable companies provide or plan to provide.

5 Q And would it be fair to say that that's  
6 primarily video programming?

7 A Yes, that's correct.

8 Q And you are not claiming to have any  
9 special expertise regarding the broadcast or radio  
10 industry, are you?

11 A No, I'm familiar with the industry  
12 generally, but no, I'm not.

13 Q And am I also correct that aside from this  
14 proceeding, you don't have any first hand experience  
15 with the sound recording industry?

16 A No, not specifically, no.

17 Q And other than the digital music  
18 subscription services that are at issue in this  
19 proceeding, you are not claiming to have any special  
20 expertise with other means of dissemination of sound  
21 recordings, are you?

22 A Not specifically, no.

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1 Q And you don't claim to have any expertise  
2 with respect to music royalties, is that right?

3 A No.

4 Q And you are not testifying today regarding  
5 the appropriate royalty rate in this proceeding, are  
6 you?

7 A No, I'm not.

8 Q That's all I have.

9 CHAIRPERSON EHRIG: Thank you. You may  
10 proceed.

11 DIRECT EXAMINATION BY MR. GARRETT

12 BY MR. GARRETT:

13 Q Just one follow up question, outside of  
14 the work that you have done for RIAA in this  
15 proceeding, do you have any experience generally with  
16 digital audio services?

17 A Yes, I do just in the normal course of my  
18 business in working with the cable industry and in  
19 past efforts looking at potential market demand for  
20 services of this type.

21 Q Mr. Trautman, I take it you are familiar  
22 with the digital audio services that are parties in

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1 this proceeding?

2 A Yes, Music Choice, DMX and Musak.

3 Q Do you consider those services to provide  
4 subscription programming as you've described it here  
5 in your report?

6 A Yes I do.

7 Q And why is that?

8 A Well, it's because, at least  
9 traditionally, they have provided programming that is  
10 available through subscription programming  
11 distributors and is available to consumers either for  
12 a fee or as part of a package for which a consumer  
13 pays a fee.

14 Q Okay. Now, on pages 1 to 3 of your  
15 report, Mr. Trautman, you describe the history and  
16 market development of a subscription programming  
17 industry, correct?

18 A Yes.

19 Q I wonder if you would just briefly  
20 describe for the Panel here, the information that you  
21 concluded on pages 1 through 3?

22 A Sure. Well, to begin with, the sort of

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1 roots of the subscription programming industry, it  
2 really begins with the evolution of the cable industry  
3 in the 1950s. At that time television was in its  
4 infancy and there was demand, or there appeared to be  
5 interest among consumers outside the reach of over the  
6 air broadcast signals, in that program. And  
7 entrepreneurs came up with the idea of putting a tower  
8 on a mountain that could receive those signals and  
9 then running coaxial cable down into the community and  
10 connecting that cable to individual homes, and selling  
11 a subscription programming service.

12 In essence, at that time, it was what it  
13 would commonly be referred to as a reception service.  
14 It gave people reception, broadcast programming that  
15 they otherwise would not have been able to receive  
16 over the air with an conventional antenna that they  
17 might have put on the rooftop.

18 Over time and up into the 1970s, the  
19 industry remained fairly much of a rural industry in  
20 providing that type of service. And then other  
21 programming services began to evolve that provided  
22 additional and both different or additive or

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1 incremental programming over and above the reception  
2 service that the cable industry had traditionally  
3 provided.

4           The availability of these new services,  
5 many of which focused on a special type of niche  
6 programming, focussing on a specific subject area or  
7 on an area that was of interest to a particular  
8 demographic group, or of interest to an affinity group  
9 that might like a certain type of programming, began  
10 to evolve. That allowed the industry to become  
11 valuable and to move into areas where you could  
12 already receive your broadcast signals over the air  
13 adequately.

14           Following that the industry grew very  
15 rapidly. Concurrent with the development of those  
16 types of services, as recently as 1980 there were  
17 approximately 15 million cable subscribers in the  
18 country, and most of those at that time were still,  
19 tended to be concentrated in smaller markets. Over  
20 the past 16, 17 years you've had essentially a four  
21 fold increase in the number of customers to more than  
22 60 million currently.

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1           Q       You use the term niche programming, and I  
2 think you did define it during your answer. But could  
3 you just again describe what you meant by niche  
4 programming?

5           A       Well, niche programming services are  
6 services which offer programming -- it's not  
7 necessarily programming that was different from what  
8 was available somewhere else. It's rather programming  
9 that a particular channel or set of channels  
10 concentrated on one area of programming all of the  
11 time. So that there was a much greater level of  
12 choice and variety available to the consumer.

13                   For example, whereas there was sports  
14 programming available on broadcast stations and  
15 broadcast networks, ESPN provided, and does still  
16 provide sports programming on a 24-hour basis so that  
17 it is available all the time. Similarly, a service  
18 like the History Channel, while there may be  
19 occasional history programming on various other  
20 services, makes history programming available all the  
21 time to those who are interested in history.

22                   Similarly, the digital audio services make

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1 music programming, and a wide variety of music  
2 programming that in many instances might not otherwise  
3 be regularly available to people available on a 24-  
4 hour basis and multiple channel basis.

5 Q On page 2 of your testimony, Mr. Trautman,  
6 you refer to -- you have a table there that refers to  
7 leading cable MSOs. Do you see that?

8 A Yes.

9 Q Could you just describe what an MSO is?

10 A Yes. MSO stands for Multiple System  
11 Operator and that, I guess, to start at the beginning,  
12 there are in the country approximately, the numbers  
13 vary, but about 10,000 individual cable systems.  
14 These companies or MSOs own ranging from several to  
15 many of those individual systems that are in different  
16 markets around the country. As you can see, the  
17 largest ones have aggregated many, many of those  
18 systems and therefore serve a large number of  
19 subscribers. The two largest in the table are, again,  
20 TCI or TeleCommunications, Inc. serving almost 15  
21 million customers, and Time Warner Cable which serves  
22 almost 12 million as of the date of this report.

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1 Q Underneath that table you describe some of  
2 the alternative distribution technologies that have  
3 attempted to compete with cable, correct?

4 A Yes.

5 Q I wonder if you can just briefly describe  
6 what you mean by alternative distribution  
7 technologies.

8 A Sure. Well, cable television, or  
9 transmitting subscription programming over a coaxial  
10 cable is one way of distributing this programming to  
11 consumers. But there are other ways that it can be  
12 done as well. And, beginning in the late 1970s,  
13 several forms evolved. One that is still around today  
14 is the home satellite dish distributor which is a  
15 company that takes programming that is already up on  
16 a satellite and puts together that programming in a  
17 package and then a consumer can buy -- you've probably  
18 seen the large, the larger, what I refer to as C-Band  
19 home satellite dishes that somebody might have in  
20 their backyard. Using that dish they can receive,  
21 again, for a fee, various subscription programming  
22 services.

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1                   There is also a technology called channel  
2 multi-point distribution service, or MMDS, which would  
3 do something fairly similar, although they erect a  
4 transmission tower in an individual market and then  
5 using microwave frequencies, send a signal to a  
6 rooftop antenna that a consumer might again have  
7 either purchased or leased from that company to  
8 receive the programming.

9                   Both of those services are still around  
10 today and have, ranging from several hundred thousand  
11 to a couple of million customers in total.

12                  Q     You are familiar with direct broadcast  
13 satellites?

14                  A     Yes.

15                  Q     Is that another type of subscription  
16 programming service?

17                  A     Yes. And that is a service which has,  
18 although it has been around for a while, in its  
19 current form it's quite new, began with the launch of  
20 a service called PrimeStar in 1991 and then really  
21 took off as an industry with the launch of a service  
22 called DirectTV in June of 1994.

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1                   That direct broadcast satellite is a  
2 service which these companies have placed their own  
3 satellites in orbit and send programming up to those  
4 satellites which then is retransmitted down to  
5 consumers who have purchased, or in a few cases again  
6 leased, small receiving dishes that can pick up the  
7 programming that's on these satellites.

8                   Q       On page 3 of your testimony, you refer to  
9 a number of the existing and planned DBS services.  
10 Correct?

11                   A       Yes.

12                   Q       Could you just identify those for us?

13                   A       Yes, there is DirecTV which launched in  
14 1994, PrimeStar which has been around since 1991 but  
15 really didn't begin marketing in earnest until 1994  
16 also. United States Satellite Broadcasting which  
17 shares a satellite with DirecTV and has been providing  
18 programming since 1994 also. Echo Star launched last  
19 year as did Alpha Star.

20                   Then there is also, has been a proposed  
21 service originally called American Sky Broadcasting,  
22 now referred to as Sky which appears now may be

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1 possibly merging with one of the existing services,  
2 PrimeStar.

3 Q American Sky Broadcasting is a service  
4 owned by the News Corp Fox?

5 A That's correct.

6 Q Mr. Trautman, you also refer, on page 3  
7 there, to a report of the FCC. Do you see that?

8 A Yes.

9 Q And that report is attached to your  
10 report, correct?

11 A Yes, it is.

12 Q What was the purpose of including that  
13 report in your testimony?

14 A Well, the purpose was really just for  
15 informational purposes to provide additional  
16 background on the cable and satellite industries.

17 Q The report that you have included is dated  
18 December 11, 1995, correct?

19 A Yes.

20 Q And that was the Commission's Second  
21 Annual Report Assessing the Status of Competition in  
22 the Market for the Delivery of Video Programming?

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1 A O believe it was the second one, yes.

2 Q And there has been a subsequent report  
3 that's been issued by the FCC, correct?

4 A Yes, at the end of 1996.

5 Q And that was issued after your testimony  
6 had been prepared, correct?

7 A That's correct.

8 Q Your Honor, we do have a copy of the  
9 updated report. The one that was included in Mr.  
10 Trautman's testimony was current as of that time. The  
11 purposes that we are offering simply to describe the  
12 industries involved here generally. There is probably  
13 not much change, but we do have a more recent version  
14 and I would like to submit it for the record. I  
15 believe that it's something that the Panel would take  
16 official notice of.

17 CHAIRPERSON EHRIG: Is there any  
18 objection? [No response.] Okay. If you can  
19 distribute it we will take notice of it.

20 MR. GARRETT: I'm sorry, your Honor.

21 CHAIRPERSON EHRIG: If you can distribute  
22 -- do you have copies --

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1 MR. GARRETT: Yes, yes, we do.

2 CHAIRPERSON EHRIG: Then we will take  
3 notice of it.

4 MR. GREENSTEIN: Your Honor, just for  
5 purposes of clarification, you are not intending to  
6 examine the witness at this time.

7 MR. GARRETT: No

8 CHAIRPERSON EHRIG: No

9 MR. GARRETT: It's -- the report that we  
10 put in has since been updated by the Commission, and  
11 we simply wanted to have the updated report before the  
12 Panel.

13 MR. PRAED: [Off mike.] It's updated?

14 MR. GARRETT: Yes, it's supposed to be.

15 CHAIRPERSON EHRIG: Do you want to label  
16 that in some way?

17 MR. GARRETT: Yes, let's mark this as RIAA  
18 Exhibit 23.

19 CHAIRPERSON EHRIG: Okay.

20 JUDGE NELSON: Do you want to make it 12A?

21 MR. GARRETT: Well, I -- sure, yes, that's  
22 fine too. We will make it Exhibit --

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1 CHAIRPERSON EHRIG: Twelve A.

2 MR. GARRETT: -- twelve A.

3 (Whereupon, the above-referred  
4 to document was marked as RIAA  
5 Exhibit No. 12A for  
6 identification.)

7 CHAIRPERSON EHRIG: And we will take  
8 judicial notice of it.

9 MR. GARRETT: Thank you.

10 CHAIRPERSON EHRIG: Yes, Mr. Garrett.

11 BY MR. GARRETT:

12 Q Let me ask you to turn to page 4 of your  
13 testimony, Mr. Trautman.

14 A Sure.

15 Q You refer there to industry structure,  
16 correct?

17 A Yes.

18 Q I wonder if you could just briefly  
19 describe the information that you presented to the  
20 Panel there.

21 A Sure. It may be helpful to refer to the  
22 figure on page 5. In looking -- in attempting to

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1 understand the structure of the subscription  
2 programming industry, we sometimes find it helpful to  
3 think of it in terms of a traditional distribution  
4 chain that you would have for a variety of businesses  
5 or industries. And that's what we have tried to do  
6 here is just to show that the traditional steps in the  
7 distribution chain exist here as well, and to then  
8 kind of show where the different organizations and  
9 companies that are involved in the business fit.

10 And, what you see is that there is a  
11 production function, and that is in that area of the  
12 business is where the programming itself is created.  
13 And, outside program suppliers, like motion picture  
14 studios and the recording companies for the music  
15 services, are involved in that production function.

16 The program networks, or programming  
17 services themselves, also do some of their own  
18 programming production, and in fact, some do very  
19 little of it, some do a lot.

20 Q Could you give us some examples of the  
21 type of networks that you refer to as doing a little,  
22 doing a lot?

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1           A        Sure.  Cable News Network, for example,  
2           would be an example of one that does a lot.  They  
3           provide 24-hour news programming and most of that  
4           production is live programming and is programming that  
5           they do in their studio.

6                     Although they do acquire news service  
7           programming and news feeds from various outside  
8           sources.  An example of someone who would do not very  
9           much of their own production, well the Digital Music  
10          Service --

11                    MS. LUPOWITZ:  Objection, I'm going to  
12          object, I think that goes beyond what's in his report.

13                    MR. GARRETT:  Well his --

14                    MS. LUPOWITZ:  And I believe RIAA has  
15          another witness that will be testifying about the  
16          digital audio services and what they do or don't do.

17                    CHAIRPERSON EHRIG:  Mr. Garrett?

18                    MR. GARRETT:  I think that he does discuss  
19          the digital audio services in his report.  He  
20          certainly discussed the different types of producers  
21          of programming, those who distribute the kind of  
22          programming and he refers specifically to the digital

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1 audio services.

2 MS. LUPOWITZ: I think the discussion is  
3 only in the most general terms and more in terms of  
4 the means by which they are distributed, and not by  
5 their production -- in terms of their production or  
6 programming.

7 CHAIRPERSON EHRIG: I think he can answer.  
8 Objection overruled. Could you ask the question again  
9 please?

10 BY MR. GARRETT:

11 Q Do you want to continue with the answer  
12 that you were going to give?

13 A Well, I was simply going to say that those  
14 companies tend to acquire their programming from, in  
15 this case, the record companies.

16 Q Okay. You refer also, on your chart, to  
17 the wholesale distribution.

18 A Yes, and sort of the next step in the  
19 chain is wholesale distribution. This is really where  
20 the programming networks or programming services fit  
21 into the equation primarily, and what their wholesale  
22 distribution function is is to assemble this

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1 programming that they have either produced or acquired  
2 into a package which they then market to the  
3 retailers. And that is a primary part of their  
4 activity is to sell that, attempt to sell that  
5 programming to the various retail distributors that  
6 are out there.

7 At that retail distribution step in the  
8 chain, the retailers are the companies that we've just  
9 spoken about, the cable systems or MSOs, the direct  
10 broadcast satellite services, and on a more limited  
11 basis the MMDS and C-Band satellite companies. And  
12 those companies acquire from among the variety of  
13 networks that are available to them from these  
14 wholesale distributors, they themselves assemble a  
15 package of services taking into account what they  
16 think will have the greatest appeal in their market  
17 and put together those services in something that they  
18 sell then on to the consumer.

19 As the consumer, in this case is most  
20 often residences, but also includes commercial  
21 establishments, bars, restaurants and businesses.

22 Q And the next step in the chain is the

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1 retail distribution. Correct?

2 A Yes.

3 Q Okay, could you describe that?

4 A Which, well, as I mentioned, are the cable  
5 companies and the direct broadcast satellite services  
6 that assemble the program, the programming services  
7 that have been put together by the programming network  
8 companies and then sell that directly to the consumer.

9 Q And you also mentioned the final step  
10 before, is the households and commercial  
11 establishments. Correct?

12 A Yes.

13 Q Okay. Let me ask you to turn on pages 6  
14 through the end of your report, you describe the  
15 different types of programming sources of distribution  
16 relationships. Correct?

17 A Yes, that's correct.

18 Q In particular, you have Table 1 on page 7.  
19 Do you see that?

20 A Yes.

21 Q Could you describe what that Table 7 is  
22 and how it relates to your discussion on pages 6

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1 through 15?

2 A Yes, this is a line up of programming and  
3 a description, just kind of a descriptive overview of  
4 the packages that are available from the Denver cable  
5 system of TeleCommunications, Inc. or TCI, in this  
6 case TCI of Colorado. And this is just intended to be  
7 a representative example of a typical offering from a  
8 cable distributor.

9 Q You identify on Table 1 a number of  
10 different categories of programming. Do you see that?

11 A Yes.

12 Q Could you explain what those different  
13 categories are as I believe you've done on pages 6  
14 through 15 of your written report?

15 A Yes. You will see that there are, under  
16 the, on the first page of the Table, we start out with  
17 predominantly what are listed as local broadcast  
18 signals. And those are, that kind of goes all the way  
19 back to the roots of cable television. Those are the  
20 local broadcast stations that are in, in this case in  
21 Denver, that are retransmitted by the cable system as  
22 part of the services they provide.

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1           Then you also see on there a few distant  
2 broadcast services which are again broadcast stations  
3 that may be brought in from other markets and offered  
4 by this Denver system in this example.

5           Then you have also on the Table, basic  
6 services. These are the cable programming networks  
7 that were really focussed on here in -- or a group of  
8 them and those are typically satellite delivered  
9 services that the cable system picks up and includes  
10 in its package and this is in essence the package of  
11 services that the cable system is seeking to market to  
12 the consumer as offering a choice in variety that the  
13 cable industry seeks to offer.

14           And you will see some examples of services  
15 on here like Black Entertainment Television which is  
16 targeted to an ethnic audience. Down a little bit  
17 lower Nickelodeon which is a service targeted toward  
18 children.

19           On the second page, American Movie  
20 Classics which is a classic movie service that is  
21 offered commercial free to movie -- or is a service  
22 that appeals to movie buffs. And those and the other

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1 services on here, constitute the basic services.

2 Q Okay. On page 8 are you also referring to  
3 the premium services there?

4 A Yes.

5 Q Explain that again please.

6 A Well, the premium - the basic services as  
7 well as the local broadcast that I mentioned earlier,  
8 all grouped together in a package that is sold, all of  
9 the channels in essence are received by the customer  
10 for one total monthly fee. In this case, if you go  
11 back to the first page, the expanded basic offering,  
12 which includes all of the channels on the first page,  
13 plus the first, essentially the first half of page 8,  
14 is available for \$22.85 a month.

15 The premium services are services which  
16 are sold on an individual or a la carte basis and the  
17 customer who is interested in one of those services  
18 would pay an additional fee of anywhere from \$9.95 to  
19 \$14.95 per service per month in order to receive one  
20 of these services.

21 Q Let me ask you to turn now to Table 2 on  
22 Page 10.

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1 A It begins on Page 9.

2 Q Yes. I'm sorry. You're right.

3 Would you just describe what Table 2 is?

4 A Well, this is very similar to Table 1  
5 except this is a programming lineup in packages except  
6 it's for a satellite, a direct broadcast satellite  
7 company, DirectTV.

8 And, again, this just describes the  
9 various programming services which are offered by  
10 DirectTV and the packages under which those services  
11 are available.

12 Q Now, go back again to Table 1. The TCI  
13 system in Denver carries Digital Music Express, does  
14 it not?

15 A Yes, it does.

16 Q Where is that shown on Table 1?

17 A That's on Page 8 near the bottom. And  
18 it's listed under the premium services.

19 Q So this is a service on this particular  
20 cable system that one would have to pay a separate  
21 monthly fee for?

22 A That's correct.

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1 Q Now, going to Table 2, does DirectTV carry  
2 any digital audio service?

3 A Yes. They offer Music Choice, which is on  
4 Page 9. It's actually listed twice on here, under --  
5 but under the Plus DirectTV package, the Music Choice  
6 service is available as part of that package.

7 And it's also available -- the full  
8 service is available as part of the -- essentially all  
9 of the DirectTV packages with the exception of this  
10 Select Choice package that offers only a sampler  
11 version of the Music Choice service.

12 Q Just focus for a moment here on the Plus  
13 DirectTV package. That costs \$14.95 per month;  
14 correct?

15 A Correct.

16 Q And for 14.95 a month, you get all of the  
17 different basic services that are identified there.  
18 Is that correct?

19 A That's correct.

20 Q And that would include 31 channels of  
21 Music Choice?

22 A Correct.

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1 Q And then you refer to under the select  
2 choice a five-channel sampler?

3 A Yes.

4 Q Could you just explain what you meant by  
5 that?

6 A Well -- and I should clarify. The Select  
7 Choice is a passage that is not subscribed to by many  
8 of the DirecTV customers, but the Music Choice sampler  
9 that's included there, rather than including all 31  
10 channels of Music Choice, only includes 5 of the  
11 channels.

12 Q Now, is there any difference in the way  
13 the digital audio services are offered in DirecTV  
14 versus at least the one cable system that you put here  
15 in Table 1?

16 A I'm sorry. Could you repeat that?

17 Q Yes. Is there a difference in the way  
18 that digital audio services are offered by TCI of  
19 Colorado, the Denver system, versus DirecTV?

20 A Well, yes in the sense that you have to  
21 pay an additional monthly fee if you want to get DMX  
22 from TCI of Colorado; whereas, when you subscribe to

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1 any one of these packages from DirectTV, you would --  
2 Music Choice would be included as part of the package.

3 MR. GARRETT: I have no further questions  
4 at this time. Thank you.

5 CHAIRPERSON EHRIG: Thank you.

6 Ms. Lupowitz?

7 CROSS-EXAMINATION

8 BY MS. LUPOWITZ:

9 Q Mr. Trautman, in your declaration, you  
10 state that RIAA has asked Sports and Company to  
11 describe the cable and DBS subscription programming  
12 industry in which the digital audio services operate.  
13 Is that correct?

14 A Sorry. I don't have it in front of me.

15 Q You don't have your report in front of  
16 you?

17 A I have my report. I don't have the  
18 declaration.

19 Q It's that first page testimony of James M.  
20 Trautman.

21 A Yes. I don't have the --

22 MR. GARRETT: It includes his résumé.

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1 THE WITNESS: -- the summary of that  
2 declaration.

3 MS. LUPOWITZ: That's correct.

4 THE WITNESS: It's -- I'm sorry.

5 CHAIRPERSON EHRIG: Well, if I can  
6 interrupt with housekeeping, are you going to offer  
7 Exhibit 12 into evidence? We already took care of  
8 12A.

9 MR. GARRETT: Yes, Your Honor, I will.

10 CHAIRPERSON EHRIG: And the direct  
11 testimony, the direct testimony of Mr. Trautman. Are  
12 there any objections to that?

13 MS. LUPOWITZ: No objections.

14 CHAIRPERSON EHRIG: They will be received.

15 (Whereupon, the aforementioned  
16 documents, having previously  
17 been marked for identification  
18 as RIAA Exhibits Numbers 12,  
19 12A, and Trautman testimony,  
20 respectively, were received in  
21 evidence.)

22 THE WITNESS: Yes, I do.

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1 BY MS. LUPOWITZ:

2 Q Now, your report is limited to cable and  
3 satellite dissemination of digital audio services. Is  
4 that right?

5 A Well, there is brief discussion of other  
6 distribution approaches but focuses on cable and  
7 satellite.

8 Q Now, you testified regarding other  
9 distribution systems for video programming; for  
10 example, backyard dishes. Is that right?

11 A Yes. Those are mentioned in the report.

12 Q And is it true that all or most of the  
13 video subscription services are available to backyard  
14 dish consumers?

15 A All or most of the video subscription  
16 services? Yes, that's true.

17 Q But isn't it the case that digital audio  
18 services are not available to backyard dish customers?

19 A I'm not aware of whether they are or are  
20 not.

21 Q So you don't know?

22 A No, I do not.

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1 Q Now, directing your attention again to the  
2 report that's been submitted in this proceeding as  
3 RIAA Exhibit 12, your report doesn't address other  
4 means by which audio sound recordings are disseminated  
5 other than cable and satellite. Is that right?

6 A No.

7 Q And your report doesn't consider  
8 traditional broadcast radio. Is that right?

9 A No, it doesn't provide an analysis of  
10 that.

11 Q And isn't it also true that your report  
12 does not consider the new digital audio radio  
13 satellite services?

14 A That's correct. It does not.

15 Q And isn't it also true that the report  
16 contains no discussion of traditional album or record  
17 sales?

18 A No, nor was it intended to.

19 Q In preparing your report, you didn't  
20 interview anyone at the Digital Audio Services, did  
21 you?

22 A No, I did not.

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1 Q And isn't it true that your report doesn't  
2 cite any materials that have been prepared by the  
3 Digital Audio Services?

4 A I'd have to look through it, but I don't  
5 believe that it does.

6 Q Am I correct that your report doesn't  
7 discuss any analogy between royalties paid for cable  
8 television programming and the appropriate royalties  
9 for the digital audio services at issue here?

10 A My report discusses generally programming  
11 investment and economic characteristics of some of the  
12 services but doesn't make any direct comparisons.

13 Q Am I also correct that your report  
14 contains no mention at all of Musak and Musak's  
15 digital audio subscription service?

16 A I don't believe that it does. Musak is  
17 available on one of the satellite services that are  
18 mentioned in my report, but --

19 Q Your report does not make any mention at  
20 all of Musak --

21 MR. GARRETT: I'm sorry. Were you  
22 finished? I think he was about to finish his answer.

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1 THE WITNESS: Yes. I was just going to  
2 say that Musak is available on Echo Star, which is one  
3 of the services that is discussed in my report. But  
4 I don't know that there's any specific mention of  
5 Musak.

6 BY MS. LUPOWITZ:

7 Q I'd like to direct your attention to Page  
8 13 of your report. And, just for clarification, when  
9 I say, "your report," I'm referring to RIAA Exhibit  
10 12.

11 CHAIRPERSON EHRIG: Thank you.

12 THE WITNESS: Yes.

13 BY MS. LUPOWITZ:

14 Q And directing your attention to -- it's  
15 the middle paragraph but the first full paragraph on  
16 Page 13. Middle of that paragraph, it states that,  
17 "Virtually all existing services experience several  
18 years of losses prior to reaching break-even and  
19 eventually profitable levels of distribution." Is  
20 that right?

21 A That's correct.

22 Q Yet, your report doesn't consider the

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1 profitability of the digital audio services at issue  
2 in this proceeding, does it?

3 A Well, the digital audio services are among  
4 -- well, I guess this is specifically referring here  
5 to basic networks, but my reference is to programming  
6 services in general, which would include the digital  
7 audio services.

8 Q So then would it be fair to say that you  
9 would agree that the digital audio services will be  
10 experiencing several years of losses before breaking  
11 even?

12 A No, that wouldn't be fair to say. What  
13 would be fair to say is that I would expect a  
14 programming service such as a digital audio service  
15 to, like essentially all other cable programming  
16 services, experience a number of years of losses  
17 initially, before becoming profitable, and then at a  
18 point at which they reach a certain distribution level  
19 become profitable and potentially financially  
20 successful.

21 So that's a pattern that's typical of all  
22 of these businesses and does not reflect on -- would

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1 not be different. I mean, it would be the same for  
2 the digital audio services.

3 Q Isn't it true that your report does not  
4 contain any data on the penetration rates for digital  
5 audio services, how many cable --

6 JUDGE NELSON: I'm sorry. What was the  
7 word?

8 MS. LUPOWITZ: I'm asking whether the  
9 report contains any data on the penetration rates of  
10 digital audio services, specifically how many cable  
11 subscribers or DBS subscribers actually receive the  
12 digital audio musical services.

13 THE WITNESS: No. There are no specific  
14 numbers in there.

15 BY MS. LUPOWITZ:

16 Q And I believe you testified that there are  
17 approximately 10,000 individual cable systems. Is  
18 that right?

19 A More or less, yes.

20 Q And in Table 1 of your report, which is on  
21 Pages 7 and 8, you show the line-up of one of these  
22 cable systems, TCI in Denver.

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1 A Correct.

2 Q Out of the 10,000 individual cable  
3 systems, are you aware of how many actually carry a  
4 digital audio music subscription service?

5 A Well, I'm not aware of the specific  
6 number, but that really wouldn't be the appropriate  
7 way to look at it anyway. It would be how many of the  
8 total subscribers in the country have access to these  
9 services. And I believe that that percentage is quite  
10 high.

11 Q But your report does not contain any  
12 mention of how many of the total cable subscribers or  
13 DBS subscribers can actually receive the digital music  
14 services.

15 Is that right?

16 A No, it is not.

17 Q Now, am I also correct your report does  
18 not contain any description of the specific equipment  
19 that cable providers must purchase and install in  
20 order to transmit digital audio services? Does it?

21 A No, there's no discussion of that.

22 Q Am I also correct that your report does

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1 not contain any description of the special equipment  
2 that subscribers must use in order to receive digital  
3 audio music services?

4 A No, there is not.

5 Q I believe you just testified that you  
6 consider the access rate quite high for the number of  
7 cable subscribers that may have access to digital  
8 music subscription services. Is that right?

9 A That's correct.

10 Q Would you consider a three percent  
11 penetration rate the number of cable subscribers that  
12 actually receive these services to be quite high?

13 A Well, I think like most premium services  
14 --

15 Q Can you just answer my question first?  
16 Would you consider a three percent penetration rate to  
17 be quite high?

18 A Well, I'm --

19 CHAIRPERSON EHRIG: Let him answer because  
20 that's --

21 THE WITNESS: -- attempting to answer your  
22 question.

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1 CHAIRPERSON EHRIG: Yes, yes.

2 THE WITNESS: First of all, the access  
3 rate is not penetration rate. And that was the  
4 lead-in to your question. And that was what I  
5 testified to earlier.

6 And, secondly, in terms of penetration,  
7 for a premium service that is sold on an a la carte  
8 basis, relatively small percentages are common.

9 MS. LUPOWITZ: I still don't think you  
10 answered my question.

11 BY MS. LUPOWITZ:

12 Q Would you consider a three percent  
13 penetration rate to be quite high?

14 MR. GARRETT: I'm sorry. Just to clarify,  
15 is this a three percent penetration rate for a premium  
16 service? Is that the question?

17 MS. LUPOWITZ: This is a three percent  
18 penetration rate for cable subscribers that actually  
19 receive digital audio services, regardless of premium  
20 or pay.

21 THE WITNESS: Well, that's not correct.  
22 The penetration rate --

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1 JUDGE NELSON: She didn't ask you whether  
2 it was correct or not. She just asked you whether or  
3 not you would think that was low or high.

4 THE WITNESS: Well, three percent  
5 penetration could be perfectly acceptable from a  
6 business point of view.

7 MS. LUPOWITZ: I didn't ask whether it was  
8 perfectly acceptable or common.

9 BY MS. LUPOWITZ:

10 Q The question is: Would you consider that  
11 to be quite high?

12 JUDGE NELSON: By "high," you mean what,  
13 that you would --

14 MS. LUPOWITZ: That he --

15 JUDGE NELSON: No, no, no. I'm just  
16 trying to get clarification on what your question is.  
17 Do you mean that it's a high penetration rate and the  
18 extent that you would expect that there would be less  
19 subscribers getting it?

20 Is that what your question is or that you  
21 would think that that is less than you would expect to  
22 be people who were actually getting the service off

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1 the cable or is that what your question is?

2 MS. LUPOWITZ: I think what we're trying  
3 to get to, given the number of cable and other  
4 subscribers that have access to these services, the  
5 number that actually choose to receive it and how that  
6 falls in a schema. And, in fact, does he consider it  
7 to be a large number or would you consider it to be  
8 more or less? Would he consider that to be high?

9 JUDGE NELSON: How about a foundation? Do  
10 you have any knowledge of all the people who subscribe  
11 to cable, what percentage actually gets the digital  
12 recording?

13 THE WITNESS: Yes. I have a general idea.

14 JUDGE NELSON: What's that number?

15 THE WITNESS: Well, I think when it's  
16 offered on a premium basis, it's in the range of what  
17 she's talking about is how --

18 JUDGE NELSON: Three percent?

19 THE WITNESS: Now, that's not the number  
20 of people who have the opportunity to purchase it, but  
21 that's in a premium situation the number of people who  
22 or the percentage of people or households who choose,

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1 approximate percentage of people who choose, to pay  
2 the additional monthly fee to receive it when it's  
3 priced -- and I would say that would only be a fair  
4 characterization of when it would be priced in the,  
5 oh, approximately \$10 per month price range.

6 CHAIRPERSON EHRIG: Could I ask a  
7 question?

8 THE WITNESS: If it were -- yes. I'm  
9 sorry.

10 CHAIRPERSON EHRIG: No. Please.

11 THE WITNESS: If it were offered in other  
12 forms of packages, the penetration could and, in fact,  
13 would be much higher depending on the effective price  
14 that's charged for the service.

15 But if it's sold on a purely a la carte  
16 basis for approximately \$10 per month, I would say  
17 that's probably a fair characterization of the  
18 penetration.

19 CHAIRPERSON EHRIG: You had mentioned or,  
20 else, it was mentioned in the question something about  
21 what a subscriber must have to get access to these  
22 services. Is it anything other than a subscription to

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1 a cable service?

2 THE WITNESS: Well, if they want to pay  
3 the additional monthly fee to get one of these  
4 services, then the cable company will come out and put  
5 additional equipment in the subscriber's home in order  
6 for them to receive the service.

7 CHAIRPERSON EHRIG: This is the box you  
8 were showing us yesterday?

9 THE WITNESS: Yes.

10 CHAIRPERSON EHRIG: Okay. Thank you.

11 THE WITNESS: Yeah. But that's included  
12 in the fee.

13 CHAIRPERSON EHRIG: Right. You may  
14 continue.

15 BY MS. LUPOWITZ:

16 Q And, again, your report made no mention of  
17 this additional equipment that would be required for  
18 consumers to receive the digital music services?

19 A No. And it's important to understand that  
20 the new cable equipment that is coming out has the  
21 capability in and of itself to make this service  
22 available; for example, the digital cable converter

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1 boxes.

2 MR. SOKLER: Can I move to strike that  
3 last answer, Your Honor? I don't think there's  
4 anything in his direct testimony nor a pending  
5 question that he'd be testifying on technology at all.

6 CHAIRPERSON EHRIG: Well, I think he was  
7 answering my question, really.

8 MR. SOKLER: I thought you already had  
9 your answer to your question, Your Honor.

10 CHAIRPERSON EHRIG: He was supplementing  
11 it, I believe.

12 MR. GARRETT: Well, Your Honor, I'll also  
13 point out that Ms. Lupowitz has asked a number of  
14 questions about what's contained and not contained in  
15 his report.

16 CHAIRPERSON EHRIG: Yes. I did not strike  
17 it.

18 MS. LUPOWITZ: Well, let me follow up.

19 BY MS. LUPOWITZ:

20 Q That technology that you're referring to,  
21 the digital set-top boxes, that's not available in  
22 common use today, is it? In order for a consumer to

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1 receive a digital music audio subscription service  
2 today, they need special equipment in their home. Is  
3 that right?

4 A Yes, that's correct, from a cable company.

5 Q Am I correct that DMX is also offered as  
6 a basic service on the PrimeStar satellite  
7 distribution system?

8 A That's correct, yes.

9 Q And that would not require customers to  
10 pay any extra monthly fee to receive DMX. Is that  
11 right?

12 A No. It would be part of the package. It  
13 would be, in effect, built into the package price that  
14 they're paying to receive the basic package of  
15 services.

16 Q I'd like to direct your attention to  
17 Attachment A to your report, which is the FCC annual  
18 assessment of this data's competition in the market  
19 for delivery of video programming.

20 A Uh-huh.

21 Q Am I correct that the FCC report does not  
22 define video programming and audio programming as the

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1 same product market?

2 A Where specifically are you referring to?

3 Q I direct your attention to Page 63,  
4 Paragraph 129.

5 JUDGE NELSON: Paragraph what?

6 MS. LUPOWITZ: One twenty-nine.

7 CHAIRPERSON EHRIG: Could you repeat your  
8 question, please?

9 BY MS. LUPOWITZ:

10 Q Am I correct that the FCC report, which is  
11 Attachment A to RIAA Exhibit 12, does not define video  
12 programming and audio programming as the same product  
13 markets?

14 MR. GARRETT: Wait, Your Honor. I'll  
15 object to that question here. This report was  
16 prepared by the FCC pursuant to a mandate in the 1992  
17 Cable Act, which required them to identify, to report  
18 on a particular area of concern to the Congress. So  
19 they were the ones that defined what it was that the  
20 Commission should be looking at in the first instance.

21 And then the Commission went out and asked  
22 for comments from others to further supplement that

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1 definition. But it was all constrained by the statute  
2 in the first instance.

3 I think it's simply argumentative to be  
4 talking about what the FCC did or didn't define,  
5 particularly without putting it in the context of what  
6 they were being asked to do by Congress.

7 MS. LUPOWITZ: Well, Mr. --

8 CHAIRPERSON EHRIG: Ms. Lupowitz, I think  
9 this report will speak for itself. We have taken  
10 notice of the supplement. I don't think it's  
11 necessary to say that it's not in here. We're just  
12 looking at revenues in here.

13 MS. LUPOWITZ: I would just submit that to  
14 the extent that Mr. Trautman has attached this to his  
15 report in this matter --

16 CHAIRPERSON EHRIG: Well, he didn't write  
17 it.

18 MS. LUPOWITZ: -- and somehow deemed that  
19 it's analogous, we can inquire a bit as to the scope  
20 of its relevancy.

21 JUDGE NELSON: Let me just ask a  
22 mechanical question. Are you asking the panel to read

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1 not only what's attached to -- this is the old report,  
2 but also the new report or are there just some  
3 sections that we can --

4 CHAIRPERSON EHRIG: It's my understanding  
5 that the new is just an update of the old, which  
6 Congress mandates that they do every year.

7 MR. GARRETT: That's my understanding,  
8 Your Honor. And I don't mean to preclude Ms. Lupowitz  
9 from arguing in her proposed findings that the FCC  
10 here has defined product market in one way as opposed  
11 to the other.

12 We are all going to be free to refer to  
13 this report or any other official FCC document here to  
14 make the arguments that we want.

15 My objection is simply that this is not  
16 the appropriate witness here to be asking to render  
17 conclusions about what the FCC meant or didn't mean.  
18 That's all.

19 CHAIRPERSON EHRIG: Your objection is  
20 sustained.

21 Do you have any other areas of  
22 questioning?

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1 MS. LUPOWITZ: That's all I have.

2 CHAIRPERSON EHRIG: Do you have any  
3 redirect?

4 MR. PRAED: I'm sorry, Your Honor. I'm  
5 sorry. I would like to ask just a few questions on  
6 behalf of Musak, just a few, if I may.

7 CHAIRPERSON EHRIG: Absolutely.

8 MR. PRAED: Thank you.

9 Mr. Trautman, my name is John Praed. I'm  
10 with Latham and Watkins, and I represent Musak.

11 CROSS-EXAMINATION

12 BY MR. PRAED:

13 Q In listening to your direct and Ms.  
14 Lupowitz's cross --

15 MR. GARRETT: Excuse me. Will you be able  
16 to get him?

17 THE REPORTER: Would you come forward,  
18 please?

19 BY MR. PRAED:

20 Q I just wanted to clarify: To your  
21 knowledge, is Musak available over coaxial cable?

22 A To my knowledge, no.

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1 Q In other words, it's only available over  
2 satellite. Isn't that correct?

3 A To consumers' homes. That's my  
4 understanding, yes.

5 Q Correct. To consumers, correct. And of  
6 all the satellite providers, it's only available  
7 through Echo Star. Isn't that correct?

8 A That's my understanding, yes.

9 MR. PRAED: Okay. Thank you. No further  
10 questions.

11 CHAIRPERSON EHRIG: Mr. Garrett, do you  
12 have any direct? And if so, can you finish it in five  
13 minutes?

14 If not, then we can go to lunch.

15 MR. GARRETT: Your Honor, I do have  
16 redirect. I don't think it will take more than five  
17 minutes. There's just one line of questioning.

18 CHAIRPERSON EHRIG: All right. Then go  
19 ahead.

20 REDIRECT EXAMINATION

21 BY MR. GARRETT:

22 Q Mr. Trautman, I just wanted to go back to

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1 the question about penetration rates and make certain  
2 the record is clear.

3 A Uh-huh.

4 Q First of all, let me ask you to  
5 distinguish between the digital audio services when  
6 they are offered via DBS versus when they are offered  
7 via cable. All right?

8 A All right.

9 Q And let's talk first here about when  
10 digital audio services are offered over DBS. Okay?

11 A Okay.

12 Q And could you explain to us just very  
13 briefly how the digital audio services are offered and  
14 how that relates to their penetration rates?

15 A Well, they are offered as part of what I  
16 would refer to as the basic packages that are provided  
17 by the satellite companies. And, therefore, they're  
18 available and received by a very high percentage of  
19 the satellite customers, upwards of 90 percent to even  
20 100 percent in the cases of where they're on the  
21 lowest available package.

22 And so the penetration in that example

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1 would be in the 90 to 100 percent range.

2 Q And there you're referring to the offering  
3 of the digital audio services via DBS; correct?

4 A Correct.

5 Q And you're saying there that the  
6 penetration rates when we're confining our inquiry to  
7 DBS is upwards of 90 percent; correct?

8 A That's correct.

9 Q Now, let me then contrast that to when DMX  
10 or Music Choice is offered via cable. Okay?

11 A Sure.

12 Q Just describe again. Now I want you to  
13 distinguish between -- you referred to premium  
14 services; correct?

15 A Correct.

16 Q And you've also referred to basic  
17 services; correct?

18 A Correct.

19 Q Could you just explain for the record what  
20 the penetration rates are when we're talking about the  
21 premium versus a basic, focusing on the digital audio  
22 services?

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1           A       Okay. Well, if a digital audio service  
2 were to be offered as part of a basic package on a  
3 cable system, then it would be similar to the way it  
4 is in the satellite marketplace, that the penetration  
5 would be in the 90 to 100 percent range.

6           Q       Okay. Let me just stop you there. At the  
7 present time, these services, how widely or not widely  
8 available are they offered as a part of basic?

9           A       Well, by cable operators, they are not  
10 typically currently offered as basic services.

11          Q       Now talk about the penetration rates for  
12 pay cable and premium services.

13          A       Yes. When premium services are offered --  
14 and those are offered. There are various methods that  
15 are used. In some cases, they're offered at lower  
16 prices or some cases they're offered at higher prices.  
17 Some cases they're in some sort of package.

18                   But for the digital audio services and all  
19 other premium services, you have much lower  
20 penetration rates than that because they're offered at  
21 a separately monthly fee over and over the monthly fee  
22 for the primary package of services.

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1                   And in the case of the digital audio  
2 services, if they are on a purely a la carte basis at  
3 a full fee of maybe approximately \$10 a month, then  
4 they would have penetration possibly in the 3 percent  
5 range.

6                   Q       Are there other premium services that  
7 have, what is that, by single-digit penetration rates?

8                   A       Yes, there are, things like -- well, I  
9 would say that probably most of the premium services  
10 with the exception of Home Box Office probably have  
11 single-digit penetration rates.     And there are  
12 certainly premium services that have three percent or  
13 lower as well.

14                   MR. GARRETT: I have no further questions,  
15 Your Honor.

16                   JUDGE FORTKORT: Is it customary to offer  
17 them bundled with other services when there's a  
18 premium rate or is that --

19                   THE WITNESS:     For the digital music  
20 services?

21                   JUDGE FORTKORT: Yes.

22                   THE WITNESS: I think that's becoming more

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1 and more common and is part of the planning that is  
2 going on. But currently and historically in most  
3 cases, they have been offered individually.

4 JUDGE FORTKORT: And when they're bundled  
5 with somebody else, they're going to get less money  
6 from that cable program? In other words, I might pay  
7 \$10 for the digital sound as a separate thing, but if  
8 I pay for it as part of a package, then the  
9 subscription services are going to get less money?

10 THE WITNESS: Well, on a per-customer  
11 basis, they will get less. They may actually in total  
12 end up getting more because more people subscribe to  
13 the package, but --

14 CHAIRPERSON EHRIG: Ms. Lupowitz,  
15 referring to the redirect, please.

16 MS. LUPOWITZ: All right. I have I think  
17 just hopefully one brief question.

18 RECROSS-EXAMINATION

19 BY MS. LUPOWITZ:

20 Q I believe you just testified that when  
21 digital audio music services are offered as part of a  
22 basic package, that penetration is in the 90 to 100

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1 percent range. Is that correct?

2 A Yeah, approximately.

3 Q But you're not saying that 90 to 100  
4 percent of those cable subscribers or satellite  
5 subscribers actually have the home equipment necessary  
6 to receive the digital audio music services, are you?

7 MR. GARRETT: I'm sorry.

8 THE WITNESS: Well, I'm --

9 MR. GARRETT: Excuse me. Just a  
10 clarification. Are you talking about cable or  
11 satellite?

12 MS. LUPOWITZ: We can split up.

13 BY MS. LUPOWITZ:

14 Q You're not suggesting, are you, that 90 to  
15 100 percent of cable subscribers who have cables in  
16 which digital audio services are part of the basic  
17 package actually have the home equipment to receive  
18 digital music services, are you?

19 A Well, in the satellite market, I believe  
20 that the home equipment is built into the system.

21 Q In cable. I just directed my question.  
22 In the cable market, where a cable subscriber

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1 subscribes to a system where the digital audio music  
2 service is offered as part of basic, you're not  
3 suggesting that 90 to 100 percent of those cable  
4 subscribers actually have the home equipment necessary  
5 to receive the digital music service, are you?

6 A Well, as I mentioned, it's not currently  
7 commonplace for it to be offered as part of the basic  
8 service on cable. And you're correct. At present  
9 because the additional equipment would be needed,  
10 that's correct. Not all of them would have the  
11 equipment.

12 CHAIRPERSON EHRIG: Thank you.

13 Anything additional?

14 MR. GARRETT: No, ma'am.

15 CHAIRPERSON EHRIG: You may be excused.

16 Thank you.

17 (Whereupon, the witness was excused.)

18 CHAIRPERSON EHRIG: And we are recessed  
19 until 2:00 o'clock.

20 MR. GARRETT: Your Honor, I believe we're  
21 actually through for the day here. We had arranged  
22 with the other side that we would do three witnesses

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1 tomorrow and the final witness on Thursday. So we  
2 finished earlier than, frankly, we had anticipated,  
3 but this will give us more time to spend up in the  
4 cafeteria, then.

5 CHAIRPERSON EHRIG: I'm confused. Who's  
6 for tomorrow?

7 MR. GARRETT: Mr. Morris will be our first  
8 witness.

9 CHAIRPERSON EHRIG: Morris, Massarsky, and  
10 Gerbrandt.

11 MR. GARRETT: Exactly, Your Honor.

12 CHAIRPERSON EHRIG: Okay. All right.

13 MR. MARKS: One housekeeping matter.

14 CHAIRPERSON EHRIG: Yes?

15 MR. MARKS: I can't remember whether I  
16 offered Mr. Horowitz's testimony into evidence at the  
17 time. So I just wanted to make sure that I do that  
18 now.

19 CHAIRPERSON EHRIG: I think you did.

20 MR. SOKLER: The testimony exhibits except  
21 for the videotape; right?

22 MR. MARKS: Yes. The video is the only

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1 exhibit.

2 CHAIRPERSON EHRIG: I think you did, but  
3 if you didn't, --

4 MR. MARKS: Okay. Just to make sure.

5 CHAIRPERSON EHRIG: -- no objection. It  
6 is being received.

7 (Whereupon, the foregoing matter was  
8 recessed at 1:06 p.m., to be reconvened  
9 on Wednesday, June 11, 1997.)

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