

Before the  
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ORIGINAL

In the matter of:

The Digital Performance  
Right in Sound Recordings | Docket No.  
and Ephemeral Recordings | 2005-1 CRB DTRA  
(Webcasting Rate  
Adjustment Proceeding)

Volume 8

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

Thursday,  
May 11, 2006

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

BEFORE:

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

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I-N-D-E-X

WITNESS:                      DIRECT CROSS REDIR RECRO

Mark Robert Eisenberg	6	348	
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By Ms. Brown		355	

EXHIBITS                                      IDEN    RECD

Services No.:

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\*Exhibits falling under protective order

P R O C E E D I N G S

(9:38 a.m.)

CHIEF JUDGE SLEDGE: Good  
morning. We'll come to order.

MR. SMITH: We will call Mr.  
Eisenberg at this time, our next order of  
business.

CHIEF JUDGE SLEDGE: All right.  
Before you sit, if you'll raise your right  
hand.

Whereupon,

MARK ROBERT EISENBERG  
was called as a witness by counsel for Sound  
Exchange and, having been first duly sworn,  
was examined and testified as follows:

CHIEF JUDGE SLEDGE: All right,  
sir.

MR. SMITH: Shall I proceed, Your  
Honor?

CHIEF JUDGE SLEDGE: Yes, sir.

DIRECT EXAMINATION

BY MR. SMITH:

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1 Q Would you state your full name  
2 for the record?

3 A Mark Robert Eisenberg.

4 Q And where are you currently  
5 employed?

6 A Sony-BMG Music Entertainment.

7 Q What position do you currently  
8 hold with Sony-BMG?

9 A I'm the Executive Vice President  
10 for Business and Legal Affairs for the  
11 Global Digital Business Group.

12 Q How long have you held that  
13 position?

14 A Since the merger of the company  
15 in August of 2004. Sony-BMG is a joint  
16 venture between what was formerly Sony Music  
17 Entertainment, Inc. and Bertlesmann Music  
18 Group, and upon the merger in August of  
19 2004, the companies created a Global Digital  
20 Business Group, and I became the EVP for  
21 Business and Legal Affairs at that time.

22 Q Okay. Now, is Sony-BMG one of

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1 the four major record companies?

2 A Yes, it is.

3 Q Can you tell us about the artists  
4 that are included in your catalogue?

5 A Sure. We have a broad array of  
6 artists, both what we call on roster  
7 artists, artists who are still recording for  
8 us, as well as masters that are in the bulk  
9 that we continue to exploit, artists who --  
10 Bob Dylan, Billy Joel, Janis Joplin, Elvis  
11 Presley, Alan Jackson, Alicia Keys, many,  
12 many, many more.

13 Q Now, where did you work prior to  
14 the formation of the Sony-BMG joint venture  
15 in 2004?

16 A I was a Senior Vice President of  
17 Business Affairs for Sony Music  
18 Entertainment, Inc.

19 Q And how long were you with Sony?

20 A I was at Sony Music beginning in  
21 1994.

22 Q I think you said you work on

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1 something called the Global Digital Business  
2 Group. What is that?

3 A It's a -- at the time of the  
4 merger we placed all of the responsibilities  
5 for exploiting the catalog in what we called  
6 Global Digital Business Group. So instead  
7 of having a service department which  
8 licensed and did the digital distribution  
9 deals for our sound recordings, we actually  
10 had our own special unit which was solely  
11 responsible for digital revenues at the  
12 company.

13 Q And what are your  
14 responsibilities within that group?

15 A I'm responsible for negotiating,  
16 structuring and drafting the deals, me along  
17 with my team.

18 Q Okay, and what deals are you  
19 referring to?

20 A Licensing deals for Internet  
21 radio, for streaming services, both  
22 noninteractive and interactive, for digital

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1 download, for personalized and customized  
2 radio, for mobile distribution of ring tones  
3 and ring back tones and personalization  
4 products, for video streaming, for video  
5 downloads, essentially the whole gamut of  
6 exploitation that isn't tied to the physical  
7 configuration.

8 Q Okay. Now, are you a lawyer, by  
9 the way?

10 A Okay. How long have you been  
11 working in the area of digital distribution  
12 of recorded music?

13 A Since about 1997 or '98.

14 Q And that was at Sony where you  
15 began?

16 A Yes.

17 Q What role did you play in that  
18 area when you were at Sony before the joint  
19 venture?

20 A I started out at Sony as a lawyer  
21 in the traditional route doing artist  
22 contracts and negotiations and in the area

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1 around the time 1997 or so, I started to  
2 specialize in new technology and business  
3 development, and at that time headed up the  
4 licensing efforts of the company.

5 Q Now, if we could look at the time  
6 period from 1994 when you began at Sony to  
7 the present, what kinds of changes, if any,  
8 have you seen in the way the recording  
9 industry operates?

10 A Well, there have been a number of  
11 changes in the industry in general. First  
12 and foremost, there has been a lot of  
13 contraction, shrinkage in the industry in  
14 terms of personnel as a result of the loss  
15 of revenue and sales of our traditional  
16 recorded music product. So we've lost, you  
17 know, probably between 25 and 33 percent of  
18 our staff over the years as a result of  
19 that.

20 We also look for the radio  
21 streams now more than ever because it's not  
22 only about the physical configuration, which

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1 was our bread and butter product in years  
2 past, but it is about licensing revenue and  
3 diversified income streams, and in that  
4 regard what we used to regard as promotion  
5 is now looked at as another vehicle for us  
6 to license our catalogue and monetize those  
7 efforts.

8 Q Okay. Let's focus first on the  
9 reduction in sales of physical products.  
10 You are referring there to CDs primarily?

11 A Yes.

12 Q And if you could, could you give  
13 us a sense of the magnitude of the reduction  
14 in sales of products over the recent years?

15 A Well, from let's say the period  
16 1999 through 2005, our net product, net  
17 revenues have declined by a factor of about  
18 21 percent in that period, and that covers  
19 both the advent of the digital world; so  
20 digital income is included in that 21  
21 percent drop on a net basis.

22 Q What entities are you talking

1 about there when you refer to a 21 percent  
2 drop in revenue?

3 A That's the revenue for the  
4 combined company Sony-BMG, and that -- of  
5 our product sales essentially. So physical  
6 product and digital product.

7 That number also sort of masks  
8 the scenario of the problem because in that  
9 intervening period between '99 and 2005, BMG  
10 acquired Zomba catalogue, which had, you  
11 know, a significant market share. It was  
12 the biggest independent at the time, and,  
13 you know, if they had the copyrights of  
14 Britney Spears and Backstreet Boys and  
15 N'Sync and Usher or Usher actually may have  
16 been already at BMG, but it was a very  
17 significant catalogue that they had.

18 So that 21 percent decline  
19 includes the point in time where they  
20 actually acquired additional copyrights and  
21 commercialization.

22 Q Now, do you have a sense from

1 your work in the industry of where the  
2 revenues are going to be going in future  
3 years?

4 A Well, from what I see, the  
5 physical configuration continues to decline  
6 year over year, and so we're looking to the  
7 digital world to really make up for and  
8 hopefully surpass what we're making in the  
9 physical world currently.

10 Q Do you have a sense from your  
11 work on the digital side whether, if and  
12 when that will actually happen?

13 A Right now we're still playing  
14 catch-up. So I remain an optimist at heart,  
15 but right now it's very challenging. If you  
16 just look at 2004 to 2005, for example, our  
17 net revenues declined by \$100 million at the  
18 company. That's taking the growth of  
19 digital into account and balancing that  
20 against the loss of the physical, and we're  
21 still at a new shortfall in the U.S. of  
22 about \$100 million.

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1           Q       Now, have there been changes in  
2 Sony-BMG's business practices as a result of  
3 the decline of sales as you just described?

4           A       Yes. I mean, for one, it's  
5 becoming very, very important to us to focus  
6 on licensing and digital distribution  
7 activities more than ever. As I mentioned  
8 before, in the past, everyone was really  
9 focused on the singular product that we had,  
10 which was the album of an artist and the  
11 physical format.

12                   Now it's more important to  
13 diversify your revenue streams as best you  
14 can and seek out every dollar that you can,  
15 and that includes promotional efforts. So,  
16 for example, whereas we used to give some of  
17 our product away, maybe a single or a CD  
18 sampler, we would give away in the hopes of  
19 selling a bigger configuration, the album,  
20 down the road. Now we actually charge for  
21 our promotional efforts.

22                   And there are companies that

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1 realize and recognize the value of our  
2 product and our music and are willing to pay  
3 for it.

4 Q Now, you said that promotion is  
5 changed. How is promotion done how focusing  
6 on the digital space? What kinds of  
7 promotion do you see now for sales of  
8 recorded music?

9 A Well, on the Internet it's a very  
10 contextual environment. So what you'll do  
11 is try to do promotional efforts with the  
12 big portals, for example. So in AOL or  
13 Yahoo or at MSN, you will try to get premium  
14 placement on a home page or on their main  
15 music page or on a welcome screen, and you  
16 get those impressions in front of people so  
17 that they get, you know, kind of exposure to  
18 the artist and perhaps even a sampling of  
19 the music.

20 We've particularly done that with  
21 music videos where we've licensed our video  
22 catalogue, which traditionally has been used

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1 for promotional purposes. Now they're all  
2 licensed on a commercial basis and we get  
3 these premium placement and premium  
4 impressions as a result of it.

5 Q What do you mean by "premium  
6 impressions"?

7 A When you sign onto your website,  
8 let's say you're a Yahoo subscriber and you  
9 want to check your E-mail in the morning.  
10 That first page that hits you is very, very  
11 important. It's like the centerfold of a  
12 magazine or, you know, the premium spot  
13 during a super bowl for an advertiser, and  
14 it's very competitive to get those  
15 placements. So we are able to negotiate  
16 with the service providers and with the  
17 portals for placement. They pay us for that  
18 because we essentially sell or license our  
19 music or access to our artists for money  
20 plus the promotional consideration.

21 Q Now, in your role as head of the  
22 group that negotiates Sony-BMG's digital

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1 deals, are you familiar with the various  
2 voluntary deals for digital distribution  
3 that the company has made over the recent  
4 years?

5 A Yes.

6 Q And can you generalize about the  
7 factors that Sony-BMG considers in deciding  
8 whether to enter into deals with particular  
9 digital distributors and at what price?

10 A Sure.

11 Q I'm going to put up a chart and  
12 see if that helps you explain the factors,  
13 Mr. Eisenberg.

14 A Would it be all right if I sit up  
15 and point to -- thank you.

16 CHIEF JUDGE SLEDGE: Try not to  
17 turn your back to the microphone is our main  
18 concern.

19 THE WITNESS: Okay. Thank you.

20 These are some of the factors  
21 that we consider in negotiating construction  
22 of our deals. The first one and very

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1 important one is the value that the music  
2 has both intrinsically to the end user or to  
3 the consumer and also to the potential  
4 distributor of the music.

5 And by that I mean the following.

6 The end user has a certain value or  
7 recognizes a certain value in our product,  
8 and sometimes he's willing to pay for it and  
9 other times it's give it to him for free.  
10 However he consumes that product it has a  
11 potential to displace other uses that he or  
12 she might have of our product. So we have  
13 to essentially negotiate with our potential  
14 distributors based upon the end user's value  
15 of that music to him or her.

16 BY MR. SMITH:

17 Q What kinds of features of digital  
18 deals affect the value of the music to the  
19 consumer?

20 A Well, for example, if something  
21 is permanent, if something is very narrowly  
22 tailored to his or her taste, if something

1 is portable, meaning you can listen to it  
2 any time, anywhere, as opposed to having to  
3 be wired and connected to the Internet to  
4 listen to it, those will have different  
5 value propositions for the end user.

6 Q How about value to the potential  
7 distributor? What are you referring to  
8 there?

9 A There we're talking about how  
10 does the distributor or essentially our  
11 customer make money off of our music. In  
12 the traditional world you would have the  
13 wholesale price and the fiscal configuration  
14 and your retailer would mark it up and  
15 resell it. That happens oftentimes in the  
16 digital space, for example, with the digital  
17 download.

18 But there are many examples where  
19 the potential distributor recognizes  
20 additional income besides that which is  
21 specifically tied to the resale of the  
22 product. For example, a lot of the

1 potential distributors on the Internet have  
2 other businesses. Some are service  
3 providers like ISPs. Some are telecoms, and  
4 they're looking to use music to attract an  
5 audience to get a big group of people into  
6 their community in which case they can  
7 monetize in different ways, either through  
8 subscription services like an ISP DSL line  
9 or dataing services, games that they sell to  
10 the consumer, E-card sites.

11 And so what we try to do is take  
12 a look at how the potential distributor is  
13 using our music and then price our music  
14 based upon the value that the distributor is  
15 making of the content.

16 Q Now, what's the next factor you  
17 have up there, healthy business models? Can  
18 you explain that?

19 A Sure. I mean, as we migrate from  
20 a one product company that is the physical  
21 product to a proliferation of products, it's  
22 important for us to establish long-term

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1 healthy business models, and we are in a  
2 nascent world right now, that being --

3 Q A what kind of world?

4 A A nascent.

5 Q Nascent world.

6 A Nascent, well, in terms of  
7 digital distribution. If you think of, you  
8 know, the evolution of the iPod, that  
9 happened in April of 2003. That's not too,  
10 too long ago, and there are a lot of other  
11 business models besides just permanent  
12 downloads. There's Internet radio, there's  
13 streaming, there's interactive streaming,  
14 there's listens, there's pay per views,  
15 there's advertisement supported, there's  
16 subscriptions, and it's important for us to  
17 establish models that set our company up for  
18 the future because in the long run we're not  
19 going to be selling music in the way that we  
20 sell it today. So we have to make sure that  
21 taking into account our current cost  
22 structure and what we hope to make on our

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1 music that we establish long-term models for  
2 the future.

3 Q Can you give us some examples of  
4 business models that you might not think of  
5 as healthy business models for the future?

6 A I mean, there are oftentimes,  
7 again, in a nascent market where a potential  
8 distributor will come to us and say, "Well,  
9 I really don't have a business plan here. I  
10 think distributing your music over the  
11 Internet is really cool. Why don't you just  
12 give us your music for a year and we'll work  
13 it out later?" without any business model in  
14 place.

15 That may be great for the  
16 consumer in order to enjoy our music, but  
17 that's not good for us. On the flip side,  
18 there may be instances where a distributor  
19 might say, "Still don't have a business  
20 model in place, but why don't I just pay you  
21 a one-time fee and someone can have all of  
22 the music for a year?"

1                   That one time fee might be a lot  
2 of money for calendar year 2006, but it  
3 doesn't establish a long term business model  
4 for us. So we have to look at the per unit  
5 rates, the revenue shares, and the long  
6 term, you know, sustainability of the  
7 business.

8                   Q       Okay. Now, the next factor up  
9 there is the desire to avoid commoditization  
10 of the music. Can you tell us what you mean  
11 by that?

12                  A       Yeah. In some respects the way  
13 you make monetization ties back to what is  
14 the value of the music to the potential  
15 distributor. If an AOL or MSN or a Yahoo or  
16 a teleco is making a lot of money off of our  
17 content, it's hard for us to say, you know,  
18 the content is worth X cents or X dollars or  
19 X micro payment cents per unit because you  
20 look at what the end value is to the  
21 potential distributor.

22                   The monetization also comes into

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1 play when you talk about the types of  
2 recordings that you're offering to the end  
3 user. Not all music is priced alike. If  
4 you go into Circuit City or Best Buy and you  
5 go through the album bins, you'll see  
6 products priced differently. Top sellers  
7 and hip product, super star acts are priced  
8 higher than developing artists or cutout  
9 artists, and --

10 Q What's a cutout artist?

11 A An artist who has been cut out is  
12 an artist who we're no longer promoting for  
13 sale in our active catalogue. So we still  
14 have rights to that artist, but we're not  
15 actually in the marketplace actively  
16 soliciting accounts for the sale of those  
17 recordings.

18 It's important that we avoid the  
19 commoditization for our artists as well  
20 because the super star artist, first of all,  
21 we pay a lot more than a developing artist,  
22 and it's worth a lot more to the consumer.

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1           Q       Now, what are some examples of  
2 terms and digital deals that you try to  
3 achieve that would minimize commoditization  
4 of the music?

5           A       Well, with respect to the first  
6 part, the potential distributor, we take a  
7 revenue share of its distributors' receipts.  
8 So if the distributor is getting, you know,  
9 a dollar, that plays into what our pricing  
10 structure is with respect to that  
11 distributor.

12                       With respect to how sound  
13 recordings are sold vis-a-vis the charter,  
14 for example on the iTune service, if you  
15 look at how albums are priced, we have  
16 different price categories for our albums  
17 just like we do in the physical world. So  
18 you have budget, mid-price, and top line for  
19 album sales. You also have premium prices  
20 for exclusives, for example, in the mobile  
21 world where sometimes a carrier phone  
22 company will ask you, "Can I have an

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1 exclusive, first download of your artist?"  
2 They will pay us a premium for that right.  
3 Again, that voids the commoditization and  
4 recognizes the value of, you know, each  
5 individual sound recording that we have.

6 Q Okay. Now, the fourth bullet up  
7 there, first, is something called  
8 substitution, and I wonder if you could  
9 explain what you're talking about with  
10 respect to considering substitution.

11 A Sure. Again, as you migrate from  
12 the physical world to the digital world, you  
13 have a proliferation of different products  
14 and services that you're offering. So with  
15 respect to digital, you'll have streaming  
16 services. They could be passive listening  
17 experiences. They could be personalized  
18 listening experiences. They could be  
19 tethered to a computer or they could be  
20 portable. They could be for permanent  
21 ownership, and they could be in situations  
22 where you not only own it, but you can make

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1 multiple copies of it or you can put it on  
2 multiple devices.

3 All those instances are ways that  
4 we can make money off of our sound  
5 recordings, and it's important when we're  
6 pricing to make sure that our prices reflect  
7 for each of those types of uses the value  
8 that the consumer is getting, and to the  
9 extent that one use is substitutional for  
10 another use, that we've made that into the  
11 price point on a wholesale basis so that we  
12 have the ability to sell multiple products  
13 and multiple services to the same end user.

14 Q Are there some subfactors that go  
15 into your assessment of which types of  
16 digital distribution methodologies are more  
17 or less substitutional?

18 A Yeah. There's a few that are  
19 noted here. One of the things that we look  
20 at is the customizability and the  
21 personalization of the listening experience.  
22 If a consumer gets to hear something that's

1 just what he wants to hear, whether it's on  
2 demand or whether it's passively streamed to  
3 him, that has a substitutional effect on his  
4 willingness to purchase other types of music  
5 from us.

6 For example, if you're put into a  
7 niche oriented radio station and they're  
8 playing everything that he wants to hear,  
9 you know, we're not going to sell a Greater  
10 6 (phonetic) album or we're not going to  
11 sell a compilation record because all he  
12 needs to do is turn on the radio station and  
13 it's all there for him. So the  
14 customization and the personalization of the  
15 experience whether it's listening  
16 experience, passively or on demand  
17 experience is very important to consider.

18 Q Are there Internet webcasters out  
19 there operating under the statutory license  
20 that would rank relatively high on that  
21 particular factor?

22 A Yeah. I mean, on the Internet,

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1 because it's a very tactile experience, you  
2 can click on one radio station, click onto  
3 another radio station, click onto another  
4 radio station, and they're all listed right  
5 before your eyes as opposed to on the radio  
6 dial where you have six presets and you only  
7 have six choices. On the Internet you have  
8 thousands upon thousands and thousands.

9 If you go onto some of the  
10 aggregators like Live365, you'll come up  
11 with 195 different blues stations, acoustic  
12 blues, Cajun blues, Delta blues, Chicago  
13 blues. All of those are very narrowly  
14 tailored to a user's taste and interest, and  
15 those could be very, very substitutional for  
16 other services and products that we might  
17 want to offer that user.m

18 Q Now, are there other webcasters  
19 out there operating under the statutory  
20 license that you view as ranking lower on  
21 that factor?

22 A I mean, there may be some

1 simulcasters that have a lower diversity of  
2 program, you know, shorter play lists.  
3 There may be some DJ banter. So there  
4 probably is a range there in terms of  
5 customization and personalization even  
6 within Internet radio.

7 Q Let me ask you now to  
8 hypothetically consider a world in which  
9 there is no statutory license for  
10 noninteractive webcasting and ask you  
11 whether or not there's any kind of  
12 webcaster/noninteractive webcaster that you  
13 wouldn't insist on getting paid when they  
14 use your music.

15 MR. STEINTHAL: Your Honor, Ken  
16 Steinthal for DiMA.

17 Objection to the form of the  
18 question. It's a hypothetical question.  
19 This is a fact witness.

20 CHIEF JUDGE SLEDGE: Mr. Smith?

21 MR. SMITH: I think as the person  
22 who negotiates digital deals, he's certainly

1 capable of telling us whether Sony-BMG would  
2 expect to get paid for a particular service  
3 if it was not mandatory under the statute.  
4 We're just talking about the factors that go  
5 into that.

6 CHIEF JUDGE SLEDGE: As I  
7 understand it, that's different than the  
8 question you asked. So the objection is  
9 sustained.

10 MR. SMITH: Well, I'll try to  
11 rephrase, Your Honor.

12 BY MR. SMITH:

13 Q If you were voluntarily licensing  
14 noninteractive webcasting, what would you  
15 expect to be paid for the music that is used  
16 on those services?

17 MR. STEINTHAL: Your Honor, same  
18 objection.

19 CHIEF JUDGE SLEDGE: Same ruling.  
20 Mr. Smith, you didn't ask him what he has  
21 done. You asked him what he might do.

22 MR. SMITH: Yes, Your Honor. I

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1 was trying to get him to apply the factors  
2 that he considers in the voluntary  
3 marketplace to this hypothetical  
4 marketplace. Is the Court's ruling that  
5 that is not a proper form of the question,  
6 if I might inquire? I'm sorry. I'm just  
7 trying to figure out the limits of the  
8 ruling.

9 CHIEF JUDGE SLEDGE: Well, I  
10 think the concern I've got is that you've  
11 asked him what he might do in a situation.  
12 You haven't established that that has been  
13 part of his experience or part of what he  
14 does.

15 MR. SMITH: Right. Because of  
16 the statutory license he actually doesn't  
17 negotiate with the DMCA compliant  
18 webcasters. I'm trying to ask him about the  
19 hypothetical marketplace, which is the  
20 subject matter of this proceeding, and how  
21 Sony-BMG would behave if it were a willing  
22 seller in that marketplace.

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1 MR. STEINTHAL: Well, Your Honor,  
2 I think that's your task. I think it's the  
3 panel's task to take a look at the evidence  
4 of the actual markets and everything else  
5 and apply it to the hypothetical market, not  
6 this fact witness.

7 CHIEF JUDGE SLEDGE: Any other  
8 Judge want to hear that?

9 Thank you.

10 BY MR. SMITH:

11 Q Let me ask you about the real  
12 world then, Mr. Eisenberg. Can you tell us  
13 what sound clips are?

14 A Sound clips are essentially  
15 samples or excerpts of our recordings that  
16 we licensed to online retailers, like an  
17 Amazon or a walmart.com. So if you went  
18 onto the website as a consumer and you  
19 wanted to look at the track listing and hear  
20 a little 30 second clip or excerpt of that  
21 track to determine whether or not to make a  
22 purchase, you could do so.

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1 Q And are there people out there  
2 who make a business out of distributing  
3 these small clips of your songs?

4 A Yes, there are service providers  
5 who are intermediaries or middle men who  
6 essentially ask for a license to digitize  
7 our content for that purpose and then  
8 essentially resell it or relicense it to  
9 front ends or online retailers.

10 Q In negotiating with those people  
11 about the price for the sound clips, do you  
12 consider them as substitutional in any way?

13 A No, sound clips are not  
14 substitutional. No one is going to go to a  
15 website and get their fill of a recording  
16 through a 30 second sound clip. They're  
17 essentially promotional to sell the full  
18 length record. It's not an entertainment  
19 product as such. It's a sampling experience  
20 to purchase a record just like a listening  
21 booth is at a Circuit City or Best Buy.

22 Q And does Sony-BMG get paid by

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1 these businesses that make a business out of  
2 distributing these slip samples?

3 A Yes, because, again, it gets back  
4 to that first prong here, which is what is  
5 the potential distributor made from our  
6 music, and to the extent a distributor is  
7 making money even in a promotional context,  
8 we get paid. So essentially we get paid  
9 once they buy the record off of the website,  
10 plus from that middle man who's making  
11 business off -- who's selling our clips.

12 Q Okay. We'll come back later on  
13 when we get to the restricted portion of  
14 your testimony about to the exact amount  
15 that you get paid on that.

16 Let me ask you then to finish the  
17 other factors that you consider in deciding  
18 which services you see as more or less  
19 substitutional on your chart. The next one  
20 seems to be portability and ubiquity. Can  
21 you explain that?

22 A Sure. The highest value that a

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1 consumer might place on music is probably  
2 the ability to take that music that he or  
3 she bought or has access to and leave the  
4 house and go jobbing or go to the  
5 supermarket or put it in the car and listen  
6 to it any time anywhere. That leads to the  
7 portability of that music. So if a user is  
8 tethered to his computer and the only way  
9 that he can listen to it is on the desktop  
10 at his work station, that probably has a  
11 lesser value to him than something that's  
12 portable and ubiquitous, and therefore, the  
13 pricing would reflect that.

14 For example, if a user can only  
15 listen to music while at his desktop, he's  
16 more apt to buy a digital download or  
17 purchase that music in another way as well  
18 to get his fill of that sound recording.

19 Q Why would a person who is only  
20 streaming at a desktop be more likely to buy  
21 a download?

22 A Because he can't enjoy that

1 experience anywhere but the four corners of  
2 his home. If it's portable, meaning he can  
3 put it on an MP3 player or he could burn it  
4 onto a disk or he could job with it, it has  
5 much more value to the end user than a  
6 stream that's tied to a computer.

7 The ubiquity of the listening  
8 experience is also reflected in how you  
9 actually get access to the music. In a  
10 wireless environment, so when you're buying  
11 music over the telephone, you don't even  
12 have to be at your desktop to make the  
13 purchase. That's how we sell visual  
14 downloads through Verizon and Sprint  
15 currently, and that's how radios are  
16 actually offered, through Verizon and Sprint  
17 currently.

18 So instead of having to go  
19 through the efforts of going to your  
20 computer and downloading it or pressing a  
21 button, you're on the go. You're at the  
22 train station. You're at the bus depot.

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1 You hit the button. It's automatically  
2 downloaded or accessed through your portable  
3 device.

4 That has huge value to the  
5 consumer, and it's reflected in the retail  
6 price points that consumers are paying for  
7 those products.

8 Q Okay. Now, the final factor you  
9 have up there is fidelity and  
10 transmission?sound quality. Can you explain  
11 what that is and how it factors in?

12 A Right. In our voluntary deal, we  
13 have control over the sound quality of the  
14 file. So if a distributor comes to us and  
15 says, "I want to have what we call lost list  
16 files," which means there's no degradation  
17 of sound. It's even better than the CD  
18 quality.

19 They can pay for that extra  
20 fidelity, and there are some audio files who  
21 are very interested in receiving lost list  
22 files or high fidelity files.

1                   On the other hand, there may be  
2 services that say, "No, it doesn't matter to  
3 my end user and I'm willing to cap the  
4 fidelity in order to lock in a price with  
5 you. So I'll take a lesser rate for capped  
6 functionality or capped fidelity, and that's  
7 okay with me."

8                   In voluntary use we have that  
9 control to say, you know, a 32 kilobit  
10 stream is worth X and a 192 kilobit stream  
11 is worth Y.

12                  Q       Okay. Now, I want to turn to a  
13 slightly different topic, which is the rate  
14 structure that you use in your voluntary  
15 deals. Again, we're going to get to the  
16 details in a little while, but let me ask  
17 you is there a way that you seek to get  
18 compensated for the music that you sell on  
19 the Internet?

20                   And in particular I'm asking you  
21 now about the greater of formula.

22                  A       Yes. In our voluntary deals, we

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1 set it up to point to the following  
2 framework, and it reflects, again, the value  
3 to the end user and the value derived by the  
4 potential distributor. So we seek the  
5 greater of three prongs. The first is a  
6 percentage of the revenue that the potential  
7 distributor is making off of our recordings.

8 So can I get into the numbers  
9 here?

10 Q No, I think you should wait until  
11 we do that service by service. Plus I'll  
12 ask the Court to make a restricted portion  
13 of the transcript. This is just more of the  
14 categories and how they work.

15 A Okay. So the first thing we look  
16 at is what is the distributor making off of  
17 our recordings, and we take a percentage of  
18 what the distributor is deriving from the  
19 end user or from advertising or other types  
20 of incidents or benefits that he's making  
21 from our music.

22 That's what I would call the up

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1 side participation. Then there are two down  
2 side safeguards. One is a share of the per  
3 subscriber or one is establishing a per  
4 subscriber minimum. There are many cases on  
5 the Internet and even in the physical world  
6 where our product is given away as a lost  
7 leader for other purposes. In the physical  
8 world, the best case example is Circuit  
9 City, which, you know, sells many times our  
10 CDs at below cost because they attract the  
11 user into the store and they can sell  
12 washing machines and dryers and other  
13 appliances. It's a good business for them,  
14 and we get paid our wholesale price.

15 MR. STEINTHAL: Your Honor, if I  
16 can impose an objection on a foundational  
17 basis about what Circuit City is doing and  
18 why it's doing it, it's clearly hearsay  
19 unless there's a foundation for it.

20 CHIEF JUDGE SLEDGE: Mr. Smith.

21 MR. SMITH: First of all, hearsay  
22 is admissible in this proceeding, Your

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1 Honor, and he's been in the record business  
2 for 12 years. He's talking about one of  
3 their biggest retailers, and he's just  
4 talking about something that I think  
5 everybody in the record business knows.

6 CHIEF JUDGE SLEDGE: Objection  
7 overruled.

8 THE WITNESS: So just like in the  
9 digital world, service providers and portals  
10 often use their music as lost leaders or  
11 magnets to attract an audience to their  
12 site. So if we didn't have a per subscriber  
13 minimum in those cases, a revenue share  
14 could be a healthy percentage of zero. So  
15 we need down side protection to safeguard  
16 against our product being given away for  
17 other purposes.

18 Another safeguard that we have is  
19 a per play minimum. That is, again, a  
20 safeguard against a lot of usage or  
21 consumption. To the extent a user plays our  
22 music time and time again, particularly, in

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1 a portable or ubiquitous setting where, you  
2 know, 24-7 unless they sleeping they could  
3 play our music. That's substituting or  
4 taking away from revenue that we would  
5 otherwise be making from that same user as  
6 he listens to our music in other  
7 configurations.

8 So we had a greater of formula.  
9 The percentage of what the distributor is  
10 making against to minimum -- a per  
11 subscriber minimum and a per play minimum.

12 BY MR. SMITH:

13 Q You used the term "pro rata  
14 share" twice on there both with respect to  
15 the revenue percentage and the per  
16 subscriber minimum. Can you just explain  
17 that a little more, in more detail about how  
18 that works?

19 A Sure. So I won't get into the  
20 numbers, but if you ever -- if we get X  
21 percent of a distributor's receipts,  
22 obviously we weren't the only -- they are

1 licensing or distributing music from  
2 multiple record companies. We aren't the  
3 only company who are providing content to  
4 them. So we take a pro rata share of a pool  
5 of money from a distributor, and typically  
6 that's a ratio based upon the percentage of  
7 our plays relative to the total number of  
8 plays in the service.

9 Q Now, could I ask you? In these  
10 voluntary deals, what would be the effect of  
11 having a lesser of formula with these three  
12 factors rather than a greater of formula?

13 A Well, lesser of formula would be  
14 terrific because, for example, if you have  
15 got a very healthy percentage of a  
16 retailer's or a distributor's receipts but  
17 there were no receipts because he gave the  
18 music away to sell something else, then you  
19 get, you know, a high percentage of nothing.  
20 So it's very important to have greater of  
21 formula so that you're protected on the  
22 consumption and also on the up side of what

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1 the distributor is making from your content.

2 Q I'm going to put up another chart  
3 here and ask you if you could to talk about  
4 some of the non-price terms in your  
5 voluntary deals and why you think they're  
6 important. Does this chart reflect some of  
7 the central non-price terms that you assist  
8 on in your voluntary deals?

9 A It's a good representation.  
10 Maybe I'll skip around out of order and talk  
11 about some of the ones that are of very,  
12 very significant importance.

13 First, first off, in our  
14 voluntary deals we have control over what  
15 repertoire gets distributed -- we're a  
16 distributor -- and when, and this allows us  
17 to essentially hold back certain hit product  
18 or window certain hit product.

19 Q Okay. What does the term  
20 "window" mean?

21 A A window is a timing of the  
22 release. So, for example, if we have a hit

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1 single that is playing on the radio, there  
2 are a lot of people who may want to download  
3 that track. If we're able to offer it up as  
4 a download before it hits radio, then those  
5 people who buy that track more readily than  
6 if they could just turn on the radio and  
7 listen to it time and time again.

8 So you're trying to window your  
9 product in terms of functionality so that  
10 you kind of, you know, maximize the  
11 potential just like the movie business does.  
12 In the theaters, for example, you'll have a  
13 widescreen release of a motion picture. If  
14 that motion picture were available on  
15 broadcast television free or ad supported at  
16 the same time it was in the theaters, you'd  
17 have a lot less people going to the theaters  
18 and that's why there's segmenting and  
19 sequencing of the windows in the  
20 intellectual property business.

21 Q Okay. How about another one of  
22 the terms that you usually insist on in your

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1 agreements?

2 A We always get premiums for what I  
3 would call wireless or portable  
4 functionality. This is along the lines of  
5 what I talked about before. If you can  
6 listen to something any time anywhere, it's  
7 going to displace your sales or your ability  
8 to derive revenue from that same user of  
9 that same recording or other recordings in  
10 other contexts.

11 So that's also reflected in the  
12 retail prices of services. So, for example,  
13 subscription services on the market,  
14 Napster, for example, has a Napster tethered  
15 service, which you listen to at your  
16 desktop, and they have a Napster to go  
17 service, which you can listen to on an MP3  
18 player. The portable service is priced --  
19 has a retail price of \$15, and the tethered  
20 service has a retail price of \$10. It's  
21 reflected in the value to the end user.

22 And our wholesale pricing

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1 similarly reflects the value.

2 Q Okay. So I guess we have one  
3 price term that sort of slipped into this  
4 list of non-price terms. Let me ask you  
5 while we're talking about that though. Are  
6 there services out there that are webcasting  
7 in a wireless mode and using the statutory  
8 license?

9 A Yeah. Under DMCA we don't have  
10 control over whether it's a portable  
11 experience or a tethered experience. So,  
12 for example, Sprint has three radio stations  
13 on their handset, on their cell phone. We  
14 have not voluntarily licensed them. So I  
15 have to glean from that unless they are  
16 copyright infringers that they've taken DMCA  
17 licenses and are paying the standard rates  
18 that a tethered service is paying for  
19 computer delivered web radio as opposed to  
20 over-the-air delivered web radio.

21 Q Okay. Can you give us another  
22 example of a term that you insist on in your

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1 voluntary deals?

2 A Sure. In our voluntary deals, we  
3 have certain obligations that are imposed  
4 upon the distributor to promote and market  
5 artists in our sound recordings. So not  
6 only do they pay us for usage. They  
7 actually have an obligation on top of that  
8 to promote and expose and to push certain  
9 content to the end user.

10 Pushing a content does two  
11 things. It increases our play counts. When  
12 you do an allocation of the revenues, our  
13 plays are actually higher and our revenues  
14 are higher. It also exposes our artists to  
15 their user base in a way that maybe perhaps  
16 they couldn't find them otherwise if it was  
17 a large service and they could get lost in  
18 the sea of recordings, you know, among the  
19 hundreds of thousands and millions of  
20 recordings that are otherwise available.

21 Q You have up there also bit rate  
22 limitations. Can you explain that?

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1           A       Sure. We talked a little bit  
2 before about when we enter into voluntary  
3 deals we have control over the fidelity of  
4 the listening experience. So to the extent  
5 a distributor wants to have high fidelity,  
6 high quality files, they'll pay more for  
7 that. If they're not willing to or don't  
8 really care about the fidelity to their end  
9 user, we can cap that by contract in the  
10 agreement so that they can't stream or  
11 provide files in a high quality fashion, and  
12 that's reflected, again, in the wholesale  
13 pricing and typically in the retail pricing  
14 as well.

15           Q       I wanted to touch upon the  
16 electronic reporting because that's  
17 extremely important for us. We live and  
18 breathe by sales and marketing reports as a  
19 business in real time essentially. So, you  
20 know, with all of our traditional accounts  
21 in retail, we have our system set up with  
22 the storage. We know who signed what and

1 what demographic and when. We could tie it  
2 to what's happening in a local market. We  
3 can push one single over another single  
4 depending upon usage, and we get a lot of  
5 instantaneous feedback from our accounts,  
6 and we do that on the digital side as well.

7 So each of our digital accounts,  
8 we have a specification that they have to  
9 report back to us on, and it's segmented by  
10 retailer so that we know what retailer is  
11 selling or playing what. There's  
12 demographic information. There's timeliness  
13 of reporting. So we get weekly reports on  
14 the sales front and accountings on a monthly  
15 basis so that we can process it for payments  
16 to artists and to publishers.

17 For the DMCA licenses we don't  
18 get any type of reporting that's worthwhile.  
19 It's all lumped together. In fact, we don't  
20 even know what Yahoo is streaming versus  
21 what AOL is streaming versus what MSN is  
22 streaming. All of the payments come into

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1 one big bucket and they're delayed by, you  
2 know, sometimes six months to a year. Now  
3 only does it delay us or is there a delay in  
4 getting payment, but just as importantly,  
5 the information, the information flow of  
6 what is receiving a lot of air play and who  
7 likes what doesn't help us in guiding us  
8 through the rest of our business.

9 Q Now, there's also audit rights up  
10 there. Can you explain that?

11 A Yeah. In each of our deals we  
12 have the right to go in and audit and the  
13 audit relates not only to financial  
14 reporting, but also to technical measures.  
15 We want to make sure that, you know, files  
16 are not being breached, that security  
17 measures are being taken by the service  
18 providers.

19 It gets back to the security  
20 guarantees. We have DRM representations  
21 that are made by our service providers.

22 Q I think you're going to have to

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1 define that for us.

2 A Okay. The files are wrapped, for  
3 example, on a download so that you can't  
4 redistribute it to another user once you've  
5 downloaded it without that user paying  
6 essentially a fee for another purchase.  
7 It's very important because if you see what  
8 is happening on P2P networks where these  
9 files are opened, you know, those are all  
10 lost sales opportunities for us because  
11 essentially it's stolen property that's  
12 getting transmitted across the Internet.

13 The security guarantees allow us  
14 to go into the service provider to check  
15 their server logs and make sure that there's  
16 no stealing going on, that there are no  
17 security breaches and, in fact, what is  
18 being reported back to us is an accurate  
19 representation of the activity that's going  
20 on.

21 Q Let me ask you. Is Sony-BMG able  
22 to insist on any of these contractual terms

1 with regard to the statutory DMCA compliant  
2 webcasters?

3 A We have no ability to do any  
4 technical audits under the Sound Exchange.

5 Q How about with regard to the rest  
6 of the terms that you've been discussing for  
7 the last few minutes?

8 A No. None of these are -- none of  
9 these factors are baked into the statutory  
10 license. We lose all control over those  
11 things.

12 Q Let me ask you about in its  
13 voluntary deals does Sony-BMG enter into  
14 deals with a term as long as five years?

15 A No. In the Internet space, five  
16 years is eternity. The importance I notice  
17 from being in there for quite some time now,  
18 the importance is being able to react to the  
19 market and respond, you know, with quickness  
20 and deftness to different business models,  
21 and therefore, our licensing activities are  
22 really confined to a year or two years at

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1 best because if we so-called screwed up on  
2 the rates and didn't see something coming  
3 down the pike, we can fix it on the renewal  
4 term.

5 The statutory license is for a  
6 five-year term, and you don't know what will  
7 happen in the market within five years, and  
8 it's very -- it's a big risk for us in doing  
9 a long term deal.

10 MR. SMITH: Okay. Now, at this  
11 point, Your Honor, I want to make a motion  
12 to have the rest of Mr. Eisenberg's direct  
13 testimony be subject to the protective order  
14 and restricted. It's going to discuss the  
15 specific price terms of their voluntary  
16 deals. That's a significant portion of his  
17 testimony and it involves voluntary deals  
18 for all of the various categories of digital  
19 distribution that he has been discussing  
20 this morning.

21 MR. STEINTHAL: No objection,  
22 Your Honor.

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1 CHIEF JUDGE SLEDGE: All right.

2 The motion is for the application of the  
3 protective order on testimony on pricing  
4 agreements in which Sony is a party.

5 Any objection?

6 MR. STEINTHAL: No objection.

7 CHIEF JUDGE SLEDGE: Without  
8 objection, the motion is granted.

9 (Whereupon, at 10:23 a.m., the  
10 hearing was recessed, to reconvene  
11 immediately in closed session.)

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1 CHIEF JUDGE SLEDGE: Thank you.

2 We'll return to order.

3 Mr. Steinthal.

4 CROSS EXAMINATION

5 BY MR. STEINTHAL:

6 Q Good morning, Mr. Eisenberg. How  
7 are you?

8 A Very good. Thank you.

9 Q Mr. Eisenberg, as you know, I'm  
10 Ken Steinthal. I'm representing DiMA and  
11 AOL, Yahoo and Microsoft and Live365 in this  
12 proceeding.

13 I want to start with the Sound  
14 Exchange Demo No. 28. This was essentially  
15 extracted from a memo that you had written  
16 to some senior executives as Sony about  
17 Internet and streaming radio deals that had  
18 been done; is that right?

19 A I believe that some of those  
20 elements may have come from a memo, yes.

21 Q Let's take a look at that memo.  
22 We'll mark this as Services Exhibit 41.

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1 (Whereupon, the document  
2 referred to was marked  
3 as Services Exhibit No.  
4 41 for identification.)

5 MR. STEINTHAL: Services Exhibit  
6 41 is a memorandum from Larry Kanusher upon  
7 which you're copied, dated June 5, 2003.

8 And Services Exhibit 42 is a memo  
9 from you to M. Anthony, A. Lack, R. Wilcox,  
10 and P. Wiser, dated July 15th, 2003.

11 (Whereupon, the document  
12 referred to was marked  
13 as Services Exhibit No.  
14 42 for identification.)

15 BY MR. STEINTHAL:

16 Q First of all, I just want to ask  
17 a question about the documents. Why don't  
18 you, if you can, identify both of these  
19 documents for the benefit of the panel and  
20 who the people are in the "from" and "to"  
21 category so that they can get a sense of who  
22 the dialogue was being had with here?

1           A     Okay. I'll start with Exhibit  
2     42, 4094. Is that 42?

3           Q     Sure, start with 42, which is  
4     your memo.

5           A     Okay. This is a memo that I  
6     authored to Michelle Anthony, who was an  
7     Executive Vice President at Sony Music  
8     Entertainment; Andrew Lack, who was our CDO;  
9     Ron Wilcox, who was head of Overall Business  
10    Affairs at Sony Music; and Phil Wiser, who  
11    was heading up our Business Development at  
12    the time.

13          Q     And what was the purpose of your  
14    creating Exhibit 42 at the time?

15          A     Mr. Lack had just joined the  
16    company as our new CEO. So we were  
17    basically briefing him on different areas of  
18    the company. I undertook to give him a  
19    primer from a 30,000 foot view of, you know,  
20    the Internet space, streaming radio space to  
21    acclimate him to some areas and principles  
22    that he may not have otherwise been familiar

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1 with.

2 Q And I gather you sought to be  
3 accurate in drafting this memorandum to Mr.  
4 Lack?

5 A I tried to be.

6 MR. STEINTHAL: I would offer  
7 Exhibit 42 in evidence.

8 CHIEF JUDGE SLEDGE: Any  
9 objection to Exhibit 42?

10 MR. SMITH: No, Your Honor.

11 CHIEF JUDGE SLEDGE: It's  
12 admitted.

13 (Whereupon, the document  
14 marked Services Exhibit  
15 No. 42 for iden-  
16 tification was received  
17 in evidence.)

18 MR. SMITH: Your Honor, I do  
19 think it should be marked as restricted in  
20 the record. We talked before about how  
21 certain documents are restricted. This is  
22 certainly a restricted document.

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1 MR. STEINTHAL: I'm afraid, Your  
2 Honor, that most of my cross examination is  
3 going to touch upon either this memorandum  
4 or other memoranda that have been designated  
5 as restricted or some of the deals. Now,  
6 when we get to the deals, I can dance around  
7 it as I try to without mentioning numbers,  
8 but certainly I'm sure that we'll spend a  
9 bit of time on these two memos right now,  
10 and they have been marked as restricted.

11 I'll abide by whatever Mr. Smith  
12 wants to do, subject to the Court's ruling,  
13 of course.

14 CHIEF JUDGE SLEDGE: I'm not sure  
15 what ruling is asked for.

16 MR. SMITH: Well, I would make a  
17 motion to have any questioning relating to  
18 these memos or to the price terms that were  
19 discussed in the direct both have the  
20 documents admitted subject to the protective  
21 order and have the proceedings be subject to  
22 the protective order.

1 CHIEF JUDGE SLEDGE: Any  
2 objection to the implementation of the  
3 protective order for the questions examining  
4 related to Exhibits 41 and 42?

5 MR. STEINTHAL: Your Honor, let  
6 me say this about it. A lot of the  
7 examination will be about licensing strategy  
8 and structures and not about specific deals.  
9 Now, I understand this document is  
10 designated as restricted, and indeed, in its  
11 first incarnation, when it was produced to  
12 us, it had some specific restricted  
13 information. But if it's okay with Mr.  
14 Smith to keep it as public record as long as  
15 we're just talking about the strategies and  
16 the structures and not getting into the  
17 dollars and the cents as to specific deals,  
18 I'm certainly happy to conduct the  
19 examination that way.

20 CHIEF JUDGE SLEDGE: Mr. Smith.

21 MR. SMITH: Your Honor, it's an  
22 internal business document involving the

1 senior management of the company about their  
2 strategy, and I don't think that it  
3 ordinarily would be the kind of document  
4 that you would be examining on in an open  
5 court. We produced it subject to a restrict  
6 because it's a confidential matter, and I  
7 think that it deserves to be protected.

8 CHIEF JUDGE SLEDGE: All right.  
9 Well, that will require review by the Court  
10 of the document in order to make that  
11 analysis.

12 We'll recess while we review the  
13 document.

14 MR. STEINTHAL: You might want to  
15 take Exhibit 41 as well, Your Honor, because  
16 it's the same issue, I'm sure.

17 Is that right, Mr. Smith?

18 MR. SMITH: That's correct, Your  
19 Honor.

20 MR. STEINTHAL: And I will be  
21 moving that into evidence. I doubt that  
22 there will be an objection on that



1 particular document.

2 (Whereupon, the foregoing matter  
3 went off the record at 11:18 a.m.  
4 and went back on the record at  
5 11:26 a.m.)

6 CHIEF JUDGE SLEDGE: Thank you.  
7 We'll return to order.

8 On a review of Exhibits 41 and  
9 42, the Court concludes that the choice is  
10 either to separate the exhibits into what  
11 fits within the provisions of the protective  
12 order and what doesn't, and these exhibits  
13 have been produced in discovery under the  
14 terms of the protective order and no party  
15 has objected to that classification in the  
16 terms. And with these two factors, the  
17 motion is granted for the exhibits and for  
18 the testimony related to the exhibits.

19 MR. SMITH: Thank you, Your  
20 Honor.

21 MR. STEINTHAL: We will then go  
22 into a restricted session.

1 (Whereupon, at 11:27 a.m., the  
2 hearing was recessed, to reconvene  
3 immediately in closed session.)

1 FURTHER CROSS EXAMINATION

2 BY MS. BROWN:

3 Q Good afternoon, Mr. Eisenberg.

4 A Hello.

5 Q None of the agreements you  
6 reference in your written testimony or in  
7 testimony here today involved NPR or NPR  
8 Public Radio Stations, do they?

9 A I'm looking at it.

10 Q Feel free to go back through your  
11 testimony if you need to.

12 A I don't recall testifying about  
13 NPR in my earlier session today.

14 Q And do you recall in your written  
15 testimony referencing any agreements that  
16 Sony-BMG has entered with NPR or NPR  
17 stations?

18 A I don't recall any being cited in  
19 the testimony.

20 Q I'd like you to turn to page 8 of  
21 your written testimony, please. About  
22 halfway down the page you say, "Specifically

1 with respect to assessing the rates and  
2 terms that may be appropriate for a  
3 particular circumstance, Sony-BMG also takes  
4 into account additional factors, such as the  
5 intrinsic value of music and the desire to  
6 avoid its commoditization, and you talked  
7 about that earlier with Mr. Steinthal; is  
8 that right?

9 A That's correct.

10 Q And that means in terms of  
11 commoditization and the intrinsic value of  
12 music your goal is to develop an  
13 appreciation in the computer for the  
14 musician and the music being performed by  
15 that musician; is that correct?

16 A And the economic value that  
17 derives from that.

18 Q And do you think noninteractive  
19 DMCA compliant webcasting that provides  
20 detailed biographical information about the  
21 artist whose music is being streamed  
22 interview with the artist historical

1 information about the music performed by the  
2 artist and other background features helps  
3 the consumer to develop a deeper  
4 appreciation for the musician and the music  
5 performed by the musician?

6 A Editorials on our artists are  
7 good in terms of giving exposures to our  
8 artists. It doesn't necessarily mean that  
9 those same types of editorial elements can  
10 otherwise be found on portals that don't  
11 offer our music. News an AMG offer  
12 biographical information about our artists,  
13 but don't have radio streams attached to  
14 their editorial.

15 Q Assuming that streams are  
16 attached to those editorials and features  
17 about the artists, would you assume that  
18 those types of streams in conjunction with  
19 those editorial features would help develop  
20 an appreciation for the musician and music  
21 performed by that musician?

22 A It could. I mean, that doesn't

1 address the intrinsic value of the music,  
2 which I was talking about in terms of the  
3 economic value of the music, but in terms of  
4 does it help familiarize the public about  
5 our artists' editorials is very good.

6 Q And avoid what you have termed as  
7 commoditization because it's providing  
8 detail and background about the music and an  
9 appreciation for the artist?

10 A No, the commoditization isn't  
11 addressed unless we're getting paid for the  
12 content in a way that remunerates us for the  
13 costs that are involved in creating the  
14 content. So an appreciation for the artist  
15 is great, but if it doesn't drive sales of  
16 our product, it doesn't really help us.

17 Q And an appreciation for the  
18 artist that might be coupled with a click  
19 through would be closer to commoditization?

20 A Well, if the click through  
21 results in a sale, then you decommoitized  
22 it, so to speak. If the click through just

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1 sits there and nobody clicks through the  
2 link, then it really doesn't help address  
3 this commoditization point.

4 Q Are you aware that NPR is a  
5 nonprofit 501(c)(3) organization?

6 A I don't know for a fact.

7 Q Are you aware that two-thirds of  
8 the public radio stations NPR represents in  
9 this proceeding are associated with  
10 colleges and universities?

11 A I don't know the statistics.

12 Q Would you agree that educational  
13 nonprofit webcasters have very different  
14 goals from commercial webcasters?

15 A I wouldn't know what their goals  
16 are.

17 Q Well, would you agree that part  
18 of a nonprofit mandate -- if part of the  
19 mandate for NPR is to provide news and  
20 educational content free of charge to  
21 consumers, that that's a different mandate  
22 than a for-profit entity that is seeking to

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1 make money off of webcasting?

2 A I'm not sure what you mean by  
3 "mandate."

4 Q A mission to provide content,  
5 educational and news content to the public  
6 that's part of the mission and foundation of  
7 the 501(c)(3) entity.

8 A And I'm sorry. What was the  
9 question?

10 Q The question is do you think that  
11 there's a difference between a 501(c)(3)  
12 nonprofit with a mission to provide news and  
13 educational content to the public in as many  
14 means possible, including streaming, is  
15 different from a for-profit entity whose  
16 mission is to make a profit from streaming?

17 A Not in terms of the  
18 substitutionality and commoditization of our  
19 product. It doesn't help us if music is out  
20 in the public for people to consume and it  
21 displaces other types of products and sales  
22 in the marketplace that we're trying to sell

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1 to the public. It doesn't help us if the  
2 webcaster doesn't make any money off of that  
3 transaction if we're still harmed.

4 So we looked at substitutionality  
5 in the context of what is the webcaster  
6 doing with respect to our content. Whether  
7 they're making money from it or not doesn't  
8 address the substitutionality element.

9 Q Would you agree or disagree with  
10 this statement? "We know, for example, that  
11 NPR's morning edition and all things  
12 considered and weekend edition and Fresh  
13 Air, all sell records and a lot of records."

14 A I'm sorry. Who made that  
15 statement?

16 Q Bruce Iglauer, President of  
17 Allegator Records.

18 A I have no basis for -- Allegator  
19 Records is not part of my company. So I  
20 don't know what they've done with NPR to  
21 help or, you know, promote their records.

22 Q Do you know if Sony has had any

1 musicians or performers featured on NPR or  
2 NPR Websites?

3 A It's possible.

4 Q Are you aware that NPR and NPR  
5 member stations do not allow the creation of  
6 customized channels for streaming?

7 A And what do you mean by  
8 customized when you're saying that?

9 Q Customized by the user. So genre  
10 specific types of channels.

11 A They don't offer genre channels  
12 or they don't all the user to make --

13 Q They don't allow the user to do  
14 those.

15 A Because if they did, they would  
16 probably be outside of Section 114. So  
17 that's probably why they don't.

18 Q Are you aware that the streaming  
19 offered through MPR and NPR member stations  
20 is free, that you don't have to pay a fee to  
21 access the sites?

22 A I don't know that for a fact, but

1 if you're representing that as a given, I'm  
2 not going to --

3 Q I'm just asking you.

4 A I don't know.

5 Q And do you think that NPR invests  
6 time and resources in presenting artists and  
7 their work as part of its educational public  
8 service mission?

9 A I have no knowledge of that.

10 Q Do you know of any reason why  
11 the specific manner and detailed context in  
12 which public radio presents streamed music  
13 should not be considered when establishing  
14 an appropriate rate for NPR in this  
15 proceeding?

16 A Yes. We look at two elements  
17 pricing our music. One is the value that --  
18 the economic value that's derived by the  
19 service or the service provider. That's one  
20 prong. The other prong is the  
21 substitutionality or commoditization or  
22 intrinsic value of the music that's given to

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1 the end user. On that first prong if the  
2 Bandaaid as you say is for NPR not to make  
3 any money, you know, that perhaps addresses  
4 that prong or that element of the analysis.

5 But on the first prong, NPR or  
6 any non-com for that matter gives our music  
7 away and competes with the other products we  
8 have in the marketplace, we would be hard  
9 pressed to make the returns that we need to  
10 make as a business if we're competing in the  
11 marketplace at rates that are substandard.

12 Q Do you have any basis, any  
13 studies, any analysis that you have  
14 conducted or reviewed to show that NPR our  
15 its member stations and the manner in which  
16 streaming is done on those stations in any  
17 manner displaces sales, NPR specifically?

18 A I don't have an NPR related  
19 study.

20 MS. BROWN: Your Honor, can I  
21 just have one second?

22 (Pause in proceedings.)

1 BY MS. BROWN:

2 Q Mr. Eisenberg, to the extent the  
3 statute governing this proceeding requires  
4 that consideration be given to the economic  
5 risk and value that the webcasters put into  
6 webcasting, have you taken those factors  
7 into consideration?

8 A In terms of what?

9 Q In respect to the last question  
10 that I asked you in terms of the value that  
11 the webcasters are providing in this  
12 proceeding and the rate that should be  
13 established.

14 A I'm not establishing a rate. I'm  
15 making an argument as to why we think we  
16 believe or we believe or need to have a  
17 certain rate, and what I'm looking at it  
18 from the record company's perspective. I  
19 imagine that the Judges will take into  
20 account all of the criteria in the statute  
21 when rendering the panel's decision.

22 Q But you're saying you have not

1 taken those factors into consideration in  
2 terms of your answers for any of the  
3 questions that I've asked?

4 A Probably not.

5 Q Is there any economic value for a  
6 nonprofit associated with webcasting, DMCA  
7 compliant webcasting?

8 A Is there any economic value to  
9 whom?

10 Q For a nonprofit.

11 A I'm not sure I understand the  
12 question. Is there any economic benefit  
13 derived by a non-com in webcasting?

14 Q Is there any economic value  
15 associated with webcasting for a nonprofit?

16 CHIEF JUDGE SLEDGE: Ms. Brown,  
17 that question doesn't make sense. He's  
18 trying to ask you to whom.

19 MS. BROWN: To the artist and to  
20 the record company. I'm sorry that was  
21 unclear.

22 THE WITNESS: I think it's the

1 opposite. Well, it depends on whether  
2 you're paying or the non-com is paying for  
3 the stream. If the non-com is paying for  
4 the stream, then, yes, there's an economic  
5 benefit. If the non-com is paying a lesser  
6 rate, then there's a displacement of an  
7 economic revenue stream that the artist and  
8 the record company would have gotten had the  
9 listener listened to that stream from a  
10 different broadcaster.

11 MS. BROWN: No further questions.

12 CHIEF JUDGE SLEDGE: Any further  
13 cross examination of this witness?

14 (No response.)

15 CHIEF JUDGE SLEDGE: Mr. Smith,  
16 any redirect?

17 MR. SMITH: I have only about  
18 five minutes, Your Honor. I appreciate your  
19 letting us get this done.

20 CHIEF JUDGE SLEDGE: Mr.  
21 Steinthal wonders if that is a measure of  
22 minutes or --

1 (Laughter.)

2 MR. SMITH: I hope I end up with  
3 a better estimate reputation.

4 REDIRECT EXAMINATION

5 BY MR. SMITH:

6 Q Mr. Eisenberg, there was some  
7 discussion earlier in your cross examination  
8 about the dispute between Yahoo and  
9 Launchcast, on one side, and Sony, on the  
10 other side, and the other record labels  
11 about whether certain features of Launchcast  
12 allowed that service to fall within the  
13 statutory license or fall outside the  
14 statutory license. Do you recall that?

15 A Yes.

16 Q And that was a dispute that led  
17 to litigation?

18 A Yes.

19 Q I wonder if you could tell the  
20 Board the features that Yahoo claimed that  
21 it was allowed to have on its service and  
22 stay within the statutory license.



1           A       They allowed the users to make  
2           certain preferences as to songs, I believe  
3           songs, artists, and albums. So you would  
4           rank or rate like or dislike either when the  
5           song came up or before you were put into a  
6           particular play list, and those preferences  
7           would result in a generation of a play list  
8           that was customized for the end user.

9           Q       So does it produce a separate  
10          station just for that person?

11                   MR. STEINTHAL: Objection, Your  
12          Honor. Leading.

13                   CHIEF JUDGE SLEDGE: Sustained.

14                   BY MR. SMITH:

15          Q       How does the customization get  
16          effected on the site?

17          A       You take in your preferences and  
18          then you deliver a, quote, my station. So  
19          it's my favorite rock station, my favorite -  
20          - you can have multiple types of favorite  
21          stations, but of stations delivered that's  
22          customized or narrowly tailored on a one-to-

1 one basis to the end user.

2 Q And what position is Yahoo  
3 currently taking in the litigation about  
4 whether those kinds of features are  
5 permissible on DMCA compliant webcasting?

6 A Right now they're still  
7 litigating against BMG, arguing that they  
8 are, in fact, compliant with Section 114.

9 Q Okay. Now, switching topics, I  
10 wonder if you could describe quickly the  
11 ways in which the digital marketplace for  
12 delivery of music have changed since 2003.

13 A Portability has become a lot more  
14 prevalent than it used to be. I believe  
15 actually in 2003, when you wanted to listen  
16 to a stream you were, in fact, tethered to  
17 your computer. So if you went to a  
18 subscription service and you signed up for  
19 Napster or Rhapsody, you had to listen to  
20 the music at your desktop.

21 Now, we have what are called  
22 Janus devices which allow you to take a

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1 subscription listen and put it onto a MP3  
2 player and walk around with it and have it  
3 ubiquitously.

4 Also, on the teleco side of  
5 things, Verizon, Sprint and a lot of other  
6 carriers are offering third generation  
7 broadband services over the phone where now  
8 you can receive deliveries not even at your  
9 computer but on the go. So not only can you  
10 listen to it on the go. You can purchase or  
11 request the stream or the download on the  
12 go.

13 Q Are there other changes that come  
14 to mind?

15 A I mean the promotional aspects of  
16 the business have changed in terms of  
17 digital. As I mentioned before, things that  
18 we used to give away on a gratis basis, all  
19 of the products are now monetized in the  
20 digital marketplace, video streaming being a  
21 very good example of that.

22 Q Have your own assessments of the

1 substitutional and promotional effects of  
2 various forms of delivery changed since  
3 2003?

4 MR. STEINTHAL: Your Honor, I  
5 don't think that's something I covered on my  
6 cross.

7 CHIEF JUDGE SLEDGE: Mr. Smith.

8 MR. STEINTHAL: I think it's  
9 beyond the scope.

10 MR. SMITH: We had an hour of  
11 cross examination about memos written in  
12 2003 where conclusions about those issues  
13 were discussed, and I'm merely trying to ask  
14 him whether his understandings have changed  
15 since those memos were written.z

16 CHIEF JUDGE SLEDGE: Overruled.

17 THE WITNESS: Our view of  
18 substitutionality has changed somewhat in  
19 the past three years as to what constitutes  
20 substitutional behavior. We are competing  
21 in a marketplace for the consumer's  
22 listening time, whether it be through

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1 Internet radio services, through on demand  
2 subscription services, through digital  
3 downloads, through pay per view streams or  
4 pay per downloads over the cellular network.

5 We've also learned through the  
6 subscription services that it's not all  
7 about an on demand experience. It's about  
8 personalization. It's about personal  
9 shopping or preferences being suited or  
10 customized for the end user.

11 So when we have looked at  
12 spectrums or continuums in the past, we had  
13 initially thought, you know, the most  
14 substitutional aspect of our business might  
15 be an on demand stream when, in fact, if a  
16 pushed program that's narrowly tailored to  
17 an end user, interactive radio, for example,  
18 which is offered through a subscription  
19 service, those services compete for users'  
20 time or even a more passive experience like  
21 DMCA compliant radio that's very narrowly,  
22 thinly drawn like it is on the Live365 or

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1 MSN or AOL, where you can receive very niche  
2 oriented programming and you can kick back  
3 and listen for four hours at a time on very  
4 good speakers, on a sound system that  
5 parallels that of the living room  
6 experience.

7 Those are substitutional  
8 experiences because we're trying to reach  
9 the consumer for the same listening time  
10 that he's spending elsewhere.

11 BY MR. SMITH:

12 Q Okay. Let me turn to another  
13 topic and ask you to pull out Exhibit 45,  
14 which was the E-mail to you from Mr. Roback  
15 with an attachment that was admitted into  
16 evidence. Would you turn to the third page  
17 of this exhibit?

18 Now, it's Bates page 81446. Do  
19 you see that?

20 A Yes.

21 Q Under the heading "Stats for  
22 Artist Y," it says there, promotion date,

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1 May 2003, length of promo, 14 days, first  
2 week air play, 1,830,000 plays, second week  
3 air play, 1,270,000 plays, add audience,  
4 32,000,000 impressions, other visibility,  
5 92,100,000 impressions, total impressions,  
6 127,200,000 impressions.

7 Let me ask you: when you do the  
8 kinds of promotional arrangements that  
9 you've talked about with the portals, do  
10 they sometimes last a matter of two or three  
11 weeks at a time?

12 A Yes. Sometimes they could last,  
13 you know, a little bit longer, but I would  
14 say anywhere between three days and 30 days.

15 Q Do they include a combination of  
16 various kinds of exposure of the artist on  
17 the portal?

18 A We wouldn't do a promotion if it  
19 only related to radio play. I mean if you  
20 look at the number of impressions delivered  
21 up by radio here and they are very  
22 insignificant in relation to the other

1 impressions that Yahoo can deliver up  
2 through the portal experience, a key to  
3 Yahoo is the impressions that you're getting  
4 on the home page and the music page, not  
5 necessarily the radio plays.

6 Q Do you have an understanding of  
7 what is meant by add audience and other  
8 visibility, those two lines?

9 A I don't know exactly what they  
10 are, but they relate to the portal activity.

11 Q Okay. Now, in your voluntary  
12 deal for custom radio and other forms of  
13 digital delivery, Mr. Eisenberg, do you use  
14 the term "content preparation fee"?

15 A Yes.

16 Q And could you tell the Board what  
17 that is?

18 A When we deliver files, encoded  
19 files, to our service providers, there's a  
20 lot of work entailed in prepping those  
21 files. I think before there was a question  
22 asked as to whether there were any costs in



1 digital delivery. There are, as I said,  
2 some very, very significant costs, one of  
3 them being delivering files to our service  
4 provider.

5 So we typically ask the service  
6 providers in a voluntary deal to reimburse  
7 us for those costs which are quite  
8 significant.

9 Q Now, you were asked by Mr.  
10 Steinthal to assume that the revenues of all  
11 four majors have not declined and product  
12 sales for all four majors have not declined  
13 in the past five years. Do you recall that?

14 A Yes.

15 Q Now, how would the phenomenon of  
16 Sony-BMG having acquired Zomba records  
17 affect those statistics?

18 MR. STEINTHAL: Your Honor, my  
19 objection is that I didn't ask him to  
20 assume. I asked him whether he knew. There  
21 was no assumption in my question. This  
22 question assumes that, and it also has a

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1 predicate. So I object.

2 CHIEF JUDGE SLEDGE: Mr. Smith,  
3 I'm further confused by your question. What  
4 does relation of an internal action within  
5 Sony have to do with his lack of knowledge  
6 as to what the other three major labels have  
7 grown or not grown in the last few year?

8 MR. SMITH: Your Honor, I'll  
9 rephrase the question.

10 BY MR. SMITH:

11 Q In your judgement, Mr. Eisenberg,  
12 is it the best way to look at the revenues  
13 of the industry in the past five years to  
14 look just at the revenues of the four major  
15 companies and not the others?

16 A Typically people look at the four  
17 majors. You could look at the whole  
18 industry, and I'm sure MP and RAA have  
19 numbers about the industry.

20 Q If you do look at the four  
21 majors, do acquisitions by the majors of  
22 other smaller record companies affect the

1 statistics?

2 A Well, for Sony-BMG, it would  
3 certainly affect our numbers. When we  
4 acquired Zomba our revenues went up for that  
5 year because we agreed to a lot more  
6 copyrights and a lot more sales. So in that  
7 one year there was an aberration because  
8 sales may have gone up.

9 But that was because we were  
10 taking into our company a basically new  
11 company and creating a lot more sales to  
12 that.

13 MR. SMITH: I think that's  
14 sufficient, Your Honor. Thank you.

15 CHIEF JUDGE SLEDGE: All right.  
16 Mr. Steinthal.

17 RECROSS EXAMINATION

18 BY MR. STEINTHAL:

19 Q Mr. Eisenberg, very briefly, Mr.  
20 Smith asked you about portability yet again,  
21 and he mentioned some of these subscription  
22 services. When Sony licenses a subscription

1 service like MusicNet or Napster, the new  
2 Napster, which has the ability to sell to  
3 subscribers on demand streaming and limited  
4 download services, I believe you testified  
5 that one of the changes in the last few  
6 years is portability, right? That these  
7 services can now offer their consumers the  
8 ability to access on demand streaming,  
9 unlimited downloads on a portable basis, as  
10 well as on their laptop, right?

11 A Or desktop, yes.

12 Q Isn't it true that in your deals  
13 with on demand streaming and conditional  
14 download services -- and I'm afraid I'm  
15 going to have to pause because I'm going to  
16 put some numbers out here. So if I can ask  
17 that we restrict this question and answer  
18 out of respect for the positions we've taken  
19 before, Your Honor.

20 CHIEF JUDGE SLEDGE: The question  
21 is about what?

22 MR. SMITH: I'm about to quote

1 the fees that they charge on a percentage of  
2 revenue basis to these on demand streaming  
3 and conditional download services, to ask a  
4 couple of questions about how they vary, if  
5 at all, in relation to portable services and  
6 non-portable services.

7 CHIEF JUDGE SLEDGE: Any  
8 objection to going under the provisions of  
9 the protective order for the questions as  
10 just outlined?

11 (No response.)

12 CHIEF JUDGE SLEDGE: Without  
13 objection, the motion is granted.

14 (Whereupon, at 5:36 p.m., the  
15 hearing was reconvened in closed session.)

**CERTIFICATE**

This is to certify that the foregoing  
transcript in the matter of:

The Digital Performance Right in  
Sound Recording and Ephemeral  
Recordings (Webcasting Rate  
Adjustment Proceeding)

Before: Copyright Royalty Board

Date: Thursday, May 11, 2006

Place: Washington, D.C.

represents the full and complete proceedings of  
the aforementioned matter, as reported and  
reduced to typewriting.



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